

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

BILL: CS/SB's 182, 328 & 970

SPONSOR: Banking and Insurance Committee and Senators Silver, Geller, and Clary

SUBJECT: Insurance (Property Insurance)

DATE: April 10, 2001 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Deffenbaugh	Deffenbaugh	BI	Favorable/CS
2.	_____	_____	GO	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

The bill makes the following changes relating to property insurance:

- Prohibits the Florida Windstorm Underwriting Association (FWUA) from utilizing the provision that allows property and casualty insurers to submit a rate filing to an arbitration panel.
- Restricts the use of hurricane loss projection models in rate proceedings by providing that findings and factors adopted by the Florida Commission on Hurricane Loss Projection Methodology are *not admissible and relevant* in consideration of a rate filing, unless the Department of Insurance has access to all factors and assumptions used in developing the models, and unless the department is not precluded from disclosing such information in a rate proceeding.
- Revises the composition of the Board of Governors of the FWUA. Currently, there is a 15-member board, which includes 12 members representing and appointed by various segments of the insurance industry pursuant to the FWUA plan of operation, plus the Insurance Consumer Advocate and 2 consumer representatives. Under the bill, the 15-member board would consist of the Insurance Consumer Advocate, 7 representatives of specified interests appointed by the Insurance Commissioner, and 7 members representing and appointed by various segments of the insurance industry pursuant to the FWUA plan of operation.
- Reduces the boundaries of the FWUA by “deauthorizing” the area that is currently eligible for FWUA coverage between Interstate 95 and U.S. 1 in Dade, Broward, and Palm Beach Counties. After December 31, 2001, the FWUA could not accept applications for coverage in the deauthorized area.
- Establishes an assigned risk plan, beginning January 1, 2002, to remove policies located in the deauthorized area from the FWUA and assigning them to insurers.

- Deletes the provisions of current law that state that if the FWUA obtains an offer of coverage from an authorized insurer to insure a home or other risk at its approved rates, the risk is no longer eligible for coverage through the FWUA.
- Requires that if the FWUA enters into a contractual agreement for a take-out plan, the take-out insurer must 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. This provision is the same as the current provision that applies to the RPCJUA.
- Extends, for 3 more years, the law that limits the number of personal lines residential policies that insurers may non-renew for the purpose of reducing their hurricane exposure. The current limitations are scheduled for repeal on June 1, 2001, which the bill extends until June 1, 2004.
- Increases from \$20 million to \$25 million, the maximum amount of surplus that an insurer may have to qualify as a limited apportionment company in the FWUA, so as to be exempt from regular assessments for deficits in excess of \$50 million.

This bill substantially amends the following sections of the Florida Statutes: 627.062, 627.0628, 627.351, 627.7013, and 727.7014.

II. Present Situation:

Property Insurance Rate Filings - Arbitration

Florida's insurance laws require insurers to file property and casualty insurance rates for approval with the department either 90 days before the proposed effective date or 30 days after the rate filing is implemented. Under the latter option, however, the department may order the insurer to refund that portion of the rate determined to be excessive.

If the Department of Insurance disapproves a rate filing, the insurer may either request an administrative hearing under the Administrative Procedures Act (ch. 120, F.S., "APA") or seek binding arbitration (s. 627.062(6), F.S.). Under the APA, a formal adversarial hearing is held before a State Administrative Law Judge (ALJ) of the Division of Administrative Hearings (DOAH). Once the hearing is completed, the ALJ has 30 days to issue his or her Recommended Order to the Insurance Commissioner for final review. The department estimates the average time it takes for a case, which is referred to DOAH until the issuance of a Recommended Order is 3 1/2 months.

The Recommended Order contains findings of fact and conclusions of law as found by the ALJ. In turn, the department has 90 days to issue a Final Order, and that order may adopt, reject, or modify the conclusions of law contained in the Recommended Order. However, the department, in the Final Order, may not substitute findings of facts contained in the Recommended Order, which were supported by competent substantial evidence. A party may then appeal the Commissioner's Final Order to the First District Court of Appeal and that court may take upwards to a year or more to render its final decision.

In 1996, the law was amended to allow insurers to request binding arbitration of a rate filing as an alternative to an administrative hearing. (Under s. 627.062, F.S., this applies to property and

casualty rate filings, but not including private passenger automobile insurance or workers' compensation insurance rate filings.) After the department issues a notice of intent to disapprove a rate filing, the insurer may request arbitration before a panel of three arbitrators. The panel is chosen as follows: one is selected by the insurer, one by the department, and the third is chosen by the two other arbitrators. An arbitrator must be certified by the American Arbitration Association and may not be the employee of any insurance company or insurance regulator. The procedures outlined in the Arbitration Code (chapter 682, F.S.) are applied to rate arbitration and the costs of arbitration are paid by the insurer. The decision of the panel, which must be made within 90 days, constitutes the final approval of a rate filing.

There is no appeal per se of the panel's decision to a higher court, as there is under the APA. However, either party to the arbitration proceeding may apply to the circuit court to vacate or modify the panel's decision under limited conditions. In general, grounds for vacating 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. Upon initiation of arbitration, the insurer waives all rights to challenge the action of the Department of Insurance under the APA or any other law; however, these rights are restored to the insurer if the arbitrators fail to act within 90 days after initiation of arbitration.

Since the inception of the arbitration provision, only nine insurance companies and the FWUA have requested arbitration. The table below features the company, the requested rate change and the final decision by the arbitration panel. According to the Department of Insurance, during this same period, very few insurers have litigated their rate filings under the APA because the majority of those insurers have either settled their rate disputes with the department or withdrawn their filing.

Companies Requesting Arbitration Since Inception (January 1, 1997 to Present)				
Company Name	Filing Received	Filing Type	Requested Rate Change	Arbitration Decision
State Farm Fire & Casualty	May 5, 1997	F & U	25.60%	25.60%
Continental Ins. Group (CNA)	August 14, 1997	U & F	28.10%	Remand filing to Department ¹
Florida Windstorm Underwriting Assn. (FWUA)	August 25, 1997	F & U	61.00% - (Phased in over 3 years)	12.0%
United Services Auto. Assn. (USAA)	September 2, 1997	F & U	19.40%	14.80%
Nationwide Ins. Co. of Florida	December 17, 1998	F & U	29.00%	18.00%
Florida Windstorm Underwriting Assn. (FWUA)	May 3, 1999	F & U	96.00%	96.00% ²
First Floridian	June 21, 1999	F & U	17.20%	11.80% ³
State Farm Florida	October 7, 1999	F & U	7.00%	7.00%

¹ CNA's filing was remanded to the department, and the department subsequently issued a consent order approving a 12.8 percent increase. CNA was prohibited from filing a homeowners rate increase prior to January 2000.

² The maximum rate increase is capped at 20 percent for the first year, 30 percent for the second year, and 40 percent for each subsequent year. The FWUA is required to apply discounts, thus lowering the amount of premium paid, for loss mitigation retroactively to policyholders who mitigate their homes. The FWUA offers various cost saving features so that insureds can receive a fiscal incentive to retrofit their home, or where feasible, include retrofitting features in the construction of a new home. The arbitration panel decision is being challenged by the Department of Insurance.

³ The arbitration panel decision is being challenged by the Department of Insurance.

Company Name	Filing Received	Filing Type	Requested Rate Change	Arbitration Decision
United Services Auto. Assn. (USAA)	November 1, 1999	F & U	16.60%	7.70%
Cypress (Homeowners Program)	Feb. 8, 2000	U & F	12.02%	0% ⁴
Cypress (Dwelling)	Feb. 8, 2000	U & F	14.03%	0% ⁵

Source: Department of Insurance

Since the inception of arbitration, a total of 458 filings have been made which have rate level impact.⁶ Of that number, the department has issued 103 notices of intent to deny rate requests. In such cases, the insurers had the option of going to arbitration, an administrative hearing, or settling the rate dispute with the department through negotiations. Representatives with the department point out that even though only nine insurers (and the FWUA) have requested arbitration, those companies represent the largest insurers in terms of market share in the state.

Insurance companies often prefer arbitration to administrative hearings because it takes much less time for a rate decision to be rendered by the panel, and is less costly. Industry representatives claim that with arbitration, they can expect a resolution of a rate dispute within 90 days, as opposed to 9 months to a year or more (if there is an appeal), in administrative litigation. Industry officials argue that the arbitration panel reduces political decision-making and provides a level playing field for each side that results in a fair decision.

Conversely, it is also argued that the final rate decision should rest with the Insurance Commissioner. As argued from a public policy perspective, the elected Insurance Commissioner, and not an arbitration panel, should be the final rate-setting authority. Additionally, consumers expect their elected insurance representative to advocate their interests, as opposed to the interests of insurance companies, when insurers seek rate increases. The primary concern is the arbitration panel decision to grant a substantial increase for the FWUA (see chart above).

Use of Loss Projection Models

Insurers and regulators have become increasingly dependent on hurricane loss projection models to estimate the expected losses from hurricanes, particularly after Hurricane Andrew. The premiums that insurers are required to pay for coverage from the Florida Hurricane Catastrophe Fund are based on models that have met the standards approved by the Florida Commission on Hurricane Loss Projection Methodology (Commission), which was created by act of the Legislature in 1995.⁷ Also, the Department of Insurance requires insurers to use hurricane models to determine the amount of surplus and reinsurance needed in order for the insurer to be

⁴ Cypress was allowed to keep the premium it collected from policyholders from April 1, 2000 to October 1, 2000.

⁵ Cypress was allowed to keep the premium it collected from policyholders from April 1, 2000 to October 1, 2000.

⁶ These figures are as of November 2000.

⁷ Ch. 95-276, Laws of Florida; currently in s. 627.0628, F.S. The Florida Hurricane Catastrophe Fund, commonly referred to as the "Cat" Fund, is a state trust fund administered by the State Board of Administration (SBA), created in 1993 to reimburse residential property insurers for a portion of their hurricane losses (ch. 93-409, Laws of Florida, currently in s. 215.555, F.S.). The Fund collects premiums from insurers on a tax-exempt basis and provides additional reinsurance capacity at lower rates than can be obtained from private reinsurers.

approved for taking a block of policies out of the Residential Property and Casualty Joint Underwriting Association (RPCJUA) or Florida Windstorm Underwriting Association (FWUA).

The 1995 law creating the Commission on Hurricane Loss Projection Methodology provides legislative findings and intent that reliable projections of hurricane losses are necessary to ensure that rates for residential property insurance are neither excessive nor inadequate; that the ability to make these projections has been greatly enhanced by the development of computer models; that it is the public policy of the state to encourage the use of the most sophisticated actuarial methods to assure that rates are lawful; and that there is a need for expert evaluation of the models. The Commission is administratively housed in, but independent of, the State Board of Administration and is composed of eleven members: the Insurance Consumer Advocate of the Department of Insurance, the Chief Operating Officer of the Florida Hurricane Catastrophe Fund, the Executive Director of the RPCJUA, 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 the following six members appointed by the Insurance Commissioner: a department actuary, a private sector actuary, and four State University System faculty members with expertise in insurance finance, statistics, meteorology, and computer system design.

The Commission has adopted standards and specifications of acceptable computer models and as of November 1999 has approved five different models as having met these standards.⁸ The original 1995 act provided that the findings of the Commission were binding on the department except in certain circumstances, but amendments in 1996 provided, instead, that the findings and models approved by the commission are *admissible and relevant* in the department's consideration of a rate filing or in any administrative or judicial review of the department's actions (ch. 96-194, Laws of Florida).

A "public model" is currently being developed by the Florida State University System. In last session's appropriation act, \$1,211,178 was appropriated from the Insurance Commissioner's Regulatory Trust Fund to the State University System (SUS) to develop a public hurricane loss projection model to estimate the expected losses from hurricanes to "guarantee appropriate insurance rates regulation."

Critics of the models have argued for restricting or limiting the use of hurricane loss projection models in rate filings. These critics advocate that the results from a model are not admissible or relevant unless all of the assumptions used to develop the model are revealed to, or known by, the department. These persons state that the modeling procedure is flawed because many of the actuarial and other assumptions used in the modeling process are not known to regulators due to the proprietary nature of certain information. Thus, regulators have no way to judge the accuracy or reliability of such models.

Furthermore, critics note that there are wide differences among the different models. For example, the Department of Insurance has prepared comparisons showing a wide disparity in

⁸ The five modelers are: Risk Management Solutions (RMS); E.W. Blanch (Catalyst) ; EQECAT; Applied Insurance Research (AIR); and Applied Research Associates (ARA). These models are approved under the Commission's 1999 standards. These same models have made submissions to be reviewed by the Commission under the 2000 standards and such reviews will take place during this year.

projected loss costs in certain areas among the five modelers who have currently met the standards of the Commission. The department has compared the five models and found differences as to average loss costs pertaining to construction types of homes among the 67 counties in the state and as to probable maximum loss data. For example, the estimated probable maximum loss (PML) for a 100-year storm ranges from a high of \$83 billion from one modeler (Applied Research Associates) down to \$23 billion for another modeler (E.W. Blanch). Also, there exists a public distrust of models.

Insurance companies advocate the use of catastrophe models because they are the best way to evaluate catastrophic loss costs, are more accurate than the old method, are generally accepted within the actuarial profession and are widely used in the insurance industry. In fact, computer modeling has exposed tremendous errors in ratemaking practices that had been accepted for decades. The Legislature emphasized these concepts in finding that the "ability to accurately project hurricane losses has been enhanced greatly in recent years through the use of computer modeling...and that it is the public policy of the state to encourage the use of the most sophisticated actuarial methods to assure that consumers are charged lawful rates..."

The traditional actuarial method of basing insurance rates on past historical data has severe limitations when applied to hurricanes. In order to get a true picture of what the real loss potential is, a much longer period of experience is needed than for other property insurance risks. But, the older the data, the more it must be modified to reflect current population, property value, construction, building codes, and other factors, which make some type of modeling process necessary.

The use of modeling in setting rates is also argued to be a key to attracting the necessary capital to underwrite the hurricane risk. Insurers must maintain large catastrophe reserves or purchase reinsurance to cover hurricane claims that exceed premium income. Bonding provides part of this capital through state-created facilities supported by assessments. But the hurricane risk retained by the private sector must be underwritten by investors who voluntarily commit their capital. Catastrophe models are almost universally accepted by the capital markets and disallowing or limiting their use could severely restrict access to needed capital and cause greater problems of availability of coverage.

Those who argue that the current law should not be changed point out that it merely provides that models approved by the Commission are admissible and relevant and are not binding on the department as the law previously stated. The Legislature created the Commission precisely for the purpose of expert evaluation of models. The Commission, a body independent of both the insurance industry and the department, is comprised of eleven experts, of which seven are appointed by the Insurance Commissioner, who thoroughly review all aspects of the catastrophe model, including the information deemed proprietary. As a result of the standards developed by the Commission, many changes were made to the models that improved their reliability.

Finally, it is asserted that certain modeling information is proprietary because companies have spent millions of dollars in developing the models and thus have required outside parties to examine the models and agree not to divulge their trade secrets to competitors. Thus, regulators can review the proprietary information so long as they agree not to divulge the trade secrets.

Florida Windstorm Underwriting Association (FWUA);**Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA)**

The Florida Windstorm Underwriting Association (FWUA), created in 1970, provides windstorm coverage for personal and commercial property only in those geographical areas of the state determined by the Department of Insurance as meeting statutory criteria of eligibility (s. 627.351(2), F.S.). In order to obtain coverage for other perils such as fire, theft, and liability, a policyholder must obtain a separate "ex-wind" policy from another insurer. Currently, the FWUA has 429,672 policies representing an exposure of \$93.4 billion with a probable maximum loss (PML) of \$4.7 billion.

Currently, the FWUA operates under a 15-member board, which includes 12 members representing and appointed by various segments of the insurance industry pursuant to the FWUA plan of operation, plus the Insurance Consumer Advocate and two consumer representatives (one appointed by the Insurance Commissioner and one appointed by the Governor). The Department of Insurance must approve the plan of operation of the FWUA. Otherwise, the department generally has the same regulatory powers over the FWUA's premiums and policies as it has with respect to voluntary market insurers.

Coastal areas of 29 of Florida's 35 coastal counties are currently eligible for FWUA coverage, generally within a distance of 1,000 feet from the coast, but in Dade, Broward, and Palm Beach Counties, the area east of I-95 is eligible, which extends as far as 5 miles from the coast. The entire area of Monroe County is eligible. Further expansion of eligible areas is currently prohibited.

The Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA), created in 1992 after Hurricane Andrew, provides residential property insurance coverage in all areas of the state, (s. 627.351(6), F.S.). Commercial coverage is available only for residential structures, including condominiums, apartment buildings, and cooperatives. The policies provide coverage for all perils covered under a standard residential policy, subject to certain underwriting requirements. The RPCJUA policies exclude windstorm coverage on property located in an area eligible for windstorm coverage from the FWUA. The JUA operates pursuant to a plan of operation approved by the department, and is governed by a board consisting of 7 members representing insurers and 6 members representing non-insurer interests, including consumers.

Claims paid by the FWUA and JUA are funded by premiums paid by their policyholders and, if necessary, assessments on all property insurers in the state and their policyholders. Both associations must purchase a specified amount of reinsurance from the Florida Hurricane Catastrophe Fund and may obtain additional private reinsurance. Either association may borrow, issue bonds, and secure other types of debt financing, and may pledge assessment revenues as security.

RPCJUA premiums are required by law to be set in each county at the highest rates charged by the top 20 insurers in the state. This requirement does not apply to FWUA premiums, which are subject to the same requirements that apply to authorized insurers generally and, as such, rates may not be excessive, inadequate, or unfairly discriminatory. However, legislative intent provides that FWUA rates not be competitive with voluntary market rates and requires its plan of operation to provide, by January 1, 1999, a means of assuring that FWUA rates are reflective of

department-approved hurricane rates in the voluntary market. Both the RPCJUA and the FWUA may utilize the arbitration process as other insurers. (See summary above.)

If necessary to fund losses, both the FWUA and RPCJUA may impose *regular assessments* against all authorized property insurers, in proportion to their statewide market share of premiums. Regular assessments, in any one-year, may not exceed the greater of 10 percent of the deficit or 10 percent of the prior year's statewide premium for property insurance. Insurers are permitted by law to recoup regular assessments from their policyholders in future rate filings. If the deficit exceeds the maximum amount that can be obtained from regular assessments, all new and renewal property insurance policies in the state are subject to *emergency assessments*, to be collected by insurers as surcharges paid by their policyholders. Emergency assessments are generally limited to the same amount each year as regular assessments and may be pledged by the board of the FWUA or JUA to secure debt financing necessary to pay claims, which assessments would continue until the debt is satisfied.

An insurer that qualifies as a *limited apportionment company* is exempt from regular assessments by the FWUA for the amount a deficit that exceeds \$50 million. To qualify, an insurer must have a surplus of \$20 million or less, and must write at least 25 percent of its total countrywide property insurance premiums in Florida. The amount that cannot be assessed against a limited apportionment company is spread proportionately to all other insurers subject to the regular assessment. A limited apportionment company is not exempt from collecting emergency assessments from its policyholders as may be necessary to fund FWUA deficits.

The boundaries of the FWUA directly affect the obligation of private market insurers to provide windstorm coverage. As noted above, outside the FWUA eligible areas, insurers must include windstorm coverage in every residential property insurance policy they write. Inside FWUA areas, insurers are free to write policies that exclude windstorm coverage.

In May 1999, the FWUA filed a rate increase, which was ultimately approved by an arbitration panel at 96 percent. This percentage represented an overall statewide average, which would be incrementally implemented: the maximum rate increase is capped at 20 percent for the first year, 30 percent for the second year, and 40 percent for each subsequent year. The FWUA is required to apply discounts, thus lowering the amount of premium paid, for loss mitigation retroactively to policyholders who mitigate their homes.

Offers of Coverage to FWUA Policyholders from Insurers in the Voluntary Market

In 1996, legislation was enacted to provide that if the FWUA obtains an offer from an authorized insurer to cover a risk (e.g., a homeowner's policy) at its approved rates under either a standard policy including wind coverage, the risk is no longer eligible for coverage through the FWUA. Upon termination of eligibility, the FWUA must provide written notice to the policyholder and agent of record stating that the FWUA policy must be canceled 60 days after the date of the notice because of the offer of coverage from an authorized insurer. (Ch. 97-55, Laws of Florida.) This is the same that applies to the RPCJUA [s. 627.351(6)(c)5., F.S.]. However, the situation is different as applied to the FWUA, because forcing a FWUA policyholder to accept a policy from a take-out insurer forces a policyholder to lose not only their FWUA policy, but also their ex-wind policy (if the ex-wind insurer is not willing to write the wind), assuming that the

policyholder desires to have windstorm coverage or is required to do so under the terms of his or her mortgage. This has a detrimental impact on the ex-wind insurer, as well, which loses the business.

Take Out Commissions Paid to Agents

The current law requires that if the RPCJUA enters into a contractual agreement for a take-out plan, the agent of the RPCJUA policy is entitled to retain any unearned commission on the policy and the take-out insurer must pay to the 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. This provision does not apply to policies taken out of the FWUA.

Limitations on Non-Renewal of Property Insurance (“Moratorium”)

After Hurricane Andrew, many insurers sought to reduce their exposure to hurricane losses in Florida by non-renewing policies. In response, the Department of Insurance issued a series of emergency rules limiting insurers' authority to cancel or non-renew policies.

In the May 1993 Special Session, the Legislature imposed a moratorium on non-renewals, prohibiting insurers from non-renewing any personal lines residential property insurance policy for the purpose of reducing hurricane exposure during the 180-day period from May 19 until November 14, 1993. In the November 1993 Special Session, the Legislature enacted a 3-year “moratorium phase-out” that followed the 180-day moratorium, that prohibited insurers from non-renewing, for the purpose of reducing hurricane exposure, more than 5 percent of their policies in the state or more than 10 percent in any one county in any 12-month period. Exceptions were provided for insurers that could demonstrate an unreasonable threat to their solvency. The limits applied separately to homeowner's policies, mobile home owner's policies, and all personal lines residential policies, which include condominium unit owners, tenants, and similar policies. (Ch. 93-410 and 93-411, L.O.F.; creating s. 627.7013, F.S.)

The 3-year “moratorium phase-out” was scheduled to expire on November 14, 1996. But, the 1996 Legislature replaced it with a 3-year “moratorium completion” that ran from June 1, 1996, until June 1, 1999. It applied to policies in effect on June 1, 1996, and did not apply to policies written after that date. This moratorium continued the same percentage limits on non-renewals and added a new section (s. 627.7014, F.S.) that applied the same limits to condominium association policies, which were not covered under the prior law. However, the 1996 law allowed insurers to transfer policies to another authorized insurer and allowed an insurer to apply to the department for approval of a greater number of non-renewals of the windstorm portion of policies in areas eligible for windstorm coverage from the FWUA. The department approved such plans for the state's two largest writers, State Farm and Allstate. (Ch. 96-194, L.O.F.)

In 1998, the Legislature again extended the limitations on non-renewal of residential property policies, until June 1, 2001, which is the current law in ss. 627.7013 and 627.7014, F.S. The limits continue to apply only to those policies that were in effect on June 1, 1996. Legislative findings state that as of January 1, 1998, the general instability of the market was reflected by the fact that the FWUA had more than 400,000 policies in force, approximately half of which were initially issued after January 1, 1997, and that the RPCJUA still had approximately 500,000

policies in force. The law provides that the moratorium will also cease to operate once the property exposures of the FWUA and RPCJUA, combined, remain below \$25 billion for 3 consecutive months.

In 1998, the U.S. Court of Appeals for the Eleventh Circuit upheld the facial constitutionality of the 1993 version of the moratorium statute, but left open the possibility that the statute could be unconstitutional as applied, in the case of *Vesta Fire Ins. Co. v. State of Florida, Department of Insurance*, (141 F.3d 1427). For additional analysis of this case, see Constitutional Issues, below. It is questionable whether the limits on non-renewals continue to have any significant impact on the market. Those insurers seeking to reduce their hurricane exposure have done so, through a combination of non-renewing policies up to legal limits, transferring policies to other insurers, restrictive underwriting, normal attrition (sale of homes), increasing hurricane deductibles, limiting coverages and, in some cases, forming Florida-only subsidiaries. Also, the mere passage of time lessens the impact of the moratorium, because it does not apply to any policy issued after June 1, 1996.

A related issue is that of insurers seeking to withdraw from the state. Section 624.430, F.S., provides that an insurer desiring to surrender its certificate of authority, withdraw from the state, or discontinue the writing or any kind or line of insurance must give 90 days' notice in writing to the department setting forth its reasons for doing so. After Hurricane Andrew, the department issued an emergency rule that interpreted the statute as authorizing the department to allow the department to impose such reasonable terms and conditions as necessary to prevent or ameliorate adverse consequences to policyholders. (Rules 4ER92-11 and 4ER93-5, F.A.C.). Later, the department adopted a permanent rule establishing procedures for withdrawal which prohibits an insurer from taking any action until 90 days after the receipt by the department of the notice required by s. 624.430, F.S. (4-141.020, F.A.C.) The notice must describe what treatment will be given to affected Florida policyholders and what steps will be taken regarding processing of any outstanding claims. The rule also provides, "No surrender or attempted surrender of a certificate of authority is effective until accepted by order of the department."

III. Effect of Proposed Changes:

FWUA may not Utilize Arbitration of Rate Filings

Section 1 of the bill amends s. 627.062, F.S., to prohibit the Florida Windstorm Underwriting Association (FWUA) 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, as an alternative to an administrative hearing under chapter 120, F.S.

Restricted Use of Hurricane Loss Projection Models

Section 2 of the bill amends s. 627.0628, F.S., to provide that findings and factors adopted by the Florida Commission on Hurricane Loss Projection Methodology as to the accuracy or reliability of hurricane models are *not admissible and relevant* in consideration of a rate filing, unless the Department of Insurance has access to all factors and assumptions used in developing the actuarial methods, principles, standards, models, or output ranges found by the commission to be

accurate or reliable. Further, the department may *not be precluded* from disclosing such information in a rate proceeding, in order for the findings to be admissible and relevant.

Florida Windstorm Underwriting Association

Board of Governors

The bill revises the composition of the Board of Governors of the Florida Windstorm Underwriting Association. Currently, the FWUA operates under a 15-member board, which includes 12 members representing and appointed by various segments of the insurance industry pursuant to the FWUA plan of operation, plus the Insurance Consumer Advocate and 2 consumer representatives (1 appointed by the Insurance Commissioner and 1 appointed by the Governor).

Under the bill, the 15-member board of the FWUA would consist of:

- The Insurance Consumer Advocate;
- 7 representatives of specified interests appointed by the Insurance Commissioner (1 representative of financial institution engaging in residential mortgage lending within FWUA areas; 1 representative of realtors engaged in the sale of residential property in FWUA areas; 1 representative who has expertise in State minimum Building Codes and coastal construction; 1 FWUA policyholder; 1 property and casualty insurance agent; and 1 consumer appointed by the Insurance Commissioner); and
- 7 members appointed as specified in the FWUA plan of operation (presumably insurer representatives appointed by the insurer members of the FWUA).

The bill also specifies that the current limited immunity from liability for FWUA board members acting within the scope of their duties does not extend to any violation of criminal law.

Reduction of Boundaries of the FWUA; Assignment of Affected Policies to Insurers

The bill reduces the boundaries of the FWUA by "deauthorizing" the area that is currently eligible for FWUA coverage between Interstate 95 and U.S. 1 in Dade, Broward, and Palm Beach Counties.

The bill establishes as assigned risk plan to provide for the following:

- after December 31, 2001, the FWUA could not accept applications for coverage for a risk located in what is termed the "deauthorized area." That term means the area between I-95 and US 1 in Miami-Dade, Broward and Palm Beach counties;
- until January 1, 2002, the FWUA must afford all authorized insurers to voluntarily remove policies located in the deauthorized area from the FWUA. Each policy must be written for at least 3 full annual policy terms, using rates and forms approved by the department;
- beginning January 1, 2002, the FWUA must identify personal lines residential policies in the deauthorized area that will be assigned to each insurer. The FWUA

- shall provide each insurer access to information concerning each policy assigned to the insurer;
- the selection and assignment of such policy must be coordinated by the FWUA among the various insurers by allocating distribution of policies in a manner as to do the following: a) limit adverse solvency consequences; b) avoid excess concentration of policies in any one area with respect to the insurer's personal lines residential coverage book of business; c) take into account the characteristics of risks underwritten in the voluntary market by the assigned insurer; and d) attempt to match risks as closely as possible to the insurer's expertise as well as take into account variations in the market value of the assigned risks;
 - the assignment of risks must be equal to the insurer's proportional share of the personal lines residential insurance policies written in Florida. Insurers who voluntarily remove policies may receive a reduction in the number of risk assignments;
 - if more than one insurer within an insurer group is authorized to write personal lines residential coverage in Florida, insurers in the group may cede the assignments among authorized members of the group as approved by the department;
 - each insurer must renew each assigned policy for at least 3 years, unless canceled for a lawful reason other than reducing hurricane exposure or if nonrenewed by the policyholder;
 - insurers may offer an assigned policyholder coverage for non-wind perils; if such offer is accepted, the insurer may write an "all perils" coverage at the insurers approved rates and on approved forms;
 - if the assigned policy is canceled or is nonrenewed by the insurer for any reason during the 3 year period, the insurer must accept another similar assigned policy;
 - the producing agent will retain the assigned policy if a policy is assigned to an insurer with which the producing agent has a contract. If the policy is assigned to an insurer that is using a managing general agent, the producing agent is entitled to act as the brokering agent. If the agent is not appointed with the assuming insurer, that agent shall receive a \$50 fee, payable by the FWUA;
 - if the insurer believes that the assigned policy would result in insolvency or impair capital and surplus, and reasonable means to avoid insolvency or impairment are unavailable, the insurer may petition the department for revision of selection and assignment of such risks; however, the insurer must bear the burden of proving such assignment would result in such insolvency or impairment;
 - failure of an insurer to accept an assigned risk constitutes a willful violation of the Code and each policy refused or rejected constitutes a separate violation (the department may impose a fine not to exceed \$20,000 for each willful violation or suspension or revocation of an insurers certificate of authority);

The bill authorizes the department to adopt rules to implement the assigned risk plan; the department may also amend the FWUA's plan of operation or bylaws as well as that of the market assistance plan established under s. 627.3515, F.S.

Take-out Offer no longer makes a policyholder ineligible for FWUA coverage

The bill deletes the provisions of current law that state that if the FWUA obtains an offer of coverage from an authorized insurer to insure a home or other risk at its approved rates under either a standard or basic policy including wind coverage, the risk is no longer eligible for coverage through the FWUA.

Limited Apportionment Companies

The bill increases from \$20 million to \$25 million, the maximum amount of surplus that an insurer may have to qualify as a limited apportionment company in the FWUA. As a limited apportionment company, an insurer is not subject to regular assessments for FWUA deficits in excess of \$50 million. The amount that cannot be assessed against a limited apportionment company is spread proportionately to all other insurers subject to the regular assessment.

Take out payments to agents

The bill requires that if the FWUA enters into a contractual agreement for a take-out plan, the agent of the FWUA policy is entitled to retain any unearned commission on the policy and the take-out insurer must pay to the 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. This provision is the same as the current provision that applies to the RPCJUA.

Extension of Limitations on Non-Renewal of Property Insurance ("Moratorium")

Section 4 of the bill amends s. 627.7013, F.S., to extend, for 3 more years, the operation of the law that limits the number of personal lines residential policies that insurers may non-renew for the purpose of reducing their hurricane exposure. The current limitations are scheduled for repeal on June 1, 2001, which the bill extends until June 1, 2004.

As currently provided, the limitations would apply only to those policies in effect on June 1, 1996, and would prohibit insurers from non-renewing, for the purpose of reducing hurricane exposure, more than 5 percent of their personal lines residential policies in the state or more than 10 percent in any one county in any 12-month period. The same exceptions would apply as under current law, such as allowing for department-approved waivers for insurers that can demonstrate an "unreasonable risk of insolvency," specifying that insurers may transfer policies to other authorized insurers without counting as a non-renewal, and allowing for unlimited non-renewals for underwriting reasons or any other lawful reason unrelated to the risk of loss from hurricane exposure. The law would also continue to provide that the moratorium will cease to operate once the property exposures of the FWUA and RPCJUA, combined, remain below \$25 billion for 3 consecutive months.

The bill makes legislative findings that the conditions of market instability continue to exist, reflected by the fact that the FWUA has more than 400,000 policies in force and that the RPCJUA has more than 60,000 policies in force, as of January 1, 2001.

Section 5 of the bill amends s. 627.7014, F.S., to extend for 3 more years, the operation of the law that limits the number of condominium association policies that insurers may non-renew for the purpose of reducing their hurricane exposure. The current limitations are scheduled for repeal on June 1, 2001, which the bill extends until June 1, 2004.

The bill would apply the limitations and exceptions that apply under current law, which are substantially the same limits and exceptions described in the section above for personal lines residential policies.

The bill makes legislative findings that the conditions of market instability continue to exist, reflected by the fact that the FWUA has approximately 9,000 commercial residential policies in forces as of December 31, 2000.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

The bill extends for 3 more years the current limits on the number of residential property insurance policies that insurers may non-renew, which raises constitutional issues. In 1998, the U.S. Court of Appeals for the Eleventh Circuit upheld the facial constitutionality of the moratorium statute, s. 627.7013, F.S., but left open the possibility that the statute could be unconstitutional as applied, in the case of *Vesta Fire Ins. Co. v. State of Florida, Department of Insurance*, (141 F.3d 1427). The lower court, the U.S. District Court for the Northern District of Florida, had upheld the constitutionality of the 1993 moratorium statute which was scheduled for repeal in 1996. By the time the case was heard by the appellate court, the 1996 Legislature had extended and modified the moratorium until 1999. The current law's extension to 2001 had not yet been enacted. The Court held that the law did not violate the constitutional prohibition against a state law impairing the obligation of contracts. The Court recognized that a substantial impairment to insurance contracts existed, but also found that Florida demonstrated a legitimate public purpose of protection and stabilization of the Florida economy, particularly the real estate market. The Court determined that unless the State itself is a contracting party, courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure. In this case the State was not party to the insurance contracts, so based upon the Legislature's judgment, the statutes' impact on existing insurance contracts was not an unconstitutional impairment.

However, the Court in *Vesta* also determined that a factual issue existed as to whether or not the moratorium statute was an unconstitutional “regulatory taking.” The Fifth Amendment states, in part “...nor shall private property be taken for public use, without just compensation.” The Court stated that the Supreme Court recognized three factors that must be considered to identify a regulatory taking: (1) the economic impact of the challenged regulation or statute on the plaintiff; (2) the extent to which the regulation interferes with investment-backed expectations; and (3) the nature of the challenged action. The Court held that it was improper for the lower court to grant summary judgment for the State on this issue and remanded the case for evidentiary findings. The Court noted that the extension of the moratorium statutes until 1999 occurred after the insurer filed its complaint, but expected that the insurer would be permitted to include the economic effect of the extension. However, upon remand, the insurer and the State of Florida reached a settlement in this case which was voluntarily dismissed

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

All authorized insurance companies writing personal lines residential coverage will be required to assume those FWUA policies which are in the deauthorized area under the bill, in Dade, Broward, and Palm Beach Counties, beginning January, 2002. This plan could adversely affect the solvency of insurance companies by reducing a company's control over its exposures. Further, the assigned risk plan will force companies to commit capital to the assigned policy, obtain additional reinsurance from the Florida Hurricane Catastrophe Fund and from private reinsurers, and put pressure on companies to non-renew existing business in order to accommodate assignments. The weakening of an insurance company's solvency or a company's loss of control over its catastrophic exposures could lead to a downgrade in the company's claims-paying-ability rating from A. M. Best Co., and other rating agencies, which could reduce the company's profitability or increase its cost of capital.

Restricting the use of hurricane models - If a modeling company is not willing to divulge proprietary assumptions used in developing the model or is not willing to allow the department to divulge such information in a rate hearing, the results of the model would not be admissible. This may make it more difficult for an insurer to justify a rate increase for windstorm coverage.

Based on the assumption that an arbitration panel is more likely to grant a rate increase, or that such a rate increase would be approved more quickly, the bill would have the effect of reducing the impact of rate increases for FWUA policyholders. Conversely, the FWUA may be less likely or able to obtain what its board considers to be adequate rates or to obtain a quick resolution of a rate filing. This could lead to greater assessments on voluntary insurers and their policyholders.

Insurers still seeking to reduce their hurricane exposure in Florida would remain subject to the limitations on non-renewal of residential property insurance policies, which limitations are currently scheduled for repeal on June 1, 2001, but would be extended until June 1, 2004. Policyholders who have been insured by the same insurer since June 1, 1996, would be afforded the protection of the extended limitations.

By increasing the maximum surplus from \$20 million to \$25 million for an insurer to qualify as a limited apportionment company in the FWUA, more insurers would be exempt from regular assessments for FWUA deficits in excess of \$50 million. The amount that cannot be assessed against a limited apportionment company will be spread proportionately to all other insurers subject to the regular assessment.

C. Government Sector Impact:

Additional costs are likely to be imposed on the Department of Insurance in implementing the provisions of this bill, but such costs are indeterminate.

The Division of Administrative Hearings may have more rate hearings as a result of the passage of this bill.

VI. Technical Deficiencies:

The Department of Insurance has raised the following concerns as to the provisions of the bill restricting the use of hurricane models in rate proceedings (which are also in SB 328):

“The language in the bill states that the department shall have access to the factors and assumptions’ used in developing a computer model. The department’s experience with computer models suggests that in current use, the department can access the set of factors and assumptions underlying a model’s construction. What is needed by the department is how, after input, factors and assumptions are manipulated to give results -- how factors are weighted or how variables are assigned to various assumptions to give a loss amount or a loss percentage projection. The language in the bill may not be as precise or as comprehensive as is needed.

The term ‘rate proceeding’ is undefined elsewhere in statute and thus may need further definition in this bill.

Since hurricane models are proprietary business materials, there may be a need for a public records exemption or other protective language for any use the department would make of this information in a rate proceeding (e.g., a rate review or in defense in an administrative hearing). Further, the department may need rule making authority to guide the department in its assessment of information obtained under the bill.”

VII. Related Issues:

None.

VIII. Amendments:

None.

This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.
