

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based only on the provisions contained in the legislation as of the latest date listed below.)

Date: October 30, 1997 Revised: 01/06/98 \_\_\_\_\_

Subject: Windstorm Insurance Risk Apportionment

	<u>Analyst</u>	<u>Staff Director</u>	<u>Reference</u>	<u>Action</u>
1.	<u>Emrich/Deffenbaugh</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Fav/1 amendment</u>
2.	_____	_____	_____	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____

I. Summary:

A provision of the omnibus property insurance bill passed by the 1997 Legislature temporarily suspended expansion of the areas eligible for windstorm coverage from the Florida Windstorm Underwriting Association (FWUA) until October 1, 1998. (Sec. 5, Ch. 97-55, L.O.F., creating s. 627.351 (2)(e), F.S.) This bill deletes the October 1, 1998 date, thereby continuing, indefinitely, the current prohibition on expanding the geographical boundaries of the FWUA.

The temporary freeze on the FWUA geographical boundaries enacted in 1997 was prompted by tremendous growth in the number of policies and exposure to losses for the FWUA. Presently the FWUA does not have sufficient reserves to fund its expected hurricane losses. It must depend upon assessments against insurers and additional debt financing which will trigger surcharges against all property insurance policyholders in the state. The dangerously high concentration of policies in South Florida, in particular, exposes the FWUA to the threat of a multi-billion dollar loss that could result in significant surcharges for every residential policy in the state for many years.

Though not expressly required, the moratorium on expanding the FWUA boundaries until October 1, 1998, was enacted last session with the understanding that the Legislature would consider whether the statutory criteria for area eligibility for the FWUA should be revised. During this summer, the staff of the Senate Banking and Insurance Committee studied this matter and recommended prohibiting further expansion of the areas eligible for FWUA coverage. (See Staff Interim Project Report, "Establishing Geographical Boundaries for the Florida Windstorm Underwriting Association," Report Number 97-P-08; August 1997.)

This bill amends section s. 627.351(2)(e) of the Florida Statutes.

**II. Present Situation:****Background**

Hurricane Andrew caused \$16 billion in insured losses in 1992, severely impacting the Florida property insurance market. Many insurers stopped writing new residential policies which led, in part, to the creation of the Residential Property and Casualty Joint Underwriting Association (RPCJUA) and expansion of the Florida Windstorm Underwriting Association (FWUA) as a means of assuring that all Floridians have access to property insurance. A third entity, the Florida Hurricane Catastrophe Fund (Fund), was created to reimburse insurers for a portion of their hurricane losses, to enable insurers to write more policies and to assure policyholders that some of their premiums would be held by the state and used only for paying insured hurricane losses in Florida.

In 1997, s. 627.351(2)(e), F.S., was created to temporarily freeze expansion of FWUA geographic boundaries until October 1, 1998. The staff of the Senate Banking and Insurance Committee subsequently reviewed this matter and issued a report, noted above, recommending that the Legislature continue, indefinitely, the current prohibition on expanding the geographical boundaries of the FWUA because: (1) further expansion will increase the exposure of the FWUA to catastrophic losses and exacerbate problems in securing adequate financing to pay claims following a major storm, and (2) expansion is likely to result in less windstorm coverage written in the private, voluntary market since insurers would be permitted to exclude windstorm coverage in more areas of the state.

**Florida Windstorm Underwriting Association**

Founded in 1970, the Florida Windstorm Underwriting Association (FWUA) provides windstorm coverage in areas within 29 of Florida's 35 coastal counties. The FWUA issues coverage only for windstorm and hail losses in those areas of the state determined by the Department of Insurance to meet statutory criteria for eligibility. In most counties, the eligible area is a relatively narrow strip such as the area within 1,000 feet from the coast. However, in Dade, Broward, and Palm Beach counties, the area east of Interstate 95 is eligible for coverage, which extends as far as 5 miles from the coast. The entire area of Monroe County is eligible as are the entire city limits for Pensacola, Sarasota, Daytona Beach, Ormond Beach, and South Daytona Beach.

In summary, the current law for eligibility of FWUA coverage consists of three criteria that must be met: (1) due to the lack of windstorm insurance, economic development is being deterred, mortgages are in default and banks are unable to make loans; (2) state minimum building codes are being enforced; and, (3) providing windstorm insurance is consistent with all laws related to coastal development and protection. Upon petition by an interested party, the Department of Insurance (DOI) holds a hearing, receives evidence and issues a final order determining whether the three criteria have been met. The present law also authorizes DOI to declare that a county or area no longer meets the criteria, but DOI has never taken this action. In 1996, the law was

amended to essentially require DOI to make a “what if” analysis of the economic situation in an area and to determine whether, absent the RPCJUA, the economic criteria would be met.

A purchaser of a windstorm policy from the FWUA must obtain a separate “ex-wind” policy from another insurer that covers other perils such as fire, theft, and liability. The FWUA issues policies for both residential property and commercial non-residential property. The boundaries of the FWUA directly affect the obligation of insurers to provide windstorm coverage. Insurers are permitted to write ex-wind policies in those areas eligible for coverage from the FWUA, but outside of FWUA-eligible areas, all residential property insurance policies are required to provide coverage for windstorm or hurricane losses [s. 627.0629(6), F.S.]. Legislative changes in 1997 provided that an applicant or policyholder is not eligible for FWUA coverage if an offer of coverage is made by an authorized insurer at its approved rates. (Sec. 5, Ch. 97-55, L.O.F., amending s. 627.351(2)(b)1, F.S.)

The number of windstorm policies written by the FWUA has increased from 62,000 policies in 1992 with \$7.5 billion of insured property value (exposure), to over 385,000 policies as of September 30, 1997, with exposure of \$69.1 billion. The FWUA projects that it will insure 420,000 policies by the end of 1997 with \$73.9 billion in exposure, and 491,000 policies by the end of 1998 with \$86.3 billion in exposure. Estimates by both Applied Insurance Research (AIR) and Risk Management Solutions (RMS), based on the FWUA’s exposure as of June 30, 1997, project a probable maximum loss (PML) of \$3.1 billion for a 100-year storm and \$5 billion for a 250-year storm. (The PML is an insurer’s single greatest loss that is probable over a specified period of time.) The 100-year PML is projected to be \$4.2 billion based on policy count at the end of 1997, and \$4.9 billion at the end of 1998.

Premiums paid by FWUA policyholders provide the first source of funding for FWUA losses. After premium income, the second level of funding for FWUA losses comes from “regular” assessments against all authorized property insurers, in proportion to their statewide market share of property insurance premiums, which assessments cannot exceed the greater of 10 percent of the FWUA deficit or 10 percent of the prior year’s statewide premium for property insurance (currently about \$366 million). Since 1993, insurers have been allowed to recoup any assessments in the form of increased premiums in the following year to their policyholders in the voluntary market.

If the FWUA’s deficit in any year exceeds the maximum regular assessments, all new and renewal property insurance policies in the state are subject to “emergency assessments.” Emergency assessments are limited in each year to the greater of 10 percent of the deficit plus interest and other expenses of debt financing, or 10 percent of the prior year’s statewide premium for property insurance plus expenses of debt financing. Emergency assessments may be pledged by the board in order to secure debt financing to fund a deficit, and continue until the deficit or debt is paid.

The FWUA has currently secured financing that will enable it to pay \$4.2 billion in claims, of which about \$1.3 billion is reinsurance (\$1 billion from the Cat Fund and \$300 million of private reinsurance), but \$2.9 billion is through regular assessments, note proceeds, and a line of credit,

which are forms of debt financing that must be repaid through increased premiums or emergency assessments on all property insurance policyholders in the state.

### **Florida Residential Property and Casualty Joint Underwriting Association**

In response to the disruption of the property insurance market after Hurricane Andrew, the RPCJUA was created in 1992 to provide residential property insurance to persons unable to find coverage in the voluntary market (Ch. 92-345, L.O.F.). The policies provide coverage for all perils covered under a standard residential policy, including windstorm, fire, theft, and liability, subject to underwriting requirements. However, in those geographic areas that are eligible for windstorm coverage from the FWUA, the RPCJUA policies exclude coverage for windstorm.

#### **III. Effect of Proposed Changes:**

This bill deletes the scheduled repeal of the prohibition on extending the geographical boundaries of the FWUA. The effect of the bill is to prohibit, indefinitely, the further expansion of the FWUA.

Prohibiting further expansion of the FWUA mitigates the growth in the number of policies and exposure insured by the FWUA and the potential for unfunded liability. However, in those areas that are not eligible for FWUA coverage, persons who are unable to obtain coverage in the voluntary market may obtain coverage from the RPCJUA. The bill is likely to have the effect of fewer wind policies being written in the FWUA and RPCJUA combined, as discussed in Economic Impact, below.

#### **IV. Constitutional Issues:**

##### **A. Municipality/County Mandates Restrictions:**

None.

##### **B. Public Records/Open Meetings Issues:**

None.

##### **C. Trust Funds Restrictions:**

None.

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V. **Economic Impact and Fiscal Note:**

A. **Tax/Fee Issues:**

None.

B. **Private Sector Impact:**

By limiting expansion of the FWUA under this bill, presumably more windstorm coverage would be written in the private, voluntary market since insurers would not be permitted to exclude windstorm coverage in more areas of the state. This conclusion is based, in part, on a market analysis conducted by staff in its interim report, noted above, which compared the wind policies written in Dade and Broward counties to the wind policies written in Palm Beach County by the FWUA and the RPCJUA over an 8-month period (Oct. 1996-May 1997). The analysis found that by making Palm Beach County eligible for FWUA coverage, it lessened the incentive for private market insurers to write windstorm coverage in that county.

Specifically, the analysis determined that the average number of wind policies written each month in Palm Beach County by the RPCJUA and FWUA, combined, increased nearly 25 percent, comparing the 3 months (Oct.-Dec. 1996) immediately prior to the time that Palm Beach County became eligible for coverage from the FWUA (mid Dec. 1996), to the 5 months immediately after Palm Beach County became eligible (Jan.-May 1997), increasing from an average of 3,441 to 4,292 new residual market policies per month. In contrast, during this same period, the average number of wind policies written in Dade and Broward counties by the RPCJUA and FWUA, combined, decreased 32 percent and 29 percent, respectively, down from an average of 6,754 to 4,605 new policies per month in Dade County, and from an average of 5,910 to 4,197 in Broward County. Though not conclusive, this is evidence that insurers in the voluntary market may be less likely to write windstorm coverage in FWUA areas, where insurers are permitted to write ex-wind policies, as compared to RPCJUA areas, where they are not permitted to write ex-wind policies. Thus, expanding the areas eligible for the FWUA would be expected to increase the total number of policies and exposure written in the residual market (the RPCJUA and FWUA combined). By limiting growth of the residual market, the bill would limit the potential for deficit assessments against property insurers and surcharges on their policyholders.

By prohibiting further geographic expansion of the FWUA, persons who live in areas that could potentially meet the statutory criteria for FWUA would, instead, have access to coverage from the RPCJUA if coverage is not otherwise available. In general, current rates for RPCJUA coverage are higher than the combined rates for coverage from the FWUA and the insurer writing the ex-wind policy. Rates for the RPCJUA are required to be set at the rates of the insurer with the highest rates in a county, using the top 20 insurers in the state by premium volume. Rates for the FWUA are not subject to this requirement, but the 1997 act provides legislative intent that FWUA rates not be competitive with voluntary market rates, and requires the FWUA plan of operation to provide, no later than January 1, 1999, a means

of assuring that FWUA rates are reflective of DOI-approved hurricane rates in the voluntary market. In 1996, the FWUA had its first rate increase in 13 years, averaging 31 percent statewide. In August 1997, the FWUA filed for a rate increase averaging 62 percent statewide, to be phased-in over a 3-year period. However, 20 counties would experience a decrease or no change and only nine counties would experience a rate increase.

**C. Government Sector Impact:**

None.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Amendments:**

#1 by Banking and Insurance:

Repeals the provision that deleted the October 1, 1998, date which in effect continued the prohibition on expanding the geographical boundaries of the FWUA. Provides for temporarily suspending expansion of the areas eligible for windstorn coverage from the FWUA until October 1, 1999. (WITH TITLE AMENDMENT)