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**HOUSE OF REPRESENTATIVES
COMMITTEE ON
INSURANCE
ANALYSIS**

BILL #: HB 291
RELATING TO: Windstorm property insurance
SPONSOR(S): Representative(s) Ryan and Gottlieb
TIED BILL(S):

ORIGINATING COMMITTEE(S)/COUNCIL(S)/COMMITTEE(S) OF REFERENCE:

- (1) INSURANCE YEAS 11 NAYS 0
 - (2) STATE ADMINISTRATION
 - (3) GENERAL GOVERNMENT APPROPRIATIONS
 - (4) COUNCIL FOR COMPETITIVE COMMERCE
 - (5)
-

I. SUMMARY:

Property insurers, including the Florida Windstorm Underwriting Association (FWUA) and the Residential Property and Casualty Joint Underwriting Association, may challenge rate filings disapproved by the Department of Insurance (Department) utilizing arbitration in lieu of an administrative hearing. Under the bill, the FWUA would no longer be able to utilize arbitration to challenge disputed rate filings.

Prior to Hurricane Andrew in 1992, insurers used the "excess wind procedure" to estimate hurricane losses, a procedure based on historical loss data and ratios between wind and non-wind losses. After Hurricane Andrew, insurers have generally relied upon a combination of historical data and computer models to project hurricane losses. In 1995, the Legislature created the Florida Commission on Hurricane Loss Projection Methodology to "provide the most actuarially sophisticated guidelines and standards for projection for hurricane losses possible." The Insurance Commissioner appoints a majority of the 9 commission members. The Commission has approved 5 models for use by insurers.

Under the bill, insurers would be required to base all residential property insurance rate filings on the average losses of the most recent 30-year period. Computer models could be used to augment the historical experience, if the model used is the public model or a model in which the underlying assumptions, data, and methodologies are available to the Department of Insurance for inspection or challenge *in camera* in any administrative or judicial hearing.

The FWUA is governed by a 15-member board of directors, consisting of 12 insurance industry representatives. Board members are not required to be residents of Florida. Six of 15 reside in another state. The bill would amend the composition of the board to replace 3 of the 12 insurance industry representatives with 3 additional consumer representatives, and require all board members to be Florida residents.

The bill would take effect upon becoming a law.

On April 20, 2001, the Committee on Insurance adopted one amendment that is traveling with the bill. See Section VI. for an explanation.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

1. Less Government Yes No N/A

Insurers would be required to base their windstorm rate filings on average losses for the most recent 30-year period. Insurers would be prohibited from basing their rate filings on hurricane models, although models could be used under certain conditions to augment the historical experience.

The Department of Insurance would be given access to the proprietary information used in the development of a computer model approved by the Florida Commission on Hurricane Loss Methodology for use by property insurers.

The Florida Windstorm Underwriting Association would be prohibited from using rate arbitration in a disputed property insurance rate filing.

2. Lower Taxes Yes No N/A

3. Individual Freedom Yes No N/A

Insurers would be required to base their windstorm rate filings on average losses for the most recent 30-year period. Insurers would be prohibited from basing their rate filings on hurricane models, although models could be used under certain conditions to augment the historical experience.

The Department of Insurance would be given access to the proprietary information used in the development of a computer model approved by the Florida Commission on Hurricane Loss Methodology for use by property insurers.

The Florida Windstorm Underwriting Association would be prohibited from using rate arbitration in a disputed property insurance rate filing.

4. Personal Responsibility Yes No N/A

5. Family Empowerment Yes No N/A

B. PRESENT SITUATION:

See Section-By-Section Analysis, II.D.

C. EFFECT OF PROPOSED CHANGES:

See Section-By-Section Analysis, II.D.

D. SECTION-BY-SECTION ANALYSIS:

Section 1. Amends s. 627.062, F.S., to prohibit the Florida Windstorm Underwriting Association from utilizing the provision that allows property and casualty insurers to submit a rate filing to an

arbitration panel after the rate filing has been initially disapproved by the Department of Insurance, as an alternative to an administrative hearing under Chapter 120, F.S.

Present Situation: When the Department of Insurance issues a notice to disapprove a property insurance rate filing, the insurer has two options: it may request an administrative hearing under the Administrative Procedures Act, or arbitration under s. 627.062(6), F.S.

Arbitration has been an option for insurers, including the Residential Property & Casualty Joint Underwriting Association and the Florida Windstorm Underwriting Association, since January 1, 1997.

Arbitration must be conducted by a panel of three arbitrators: one chosen by the insurer, one chosen by the Department of Insurance, and the third chosen by the other two arbitrators. Each arbitrator must be certified by the American Arbitration Association and may not be the employee of any insurance company or insurance regulator. The costs of arbitration must be paid by the insurer.

The procedures specified in the Arbitration Code in Chapter 682, Florida Statutes, are applied to rate arbitration. Rules adopted by the Department of Insurance regulating arbitration may not be inconsistent with the arbitration rules of the American Arbitration Association as of January 1, 1996.

The final decision of the arbitrators must be treated as the approval of a rate filing.

Under arbitration, either party may apply to the circuit court to vacate or modify the decision as provided in ss. 682.13 and 682.14, F.S. In general, grounds for vacation include corruption or fraud, evident partiality by a neutral arbitrator, and action beyond the arbitrators' powers or jurisdiction. Grounds for modification include miscalculations, errors as to form, and actions on matters not submitted for arbitration.

Since 1997, the Florida Windstorm Underwriting Association has utilized arbitration in two of its rate filings.

Section 2. Insurers would be required to base all residential property insurance rate filings on the average losses of the most recent 30-year period. Computer models could be used to augment the historical experience, if the model used is the public model or a model in which the underlying assumptions, data, and methodologies are available to the Department of Insurance for inspection or challenge *in camera* in any administrative or judicial hearing.

Present Situation: Prior to Hurricane Andrew in 1992, insurers used the "excess wind procedure" to estimate hurricane losses, a procedure based on historical loss data and ratios between wind and non-wind losses. The excess wind procedure does not take into account certain hurricane exposure factors such as increased population in coastal areas, higher property values, changes in construction techniques and materials, and building codes.

After Hurricane Andrew, insurers increasingly relied upon computer models used in conjunction with historical data to project hurricane losses. Hurricane computer models are designed to estimate possible hurricane damage. Factors considered in the development of a hurricane model include: meteorological variables, exposure, engineering, and losses. The hurricane models do not take into account factors such as specific damage caused by windborne debris, insurance fraud that may occur after a catastrophic event, and some weather-related events, such as a tornado caused by the hurricane.

In 1995, the Legislature found, "it is the public policy of this state to encourage the use of the most sophisticated actuarial methods to assure that consumers are charged lawful rates"¹ and created the Florida Commission on Hurricane Loss Projection Methodology in 1995. The Commission was created to "provide the most actuarially sophisticated guidelines and standards for projection for hurricane losses possible" and is charged with considering any actuarial methods, principles, standards, models, or output ranges that have the potential for improving the accuracy or reliability of loss projections in property insurance rate filings.

The Commission has adopted standards and specifications for acceptable computer models and as of November 1999, has approved five different models as having met these standards. The results produced by hurricane models can vary. For example, according to the Florida Commission Hurricane Loss Methodology, of the 5 models approved for use, average annual statewide losses vary from a high of \$3.16 billion, to a low of \$1.05 billion.

The Insurance Commissioner appoints a majority of the members appointed to the Florida Commission on Hurricane Loss Projection Methodology. Membership on the Florida Commission on Hurricane Loss Projection Methodology consists of the Insurance Consumer Advocate, the Chief Operating Officer of the Florida Hurricane Catastrophe Fund, the executive director of the Residential Property and Casualty Joint Underwriting Association, the director of the Division of Emergency Management of the Department of Community Affairs, the actuary member of the Florida Hurricane Catastrophe Fund Advisory Council, and 6 members appointed by the Insurance Commissioner, including an employee of the Department of Insurance, an actuary, and the following 4 faculty members from the State University System: an expert in insurance finance with a background in actuarial science, an expert in statistics with a background in insurance, an expert in computer systems design, and an expert in meteorology who specializes in hurricanes.

Initially, reinsurers used hurricane models to examine the distribution of coastal exposure, estimate probable maximum loss, and allocate capacity. Insurers and regulators recently have become reliant on the use of hurricane loss projection models to estimate the expected losses from hurricanes, particularly after Hurricane Andrew. The Department of Insurance requires insurers to use hurricane models to determine the amount of surplus and reinsurance needed for the insurer to be approved for taking a block of policies out of the Residential Property and Casualty Joint Underwriting Association or Florida Windstorm Underwriting Association. The Florida Hurricane Catastrophe Fund utilizes computer models in determining the premiums to charge insurers for reimbursement contracts.

While insurance rate filings are considered public record and the proceedings of the Commission are open to the public, companies owning a hurricane model consider the information regarding the design and construction of that model to be proprietary. Access is restricted. The State Board of Administration has hired a Professional Team to review the models on-site on behalf of the Commission.²

For fiscal year 2000-2001, the Legislature appropriated \$1.2million from the Insurance Commissioner's Regulatory Trust Fund under the Department of Insurance to the State University System to develop a public hurricane loss projection model to estimate the expected losses from hurricanes to "guarantee appropriate insurance rate regulation." The Department of Insurance has entered into a contract with Florida International University to oversee the development of the public model. The Department of Insurance expects the public model to be completed in March 2003.

¹ Section 627.0628, Florida Statutes

² The Professional Team is comprised of individuals having professional credentials in the following disciplines: actuarial science, statistics, meteorology, computer science, and engineering. The Professional Team provides the Commission with a written report of the on-site test results, and the Commission either rejects or approves the model.

The Department of Insurance is requesting an additional appropriation of \$900,000 for fiscal year 2001-2002 from the Insurance Commissioner's Regulatory Trust Fund for the public model.

Section 3. Amends s. 627.351, F.S., relating to insurance risk apportionment plans. The composition of the 15-member governing board of the Florida Windstorm Underwriting Association would be revised to replace 3 of the insurance industry representatives with 3 consumer representatives and require all members of the board to be state residents. This would reduce the number of insurance industry representatives from 12 to 9 and increase the number of consumer representatives from 3 to 6.

Present Situation: The Florida Windstorm Underwriting Association operates under a 15-member board of directors, which includes the Insurance Consumer Advocate, one consumer representative appointed by the Insurance Commissioner, one consumer representative appointed by the Governor, and twelve members appointed by the insurance industry. Currently, there is no residency requirement for Florida Windstorm Underwriting Association. Currently, 6 of the governing board members do not reside in the state, according to the Florida Windstorm Underwriting Association.

Section 4. Provides an effective date of upon becoming law.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None

2. Expenditures:

None

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None

2. Expenditures:

None

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

HB 291 could reduce the number of hurricane models approved for use in property insurance rate filings. Since the information used by the modeling companies in the development of hurricane models is considered proprietary, some modeling companies may not want the underlying assumptions, data, and methodologies to be available to the Department for inspection or challenge, as records held by the Department of Insurance are subject to the public records law. These models would no longer be available for use by property insurers in the state.

The bill would restrict the use of computer models in rate filings. To the extent the method used to project hurricane losses produces different results, the proposed rates of Florida Windstorm

Underwriting Association policyholders could be higher or lower. This could have a corresponding influence on the likelihood of assessments on non-FWUA policyholders.

FISCAL COMMENTS:

None

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that municipalities or counties have to raise revenues in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

N/A

B. RULE-MAKING AUTHORITY:

N/A

C. OTHER COMMENTS:

HB 291 would prohibit the Florida Windstorm Underwriting Association from using the option of rate arbitration under s. 627.062, F.S., but not under s. 627.351(2), F.S. Without a conforming amendment, the Florida Windstorm Underwriting Association could still utilize arbitration to challenge disputed rate filings.

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

On April 20, 2001, the Committee on Insurance adopted an amendment that is traveling with the bill.

The "remove-everything" amendment would replace the substance of the bill, rewriting it to include the following:

- Extend by up to 5 years, the exemption from regular assessments of the Residential Property and Casualty Joint Underwriting Association and the Florida Windstorm Underwriting Association and certain premium taxes available to minority-owned property and casualty insurers.
- Replace the proposed prohibition against the use of computer models in rate making unless developed exclusively with public funds with a requirement that all rate filings for windstorm

insurance reflect historical insurance data and any computer model used in the rate filing be based upon standards approved by the state methodology commission.

- Increase from \$20 million to \$25 million the amount of surplus qualifying an insurer as a limited apportionment company. These companies receive an exemption from FWUA regular assessments when aggregate losses exceed \$50 million under current law.
- Require the FWUA, if it enters into a contractual agreement for a take-out plan, to require the take-out insurer to pay to the previous agent an amount equal to the insurers' usual commission for the policy or offer to allow the agent to continue servicing the policy for a period of not less than 1 year.
- Extend the moratorium prohibiting insurers from canceling or nonrenewing more than a certain percentage of their policies for the purpose of reducing their hurricane exposure.
- Revise the composition to reduce from 12 under current law to 4, the number of members designated in the plan of operation. It would substitute a representative of residential mortgage lenders and of realtors, a FWUA policyholder, licensed agent, and a representative with expertise in building codes and coastal construction for 5 of these. In sum, there would be 6 consumer representatives, 4 representatives specified in the plan of operation, and 5 representatives with the designated background.

VII. SIGNATURES:

COMMITTEE ON INSURANCE:

Prepared by:

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Meredith Woodrum Snowden

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