PROPERTY AND CASUALTY INSURANCE REFORM COMMITTEE INTERIM REPORT AND RECOMMENDATIONS

NOVEMBER 15, 2006

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SUMMARY OF FINDINGS

Florida is a growing state with a robust economy and an increasing population. Property insurance for homeowners and commercial interests must be available to keep Florida's economic engine running. The eight 2004-2005 hurricanes caused nearly $36 billion in estimated total Florida specific losses across 2.8 million claims. The result is cost and availability challenges for the residential and commercial property insurance market. The increased frequency of hurricanes, coupled with losses in the billions, led to higher property losses as well as increased demand and costs for repairing and rebuilding. Hurricane models, which insurers and reinsurers use to make business decisions, predict more frequent and expensive events.

As a result of the multiple hurricanes impacting Florida and the Gulf region of the United States, the cost of reinsurance is increasing dramatically while the availability of coverage to insurers is declining. The reinsurance industry indicated that the demand for reinsurance increased by 120 percent over last year, while the availability is only 80 percent of last year.

Recent events have caused the private industry to reach its threshold for risk in Florida's residential property markets and, in recent years, fewer insurance companies want to conduct business in the state. Many of the large nationally known insurers are capping or reducing exposure. In response to the challenges in the market, Governor Bush signed Senate Bill 1980 which provides incentives to insurers to participate in the Florida property insurance market.

Hurricanes are a way of life for Florida's 17 plus million residents as a result of their damage. Residential and commercial insurance costs and availability are now the biggest issues facing the Florida Legislature and Florida's state and local leaders. In June 2006, Governor Jeb Bush issued Executive Order 06-150 creating the Property and Casualty Insurance Reform Committee (Committee) to examine the Florida insurance market and make recommendations to reduce the cost of premiums, increase the availability of

insurance, and reduce the risk to homeowners and businesses. Under Governor Bush's leadership, the Committee worked diligently over the past 90 days to craft substantial insurance reforms that could have a lasting impact for Florida's residents and insurance consumers. The recommendations address every aspect of the insurance market from insurance policy contractual reforms to providing methods to bring new capital to Florida's insurance market. Floridians must be educated to the fact that building safer structures and retrofitting existing ones will lower their insurance premiums. According to national modeling companies, Florida is the most high risk state in the country for potential catastrophic risk.

The Committee met for three months beginning in early August. Members developed recommendations in ten topic areas – Residential Insurance Market and Consumer Issues, Commercial Insurance Market and Property and Casualty Joint Underwriting Association, Florida Building Code, Mitigation, Florida Hurricane Catastrophe Fund, Reinsurance Market, Windstorm Boundaries, Citizens Property Insurance Corporation, Market Incentives and Barriers, and Federal issues. These recommendations address every issue the Governor's Executive Order asked the Committee to review.

The major components of the recommendations to the Legislature are as follows:

Maximize and leverage the use of the Florida Hurricane Catastrophe Fund (CAT Fund), the state's reinsurance entity, during this current cycle of astronomically high private market reinsurance rates. Recent reinsurance market rates caused significant negative premium impact to consumers via the cost of reinsurance on direct writers. The Committee recommends authorization of a lower level of CAT Fund coverage below the $5.3 billion attachment point, for a limited time duration of perhaps two storm seasons, on a voluntary participation basis. The Legislature should consider a similar short term market enhancement on the top end of the CAT Fund above the $15 billion cap and investigate allowing commercial non-residential property insurers to access some level of CAT Fund coverage. The Committee recommends a "near market rate" premium should be charged for this coverage.

Create enhanced insurance policy transparency to allow consumers of residential and commercial policies to be specifically informed on the details of their premium charges. The specific dollar amount of potential premium mitigation discounts available and itemized by mitigation measure; assessments from authorized entities such as Citizens Property Insurance Corporation (Citizens), the CAT Fund, and the Florida Insurance Guaranty Association (FIGA); rate increase premium impacts, agent's commissions; and specific premium tax amounts should be on the premium notice and policy. This transparency must be in plain language and easy for consumers to understand. Insurers should be required to offer policy options such as ex-wind (covering all perils other than property losses caused by wind), wind only , excluding personal contents coverage, lower dwelling limits options, and unlimited deductible options. Finally, the Office of Insurance Consumer Advocate should be moved to report directly to the Governor and Cabinet (Financial Services Commission) and strengthen its independence.

Eliminate the Panhandle exemption and require a uniform statewide building code that requires American Society of Civil Engineering (ASCE) wind lines and prohibits any change in future statewide building codes unless the change enhances the structural integrity of the code as it relates to wind protection. The Committee also encourages local governments to consider providing incentives for building to a code plus standard for new construction.

Consider maintaining and expanding the Mitigation Program created during the 2006 Session. Mitigation of homes has the potential of reducing Florida's loss exposure by over 60 percent. The Committee learned that every dollar spent on mitigation translates to an average of four dollars in savings. Earmark a portion of mitigation funding for Citizens policyholders to reduce the risk of greater exposure to back-end assessments on all Floridians. Require modeling firms used by insurers in their rate filings, to recalibrate their models to take into account the results of mitigation. Finally, standardize insurance mitigation premium discounts.

Eliminate the lengthy and costly process of Citizens seeking rate increases with the Office of Insurance Regulation (OIR). Require OIR to set Citizens' rates regularly, based on the highest approved rates in the voluntary market. The Legislature should also eliminate the state's antiquated windstorm boundaries to allow Citizens to write a complete policy throughout the state. Encourage Citizens policyholders to upgrade and retrofit their structures through mitigation techniques. Finally, enact insurer incentives to encourage Citizens take-out plans.

Evaluate numerous market incentives to bring additional capital formation and insurer opportunities in Florida. Extend and modify the Insurance Capital Build-up Incentive Program to allow more flexibility for insurance companies to access the capital. Encourage new capital market risk transfer vehicles and promote the State Board of Administration's use of financing techniques such as catastrophe bonds, sidecars, and other capital market alternatives. Continue and promote Florida's review of state participation in an insurance exchange for its catastrophe risk transfer products and evaluate changes to Florida's captive insurer law. Seek possible viable methods to create tax free catastrophe reserve accounts. Finally, merge the Property Casualty Joint Underwriting Association's commercial policy underwriting process with Citizens' commercial policy issuance to streamline the two entities duplicative state action.

GOVERNOR'S EXECUTIVE ORDER/INSURANCE REFORM COMMITTEE/ TECHNICAL ADVISORY COMMITTEE

On June 27, 2006, Governor Jeb Bush issued Executive Order 06-150 creating the Property and Casualty Insurance Reform Committee (Committee) to study Florida's insurance issues and make recommendations to the Governor, the President of the Senate and the Speaker of the House of Representatives. (Exhibit 1)

The Executive Order states that 15 members will be appointed. On July 26, 2006, the Governor appointed the Committee and named Lt. Governor Toni Jennings its chairperson. (Exhibit 2) The Committee is a diverse group of public and private representatives from around the state. To ensure that the Committee was fair and objective, no insurance industry representatives were appointed. A twelve member Technical Advisory Committee with expertise in insurance issues was appointed. (Exhibit 3) Along with the Technical Advisory Committee, the Insurance Commissioner, Senior Florida Hurricane Catastrophe Fund (CAT Fund) Officer, Director of the Florida Comprehensive Hurricane Damage Mitigation Program, and the Executive Director of Citizens Property Insurance Corporation (Citizens) were asked to assist the Committee.

The Executive Order specifically requested the Committee make recommendations to improve competition and create incentives for private insurance and reinsurance in the areas of residential, commercial, manufactured homes, condominiums/apartments, and government entities; encourage commercial and residential mitigation; improve insurance agent underwriting practices; depopulate Citizens; reduce the exposure of the CAT Fund by substituting private alternatives; evaluate the preliminary results of SB 1980 including the capital build-up program, mitigation program, private insurance competition and capacity measures and Citizens rate changes; and influence national catastrophe risk management planning.

The Committee was charged with presenting its Interim Report no later than November 15, 2006, a Mid-Term Report no later than December 15, 2006 and its Final Report no

later than February 1, 2007, to the Governor, the President of the Senate, and the Speaker of the House of Representatives. The Committee's website is: http://www.myfloridainsurancereform.com/wycd.htm.

The Committee held the following meetings:

- August 8, 2006; Tallahassee – members received historic overview of Florida's insurance market and present programs;
- August 24, 2006; Orlando – discussion items included the CAT Fund, reinsurance, capital markets and mitigation;
- September 7, 2006; Tallahassee – Committee began formulating recommendations in the areas of the CAT Fund, private reinsurance market alternatives and mitigation;
- September 21, 2006; Miami – discussion centered around the size, scope and operations of Citizens and recommendations for additional reforms effecting Citizens; heard from a panel of modeling companies regarding their activities and the market's use of insurance modeling companies;
- October 4, 2006; Tallahassee – deliberations on commercial insurance and condominium/community housing insurance issues; the state's public school facility property insurance crisis discussed , along with a proposal that could help public hospitals in Florida pool their risks for property insurance;
- October 12, 2006; Tampa Bay area – reviewed proposals of the Consumer Advocate Office, consumer issues, sinkholes and six significant reform proposals;
- October 26, 2006; Tallahassee – federal taxation and CAT reserve issues, captive insurance alternatives, the State Board of Administration recommendations, the Florida Market Assistance Program's functions, Florida building code issues and manufactured housing alternatives were discussed; final comprehensive recommendations were reviewed; and
- November 15, 2006; Tallahassee – last meeting to discuss interim report and recommendations and final report.

The agendas and minutes are Exhibit 4.

BACKGROUND/HISTORY

Florida's property insurance cost and availability have become issues of utmost importance to its citizens and its government. Governor Bush recognizes the ongoing significance a robust insurance market has on Florida's economy.

Floridians faced unusual and extraordinary hurricane seasons during 2004 and 2005. The state was battered by numerous tropical storms and hurricanes in an 18-month period. No part of the state was spared from the effects of the storms. Governor Bush issued a series of executive orders to address the devastation in the affected areas. These include:

- Executive Order 04-182; August 10, 2004 - declared a state of emergency because of Tropical Storm Bonnie and Hurricane Charley which devastated communities in the southwestern and central portions of the state;

- Executive Order 04-192; September 1, 2004 - declared a state of emergency due to Hurricane Frances which devastated communities in the central, eastern, and northeastern portions of the state;

- Executive Order 04-206; September 10, 2004 - declared a state of emergency for Hurricane Ivan which devastated communities in the Florida Panhandle;

- Executive Order 04-217; September 24, 2004 - declared a state of emergency for Hurricane Jeanne which devastated communities in the central, eastern, and northeastern portions of the state;

- Executive Order 05-139; July 7, 2005 - declared a state of emergency for Hurricane Dennis which devastated communities in the Keys, the Big Bend, and the Panhandle;

- Executive Order 05-176; August 24, 2005 – declared a state of emergency for Hurricane Katrina which effected communities in Broward, Miami-Dade, and Monroe counties;
- Executive Order 05-183; September 18, 2005 - declared a state of emergency due to Hurricane Rita which effected Monroe County;

- Executive Order 05-219; October 19, 2005 - declared a state of emergency for Hurricane Wilma which devastated communities in southern portions of the state;

The damage caused by the 2004 season storms was of sufficient severity and magnitude that the President of the United States authorized federal funds for public assistance on October 7, 2004. The Federal Emergency Management Agency and the Small Business Administration provided aid to Florida residents and businesses affected by the storms.

Many parts of the state are still recovering from the cumulative impacts of Tropical Storm Bonnie and Hurricanes Charley, Frances, Ivan, and Jeanne, Dennis, Katrina, Rita, and Wilma. Their impacts include the loss of homes, destruction and damage to public facilities, loss of power and communication lines, and damage to public roads and highways, all of which demanded a massive infusion of state, local, and federal resources to the communities stricken by these disasters. The total insured impact has been estimated to be $35.9 billion (This excludes National Flood Insurance Plan losses). See Exhibit 5

In 1996, the Florida Legislature authorized insurers to apply deductibles based on a percentage of the amount insured (2 percent, 3 percent, or 5 percent), rather than a flat dollar amount, for damage to residential property caused by named storms (tropical storms and hurricanes). While the intent was to encourage the use of higher hurricane deductibles as a means of increasing the effective capacity of the hurricane insurance market and limiting the impact of rapidly rising hurricane insurance premiums, no one foresaw the possibility of homeowners being hit multiple times by hurricanes within a single hurricane season. During the 2004 storm season many, Floridians faced the

possibility of having to cover more than one deductible due to damage caused by multiple storms

During the 2004 Special Session, Governor Jeb Bush worked with the Legislature to provide financial relief for homeowners by reimbursing them for deductibles paid after the initial deductible was charged. The legislation also allowed insurance companies to charge only one deductible for a single hurricane season to prevent a recurrence of the multiple deduction sticker shock that devastated homeowners in Florida after the 2004 storm season. One hundred, fifty million dollars was appropriated for the reimbursement of individuals affected by the double deductible.

Governor Bush signed legislation into law in December 2005 to provide more than 19,000 Floridians hurricane relief payments totaling $9.5 million. Property tax refund checks were mailed to homeowners who were forced out of their homes for 60 days or more as a result of a named storm in 2004. The average refund for a qualified homeowner was $500.

A sales tax holiday for selected hurricane preparedness supplies was proclaimed for May 2005 and again in May 2006 coinciding with Hurricane Awareness Week.

2006 LEGISLATIVE ACTION

During the 2006 Legislative session, Governor Bush worked with the Florida Legislature to address the strained property insurance marketplace. The Legislature enacted Senate Bill 1980 which provided a myriad of reforms. They included a $715 million appropriation to Citizens Property Insurance Corporation (Citizens) to offset its 2005 deficit. This funding reduced the anticipated 11 percent premium regular assessment to about 2.5 percent. In addition, the emergency assessment was amortized over a 10-year period. Both actions saved thousands of dollars for Florida's homeowners.

The legislation amended the Florida Hurricane Catastrophe Fund (CAT Fund) to require a 25 percent rapid cash build-up factor in the premiums paid by insurers for coverage from the CAT Fund. It allowed Citizens and the State Board of Administration (SBA) to determine the method of providing CAT Fund coverage for policies of insolvent insurers assumed by Citizens (for one year only). It also modified the assessment base to not extend the exemption of medical malpractice premiums from assessments.

The legislation created an Insurance Capital Build-Up Incentive Program. The purpose was to provide funding in the form of "surplus notes" to new or existing authorized residential property insurers, under specified conditions. The amount of the surplus note could not exceed $25 million or 20 percent of total funds available for the program. The insurer dad to contribute new capital to its surplus at least equal to the surplus note and had to apply to the SBA by July 1, 2006. The combination of surplus, new capital, and surplus note was required to be at least $50 million. An insurer had to meet a minimum writing ratio of net written premium to surplus of at least 2:1 for the term of the surplus note. The writings had to be for residential property insurance in Florida covering the peril of wind. The sum of $250 million was appropriated for the program.

The legislation established the Florida Comprehensive Hurricane Damage Mitigation Program (MySafeFloridaHome) within the Department of Financial Services. It provided for free inspections of site-built, residential property, to determine what mitigation

measures are needed to reduce vulnerability to hurricane damage. It provided for 50 percent matching grants to encourage single-family, site-built homes to retrofit. Homes are required to have an insured value of $500,000 or less. Grants are limited to $5,000 (for $10,000 project), with up to 100 percent grants ($5,000) for low-income homeowners. The sum of $250 million was appropriated for this program.

The bill provided some changes to the rating law. It required the Office of Insurance Regulation (OIR) to approve a rating factor that provides an insurer a reasonable rate of return commensurate with the risk of covering hurricane losses, for that portion of the rate for which the insurer has exposed its capital and surplus and has not purchased reinsurance. It placed the burden on the OIR to establish a rate is excessive for personal lines residential coverage with insured value at $1 million or more. Insurers must provide the OIR with loss and expense information upon request. It requires OIR to reevaluate the discounts offered for homes built to meet the Florida Building Code and to determine the full actuarial value of such discounts. Effective July 1, 2007, for residential property insurance in any areas for which the OIR determines that a reasonable degree of competition exists, an insurer may increase or decrease rates by up to 5 percent statewide average or 10 percent for any territory without being subject to a determination by the OIR that the rate is excessive or unfairly discriminatory (except for unfairly discriminatory rating factors prohibited by law). This may be used once in a 12-month period.

The bill addresses many significant issues related to Citizens. It creates what has become known as a glide path regarding Citizens' rates. The glide path requires rates of the high-risk account of Citizens to be set at the 70-year Probable Maximum Loss (PML) for policies issued after March 1, 2007, 85-year PML for 2008, and 100-year PML for 2009. It requires Citizens' rates in the Personal Lines Account and the Commercial Lines Account to be sufficient to provide for the procurement of reinsurance, including the CAT Fund, to pay all claims resulting from a 100-year Probable Maximum Loss (PML). This change applies to policies issued or renewed after March 1, 2007. It requires use of the public hurricane model as the minimum benchmark for determining windstorm rates

for Citizens. It mandates that if a deficit is incurred in any account, non-homestead property policyholders will be immediately assessed up to 10 percent of premium. If this assessment is not sufficient to offset the deficit, all Citizens policyholders will be assessed up to 10 percent of premium at time of issuance or renewal. Any remaining deficit is funded by regular and emergency assessments from non-Citizens' insurance policyholders.

The bill substantially revises the oversight, internal controls, and standards of conduct which apply to Citizens employees and board members. It requires the Financial Services Commission (Governor and Cabinet), rather than the Office of Insurance Regulation (OIR), to approve Citizens' plan of operation. It requires the Executive Director of Citizens to be confirmed by the Senate. It requires Citizens to have an internal audit. It requires the OIR to do a market conduct examination of Citizens every two years and the Auditor General to conduct an operational audit of Citizens every three years. It mandates competitive solicitation for certain contracts and board approval of contracts of $100,000 or more. It requires the OIR to conduct background checks on applicants for senior management positions. Board members and senior managers are subject to the code of ethics and financial disclosure requirements applicable to public officials. It prohibits board members and employees from accepting any gift from any person or entity under contract with Citizens or under consideration for a contract. It prohibits Citizens from retaining lobbyists, but allows employees to register as lobbyists.

The legislation requires a 10-day waiting period for new applications. If an authorized insurer offers coverage during this period, the applicant is not eligible for coverage in Citizens regardless of whether the insurer appoints the agent who submitted the application. It allows Citizens to adopt policy forms that contain more restrictive coverage than provided in the voluntary market. It requires insurers writing the non-wind coverage to contract with Citizens to provide claims adjusting services for the wind coverage provided by Citizens in the high risk account. It requires Citizens to offer quarterly and semiannual premium payment plans.

Effective July 1, 2011, the legislation makes homes with a combined dwelling and content value of $1 million or more ineligible for Citizens' coverage. It defines "homestead property" to include properties granted a homestead exemption, property with a current written renter lease of at least 7 months, owner-occupied mobile or manufactured homes permanently affixed to real property, tenants coverage, commercial lines residential property (condominiums), or any non-profit hospital or continuing care retirement community. All other property is considered "non-homestead property." Effective March 1, 2007, non-homestead property is not eligible for Citizens' coverage. The bill provides provisions for a reinstatement approval process if coverage cannot be found in admitted or surplus lines market. An applicant must get four declination letters, three from surplus lines carriers and one from an admitted carrier.

The legislation addressed sinkhole claim coverage issues which have been significant market drivers in Pasco County and the surrounding Tampa Bay area. It requires the Department of Financial Services to certify engineers and geologists to serve as "neutral evaluators" of sinkhole claims disputes. This process would be mandatory but nonbinding and the costs would be paid by the insurer. If the insurer complies in a timely manner with the recommendation of the neutral evaluator, but the policyholder declines to resolve the matter in accordance with the evaluator's recommendation, the insurer is not liable for extra-contractual (bad faith) damages related to issues determined at the neutral evaluation. The insurer is not liable for attorney's fees, unless the policyholder obtains a more favorable judgment at trial. It allows residential policies to provide a deductible for sinkhole losses equal to 1 percent, 2 percent, 5 percent, or 10 percent of the dwelling limits.

FLORIDA'S RESIDENTIAL INSURANCE MARKET

Florida is a growing state, in terms of both its economy and its population. Insurance for homeowners and commercial interests must be available to keep our economic engine running. Projections from the Florida Demographic Estimating Conference show an estimated growth of five million people in Florida from 2005 to 2020, and that Florida will surpass New York to become the third most populous state by 2010. An additional five million people coming to Florida will require nearly 900,000 new homeowners' insurance policies.

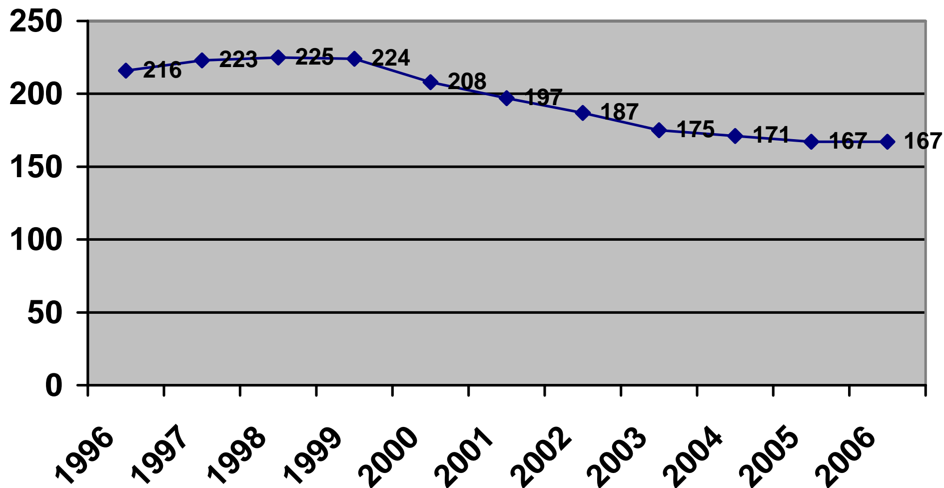
Maintaining the *status quo* is not sufficient. Not only must Florida find methods to retain the amount of insurance capital and reinsurance capital available to the Florida markets, but it must find additional areas of capital to accommodate the expected increase in demand to insure commercial businesses, and residents moving to our state.

The property and casualty market is currently experiencing three main challenges: capacity, availability, and affordability. All three of these issues are a result of the 2004-2005 hurricane seasons which featured an unprecedented eight major hurricanes creating $35.9 billion in estimated insured damage and subsequently 2.8 million claims.

Capacity As a result of the recent hurricane damage, companies are enforcing stricter underwriting standards to limit their exposure in certain high risk areas or limiting types of properties they select to insure. In 2nd Quarter 2006, there were 167 companies writing personal residential coverage in Florida, a significant drop from the high of 225 companies writing personal residential coverage in 1998.

The following is a graph of the number of companies writing personal residential policies in Florida over the past 10 years:

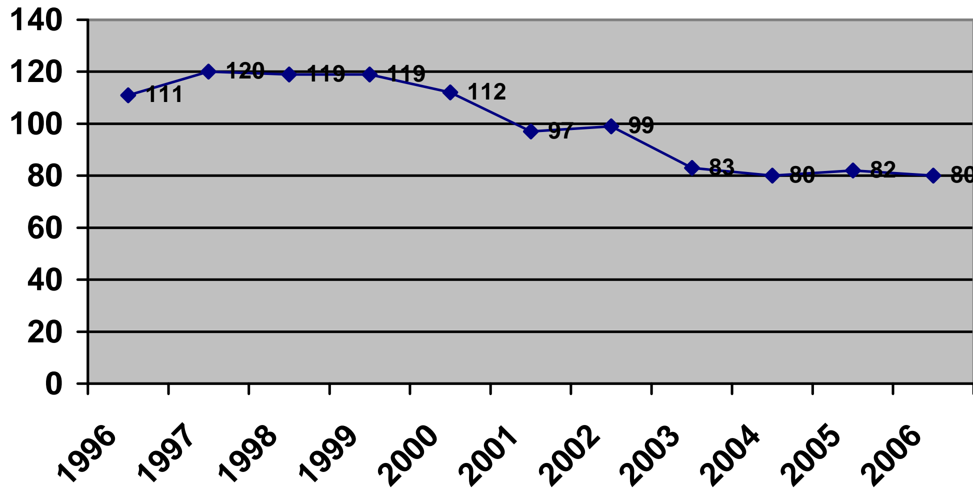
**Companies Writing Personal Residential Policies in Florida
1996-2006**



Source: Quarterly Supplemental Reporting Collection System – Section 624.424, Florida Statutes.

The number of companies actively writing property residential coverage has been declining steadily, even prior to the most recent hurricane activity. The market is dominated by five insurers – Citizens, State Farm Florida, Allstate Floridian, Nationwide of Florida and United Services Automobile Association. (Exhibit 6) The graph looks similar for the commercial residential market, which includes condominiums and, apartment buildings.

Companies Writing Commercial Residential Policies in Florida 1996-2006



Source: Quarterly Supplemental Reporting Collection System – Section 624.424, Florida Statutes.

Although insurance companies have made frequent rate increase filings since the 2004-2005 hurricane seasons, it is not the rates which are inhibiting a growth in capacity. Although not under rate regulation, the surplus lines market is also contracting. It appears the private industry has reached its threshold for risk in Florida's residential property markets. Although there have been mergers and acquisitions, over time fewer insurance companies are willing to insure property in the state. In addition, many of the property insurers willing to remain in the Florida market are either capping or reducing exposure. The manufactured housing insurance market also has tightened significantly. One in every five detached family homes in Florida is a manufactured home. Only about 19 percent of these manufactured homes were built to the 1994 Housing and Urban Development (HUD) standards. The manufactured housing market is dominated by Citizens, Foremost Insurance Company, Safeway Property Insurance Company, and Omega Insurance Company. (Exhibit 7)

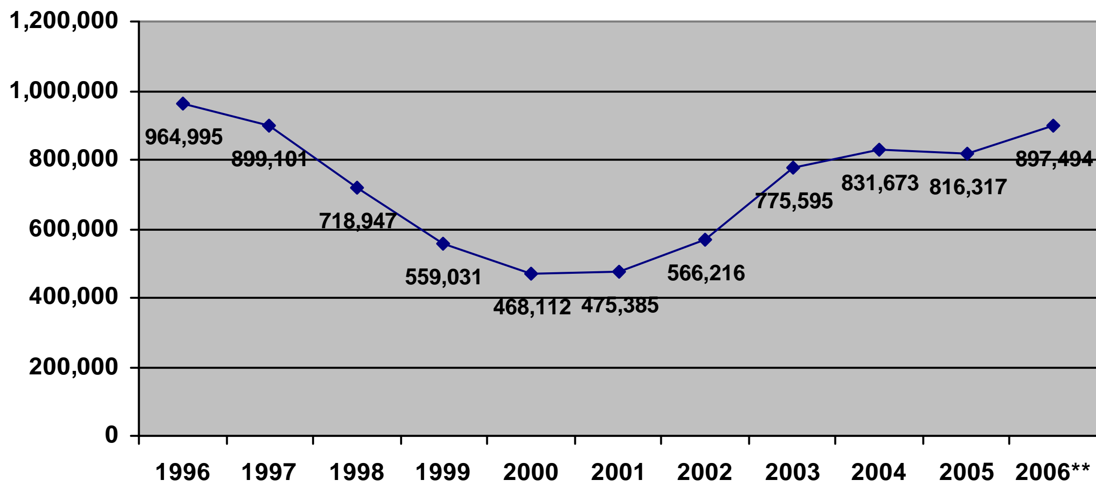
Availability In theory, availability can be bifurcated into two issues: fewer companies are writing insurance and the companies that are writing have decreased the number of

policies they are issuing. From a consumer perspective, less availability creates a considerable problem in a growing economy, which requires a constant infusion of new capital to compensate for the new homeowners entering the state. Some individuals who own their homes have the opportunity to "go bare," while the majority of people have mortgages that require homeowners' insurance.

One symptom of less availability is the growth of policies in Citizens, which the Legislature statutorily created to be the "insurer of last resort." Residual markets such as Citizens are often a measure of the "health" of a particular market – an increase in the number of policies in the residual market is a symptom of a troubled market.

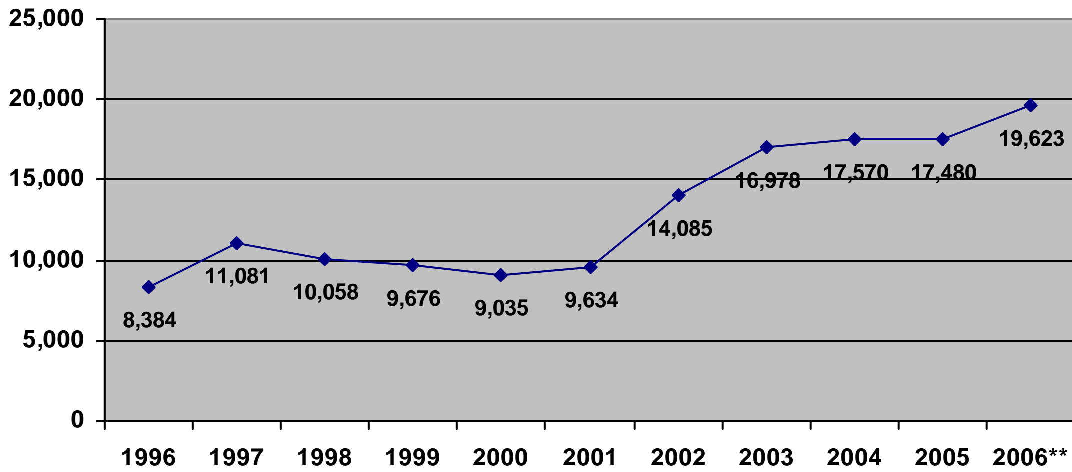
Regardless of the underlying reasons, there has been a general growth trend in the number of Citizens policies, which has continued through the last two storm seasons. The number of policies in the chart below does not include policies assumed by Citizens after the financial failure of the Poe Group of companies in May 2006; the current number of Citizens policies is now over 1.2 million. (Exhibit 8) In September alone, 70,000 Citizens applications were received.

Personal Residential Policies Insured by Citizens 1996-2006



The trend for commercial residential policies is similar:

**Commercial Residential Policies Insured by Citizens
1996-2006**



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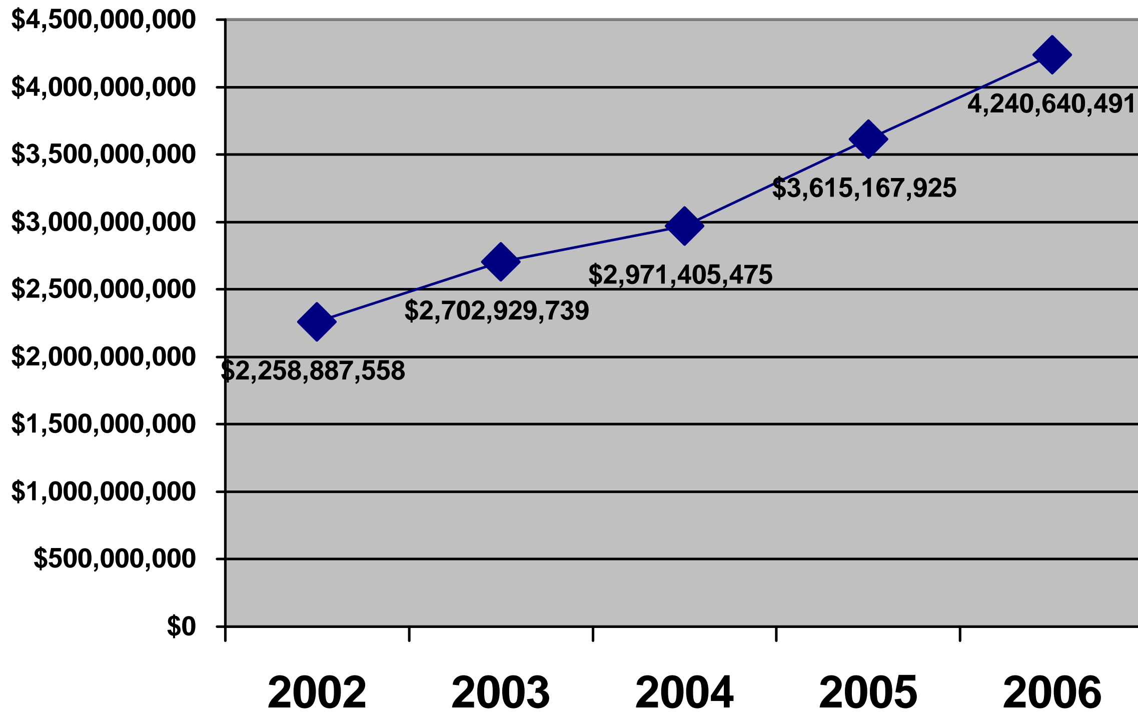
* Excludes Policies assumed by Citizens after the Poe Group insolvency.

A market that has absorbed this additional need for capacity has been the surplus lines market. According to data from the Florida Surplus Lines Service Office (FSLSO), the amount of premium collected in 2002 was $2.2 billion. Based on the most recent data available as of October 1, 2006, the projected premium for 2006 will be $4.2 billion, an increase of 88 percent in five years. Note that these surplus lines market premium amounts include both residential and commercial policies. A graph of the increase is below:

Total Aggregate Premium Collected by the FSLSO in 2002-2006



Affordability The resultant increases in insurance rates have created serious concerns for policyholders, legislators, and other leaders within state government. Property values and related taxes have escalated. Combined with insurance rate increases, Floridians are having difficulty absorbing these increases in the cost of living.

The Office of Insurance Regulation (OIR) is charged with the review of insurer rate filings to ensure rates are fair, adequate and do not unfairly discriminate. Insurers are precluded from recouping prior losses; therefore, admitted insurers are not permitted to include hurricane losses from the 2004-2005 hurricane seasons in their current rates. Florida law does not delegate statutory authority to the Insurance Commissioner for determining whether or not insurance policies are "affordable." The Insurance Commissioner is vested with the responsibility to ensure that all rates are fair and adequate and commensurate with the risk: however, there have been statutory exceptions. Insurance Commissioner Kevin McCarty intervened in Monroe County by declaring that this market was "noncompetitive" due to the fact that Citizens writes 100 percent of the

wind policies in Monroe County. This regulatory authority was specifically designated to the Insurance Commissioner for Monroe County only during the 2005 legislative session, with affordability being one of the primary factors.

In 2006, 52 of Florida's 167 property insurance carriers requested significant rate increases (over 25 percent) related primarily to the considerable increase in their cost to purchase reinsurance and the heightened expectations of future losses related to hurricanes (wind losses arising from hurricane loss models). Increases in property values also have fueled the spike in insurance premiums as have substantial increases in the cost of labor and materials to re-build after an event.

Two factors which can help stabilize the market are a reduction of exposure and an increase in capacity. During the 2006 session, the Legislature enacted legislation that addressed these factors by allocating $250 million each to the Hurricane Damage Mitigation Program and the Capital Build-Up program. Throughout the Committee meetings, numerous presenters testified that wind loss mitigation efforts were crucial to reduce exposure in the state. One modeler testified that such efforts can reduce Florida's exposure by 63 percent.

The Committee received numerous emails and similar testimony from consumers who requested that insurance policies contain more information regarding the components of their total premium. Consumers have sought to be allowed to buy various pieces of full policies and therefore have more consumer choice. The Committee adopted recommendations to provide consumers with enhanced insurance policy transparency and policy coverage options such as buying no contents or dwelling limits which would be equal to their outstanding balance on their mortgage. The Committee found that offering deductibles at higher levels than presently allowed, would allow consumers to decrease their current premium levels and absorb more of their own exposure.

Additionally, the Committee recognized the need for homeowners to participate in hardening their homes at a higher level. Florida's efforts this year to fund and create

incentives to mitigate homes has been monumental. The Committee adopted recommendations to not only continue the mitigation program but to fund additional free home inspections and encourage standardization and uniformity of the corresponding mitigation insurance discounts. The Committee found that the state's current initiative studying a uniform grading system for residential structures should be continued.

The Committee also found that the Office of Insurance Consumer Advocate (Office) should report to the Financial Services Commission and its independence should be strengthened to benefit all Florida consumers of residential and commercial insurance products.

Florida's Residential Insurance Market Recommendations

Transparency for consumers (residential and commercial). Require the *premium notice and policy* to

- specify premium mitigation discounts available (by dollar amount) for each policyholder on each mitigation measure and for a combination of various mitigation measures, in a format specified by OIR.
- identify amounts recouped for assessments by Citizens Property Insurance Corporation (Citizens), the Florida Hurricane Catastrophe Fund (CAT Fund), or the Florida Insurance Guaranty Association (FIGA), respectively. Prohibit abbreviations.
- identify the amount of any premium increase that is due to a rate increase and the amounts that are due to coverage changes.
- identify the amount (by dollar) of the agent's commission.
- identify the amount of insurance premium tax by dollar amount.
- require plain language in insurance policies (1)

Move the Office of the Consumer Advocate under the Financial Services Commission (Cabinet) rather than the Chief Financial Officer for oversight. Request the Legislature review the authority currently vested in the Consumer Advocate regarding independence and effectiveness for Florida consumers. (2)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

Florida's Residential Insurance Market Recommendations (continued)

Require insurers to offer a policy that excludes windstorm coverage from a residential property insurance policy if the policyholder signs a written rejection of such coverage on a form approved by OIR with appropriate disclosures. Insurers would still be required to offer a policy that includes windstorm coverage. (In windstorm and non-windstorm areas of the state) (3)

Require insurers to offer dwelling limits for windstorm coverage that only covers the outstanding balance of the mortgage. (4)

Require insurers to offer policies that provide no personal contents coverage. (5)

Eliminate maximum allowable deductibles, i.e., allow insurers to offer deductibles of any amount in addition to the 2, 5, and 10 percent deductibles that must be offered. (6)

Revise the Florida Market Assistance Plan (FMAP) to provide for more efficiency. Refine the FMAP guidelines to allow that during the 10 day waiting period applicable to Citizens policies, an exclusion is in place for any potential insured who has a real estate closing during the 10 day waiting period. (7)

Ensure that insurance companies appropriately adjust premiums for homeowners when meaningful and verifiable mitigation measures are undertaken. (Premium discounts) Standardized or uniform credits with smaller ranges should be developed while allowing market competition in the credit process. (18)

Recommend appropriation from the Legislature solely for free inspections encouraging more homeowners to mitigate. (20)

Create a Sales Tax Rebate Program where consumers can apply to the Florida Department of Revenue for sales tax credits/rebates for approved mitigation materials and supplies. Require the filing of a mitigation verification inspection form as proof of purchase with the Department of Revenue. (21)

Ensure insurance companies and agents are providing specific information to homeowners who want to know the premium discounts available for various mitigation options and the means for obtaining the discounts (e.g., continuing education requirements for agents). (22)

Develop public/private partnerships to educate homeowners regarding the advantages of fortifying their homes. (23)

Adopt and fund a uniform grading system for evaluating the hurricane strength of homes and commercial buildings. (24)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

FLORIDA'S COMMERCIAL INSURANCE MARKET

Many of the challenges faced by the residential property market are mirrored in the commercial non-residential (business) property market. The heightened expectation of future losses, both in terms of frequency and severity of storms, coupled with the increased cost of reinsurance were significant detriments to the commercial property market. (Exhibit 9)

Beginning in May and June of 2006, business policyholders experienced an increase in non-renewals or cancellations of policies, significant rate increases, increases in deductibles, and/or less coverage with higher rates for property insurance coverage. In response to those concerns, the Office of Insurance Regulation (OIR) conducted a Commercial Business Property Insurance Survey for a two-week period starting July 12, 2006. The survey was available to any businesses wishing to participate and was accessible via the Internet. The intent of conducting this survey was to evaluate the commercial business property insurance market in order to address the challenges currently faced by business owners in our state. The OIR had heard anecdotal accounts of numerous business owners unable to secure adequate coverage at any price or who could secure adequate coverage for a rate which they found reasonable. In fact, some businesses have indicated they may re-locate their organization to another state in which insurance is more reasonable.

As insurance companies sought reinsurance contracts in 2006 prior to hurricane season, it became apparent that reinsurance in the commercial market would be more expensive and with less capacity. The Department of Financial Services, members of the Cabinet, and the OIR began to receive complaints from businesses, particularly small businesses, that their property insurance was being non-renewed or the price was increasing to the point that the business could not continue. The OIR survey was sent to chambers of commerce and other organizations to gather unscientific confirmation of this capacity shortage. The OIR survey received 1,914 responses from Florida businesses. Based upon the proportion of respondents that indicated their business was located between 0

and 10 miles from the coast. It appeared that those closest to the coast were most concerned about the cost and availability of property insurance coverage. Approximately 80 percent of the respondents reported they had an increase in their deductibles, had found coverage which seemed unreasonable, found coverage, but not all that was desired, or did not find coverage. Ninety-six percent of the respondents had rate increases and 38.2 percent reported an increase of over 100 percent in the price of property coverage. Sixty-nine percent were located within 10 miles of the coast. In addition to factors such as location near the coast or inside the windstorm boundary, different construction types, and a variety of uses affecting commercial rates.

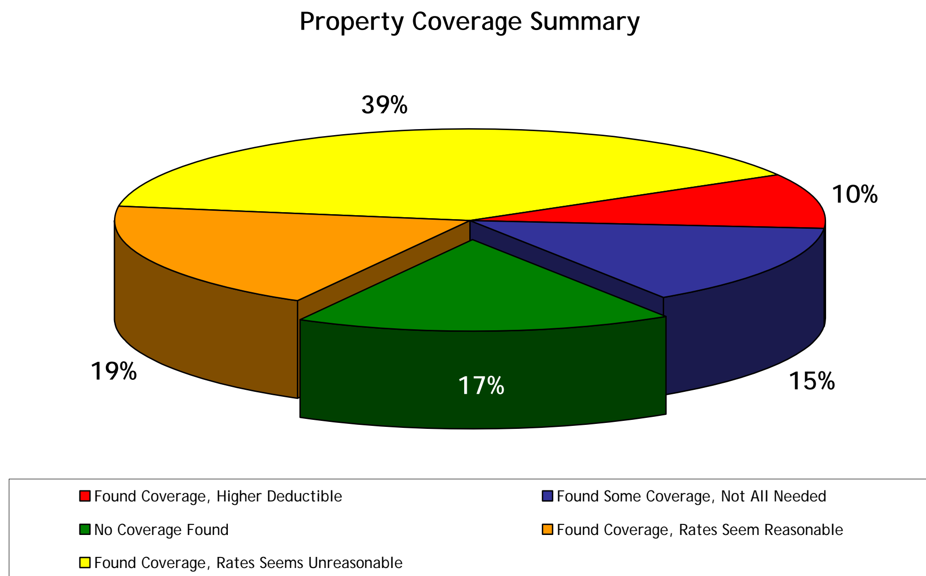


Figure 1

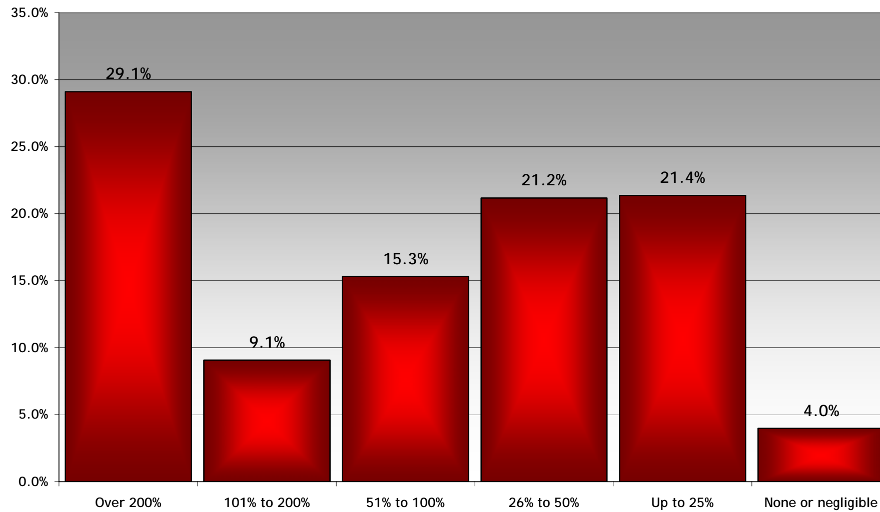


Figure 2

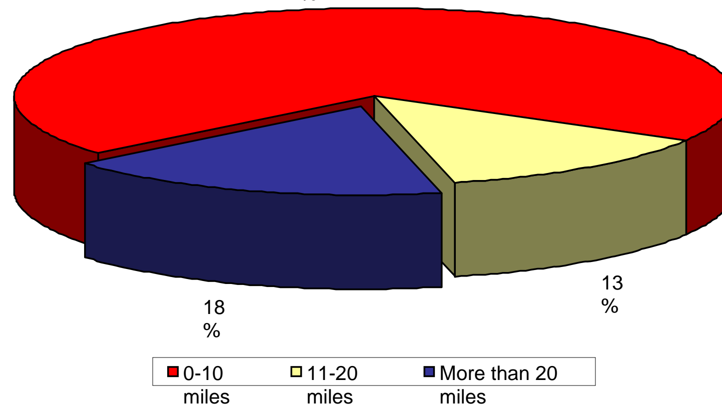


Figure3
Florida Office of Insurance Regulation Commercial Property Insurance Survey

The results of the survey coupled with the results of business inquiries made to the Florida Market Assistance Plan (FMAP), prompted Insurance Commissioner McCarty to consider alternative means of providing commercial property coverage to Florida businesses. Most of the options for providing more capacity require legislative changes. Re-activation of the Property and Casualty Joint Underwriting Association (PCJUA) was

a viable option because it could be done by the Financial Services Commission (FSC), by administrative rule, and without a legislative change. On August 1, 2006, Insurance Commissioner McCarty presented to the FSC a draft plan to re-activate the PCJUA which would help Florida businesses that could not find adequate insurance coverage protect their commercial property.

The PCJUA was created in 1986 by section 627.351(5), Florida Statutes, to deal with a commercial insurance crisis at that time. It was eventually deactivated but, the enabling statute remained along with the triggering mechanism which allows for reactivation. According to statute, the PCJUA is overseen by a 13-member board that is appointed by the Chief Financial Officer and financed by premiums along with potential assessments and post-catastrophe bonding.

The FSC voted unanimously to have the OIR begin the rule-making process and at the next meeting on August 15, 2006, it approved an emergency rule establishing the activation of the PCJUA to make commercial property insurance available to Florida businesses unable to find coverage in either the admitted or surplus lines insurance markets.

Under the law for the PCJUA to be activated, a minimum of 100 applications had to be received by the Florida Market Assistance Plan (FMAP) within a 3-month period. FMAP was required to try to find coverage and unless 80 percent of those applicants received a quote for insurance coverage, the statutory trigger was met. FMAP reported that it received the 100 applications, shopped for coverage, and only 11 percent of the applicants received tentative quotes for coverage. Therefore, the trigger requirement was met for commercial property insurance.

The organizational meeting of the PCJUA's new board of directors was held on August 25, 2006. The Board approved a contract with a service provider ICAT and the PCJUA began accepting applications, writing its first policy in September, and was fully operational in October 2006.

The PCJUA currently writes wind-only coverage for commercial non-residential properties throughout the state except those areas in which Citizens writes wind-only policies (within the windstorm boundaries). Due to the limited assessment base currently in statute (the commercial non-residential property market), the Board voted to write coverage only for properties valued at $1 million or less. The PCJUA will also provide contents coverage for up to $750,000 and business interruption coverage up to $250,000 for a total amount of coverage of $2 million. In order to qualify for coverage with the PCJUA, coverage must be unavailable in the private market, including the surplus lines market. Frequently asked questions (FAQ) regarding the PCJUA may be found at: http://www.floir.com/pdf/PCJUA_FAQs.pdf.

As of October 26, 2006, the PCJUA has:

- made 1,595 quotes for coverage;
- bound 108 policies with 166 total buildings;
- written $772,000 in premium for a total insured value of $43.9 million;
- appointed 446 agents;
- premium for 76 percent of policies was less than $10,000;
- 74 percent of quotes were for buildings constructed prior to 1990;
- 80 percent of quotes were for properties five miles or less from the coast;
- the three leading counties by total insured value were Brevard, Escambia and Hillsborough.

Other commercial properties such as hospitals, nursing homes, and schools have been impacted by the high cost of property insurance and a lack of availability of sufficient property insurance. The Committee heard testimony regarding the significant rise in the cost of public school facilities' property insurance and the considerable decrease in total insured value of these insured properties. In 2006, only 2.86 percent of the total value of the state's public school facilities were insured as compared to 21.3 percent in 2004. The Committee understands that Florida's public school facility insurance issues have become a potential exposure problem for the state and need to be further reviewed. (Exhibit 10)

The Committee received testimony from representatives of the commercial market. explaining that the "perception of risk" dramatically increased after the 2004-2005 storm seasons. Therefore, the available capital is no longer sufficient to meet this increased perception of risk.

Another concern expressed in testimony was that actual losses incurred from the 2004-2005 hurricane seasons were much greater than hurricane loss models projected for commercial risks. According to the old model, the estimated loss for a 1 in 100 year event was 22 cents on the dollar. Now, according to the new Risk Management Solutions (RMS) model, the estimated loss for a 1 in 100 year event is 58 cents on the dollar.

Testimony indicated commercial property insurance is difficult to price, because of the lack of uniformity in construction and use. As with residential insurers, the cost of reinsurance created another obstacle to direct writers. One insurer testified that compared to previous years, the company had to retain a greater portion of the lower layer losses. Finally, the more stringent requirements from rating organizations created yet another barrier. Under today's rating agency requirements, insurers must have more capital than before to maintain the high ratings required to ensure future capital contributions by stockholders. However, despite these challenges, both companies stated that they continue to be committed to the Florida property insurance market.

A representative from the surplus lines market testified regarding commercial property insurance. The testimony indicated that the surplus lines market will continue to supplement the admitted market; however, surplus lines cannot compensate for the significant decline in availability of coverage from the admitted market. The testimony indicated that building codes, especially in the Panhandle, should be improved. Additionally, insurers have been concerned with properties not being insured to value (underinsured), the increased cost of reinsurance, and the inability to correct pricing.

The Committee heard testimony that the tightening reinsurance market is affecting commercial insurance significantly. The Committee believes it may be prudent to offer

some level of CAT Fund coverage on a short term basis to commercial insurers to revitalize the market.

It discussed the need to consolidate and standardized the differing commercial coverage options in Citizens and the PCJUA to unify and streamline the state's commercial insurance mechanisms. This recommendation would allow Citizens to focus on residential insurance matters and reduce the likelihood that Floridians would be assessed for potential storm losses resulting to commercial structures.

The Committee heard from numerous representatives regarding the higher carrier exposure on commercial structures as compared to residential buildings. Further, commercial risks in Florida are not as uniform as Florida's residential structures. The Committee recommends uniform grading of commercial structures and state funded research reviewing the state's building code specifically as it applies to strengthening commercial buildings.

Florida's Commercial Insurance Market Recommendations

Transparency for consumers (residential and commercial). Require the *premium notice and policy* to

- specify premium mitigation discounts available (by dollar amount) for each policyholder on each mitigation measure and for a combination of various mitigation measures, in a format specified by OIR.
- identify amounts recouped for assessments by Citizens Property Insurance Corporation (Citizens), the Florida Hurricane Catastrophe Fund (CAT Fund), or the Florida Insurance Guaranty Association (FIGA), respectively. Prohibit abbreviations.
- identify the amount of any premium increase that is due to a rate increase and the amounts that are due to coverage changes.
- identify the amount (by dollar) of the agent's commission.
- identify the amount of insurance premium tax by dollar amount.
- require plain language in insurance policies (1)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

Florida’s Commercial Insurance Market Recommendations (continued)

Develop a plan to depopulate Citizens commercial risks to either the PCJUA or create a new statewide entity for all commercial risks. Prohibit Citizens from writing builders risk or commercial-commercial policies. Revise and update the PCJUA statute or new entity by expanding and updating the assessment base for the PCJUA. Seek to achieve IRS tax-exempt status for the PCJUA (Similar to Citizens). (8)

Begin state funded research concerning mitigation of commercial structures. Evaluate whether strengthening the state’s building code for commercial structures should be considered and the grading of commercial structures. (9)

Adopt statutory language to allow risk pooling for windstorm property coverage all “like” entities such as public hospitals. (Safety-net Alternative Risk Pool proposal). (10)

The Legislature shall review the market needs for adding commercial carriers to the CAT Fund and consider optional CAT Fund coverage to commercial insurers, for a limited time period. (11)

Encourage local governments to promote and advocate for code plus structures by providing incentives to builders like density bonuses, lower impact fees, and concurrency credits when new construction is built at *higher levels* than the current approved building code. (14)

Adopt and fund a uniform grading system for evaluating the hurricane strength of homes and commercial buildings. (24)

Request the Legislature to review the Federal Emergency Management Act’s (FEMA) reimbursement procedure for public school facilities and determine how the state university system’s facilities are insured under Florida law as compared to public school facility structures. (47)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

FLORIDA BUILDING CODE

Florida's population growth and numerous hurricanes in the 1940's and 1950's led to a statewide effort to develop a state specific building code. In 1974, the State Minimum Building Code law was instituted requiring all local governments to adopt and enforce a building code. The system provided four separate model codes which local governments could adopt that established minimum standards of health and life safety for the public. In that system, the state's role was limited to adopting all or relevant parts of new editions to the four model codes. Local governments could amend and enforce their local codes as they saw fit.

In 1992, Hurricane Andrew demonstrated this system of local codes did not provide the level of public protection necessary. The Miami-Dade County code that was universally acknowledged to set the strongest standard for hurricane protection essentially failed. The resulting problems had impacts well beyond southern Miami-Dade County. The state filled the property insurer void left by failed and fleeing private insurance companies and the federal government poured billions of dollars of aid into the disaster area.

After Hurricane Andrew, Miami-Dade County conducted an exhaustive review of its building code and made significant changes to both the code and support systems for code enforcement. In other areas of the state the Board of Building Codes and Standards (predecessor to the Florida Building Commission) adopted significant upgrades to wind resistance standards of the model state minimum code that was used by the majority of other local governments. The state instituted licensing of local governments' building code enforcement personnel. These steps proved critical to the contributions of building codes to improved building performance in the 2004 hurricane season. The state, like Miami-Dade County, went beyond just modernizing the state minimum building codes. In 1996, a study commission was appointed to review the system of local codes created by the 1974 law and make recommendations for modernizing the entire system. The

1998 Legislature adopted the study commission's recommendations for a single state building code and an enhanced oversight role for the state in local code enforcement.

The 2000 Legislature authorized implementation of the Florida Building Code. The first edition replaced all local codes on March 1, 2002. Florida enacted a statewide building code marking the first such "unified" building code in the nation. The Florida Building Code is a consensus-based, unified source of construction regulation for the state and establishes minimum safety standards for the design and construction of buildings to protect lives and property, promotes innovation and new technology, and ensures economic viability through the availability of safe and affordable buildings and structures.

The first major tests of the building code enhancements implemented since Hurricane Andrew came with 2004's Hurricanes Charley, Frances, Ivan, and Jeanne. Hurricanes Frances and Jeanne produced winds below the design speeds required by the code but they were long in duration and produced significant rainfall. Hurricane Charley was a storm that moved quickly across the state and produced less rainfall.

Hurricane Ivan, like Hurricane Opal in 1995, was a category 4-5 storm when it approached the Panhandle. Its winds diminished dramatically as it approached land but the accompanying storm surge wreaked havoc along barrier islands and mainland waterways. Each storm provided different kinds of tests and exposed different types of building failures. Generally older buildings had major property damage and were unsafe shelters where as buildings built to the current code had minor property damage and provided safe shelter.

Assessments conducted in the wake of the devastating 2004 hurricane season further validated that Florida's Building Code increased the soundness of structures in Florida, thereby providing for the safety of our citizens.

It is essential that Florida maintain pace with the evolving standards because its coastal exposure and rapidly expanding population create a major risk and limit options for ensuring the safety of its citizens. The Florida Building Commission keeps pace by amending the code annually to adopt updated reference standards and by major updates every three years to incorporate new editions of the national model codes. A major focus of efforts in 2004 was developing the first update to the code. Currently, the Florida Building Code has increased standards for hurricane protection and differs from the requirements of the national model by including:

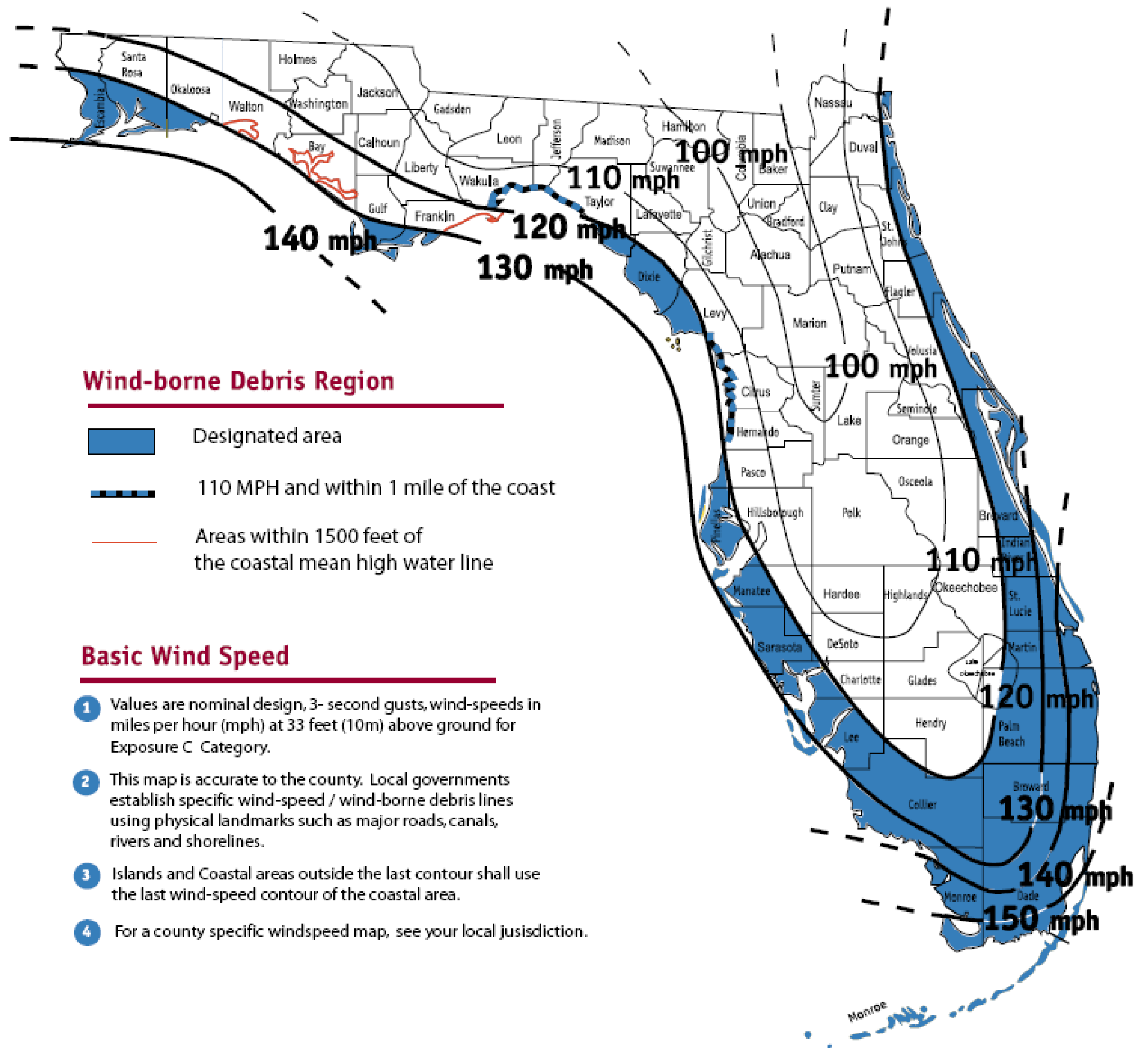
- increased design practices for homes from 100 mph to 110 mph;
- higher standards to limit water intrusion through walls;
- requirements for identifying pressure ratings for windows on building plans and on window labels;
- requirements for pressure ratings for garage and entry doors;
- higher standards for roof covering wind ratings and testing.

To further ensure that new homes are built to withstand hurricane damage in the future, legislation enacted in 2006 (CS/CS/SB 1774) removed a legislatively established exemption for the Northwest Florida Region to allow the Florida Building Commission to designate appropriate wind lines for the area based on science-based research. The Florida Building Commission has proposed a revised Wind Borne Debris map which continued a different standard for the Panhandle.

Proposed
Effective Date March 1, 2007

State of Florida

Wind-Borne Debris Region



www.florida building.org

Another core component regarding Florida's Building Code is local government enforcement of an existing building code. After Hurricane Andrew roared through Miami-Dade County in 1992, it become clear that building code enforcement issues existed. At the September 21, 2006 Committee meeting, a representative of the Insurance Services Office (ISO) educated the Committee on ISO's Building Code Effectiveness Grading Schedule (BCEGS). BCEGS is a process of rating a local building department on a scale from 1 (high) to 10 (low) on their effectiveness. ISO reviews local building departments, building codes and plan reviews on new buildings. They also conduct field review and training. BCEGS ratings incentivize building department operations, promote code compliance, and ultimately reduce property losses. Rated building departments generally fall in three ranges of ratings: 1-3, 4-6 and 7-9. Coral Gables (Miami-Dade County) is the only number 1 rated building department in Florida. There are currently no number 9 or 10 rated local governments in the state, however, the City of Waldo (Alachua County) and Santa Rosa County are the only number 8 rated local governments in Florida. Not every Florida city has a BCEGS rating but all 67 counties are rated. The nine local governments currently not rated are:

- Boca Raton (Palm Beach County);
- Briny Breezes and Golfview (Palm Beach County);
- Dundee (Polk County);
- Hialeah Gardens and Virginia Gardens (Miami-Dade County);
- Ocean Breeze Park (Martin County); and
- Sea Ranch Lakes and Seminole Tribe (Broward County).

The range of insurance credits varies from 15 percent in a number 1 rated community to a surcharge in the worst rated communities. The Committee learned that movement into a lower range could result in significant insurance discounts.

The Committee heard testimony regarding the need for a uniform state building code that did not contain lower levels of wind resistance. The Panhandle's lack of uniformity with the rest of Florida has been a factor in the modeling companies' rate level projections.

The Panhandle standard has also been an issue for reinsurers evaluating Florida's loss projections. The Committee believes the statewide building code should contain no exceptions or lower protection standards.

Finally, the Committee recognized the need for local governments to evaluate incentives for new structures to be built to a code plus standard. This code plus standard should produce lower insurance rates since the structures would be able to withstand higher wind speeds and resulting risk levels.

Florida Building Code Recommendations

Put a uniform statewide building code in place that requires American Society of Civil Engineers (ASCE) wind lines to be adopted and prohibit any changes in future statewide building codes unless such a change enhances the structural integrity of the code as it relates to wind protection. (12)

Develop a code plus standard that the insurance industry would recognize for maximizing premium discounts. (13)

Encourage local governments to promote and advocate for code plus structures by providing incentives to builders like density bonuses, lower impact fees, and concurrency credits when new construction is built at *higher levels* than the current approved building code. (14)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

MITIGATION

Any long-term solution to the Florida hurricane insurance market must recognize the critical link between a structure's wind-resistance and survivability. Initially at the time of construction, or subsequently through retrofitting, increasing the wind-resistance of buildings will deliver a return on investment by reducing damage and therefore insurance losses. Fundamental approaches to increasing structures' survivability include adoption and enforcement of strong model building codes, increased public awareness of hurricane mitigation, and implementation of mitigation consumer assistance programs.

Mitigation is the ongoing effort to lessen the impact disasters have on people's lives and property through damage prevention. Within this context, hurricane mitigation can be defined as "a construction activity that fortifies or hardens the envelope of residential structures by using a variety of techniques." Techniques may include reinforcing roof-to-wall connections, reinforcing roof systems, use of superior roof material attachment methods, placement of secondary a water barrier on roof decking, and protection of all openings (window, doors, garage doors and gable vents, etc.) by either installing shutter systems or using wind and impact-resistant window and/or door systems.

Evidence demonstrates that safe homes can be built without prohibitive cost increases, especially when cost is calculated in the context of loss of quality of life post-hurricane, the payment of insurance deductibles and general societal costs. Because of the age of Florida's housing stock, particular emphasis on meaningful mitigation retrofits to existing homes is critical in order to make people safer in their homes, to allow them to shelter in place, and to reduce their risk of loss. By reducing their risk of loss, policyholders make it less likely that they will need to incur the additional cost of their deductible or suffer the inconvenience and cost associated with temporary housing.

Programs to educate consumers and contractors regarding true cost benefits of mitigation and availability of insurance incentive programs provide important and useful information for home buyers regarding the value of wind-resistant attributes. These

programs are driving a growing market for hurricane mitigation as evidenced by demand for shutters and opening protection technologies. Effective means of spreading this information could be the use of real estate sellers' disclosure forms.

According to the report issued in 2005 by the Multi-hazard Mitigation Council of the National Institute of Building Sciences, "*Natural Hazard Mitigation Saves: An Independent Study to Assess the Future Savings from Mitigation Activities*", each dollar spent on mitigation, saves society an average of four (4) dollars. The study found that the "natural hazard mitigation activities funded by the three FEMA grant programs between 1993 and 2003 were cost-effective and reduced future losses from earthquake, wind, and flood events; resulted in significant net benefits to society as a whole (individuals, states, and communities) in terms of future reduced losses; and represented significant potential savings to the federal treasury in terms of future increased tax revenues and reduced hazard-related expenditures."

Following the 2005 storm season, Governor Bush's Fiscal Year 2006-2007 Budget Recommendations included hurricane related programs and mitigation. The Legislature approved $658 million in funding. Two significant mitigation initiatives were the Florida Comprehensive Hurricane Damage Mitigation Program housed in the Department of Financial Services (DFS) and the Florida Home Rating System located at the University of Florida. Key Mitigation components of the Fiscal Year 2006-2007 General Appropriations Act included:

- **General Population Shelters**: $25.6 million was provided to create safe public shelters to protect Floridians during a hurricane, including a regional sheltering pilot project. This significant investment will expedite the elimination of Florida's shelter deficit.

- **Emergency Operations Centers:** $45 million was provided to build or mitigate county Emergency Operations Centers to ensure they can survive a major hurricane.

- **Affordable Housing:** In addition to $243 million for traditional housing programs and $80 million for extremely low income housing production and innovative approaches to workforce housing, $190.9 million was provided for affordable housing in communities impacted by the hurricane season of 2005, including:
  - $92.9 million for the Rental Recovery Loan Program to leverage federal funds and private capital to build, rebuild and repair rental housing.
  - $82.9 million to meet the needs of communities impacted Hurricanes Katrina and Wilma, with a prioritization for affordable housing in the most impacted areas of the state.
  - $15 million for farmworker housing and housing for frail elders, people with disabilities, and homeless families.
  - $100,000 for training and technical assistance to local governments and non-profit organizations to utilize housing funds quickly and effectively.

During the 2006 General Session, the Legislature enacted SB 1980 which created the Florida Comprehensive Hurricane Damage Mitigation Program (MySafeFloridaHome) and appropriated $250 million to provide financial incentives to encourage residential property owners of this state to retrofit their properties, making them less vulnerable to hurricane damage and helping decrease the cost of residential property and casualty insurance. The program provides grants for hurricane shutters, roofing, and other improvements to better protect up to 45,000 homes against hurricane damage and reduce the state's insurance potential maximum loss. The program provides for free home inspections which must include a rating scale specifying the current and projected wind resistance rating, and insurer-specific information on insurance credits and discounts. It provides for 50 percent matching grants to encourage single-family, site-built homes to retrofit. A home must have insured value of $500,000 or less. Grants are limited to $5,000 (for $10,000 project), with up to 100 percent grants ($5,000) for low-income homeowners.

The Department of Financial Services (DFS) has seen an overwhelming response. As of mid-October 2006, there have been over 13,000 requests for inspection applications by phone, over 91,000 inspection applications have been submitted online and nearly 60,000 inspection applications have been received by the Department by mail. Approximately 12,000 inspections are expected to be completed by November 2006. The program has been operating since August 15, 2006. For more information: http://www.mysafefloridahome.com/

The Executive Office of the Governor, DFS, and the Office of Insurance Regulation (OIR) have partnered to bring a series of free homeowner expositions to Florida with local and statewide businesses and not-for-profit agencies providing information and mitigation methods to help Floridians learn ways to make their homes more hurricane-resistant.

The "Fortify Florida" fairs feature insurance company representatives on hand to help homeowners understand which hurricane-resistance measures will protect their homes and how they can apply for discounts on their insurance premiums. By law, insurance companies are required to offer policyholders discounts on the wind-coverage portion of their homeowner policy premiums for specific measures that reduce their homes' exposure to windstorm damage. The Financial Services Commission recently amended and strengthened OIR's administrative rule (Rule 69O-170.0155, Notice of Premium Discounts for Hurricane Mitigation) related to these mitigation premium discounts.

The OIR, in an effort to assist policyholders in better understanding the premium discount credits available, has developed a new consumer friendly form that provides information on how credits are calculated, how policyholders can take advantage of the discount credits available, and additional information regarding the My Safe Florida Home Program. The form requires companies to provide policyholders specific mitigation discount credits to illustrate to policyholders the discounts they received on the hurricane portion of their premium, as well as the discounts amount they may be able to receive should they further mitigate their homes. This new form becomes effective

March 1, 2007. Thus, companies are required to file their new windstorm mitigation credits with OIR by January 1, 2007.

The "Fortify Florida" expos were held in conjunction with the My Safe Florida Home program, to provide information for Floridians and assist them in making their homes safer against hurricanes. DFS staff has been available to assist expo participants who want to apply for My Safe Florida Home free inspections. In addition to learning how they can apply for the My Safe Florida Home program, residents attending the expos can participate in home improvement how-to clinics, learn about building products designed to strengthen homes, and talk to insurance company representatives about how they can take advantage of premium discounts for hurricane hardening their homes. Workshops are held throughout the day and all exhibits and workshops are free. Three workshops have been conducted to date:

- St. Petersburg – August 26; 600 participants; 56 vendors/exhibitors; 4 workshops;
- Pensacola – September 30; 3,000 participants; 46 vendors/exhibitors; 7 workshops;
- Palm Beach – October 14; 200 participants; 55 vendors/exhibitors; 11 workshops.

SB 1980 also created the Manufactured Housing and Mobile Home Mitigation and Enhancement Program and appropriated $7.5 million for the program. It provides grants for manufactured home communities and mobile home parks, and is administered by Tallahassee Community College.

Finally, SB 1980 authorized a study for a Florida Home Rating System to provide an objective rating system that will allow homeowners to evaluate the relative ability of Florida properties to withstand the wind load from a sustained severe tropical storm or hurricane. The system must be easy for the property owner to understand, based on proven readily verifiable mitigation techniques and devices, able to be implemented based on a visual inspection program. The DFS shall implement a pilot program to be

used in conjunction with the Florida Comprehensive Hurricane Damage Mitigation Program. For more information: http://www.floir.com/HomeStructureRatingSystem.htm

Although the state's Mitigation Program is less than a year old, the Committee believes its value is limitless. Fortifying and hardening homes saves lives and insurance losses for all Floridians who make the decision to invest in and strengthen their homes before the next hurricane comes to Florida. The Committee believes that free inspections and resulting insurance savings for mitigating homes can help homeowners make the decision to retrofit their home. Additionally, tax incentives, like a state sales tax rebate program, could help incentivize homeowners to invest in their homes' strength and perform necessary mitigation retrofits. Consumers need additional information and education from their insurance agents and state and local governments on why mitigating their homes is a prudent thing to do. Specific insurance policy information regarding insurance mitigation discounts should be provided to all policyholders.

Mitigation Recommendations

Maintain and expand the commitment to the Mitigation Program being administered by the Department of Financial Services. Earmark a portion of future mitigation funding to be used for Citizens policyholders. (15)

Require the modeling firms (RMS, AIR, ARA, EQE and FIU) to recalibrate their models to take into account the results of mitigation in Florida. (16)

Require uniform mitigation verification inspection forms to be developed for all insurers. Specify the length of time an executed form is valid (spoilage). (17)

Ensure that insurance companies appropriately adjust premiums for homeowners when meaningful and verifiable mitigation measures are undertaken. (Premium discounts) Standardized or uniform credits with smaller ranges should be developed while allowing market competition in the credit process. (18)

Authorize the creation of a not-for-profit corporation to raise funds from the private sector for additional mitigation grants. (19)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

Mitigation Recommendations (continued)

Recommend an appropriation from the Legislature SOLELY for free inspections to encourage more homeowners to mitigate regardless of whether matching grants are available. (20)

Create a Sales Tax Rebate Program where consumers can apply to the Florida Department of Revenue for sales tax credits/rebates for approved mitigation materials and supplies. Require the filing of a mitigation verification inspection form as proof of purchase with the Department of Revenue. (21)

Ensure insurance companies and agents are providing specific information to homeowners who want to know the premium discounts available for various mitigation options and the means for obtaining the discounts (e.g., continuing education requirements for agents). (22)

Develop public/private partnerships to educate homeowners regarding the advantages of fortifying their homes. (23)

Require wind mitigation inspectors to be licensed or certified by the state with exceptions for licensed contractors. Licensed contractors shall be exempt, if a continuing education course in mitigation is completed. (25)

Encourage local governments to participate in the state mitigation program. (26)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

FLORIDA HURRICANE CATASTROPHE FUND

The Florida Hurricane Catastrophe Fund (CAT Fund) is a tax-exempt trust fund created in 1993 and administered by the State Board of Administration (SBA) to act as a form of mandatory reinsurance for direct residential property insurers (205 participating insurers). All insurers that write residential property insurance in Florida are required to buy reimbursement coverage (reinsurance) on their residential property exposure though the CAT Fund. Insurers can select various levels of hurricane loss protection (45, 75 or 90 percent) on losses above their retention/deductible. The vast majority of insurers (85 percent in 2005) choose the 90 percent reimbursement option.

The CAT Fund provides a reinsurance equivalent that augments reinsurance available in the private market. This 'state" reinsurance is significantly less expensive than private reinsurance, thus effectively lowering residential property insurance premiums for consumers.

The CAT Fund is required to charge insurers the "actuarially indicated" premium for the coverage provided. The CAT Fund operates on a "contract year" that runs from June 1 to May 31 of the next calendar year. Thus. the contract year matches the hurricane season. The maximum amount the CAT Fund must currently pay is $15 billion for the 2006-2007 contract year. A maximum coverage amount is calculated for each insurer based on that insurer's share of the total premiums paid to the Fund. Thus, if an insurer pays 10 percent of the total Fund premiums, its maximum CAT Fund coverage would be limited to $1.5 billion (10 percent of $15 billion) for all hurricanes occurring during the contract year.

Insurers are required to pay hurricane losses up to their "retention" level for each hurricane, like a deductible, before being reimbursed by the CAT Fund. For the 2006-2007 contract year, the retention is estimated to be $5.3 billion. Like the maximum recovery amount, a retention is calculated for each insurer based on its share of fund

premiums. For example, an insurer paying 10 percent of total fund premiums will have a retention of $530 million (10 percent of $5.3 billion) for the 2006-2007 contract year. Insurers usually purchase private market reinsurance to cover their hurricane losses for amounts below the retention, above their reimbursement limit, or for the coinsurance amount (10 percent - along side) that is the insurer's responsibility for the layer of coverage provided by the CAT Fund.

The CAT Fund is authorized to issue revenue bonds, which are funded by emergency assessments on property and casualty policyholders (other than workers' compensation and, until June 1, 2007, medical malpractice but including surplus lines), if the cash balance of the Fund is not sufficient to cover losses. The assessment base includes auto insurance. The assessment base for the CAT Fund is approximately $33 billion. Annual assessments are capped at 6 percent of premium with respect to losses from any one year and a maximum of 10 percent of premium to fund hurricane losses from multiple years.

During the 2004 and 2005 hurricane seasons, the CAT Fund performed as designed, reimbursing participating insurers for approximately $6.5 billion to date. The losses associated with the hurricane activity in 2005 have produced actual and projected payouts in excess of the CAT Fund's liquid resources, resulting in an estimated 2005 projected shortfall of $1.425 billion. To address the 2005 shortfall, the CAT Fund recently undertook a "post-event" financing of $1.35 billion, which in combination with other available resources, should be sufficient to pay all 2005 claims.

The CAT Fund's anticipated premium revenue for 2006 is $800 million. Additionally, the Trustees of the SBA approved a premium formula for 2006 which included a 25 percent increase known as a rapid cash buildup factor. This increase equates to $200 million in additional premium bringing the total CAT Fund premium to $1 billion. So if Florida avoids catastrophic loss in the 2006 season, this premium will build up for future year's storm losses.

It should be noted that the CAT Fund provides a significant layer of affordable reinsurance to property writers. SB 1980 provided an additional layer of affordable reinsurance to certain small property insurers (Limited Apportionment Companies) in the 2006 hurricane season. These companies had the ability to purchase up to $10 million of reinsurance from the CAT Fund which would have otherwise been less available and more costly. Approximately 30 insurers purchased this lower layer of coverage from the CAT Fund as part of their overall reinsurance program. Had this layer not been made available, it is possible that insurance rates would have been even higher and some insurance companies may have had difficulty purchasing sufficient reinsurance to cover their exposure in the 2006 hurricane season.

The Committee received a significant amount of testimony and deliberated many hours on the need to help Florida's insurance consumers by providing a temporary back stop or solution to the astronomical reinsurance pricing in the market which ultimately has driven direct writer premiums to record levels. The Committee had to weigh the risk of larger assessments should a catastrophic event occur versus the need to stabilize premiums by providing direct writers more reinsurance at below market rates.

The need to provide an optional lower level of coverage below and possibly above the current CAT Fund levels should seriously be considered by the Legislature for the short term (the 2007 and 2008 storm seasons). Additional coverage should not be made permanent, so as not to displace market forces permanently. The Committee believes that if a valid charge can be calculated for this temporary layer of reinsurance coverage insurance consumers will see resulting premium savings.

Florida Hurricane Catastrophe Fund Recommendations

The Legislature shall review the market needs for adding commercial carriers to the CAT Fund and consider optional CAT Fund coverage to commercial insurers, for a limited time period. (11)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

Florida Hurricane Catastrophe Fund Recommendations (continued)

The Legislature should maintain the current retention level but consider offering coverage below the retention level/attachment point (first layer of coverage) on a voluntary basis to all admitted companies participating in the CAT Fund. Any change should only be temporary/short-term. The rate for the temporary, below the current retention level, CAT Fund coverage should be increased to a "near market rate" but still allowing for savings which can be passed to consumers. (27)

Investigate raising the upper limit (currently $15 billion) to foster greater participation and determine how this modification will effect availability and affordability of premiums and determine what the private market's needs are above the upper limit of the CAT Fund. (28)

Research moving the renewal date (sometime before June) to increase flexibility and maximize carrier participation in the CAT Fund. Review whether such a date change could produce premium savings to consumers. (29)

Amend the State Constitution to limit the use of the assets of the CAT Fund (i.e., restrict legislative appropriations) to the purposes currently required by statute. Require that any appropriation from the CAT Fund in excess of $10 million be in a separate bill for that purpose only and be approved by a super-majority (e.g., three-fourths) of the membership of each house of the Legislature. (30)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

REINSURANCE MARKET

Direct writers, such as State Farm, Allstate, and similar companies, are able to provide coverage for relatively high risk policies, such as property insurance policies, by spreading their exposure to the reinsurance market. Reinsurance is purchased by insurance companies as a means to spread their risk; it is essentially insurance for an insurance company. Reinsurance companies often spread their exposure by retro ceding risk, which is an equivalent to insurance for a reinsurance company.

As part of its solvency regulation of insurers, the Office of Insurance Regulation (OIR) requires insurers covering property risks to have adequate reinsurance to ensure an insurer can withstand wind losses. After the 2004-2005 hurricane seasons, resulting in nearly $36 billion in losses, reinsurers covering property risks in Florida increased their price for coverage. Florida property insurers (both residential and commercial) found significant reinsurance rate increases which were factored into their rate filings with the OIR, resulting in requests for rate increases to the insurance buying public. In addition to the losses incurred after the two years of eight hurricanes, the following factors have reduced the reinsurance capacity in the Florida property market: predictions of increased frequency and severity of future hurricanes by the hurricane modeling firms: increased property values in which a similar book of business created a much higher exposure; increased coastal exposure throughout the state; increased cost of repair and rebuilding due to demand of building supplies and labor (demand surge); and more strict requirements by ratings agencies (AmBest, Standard & Poors and Moody's) for reinsurers to maintain favorable financial ratings. These factors created an overriding concern by the reinsurance market about exposure from Florida risks. At the present time, it appears reinsurance capacity for Florida property risk is nearly tapped out. This in turn severely limits the capacity of direct writers of property insurance.

As the 2006 hurricane season approached, the demand for reinsurance exceeded the supply. Most Florida property insurers secure reinsurance just before hurricane season begins, thus creating a situation in which many direct writers were going to the

reinsurance market simultaneously. As a result, reinsurance pricing spiked, further driving up prices to the ultimate consumer. Recent articles in Business Insurance and many Florida newspapers have reported that the leading Bermuda-based reinsurers are expecting profits as high as $4.2 billion in 2006 due to the mild hurricane season. No doubt reinsurers domiciled in the United States and Europe will be reporting similar hefty profits in 2006.

The committee heard testimony at its Orlando meeting that certain statutory collateral requirements are barriers to foreign reinsurers maximizing their participation with direct writers in Florida. The Committee recommends that these barriers be prudently revised to allow the OIR to authorize lessening these barriers for certain qualified foreign reinsurers. The recommendations should mirror the National Association of Insurance Commissioners model language on the issue.

Reinsurance Market Recommendations

Amend the reinsurance law to give insurers credit on their financial statements for other risk transfer or capital markets instruments, subject to the approval of OIR, provided there is a fully funded transfer of risk. (31)

Reduce or eliminate the trust fund (collateral) requirement for non-U.S. insurers based on a determination by the OIR of the adequacy of regulation of the country of licensure and the financial strength of the assuming insurer. (32)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

FLORIDA WINDSTORM BOUNDARIES

The windstorm boundaries that currently exist have evolved over three decades but originated with the creation of the Florida Windstorm Underwriting Association (FWUA) in 1970. The boundaries are important because they trigger when and where Citizens Property Insurance Corporation (Citizens) can sell a wind only residential insurance policy and when an insurer can market an ex-wind residential policy (other perils such as fire, theft and liability). The wind boundaries also trigger when and where a commercial-nonresidential (business) risk can be sold by Citizens and where the Property Casualty Joint Underwriting Association (PCJUA) can offer businesses coverage. Windstorm coverage protects policyholders against direct physical loss caused by hurricanes, tornadoes, windstorms and hail.

The FWUA was created to cover residential and commercial policyholders unable to secure windstorm coverage in the voluntary market. This coverage was limited to defined geographical areas in the state determined by the then Department of Insurance. Eligibility was limited to structures in areas found by the department, after public hearing, to meet three criteria: the lack of windstorm coverage in the area was deterring development, causing mortgages to be in default, and causing financial institutions to deny loans; the area was subject to the requirements of the Southern Standard Building Code or its equivalent; and that extending windstorm coverage to the area was consistent with the policies and objectives of environmental and growth management.

Florida has 35 coastal counties. The windstorm area now applies to 29 of these 35 counties. At its inception, only Monroe County was in the windstorm area. In 1992, when Hurricane Andrew hit south Florida, the wind area did not include Miami-Dade, Broward, or Palm Beach counties. The department and the Legislature, subsequent to Hurricane Andrew, expanded the boundaries of the windstorm area.

Currently, the distance from the coast ranges from 1,000 feet to many miles in Miami-Dade, Broward, and Palm Beach counties where the boundary is I-95. Monroe County

remains 100 percent within the windstorm boundary. As previously stated, the boundaries of the windstorm area directly affect the obligation of private market insurers to provide windstorm coverage. Outside the boundaries, insurers must include windstorm coverage in every residential property insurance policy they write. (Exhibit 11)

In July 2002 Citizens was created by merging the Florida Residential Property and Casualty Joint Underwriting Association (FRPCJUA) and the FWUA. The wind boundaries are key components for Citizens and Florida policyholders because they trigger when a wind-only policy can be written. The wind-only policies (residential, commercial-residential and commercial-nonresidential) make up the High Risk Account (HRA) in Citizens

In recent years, two scientific studies have been undertaken that could be used in future efforts to refine and define logical wind boundaries. SLOSH (Sea, Lake and Overland Surges from Hurricanes) is a computerized model run by the National Hurricane Center to estimate storm surge heights resulting from historical, hypothetical, or predicted hurricanes by taking into account: pressure, size, forward speed, track and winds. The calculations are applied to a specific locale's shoreline, incorporating the unique bay and river configurations, water depths, bridges, roads, and other physical features. The SLOSH model is generally accurate within plus or minus 20 percent. The SLOSH model is best used for defining the potential maximum surge for a location.

LIDAR (Light Detection and Ranging) is a remote sensing system used to collect topographic data used by the National Oceanic and Atmospheric Administration and NASA to document topographic changes along shorelines. LIDAR can measure distance, measure speed, measure rotation, and measure chemical composition and concentration of a remote target where the target can be a clearly defined object or a diffuse object. LIDAR has been tested to assess post-storm damage to beaches.

In addition to these new scientific methods, the Committee received testimony at its September 21, 2006 meeting that modeling companies could use modeling data to help refine and define the boundaries. If the Legislature decides to refine the boundaries, it is possible that the Office of Insurance Regulation (OIR), in conjunction with Florida's own Florida International University Public Loss Projection Model, could be used to perform the analysis.

Florida's windstorm boundaries have been created and amended over many years of legislative and regulatory cycles. While certainly intended to create valid pockets of wind risk areas in the state, the 2004-2005 hurricane losses illustrate the boundaries are arbitrary and antiquated. The Committee found that to depopulate Citizens over time it seems prudent to allow Citizens to write a wind and an ex-wind policy to its policyholders in the current windstorm boundary, thus, eliminating the windstorm boundary's use. This will allow for additional premium buildup in Citizens while creating competition in the market.

Florida Windstorm Boundaries Recommendations

Allow Citizens to write the full policy. Do away with the wind boundaries and the distinction of wind and ex-wind policies in the wind boundaries. (34)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

CITIZENS PROPERTY INSURANCE CORPORATION (CITIZENS)

The significant hurricane damage borne by Floridians related to Hurricane Andrew in 1992 and the multiple storms that hit the state over the past two seasons have led many property insurance companies to limit the coverage they provide in Florida or reconsider doing business in Florida entirely. Property insurance and reinsurance companies consider Florida's windstorm insurance market to be extremely risky with regard to the potential return on investment of capital.

The risky nature of insurance investments in the state and related uncertainty in the marketplace limit the availability of insurance. This weakness in the private market prolongs the need for and dependence on the Florida Hurricane Catastrophe Fund (CAT Fund) and has exacerbated the demand for Florida's residual property insurance market Citizens to provide coverage for more than 1,264,000 Florida property owners who have been unable to find coverage in the private marketplace as of October 2006. The total exposure estimated for these policies is approximately $378 billion. Citizens is averaging over 70,000 new policies per month.

Primarily because of Florida's exposure to hurricane wind damage, many Florida homeowners and businesses have been unable to secure property insurance from the private insurance market. The Florida Windstorm Underwriting Association (FWUA) was created as an insurer of last resort for wind-only coverage in coastal regions. The Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) was created in December 1992 following Hurricane Andrew to act as an insurer of last resort for hundreds of thousands of Floridians who were unable to find homeowners insurance in the private market. Citizens was created effective July 2002 by Senate Bill 1418, when the Florida Windstorm Underwriting Association and the Florida Residential Property and Casualty Joint Underwriting Association were merged. The primary benefit of creating Citizens was to achieve federal tax exempt status and increase efficiency by having one residual market mechanism rather than two separate entities.

Citizens is the state's mechanism to address the insurance availability issue that exists in Florida due to the private insurance market not meeting the demands for property insurance, especially along coastal regions and those subject to sinkholes. Designed to be the state's insurer of last resort, Citizens primarily insures Florida properties most at risk for being damaged.

By law, Citizens writes policies only for homeowners and businesses that cannot find insurance in the private market. Citizens' rates are required to be actuarially sound and higher than the private market rates in that geographic region in order to be noncompetitive. Citizens provides three types of insurance - commercial property, personal property, and high risk wind coverage**.** There are three separate financial accounts within Citizens:

- Personal Lines Account (PLA) – 826,000 policies; covers homeowners, mobile homeowners, dwelling fire, tenants, condominium unit owners;
- Commercial Lines Account (CLA) – 7,555 policies; covering condominium associations, apartment buildings and homeowners associations;
- High-Risk Account (HRA) – 430,000 policies; covers personal lines windstorm-only policies, commercial residential wind-only policies and commercial non-residential wind-only policies; in these windstorm areas, private insurers may offer other peril coverage, but are not required to provide windstorm coverage.

Property is eligible for coverage with Citizens only if there is no other offer from an authorized insurer. The insurance agency and agent must use reasonable efforts to place personal or commercial insurance applicants with an authorized insurer prior to placing the risk with Citizens. Failure to do so is grounds for termination or suspension of an agent's appointment with Citizens.

Beginning March 1, 2007, non-homestead property is eligible in Citizens only if the property owner annually obtains three declinations of coverage from surplus lines

insurers and one from an authorized insurer. The definition of homestead property for Citizens' purposes is more expanded than the definition used for property tax purposes.

Beginning July 1, 2008, homes insured for $1 million or more are ineligible for coverage in Citizens. Homes insured for $1 million or more by Citizens before July 1, 2008, can remain in Citizens for another 3 years if the homeowner meets the declination requirement. However, such property can only be covered in the high-risk account and will be considered "non-homestead property." Effective June 30, 2011, Citizens will not insure any home valued in excess of $1 million. In October 2006, Citizens reported that it had 6,574 residential policies in force that were insured for values greater than $1 million, with a total insured value of over $10 billion and a total premium of over $70 million.

Citizens' claims and operational costs are paid from premiums collected. Citizens receives no direct state government funding. For the 2006 calendar year, its total operational budget is over $105,000,000 and there are over 1,100 full time and temporary employees and consultants working in three different cities in Florida. Citizens is governed by an eight-member Board of Governors and operates under a plan of operation which is subject to approval by the Financial Services Commission (FSC). In October 2006, the FSC mandated Citizens hold three public hearings around the state regarding the recent plan of operation amendments prior to it being approved. The Board is appointed by Florida's Governor, Chief Financial Officer, President of the Senate, and Speaker of the House of Representatives.

If Citizens runs a deficit within a fiscal year, the Board must levy an immediate assessment on each non-homestead property (as defined in statute) of up to 10 percent of the premium. If this is insufficient to eliminate the deficit, the board must levy an additional assessment against all Citizens' policyholders (including non-homestead policyholders), collected upon renewal, of up to 10 percent of premium. Any remaining deficit is funded by regular and emergency assessments, either recouped from, or directly paid by, non-Citizens' property insurance policyholders. The regular assessment against

insurers could still be imposed as soon as a deficit is determined, but must be reduced by the amounts estimated to be collected from the two 10 percent surcharges. Lines of business that are subject to Citizens' deficit assessment include insurance for: fire, industrial fire, allied lines, farm owners multi-peril, homeowners multi-peril, commercial multi-peril, and mobile homes, and includes liability coverage on all such insurance, including surplus lines insurance, except for inland marine and certain vehicle insurance other than the insurance on mobile homes used as permanent dwellings. Citizens assessment base is currently not as broad as the CAT Fund assessment base which contains automobile and marine insurance. Citizens assessments are passed on directly to policyholders when an insurer files a rate increase which is approved by the Florida Office of Insurance Regulation. Citizens sustained deficits of $516 million in 2004 and $1.73 billion in 2005 due to Florida's prolific storm season.

As a result of 2004 hurricane claims, Citizens assessed $516 million to cover the deficit between premiums collected and claims filed. This assessment was made on all personal and commercial property insurers and has already been paid to Citizens by the insurers. The insurers may pass on the cost of the assessment to policyholders upon renewal of a policy. Since Citizens' policies were not factored into the assessment calculation to cover the deficit amount, Citizens further adopted a market equalization surcharge of 6.8 percent of premium to be applied to all Citizens' policies written or renewed during the 2006 calendar year. The purpose of this surcharge is to treat Citizens' policyholders equally with those who have private market insurance, to maintain the noncompetitive aspect of Citizens' rates, and to provide some level of cash surplus for claims payments, when no cash surplus exists. The market equalization surcharge to Citizens' policyholders is equated to the passing on to policyholders of the $516 million assessment on private insurers.

As a result of 2005 hurricane claims, Citizens once again found itself with a deficit. Senate Bill 1980 appropriated $715 million from General Revenue to Citizens to offset the 2005 deficit, estimated to be about $1.73 billion. This appropriation is expected to reduce an estimated $920 million regular assessment against property insurers to

$205 million, and thereby reduce an estimated average 11 percent premium surcharge to 2.5 percent for property insurance policyholders in the state (including Citizens policyholders). The bill also required that the remaining estimated $800 million of the deficit, which would require an 8 percent emergency assessment on policyholders if billed in one year, must be amortized and collected from policyholders over a 10-year period.

Coverage extends until the building or structure is completed and accepted by the owner. It does not cover losses that occur before the project is started or after it is completed. This coverage is typically purchased by the building owner, rather than the contractor. Currently, Citizens writes builder's risk policies in the High Risk Account only. The policy count is approximately 6,500 and the estimated insured value of the policies is $4.5 billion. (Exhibit 12) In response to an inquiry from the Office of Insurance Regulation (OIR) in the spring of 2006 regarding why Citizens was writing builder's risk policies, Citizens reviewed the law and rules on the subject and determined it did not have statutory authority to continue writing these policies. Therefore, the Citizens' Board decided to discontinue writing such policies on July 15, 2006, and to non-renew existing policies as of November 1, 2006. After Citizens announced its decision to discontinue writing builder's risk policies, OIR learned this type of coverage was unavailable in the private market. Thus, in July Citizens made a filing which the OIR requested and approved, to renew existing builder's risk policies until December 31, 2006, and to write new policies up to December 31, 2006, but only with actuarially sound rates.

Citizens has 34,677 commercial non-residential policies as of October 2006 in the HRA with a total exposure of over $19 billion. This includes commercial non-residential risks which are businesses located in the wind areas and builders risk policies. Citizens only insures up to the first million dollars of the property value of any such commercial non-residential risks. Builders risk policies have no pre-set cap on the amount of coverage other than the total value of the project under construction. Interestingly, one Citizens builders risk policy insures a $98 million structure. It is correct to assume a Citizens builders risk policy would translate into a Citizens residential or commercial-residential policy when construction is complete.

One of the challenges to depopulating Citizens is the "Consumer Choice" law, enacted in 2002, the same year that Citizens was created. The prior law for the RPCJUA had provided that a policyholder was not eligible for coverage in the RPCJUA if an offer of coverage was made by an authorized insurer. The Consumer Choice law provides that a Citizens policyholder who receives an offer of coverage from an insurer in the voluntary market is not required to accept that offer and may remain in Citizens if the current agent of that insured is "unable or unwilling to become appointed for the takeout insurer." Therefore, the standard for eligibility for coverage from Citizens is no longer dependent on whether other coverage is available in the voluntary market, but on the status of the agent.

Citizens has adopted procedures in conjunction with the OIR to comply with the Consumer Choice law while continuing to encourage the removal of policies from Citizens. Agent trade associations assert, and Citizens representatives acknowledge, that the Consumer Choice law is much less disruptive to a Citizens policyholder and his or her agent and allows for a smoother transition to a take-out company, if the current agent is appointed by the take-out insurers. However, Citizens also reports that the law operates to reduce the number of policies taken out. Citizens estimates that for 2004, when about 158,000 policies were taken out of Citizens, an additional 39,000 policies were not taken out due to the provisions of the Consumer Choice law.
The Consumer Choice law was amended effective July 1, 2007. As of that date, Citizens has a 10-day waiting period for new applications. If an authorized insurer offers coverage during this period, the applicant is not eligible for coverage in Citizens regardless of whether the insurer appoints the agent who submitted the application.

Agents collect a commission for the sale of insurance and continued support associated with the insurance. Agent commissions are generally paid as a percentage of premium. The current commission levels filed by Citizens are: 10 percent for PLA (multi-peril residential), 10 percent for HRA residential (wind-only residential), 12 percent for CLA

(multi-peril commercial residential), and 12 percent for HRA commercial residential and HRA commercial (wind-only commercial residential and commercial).

In order to assure that Citizens rates are not competitive with the voluntary market, the current law requires that Citizens rates for its PLA be actuarially sound and that its average rates for each county must be no lower than the average rates charged by the insurer that had the highest average rate in that county among the 20 insurers (5 insurers for mobile home coverage) with the greatest direct written premium in the state for that line of business. For its HRA wind-only policies in coastal areas, the law requires that Citizens' rates be actuarially sound and not be competitive with approved rates charged by authorized insurers. However, the law further requires Citizens and the OIR to jointly develop a wind-only ratemaking methodology to meet this purpose for rates effective on or after July 1, 2004. A wind-only rate methodology was developed that uses a variation of the "Top 20" approach mandated for personal residential multi-peril policies.

The Committee heard substantial testimony regarding Citizens and its current statutory requirements. The size of Citizens illustrates that Florida's voluntary market has constricted for numerous reasons including reinsurance capacity, cost, and insurer uncertainty after the unusually severe 2004-2005 storm seasons.

The Committee received testimony that Citizens to use excessive resources both filing and litigating rate issues with the OIR. The Committee believes that it would help Citizens to have the OIR set their rates on a regular basis, based on the highest rate approved for the voluntary market. This would allow Citizens to maintain the highest rate in the state and focus on consumer service and depopulation efforts.

Two entities currently exist to assist the commercial market. Though having different criteria, Citizens through their commercial non-residential policy and the PCJUA provide coverage for Florida businesses. To assist in the depopulation of Citizens, a consolidation of the commercial interest would seem prudent. The Legislature should

explore revising the PCJUA criteria or creating a single new entity consolidating all commercial risks.

Finally, the Committee believes it is important that Citizens policies do everything possible to reduce their risk of exposure. The Committee recommends earmarking mitigation funds for Citizens policyholders and requiring surcharges or higher deductibles on Citizens policyholders that insure structures that are not built to current statewide building code levels.

Citizens Property Insurance Corporation (Citizens) Recommendations

Revise the Florida Market Assistance Plan (FMAP) to provide for more efficiency. Refine the FMAP guidelines to allow that during the 10 day waiting period applicable to Citizens policies, that an exclusion is in place for any potential insured who has a real estate closing during the 10 day waiting period. (7)

Require the Office of Insurance Regulation to set rates for Citizens on a semi-annual or annual basis, based on the highest rate approved for the voluntary market, thus, eliminating the need, cost and time delay of rate filings. (33)

Allow Citizens to write the full policy. Do away with the wind boundaries and the distinction of wind and ex-wind policies in the wind boundaries. (34)

Require Citizens policyholders to upgrade their homes to meet the statewide building code over some period of time or risk higher hurricane deductibles (35)

Allow authorized insurers to write non-homestead Citizens' policies on an individual risk rate basis. (36)

Allow as an incentive for companies taking out substantial numbers of policies (10,000 or more) from Citizens to charge Citizens' rates for a period of three years after such take-out. (37)

Clarify the requirements in SB 1980 regarding the offer of quarterly and semi-annual payment premium payment plans to Citizens policyholders. (38)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

MARKET INCENTIVES/BARRIERS

The problems in the Florida insurance marketplace can be bifurcated into two related issues: price and availability. One of the clearest lessons from the 2004-2005 hurricane seasons is that a healthy competitive private insurance market requires capital, and the absence of the necessary capital leads to higher priced products, and fewer products available for sale.

The goal of any reform proposal must be to increase incentives for the private industry to augment available capital, potentially even leveraging public resources to increase this capital, as well as removing the barriers that provide a disincentive for capital creation. For the purposes of simplicity, the report divides these objectives into eight categories:

- Insurance Capital Build-up Incentive Program
- State-Based Equivalent Tax-Deferred Reserves
- Catastrophe Bonds
- Creating Captive Insurers/Reinsurers
- Creating or participating in an Insurance Exchange Market
- Reinsurance Credit
- Federal Tax-Deferred Reserves
- National Catastrophe Plan

Many of these proposals would require changes to the Internal Revenue Code. Insurance Commissioner Kevin McCarty has testified before Congress on numerous occasions suggesting these changes, although it is important to remember that the implementation of these proposals is beyond the power and scope of the Committee.

Insurance Capital Build-up Incentive Program

Senate Bill 1980 appropriated $250 million from General Revenue to the State Board of Administration (SBA) for lending state funds in the form of "surplus notes" to residential property insurers, under specified conditions. If the insurer applies after July 1, 2006, but

before June 1, 2007, the surplus note is limited to one-half of the new capital contributed by the insurer. No applications are permitted after June 1, 2007. The amount of the surplus note may not exceed $25 million or 20 percent of total funds available for the program (resulting in a $50 million cap). The combination of surplus, new capital, and the surplus note must be at least $50 million. The insurer must meet a minimum writing ratio of net written premiums to surplus of at least 2 to1 for the term of the surplus note, for residential property insurance in Florida covering the peril of wind. As of November 1, 2006, a total of twelve insurers have applied for $244.7 million in surplus notes. The SBA has approved the issuance of surplus notes totaling $65 million to three insurers. This program is expected to result in the twelve companies writing 1,534,576 new homeowners policies in the next four years. (Exhibit 13)

State-Based Equivalent of Tax-Deferred Reserves

The current structure and income tax laws in the United States create an unhealthy cycle when applied to catastrophic loss. The state might consider changing the Florida state insurance code to allow some state-based tax-reserves.

With IRS approval, Florida could create its own structure that would be the economic equivalent of a tax-deferred reserve. Legislation could be added to create the Catastrophe Premium Equalization Deduction. The basic structure would be to create a "deduction" on premium income for certain lines of business written by admitted carriers in the Florida market. The proceeds from this fee would be held on account for the benefit of the insurance company (either in trust or in a collateral account), with the balance being invested for the benefit of the companies by the SBA following insurance investment guidelines.

The tax contribution would have to be structured so as not to incentivize companies to misuse this account as a tax strategy. These contributions could potentially be capped. The funds would be available to pay claims resulting from hurricane losses. If a company withdrew from the market, after a reasonable period, the account balance would revert to the insurer as taxable income. It is likely that a private letter ruling from the

Internal Revenue Service would be required to seek approval of deducting this amount on an insurer's tax return. The Committee discussed alternatives such as establishing a state account to place insurance company catastrophe reserves in an attempt to shield them from federal taxation.

Catastrophe Bonds

In its most rudimentary form, the U.S. financial markets can be divided into two categories: stocks (equity capital), and bonds (debt instruments). To date, the majority of effort to improve the personal and commercial residential markets has focused on the capital side. The goal has consistently been to raise more capital to create more capacity that facilitates more insurance products, more competition, and lower prices. However, there are other mechanisms that can be utilized to create more capacity, specifically, by raising capital through the transfer of risk to other entities, such as investors.

One of the more popular sources of risk capital outside of the traditional reinsurance market is the growing catastrophe bond market. Demand is strong and growing among institutional investors as well as hedge funds for these debt instruments. These securities allow institutional investors a chance to earn fairly lucrative returns as well as to diversify their portfolio holdings. To this point, however, the ability to participate in this market by issuing catastrophe bonds to raise capital is limited to very large insurance companies, reinsurance companies, and non-insurance commercial ventures. Additional mechanisms must be created to allow smaller insurers to tap into this market.

The basic concept is for a company to issue a bond, and in exchange for an upfront purchase price, pay interest on the bond to whomever purchases the financial instrument. Investors could be banks, hedge funds, commercial business, or private investors --- thus expanding the base of capital far beyond the traditional insurance companies and reinsurance companies. Under this hypothetical, if a hurricane or other triggering event occurred, no interest would be paid on this instrument.

The use of these instruments has not increased dramatically in recent years. The majority of transactions are arranged and established offshore, especially in Bermuda, the Cayman Islands, and Ireland. The National Association of Insurance Commissioners (NAIC) has attempted to address this issue by the creation of a model act that allows U.S. insurance companies to effectively create the offshore mechanism domestically, defined as a special purpose reinsurance vehicle. To date, only a few states have adopted the law, and it has not yet been adopted in Florida. If adopted, it would give insurers another tool for arranging and managing their capital and risk.

Creating Captive Insurers/Reinsurers

Captive Insurers are entities created to insure the risk of only a specific set of companies, usually the parent company and its affiliates. To date, there has been some reluctance in Florida to pursue these new entities from both regulators and the industry.

Captive insurers have been established in other states and foreign countries, giving them the advantage of having relaxed regulatory environment to pursue capital and make investments. The state of Vermont has one of the most captive friendly statutes in the country. Over 700 domiciled captive companies create an economic incentive for the state.

Major players in the market can form captive insurers to reinsure the risk of their group of companies already operating in Florida. A more intriguing idea is to allow non-insurance entities --- such as commercial businesses or condominium associations to create captive insurance companies that would only insure their commercial interests. In many ways this could be viewed as a more formalized version of "self-insurance." There are certainly some financial risks involved with allowing these types of entities, without insurance expertise, to create these entities, but it would allow businesses greater flexibility in how they manage their risk. However, to prudently cover property exposure in Florida, these captives would need to be adequately capitalized, have appropriate oversight by experienced management, and have sufficient reinsurance.

Creating or participating in an Insurance Exchange Market

Currently there may be a significant amount of capital being held by investors that could be invested in specific types of insurance risk, but whose investors are not interested in creating an insurance company.

One market structure that could accommodate this capital is the idea of an exchange market. In this structure, investors contribute capital to underwriting group members of the exchange who then use the combined resources to cover risks either on a direct basis or as a reinsurer. In essence, this is the structure behind the Lloyd's of London market. Providers of capital contribute to an underwriting syndicate that in turn writes the risk. The exchange uses a mechanism, such as the Lloyd's Central Fund, to ensure that claims are paid in the event that a particular underwriting syndicate fails.

Activating a Florida insurance exchange will not create immediate capacity but could provide some long term availability. The creation, structure, operating mechanism, governance, and supervision of such an exchange as defined in the current statute will be time and resource intensive. In the long run, however, this may be an attractive marketplace for Florida risk. It would be prudent for Florida to consider how its catastrophic risks could be possibly traded on existing exchanges.

Credit for Reinsurance

One of the most important duties of an insurance regulator is to regulate the solvency of insurers operating in the state. Current statutory accounting provides insurers with a credit for reinsurance under certain circumstances. The current accounting methodology provides a disincentive for reinsurers domiciled outside the United States (alien reinsurers) to do business in Florida. Testimony at one of the Committee meetings suggested that the collateral requirements currently required of alien reinsurers need to be changed to more fairly reflect the financial ability of the reinsurer. The Office of Insurance Regulation (OIR) has recommended such a change be made giving the Insurance Commissioner would have the discretion to permit a credit for reinsurance as deemed appropriate. While such a change in the accounting for reinsurance is not likely

to have an immediate impact on the capacity of property insurance in the state, it will eliminate any disincentive for alien reinsurers to do business in Florida.

Federal Tax-Deferred Reserves

For most lines of insurance, losses are predictable at an aggregate level on a year-to-year basis, and the rates are structured to allow insurance companies to pay claims from that year's premium income. This standard model of insurance is problematic for Florida commercial and residential property insurance markets, as losses can fluctuate widely from year-to-year depending on storm activity. In years when no hurricanes or tropical storms reach landfall, the losses incurred by insurance companies are manageable and property insurers may enjoy underwriting profits. Conversely, in years such as the 2004-2005 hurricane seasons, when eight named storms reached landfall in Florida, the amount of loss can be staggering, in this instance, approaching $36 billion.

One logical model, adopted by virtually all other industrialized nations regulating their domestic insurance industries, allows insurance companies to accumulate "catastrophe reserves," by retaining money in years with low storm activity, in anticipation that this capital will be needed and can be used in years with high storm activity. However, the current structure of the Internal Revenue Service code prohibits this practice.

In the United States, a company earning underwriting profits in years with low storm activities may not set aside this money in any type of reserve fund on a tax-deferred basis. Reserving for potential future catastrophic losses results in taxation by the federal and state taxing authorizes at the corporate tax rate. Thus, the insurance company incurs a tax penalty for "saving" money for future catastrophic events.

The Committee believes one recommended change would be to amend the Federal Internal Revenue code to allow insurance companies to accumulate catastrophe reserves, without tax penalty, for use during high loss seasons.

National Catastrophe Plan

If anything positive could come from the aftermath of the destruction and suffering of Hurricane Katrina, it focused our nation's attention on the need for a national catastrophe plan. This catastrophe was not a "Louisiana problem," or even a "Gulf-Coast problem," it was a national problem that requires a national solution.

The federal government to date, has appropriated $120 billion in funding to rebuild the Gulf Coast, helping those affected by this devastation. It became apparent to policymakers that creating a national catastrophe fund would be the most cost effective way to pre-fund catastrophic events, as opposed to paying for catastrophes after the event. Subsequent to this disaster and the massive federal outlay of funds, legislators in Louisiana, Florida, and elsewhere have been lobbying Congress to enact federal legislation creating a national catastrophe plan. Insurance Commissioner Kevin McCarty has testified twice before Congress and has worked with the National Conference of Insurance Legislators (NCOIL) on this issue.

Although there are a myriad of proposals containing many different elements, the overarching issue is that a mega-catastrophe --- such as a repeat of the 1811-1812 earthquakes along the New Madrid fault line in Missouri or the 1906 earthquake in San Francisco – could cause in excess of $250 billion in damage, overwhelm the national insurance market, and have a significantly negative impact on the United States economy. The United States is one of the only industrialized nations in the world which relies on regional (i.e. state) disaster planning, and not a federal plan.

One component of a federal plan is to use federal financial resources to either provide a financial backstop or leverage the resources to create more capital through reinsurance. The more ambitious plan is the latter, by having state residual market entities, like the California Earthquake Authority or the Florida Hurricane Catastrophe Fund (CAT Fund), contract directly with an agency of the federal government to provide high level reinsurance at an actuarially fair price.

In this scenario, Florida would pay an actuarially fair premium for a defined high level of insurance (possibly the difference between the CAT Fund exhaustion point and the 100-year catastrophe event). The premium would be built into the CAT Fund rate and remitted to the U.S. Treasury. In years where there were no insured hurricane losses, or losses only below the trigger point, the premiums paid go into the United States Government's general revenue. If a catastrophic event triggered the contract, the U.S. Treasury would pay Florida the appropriate amount. Over the long run, based on actuarially sound rates, the only cost to the U.S. government and its taxpayers would be overhead associated with this arrangement, assuming the time-value of money was figured into the amount of the premiums.

This additional layer of federal reinsurance would make the Florida market more attractive to private insurers by greatly reducing the risk from extreme events and providing a much more stable source of risk capital. In theory, this could also "free-up" capital in the domestic reinsurance market, which would create more competition, and thus lower the price of reinsurance --- one of the main cost-drivers precipitating the recent rate increases in Florida's primary insurance marketplace.

The Committee heard testimony from many capital market representatives that Florida's insurance capital needs are vast. The State Board of Administration (SBA) studied capital market alternatives and the Committee recommends allowing the SBA to use CAT bonds, sidecars and other capital market products to transfer some of the risk of CAT Fund coverage. The Committee also suggests the Insurance Capital Build-up Incentive Program be extended and modified to allow more insurers to qualify and use the program.

Based on information presented, a range of options from seeking IRS opinions of tax free reserves, to instituting special purpose vehicles and amending Florida's captive insurers statute should be made available to enhance availability of insurance for Floridians.

Finally, the Committee recognizes the need for federal legislation to create a national CAT Fund. The Legislature and Governor should continue pursuing legislation in Congress related to a CAT Fund, tax exempt catastrophe reserves, and federal funding for ongoing windstorm studies.

Market Incentives/Barriers Recommendations

Provide additional funding to the Insurance Capital Build-up Incentive Program for 2007 with some capital being set aside for insurers specifically writing manufactured housing policies. The Legislature should consider lowering the total surplus requirement for an eligible insurer from the current $50 million. The Legislature should also consider relaxing the requirement that insurers maintain a 2 to 1 ratio of net premiums to surplus. Finally, the Legislature should consider providing that the date of application for a surplus note and the date of issuance of such funds must be prior to April 1, 2007. (Prior to the 2007 storm season and in time to purchase reinsurance) (39)

To protect insurance policyholders, the minimum surplus requirement for property insurers (currently $5 million) should be evaluated for a possible upward revision. (40)

Promote and facilitate the use of capital markets risk transfer alternatives by amending the insurance laws to authorize OIR approval of Special Purpose Reinsurance Vehicles for the securitization of an insurer's risk (NAIC Model Act). (41)

Provide authorization for a state facility (e.g., within the State Board of Administration) to hold and invest funds invested (risked) by non-insurance entities, such as pension funds or individuals, covering specified hurricane losses for Florida insurers. (Protected cell) (42)

Authorize the CAT Fund or State Board of Administration to use catastrophe bonds, sidecars, and other capital market products to transfer the risk of CAT Fund coverage. (43)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

Market Incentive/Barriers Recommendations (continued)

Allow for state participation in an insurance exchange or possibly the establishment of an insurance exchange in Florida to securitize and market to investors specified levels of hurricane catastrophe risk of insurers. Alternatively, work with existing exchanges that trade risk transfer products (e.g., the Chicago Mercantile Exchange) to determine if a Florida hurricane risk contract can be structured. (44)

Adopt changes to the captive insurer law to liberalize Florida law and encourage the maximum use of captives by Florida's businesses and the maximum formation of captives in Florida, where appropriate. (45)

Seek an IRS opinion allowing insurers to deduct catastrophe reserves if such reserves are deposited with and maintained by the state (such as the State Board of Administration). Seek an IRS opinion allowing insurers to deduct a "catastrophe premium equalization deduction" charged and held by the state in a segregated account for the benefit of insurers for use in the event of a catastrophe. (46)

Endorse H.R. 4366 (national CAT Fund), H.R. 4836 (tax exempt CAT savings account), and S. 3116 (tax exempt CAT reserves). Endorse the filing of legislation that provides federal income tax credit for all home retrofitting expenses (mitigation) or premium grants provided by State or local government. (48)

Seek federal funding of windstorm analysis/studies equivalent to federal funding for earthquake analysis/studies. (49)

The Governor, President of the Senate and Speaker of the House of Representatives will write to our Congressional leadership supporting these federal issues. (50)

* Note – Numbers after each recommendation refer to Section 15 - Initial Recommendations

Property Insurance Issues and Options

I. Florida Hurricane Catastrophe Fund (and other State Reinsurance Coverage Options)

Issue #1: Lower Cat Fund Retention (i.e., amount of residential hurricane losses that insurer must pay before being reimbursed)

Current Law:
$5.3 billion retention for all insurers combined for 2006, increased annually by the same percentage as the growth in the Fund's exposure. (Legislation in 2005 reset retention to $4.5 billion, which grew to $5.3 billion in 2006). A separate retention is calculated for each insurer, based on its percentage of total Cat Fund premiums; e.g., an insurer paying 10% of the total Cat Fund premiums has a retention of $530 million (10% of $5.3 billion).

The full retention applies to *each* hurricane, but drops to one-third of full retention for the third and each additional hurricane (in order of loss magnitude) in a single year.

Cat Fund premiums must be set at the "actuarially indicated" amount (generally, the average annual expected loss) based on hurricane loss projection models approved by the Florida Commission on Hurricane Loss Projection Methodology, plus a 25% "rapid cash build-up factor"(per SB 1980). The 2006 premium equals 6.7% of the coverage amount (i.e., a 6.7% "rate on line").

Options:

1. Lower the 2007 retention for all insurers, (e.g., to $3 billion, $4. billion, $4.5 billion, or reset to the 2006 level of $5.3 billion), subject to annual growth thereafter pursuant to current law.

2. Lower the retention, but charge a higher premium (e.g., 50%, 75%, or 100% risk load, rather than 25%).

3. Provide an annual retention (such as $5 billion - $7 billion) rather than a per hurricane retention, but have a small, per hurricane retention (such as $500 million- $1 billion) that must still be met after the annual retention is met.

Issue #2: Temporary Offer of Cat Fund Coverage Below Retention

Current Law: SB 1980 allowed limited apportionment companies ($25 million in surplus or less and writing at least 25% of its property premiums in Florida) to purchase up to $10 million in coverage above a retention equal to 30 percent of the insurer's surplus (well below the current retention), at a premium of 50% of

the coverage amount selected (i.e., 50% "rate on line"). Coverage is reinstated at no additional premium for a second hurricane, but not for additional hurricanes. Available only for the 2006 contract year.

Options:

4. Offer all insurers (not just limited apportionment companies) the option of purchasing coverage below the retention, at rates comparable to (or less than) market level prices for a limited time**.** For example, assuming the retention in 2007 remains at $5.3 billion, offer each insurer its share of $4.3 billion excess of $1 billion at a 60% rate on line, $3.3 billion excess of $2 billion at a 50% rate on line, and $2.3 billion excess of $3 billion at a 45% rate on line. Reimbursement would be provided for 90% of losses. Coverage would be automatically reinstated at no additional charge for a second hurricane.

5. Reenact current law provision for 2007. Consider raising retention above 30% of the insurer's surplus.

Issue #3: Increase Maximum Limit of Cat Fund Coverage

Current Law:
Annual reimbursement to all insurers is limited to $15 billion annually, increased annually by the same percentage as the growth in the Fund's exposure, but not to exceed the dollar growth in the cash balance of the Fund. Due to Cat Fund losses in 2004 and 2005, the $15 billion limit has not increased since it was legislatively increased to $15 billion in 2004.

A separate annual reimbursement limit is calculated for each insurer, based on its share of total Cat Fund premiums. For example, an insurer that pays 10% of total Cat Fund premiums is limited to a maximum annual reimbursement of $1.5 billion (10% of $15 billion).

Option:

6. Increase the $15 billion limit for 2007 (e.g., $17 billion - $20 billion)

7. Require the $15 billion limit to grow annually by the same percentage as the Fund's exposure, regardless of the change in the Fund's cash balance.

Issue #4: Offer Additional CAT Fund Coverage as Incentive to Take Policies out of Citizens

Current Law: Not addressed in current law. (SB 1980 significantly restricted the payment of cash take-out bonuses to insurers by Citizens.)
Option:

8. Offer additional Cat Fund coverage to an insurer that takes a specified minimum number of policies out of Citizens. For example, if an insurer takes out at least 10,000 policies, offer coverage below the $5.3 billion retention, such as $2.3 billion in excess of $3 billion, at a rate of 30% rate on line. This coverage layer would apply to all of the insurer's residential policies, but the percentage reimbursement would be limited to the percentage of the insurer's total Cat Fund premium that is paid for the take-out policies. This same percentage would be applied to reduce the 30% rate on line.

> *Example*: An insurer takes 10,000 policies out of Citizens, which account for 20% of the insurer's Cat Fund premium. The insurer would be allowed to purchase coverage below the retention, for its share of $2.3 billion in excess of a $3 billion. For this layer, the Cat Fund would reimburse the insurer for 20% of its losses, for which the insurer would pay a 6% rate on line (20% of a 30% rate on line). (Reimbursement would be limited to 90% of losses for an insurer whose take-out policies account for more than 90% of its Cat Fund premium.)
>
> Limit the benefit to a specified period, e.g., three years, contingent on renewing the take-out policies. The rate on line could be increased over this three-year period. Proportionately reduce the reimbursement if an insurer non-renews other policies while assuming Citizens policies (i.e., measure net increase in insurer's Cat Fund exposure).

Issue #5: Changing the Renewal Date of the Cat Fund to Conform with the Global Reinsurance Market

Current Law: Currently, the contract year for Cat Fund coverage begins on June 1. However, according to OIR, most property casualty reinsurance contracts are negotiated and renewed in January of each year. Asian and some European catastrophic risk reinsurance are renewed in March/April, while most Florida property reinsurance is negotiated and renewed for a June renewal date to coincide with the FHCF. That is, many Florida insurers are going to the market after the rest of the global reinsurance market has largely cleared. In tight markets, such as those Florida companies are currently facing, this puts additional stress on both availability and affordability. According to OIR, if the renewal date for Cat Fund coverage were changed to have Florida companies in the market in March or April, or possibly even January, the market opportunities and competitive pressures would work more to the benefit of Florida companies and consumers.

Option:

9. Change the renewal date for Cat Fund coverage from June 1 to an earlier date, such as January, March, or April.

Issue #6: Funding Losses in the Cat Fund

Current Law:
If the cash balance of the Cat Fund is insufficient to meet its obligations, the SBA is authorized to issue revenue bonds funded by emergency assessments levied as surcharges against all property and casualty insurance premiums, including surplus lines insurance, *except* for workers' compensation and, until June 1, 2007, medical malpractice insurance. Annual assessments are capped at 6 percent of premium for losses from any one year and 10 percent of premium for losses from multiple years. The recent $1.35 billion bond issue to fund losses for 2004 and 2005 is expected to result in a 1 percent assessment for six years.

Options:

10. Expand the assessment based of the Cat Fund to include workers' compensation. According to OIR, this would add approximately $4 billion to the assessment base, which currently totals about $35 billion.

11. Impose an additional 1 cent sales tax for deposit into the Cat Fund. This would generate approximately $3.5 billion annually.

Issue #7: Restructure the current CAT Fund to be modeled after the National Flood Insurance Program

Option:

12. Revise the Cat Fund to provide coverage for the first $100,000 of loss per policy. Private insurers remain responsible for 10 percent of losses covered by the Fund and for losses above $100,000 per policy.

Issue #8: Provide Cat Fund Coverage for Commercial Property

Current Law:
The Cat Fund covers only residential property (including condominium associations and apartment buildings). The Cat Fund does not otherwise cover commercial property. (The 1993 act creating the Cat Fund included coverage for commercial property, but the 1995 act deleted this coverage before the Fund began providing coverage.)

Option:

13. Require the Cat Fund to cover commercial property. Issues to consider:
   - whether coverage would be mandatory or optional for insurers;
   - whether certain large or unique risks should be excluded;

  - whether coverage and pricing should be addressed differently than for residential coverage, due to unique nature of risks; such as providing quota share coverage (e.g., covering 50% of the loss, at a rate of 50% of the insurer's premium.)
  - whether current assessment limits are adequate.

(See also #120)

Issue #9: Appropriations from the Cat Fund

Current Law:
The Florida law (statute) requires that the assets of the Cat Fund be used exclusively for paying hurricane loss obligations, debt service on revenue bonds and financing arrangements, reinsurance costs, administrative expenses, and an annual appropriation for hurricane loss mitigation programs.

The law requires an annual appropriation for hurricane loss mitigation programs of at least $10 million, but not to exceed 35 percent of the prior year's investment income. Legislation in 1999 required that the $10 million must be appropriated to the Department of Community Affairs, of which $7 million must be used for programs to improve the wind resistance of residences and mobile homes and $3 million must be used to retrofit existing facilities used as public hurricane shelters. The law further directs that 40 percent of the $7 million ($2.8 million) be used to inspect and improve tie-downs for mobile homes and that 10 percent ($700,000) be allocated to the State University System dedicated to hurricane research.

Beginning in 1997, the Legislature appropriated $10 million each year from the Cat Fund, but appropriated $30 million in 2002 and $20 million in 2003, largely for beach renourishment purposes. Following the 2004 hurricanes, the Legislature appropriated $150 million from the Cat Fund to reimburse policyholders for the expense of paying multiple deductibles from two or more hurricanes.
Option:

14. Amend the State Constitution to limit the use of the assets of the Cat Fund (i.e., restrict legislative appropriations) to the purposes currently required by statute (as summarized in first paragraph under Current Law). Also require that any appropriation from the Cat Fund in excess of $10 million be in a separate bill for that purpose only and be approved by a super-majority (e.g., three-fourths) of the membership of each house of the Legislature.

15. Mandate that the $10 million set aside be appropriated entirely on the Florida Comprehensive Hurricane Damage Mitigation Program.

II. Mitigation/Premium Discounts

Issue #1: Funding Mitigation Measures

Current Law:

For 2006-2007, $250 million of non-recurring funds was appropriated from General Revenue for the Florida Comprehensive Hurricane Damage Mitigation Program within the Department of Financial Services (DFS). The unexpended balance reverts after three years (June 30, 2009). The program provides for free inspections of site-built, residential property, to determine what mitigation measures are needed to reduce vulnerability to hurricane damage and provides for 50 percent matching grants (up to $5,000) to encourage retrofitting of homes. Up to 100 percent grants (up to $5,000) are available to low-income homeowners.

DFS must adopt rules establishing priorities for grants based on objective criteria that gives priority to reducing the states' probable maximum loss for hurricanes and may further establish priorities based on the insured value, whether the dwelling is insured by Citizens, and whether the area has sufficient resources to perform the retrofitting.

Options:

16. Maintain and expand the State's financial commitment to fund the program.

17. Require uniform home inspection forms to be developed for all insurers. Specify the length of time an executed form is valid (spoilage).

18. Provide for state funded research concerning mitigation of commercial structures and whether strengthening the state's building code for commercial structures should be considered.

19. Review DFS allocation of mitigation funds and priorities for grants and recommend any changes determined appropriate. Earmark a portion of future mitigation funding to be used for Citizens policyholders.

20. Expand the funding for free inspections to encourage more homeowners to mitigate regardless of whether matching grants are available.

21. For future appropriations for mitigation grants, lower the percent match (e.g., from 50% to 20% or 30%) to fund additional homes.

22. Create a Sales Tax Rebate Program where consumers can apply to the Florida Department of Revenue for sales tax credits/rebates for approved mitigation materials and supplies.

Issue #2: Savings for Homeowners through Mitigation

Current Law:

Insurers are required by law to provide premium credits or discounts for homeowner's insurance for properties on which construction techniques have been installed which reduce the amount of loss in a windstorm. These construction techniques include roof strength, roof covering performance, roof-to-wall strength, wall-to-floor-to-foundation strength, opening protection, and window, door, and skylight strength, etc. Individual discounts or credits generally range from 3% to 25% and a fully mitigated property can qualify for total credits ranging from 20% to 42% off its wind insurance premium.

SB 1980 required OIR to reevaluate the insurance discounts and credits for homes built to meet the Florida Building Code and to determine the full actuarial value of such discounts, by July 1, 2007, for use by insurers in rate filings.

Insurers must notify policyholders upon application and renewal of the availability and range of premium discounts for mitigation techniques and describe generally what actions the policyholders must take to obtain the discounts. The prescribed form and a list of the range of premium discounts for each insurer must be available on the Internet website of DFS or OIR.

Options:

23. Ensure that insurance companies appropriately adjust premiums for homeowners when meaningful and verifiable mitigation measures are undertaken. (Premium discounts)

24. Require mid-term refunds or rate adjustments if mitigation measures are performed/completed during the policy year.

25. Ensure that insurance companies and agents are providing specific information to homeowners who want to know the premiums discounts available for various mitigation options and the means for obtaining the discounts (e.g., continuing education requirements for agents).

26. Further develop public/private partnerships to educate homeowners regarding the advantages of fortifying their homes.

Issue #3: Standard Grading System for a Home's Hurricane Strength

Current Law:
SB 1980 required OIR to conduct a study and develop a program to provide an objective rating system that will allow homeowners to evaluate their home's ability to withstand the wind load from a hurricane. OIR is expected to enter into a contract with the University of Florida to develop a home rating/grading system for this purpose.

Options:

27. Require the state to adopt and fund a uniform grading system for evaluating the hurricane strength of homes.

28. Require home inspectors to be licensed or certified by the state (with exceptions for licensed contractors).

29. Require home sellers to inform buyers of the home's hurricane rating, based on an inspection by a qualified inspector and statewide rating system.

Issue #4: Building Code

Current Law:
Legislation in 2006 authorized the Florida Building Commission to amend the Florida Building Code and to identify those areas of the state from the eastern border of Franklin County to the Florida-Alabama line (the Panhandle region) that are subject to the windborne debris requirements of the code. The commission's initial designation of the windlines for this region must address the results of the Florida Panhandle Windborne Debris Region study.

This 2006 legislation allows the commission to eliminate or revise the statutory "Panhandle exception" limiting wind-borne debris requirements to within 1 mile of the coast and amend the wind design standards to incorporate the current edition of the national model building code engineering standard (American Society of Civil Engineers Standards 7, 2002 Edition). This would subject new construction in the Panhandle region to the same windborne debris requirements (enhanced door and window protection) applicable to other areas of the state.

Option:

30. Put a statewide building code in place that requires American Society of Civil Engineers (ASCE) wind lines to be adopted and prohibit any changes in future statewide building codes unless it is to strengthen the code.

31. Limit the authority of the Florida Building Commission to modify the wind-design standard applicable to construction in the state, as adopted within the Florida Building Code, to modifications that strengthen, but do not weaken or otherwise diminish the standards within the code. (This would effectively repeal the Panhandle exception.)

32. Provide incentives to builders like density bonuses, lower impact fees, and concurrency credits when new construction is built at *higher levels* than the current approved building code (except for the Panhandle).

III. Citizens Property Insurance Corporation (Citizens)

Issue #1: Eligible Property for Coverage in Citizens

Current Law:
Citizens offers three types of property and casualty insurance in three separate accounts: 1) Personal Lines Account (PLA) which covers homeowners, mobile homeowners, dwelling fire, tenants, condominium unit owners and similar policies; 2) Commercial Lines Account (CLA) covering condominium associations, apartment buildings and homeowners associations; and 3) High-Risk Account (HRA) which covers personal lines windstorm-only policies, commercial residential wind-only polices and commercial non-residential wind-only policies.

In the HRA, Citizens provides coverage in specially designated areas which have been determined to be particularly vulnerable to severe hurricane damage. In these "wind-only" zones, private insurers may offer other peril coverage, but are not required to provide windstorm coverage. The windpool designated areas were created as part of the process for determining eligibility for the Florida Windstorm Underwriting Association. Eligibility was limited to structures in eligible areas found by the Department of Insurance, after public hearings, to meet three criteria; the lack of windstorm coverage in the area was deterring development, causing mortgages to be in default, and causing financial institutions to deny loans; the area was subject to the requirements of the Southern Standard Building Code or its equivalent; and that extending windstorm coverage to the area was consistent with the policies and objectives of environmental and growth management.

As of June 30, 2006, Citizens provided coverage to 904,193 policyholders (excluding over 300,000 Poe policyholders), making Citizens the largest insurer in Florida. The numbers of policyholders in the three accounts are: PLA – 531,882; CLA – 4,537, and HRA – 367,774. Currently, Citizens is averaging 50,000 - 55,000 new applications for coverage per month.

Property is eligible for coverage with Citizens only if there is no other offer from an authorized insurer. The insurance agency and agent must use reasonable efforts to place personal or commercial insurance applicants with an authorized insurer prior to placing the risk with Citizens. Failure to do so is grounds for termination or suspension of the agent appointment.

Beginning March 1, 2007, non-homestead property is eligible in Citizens only if the property owner annually obtains three declinations of coverage from surplus lines insurers and one from an authorized insurer. The definition of homestead property for Citizens' purposes is more expanded than the definition used for property tax purposes.

"Homestead property" is defined as: 1) a property granted a homestead tax exemption under ch.196, F.S.,; b) property for which the owner has a written lease

with a renter for a term of at least 7 months and which is insured by Citizens for $200, 000 or less; c) an owner occupied mobile home permanently affixed to real property, owned by a Florida resident, and either granted a homestead tax exemption or, if the owner does not own the land, for which the owner certifies that the mobile home is his principal place of residence; d) tenants coverage; e) commercial lines residential property; f) any county, district, or municipal hospital; not-for-profit hospital; or continuing care retirement community that is certified under ch. 651, F.S., and receives an ad valorem tax exemption under ch. 196, F.S. All other property is "non-homestead property."

Beginning July 1, 2008, homes insured for $1 million or more are ineligible for coverage in Citizens. Homes insured for $1 million or more by Citizens before July 1, 2008 can remain in Citizens for another 3 years if the homeowner annually gets three declinations of coverage from surplus lines insurers and one from an authorized insurer. However, such property can only be covered in the high-risk account and will be considered "non-homestead property." By June 30, 2011, Citizens will not insure any home insured for $1 million or more.

In February, Citizens reported that it had 6,431 residential policies in force that were insured for values greater than $1 million, with a total insured value of $16.7 billion with a total premium of $64.3 million.

In February, Citizens estimated restricting eligibility for coverage to homes with insured values of $1 million or more would reduce their probable maximum loss (PML) in the HRA by $809 million which equates to 12.5%. Additionally, this restriction would reduce Citizens' residential exposure by $16.7 billion or 14%.

SLOSH (Sea, Lake and Overland Surges from Hurricanes) is a computerized model run by the National Hurricane Center to estimate storm surge heights resulting from historical, hypothetical, or predicted hurricanes by taking into account:

- Pressure
- Size
- Forward speed
- Track
- Winds

The calculations are applied to a specific locale's shoreline, incorporating the unique bay and river configurations, water depths, bridges, roads and other physical features. The SLOSH model is generally accurate within plus or minus 20 percent. The SLOSH model is best used for defining the potential maximum surge for a location.

LIDAR (Light Detection and Ranging) is a remote sensing system used to collect topographic data used by the National Oceanic and Atmospheric Administration and NASA to document topographic changes along shorelines. LIDAR can:

- Measure distance
- Measure speed
- Measure rotation
- Measure chemical composition and concentration

of a remote target where the target can be a clearly defined object or a diffuse object. LIDAR has been tested to assess post-storm damage to beaches.

Issue #1: Eligible Property for Coverage in Citizens

Options:

33. Prohibit Citizens' from writing wind-only policies.
    - Note: Effect is that Citizens will write the whole policy in all areas of the state. (i.e., the wind-only zones for Citizens are repealed)
    - Note: Effect is that private insurers would no longer be allowed to write policies excluding wind coverage.
    - If this option is chosen, consideration should also be given to whether Citizens would continue to cover commercial non-residential property.

34. Require Citizens' policyholders to upgrade their homes to meet the statewide building code or risk higher hurricane deductibles applicable to the policy.
    - Variation: Require Citizens' policyholders to take specified mitigation measures or risk higher hurricane deductibles.
    - Note: An exception can be made for low income policyholders.
    - Note: This can be made to only apply to properties with insured values higher than a specified dollar amount.

35. Permit Citizens to surcharge properties until they are retrofitted to meet building Code requirements.

36. Eliminate the current distinction of non-homestead and homestead property within Citizens (eligibility standards).

37. Amend the definition of homestead and non-homestead property for Citizens' purposes.
    - Can revert back to definition used for property tax purposes.

38. Prohibit non-homestead properties insured by Citizens that have been paid a total loss on the policy by Citizens from being eligible for continued coverage/renewal in Citizens.

39. Require Citizens to create a separate, self-supporting account for non-homestead property.
    - Although current law differentiates homestead and non-homestead property in Citizens, it does so within the current three account structure.

40. Redraw or reduce Citizens' wind-only zones/windpool areas.
    - Reduction can be within a specified distance (1,000 feet) from shore.
    - Consider the storm surge area identified by SLOSH or vulnerable areas identified by LIDAR in creating revised windpool areas.

41. Create a task force, committee, panel, etc. to evaluate or redraw the wind only territories.

42. Exempt from Citizens' eligibility manufactured homes built before 1994 that do not meet the new HUD code.
    - Variation: Allow Citizens to surcharge such manufactured homes until they are brought up to Code.

43. Require Citizens' policyholders to upgrade their homes to meet the statewide building code or *risk cancellation or non-renewal* of the policy.
    - Variation: Require Citizens' policyholders to take specified mitigation measures or risk cancellation or non-renewal of the policy.
    - Note: An exception can be made for low income policyholders.
    - Note: This can be made to only apply to properties with insured values higher than a specified dollar amount.

44. Require Citizens' policies to have a minimum hurricane deductible (5 or 10%) if the insured value is greater than a specified amount (e.g., $250,000).

45. Revise the ineligibility date for homes insured at $1 million or more to be excluded from Citizens' coverage. Currently it is July 1, 2008.

46. Require Citizens to utilize layering arrangements with voluntary carriers rather than assume the entire exposure of every eligible risk. (i.e. make Citizens an excess carrier with private market writing coverage below the Citizens' coverage level)

47. Require the State to provide windstorm coverage up to a specified amount for each homeowner. (i.e. make Citizens or authorized insurer an excess insurer with State writing coverage below the Citizens' or authorized insurer's coverage level)
    - e.g., State provides windstorm coverage for first $50,000 of damage and authorized insurer or Citizens can provide coverage for all damage over $50,000

48. Require the State to provide windstorm coverage for a specified amount after Citizens or an authorized insurer provides coverage for a lower amount. (i.e. make State an excess insurer with Citizens or an authorized insurer writing coverage below the State coverage level)

- e.g., authorized insurer to provide windstorm coverage for first $50,000 of damage and State provides windstorm coverage for all damage over $50,000.

Issue #2: Citizens' Rates

Current Law:

In order to assure that Citizens rates are not competitive with the voluntary market, the current law requires that Citizens rates for its PLA be actuarially sound and that its average rates for each county must be no lower than the average rates charged by the insurer that had the highest average rate in that county among the 20 insurers (5 insurers for mobile home coverage) with the greatest direct written premium in the state for that line of business.
For its HRA (wind-only policies in coastal areas), the law more generally requires that Citizens rates be actuarially sound and not be competitive with approved rates charged by authorized insurers. However, the law further requires Citizens and the OIR to jointly develop a wind-only ratemaking methodology to meet this purpose, for rates effective on or after July 1, 2004. A wind-only rate methodology was developed that uses a variation of the "Top 20" approach mandated for personal residential multi-peril policies.

Under current law, there is no rate distinction between homestead and non-homestead property insured by Citizens. However, starting March 1, 2007, there is a rate distinction between property in the personal lines and commercial lines accounts and property in the high risk account.

For Citizens' policies in the personal lines account and the commercial lines account issued or renewed on or after March 1, 2007, a rate is deemed inadequate if the rate, including investment income, is not sufficient to provide for the purchase of reinsurance coverage from the Florida Hurricane Catastrophe Fund and private reinsurance (whether or not purchased) and to pay all claims and expenses reasonably expected to result from a 100-year probable maximum loss event (i.e., a 1-in-100 year hurricane), without resort to assessments or other outside funding sources.

For Citizens' policies in the high-risk account (wind-only coverage in coastal areas) issued or renewed on or after March 1, 2007, a rate is deemed inadequate if the rate, including investment income, is not sufficient to provide for the purchase of reinsurance coverage from the Florida Hurricane Catastrophe Fund and private reinsurance (whether or not purchased) and to pay all claims and expenses reasonably expected to result from a 70-year probable maximum loss event, without resort to assessments or other outside funding sources. For policies in the high-risk account issued or renewed in 2008 and 2009, the rate must be based upon an 85-year and 100-year probable maximum loss event, respectively.

As of June 30, 2006, Citizens' 100 year PML for its personal lines account is $5.891 billion and $12.187 billion for its high risk account.

In ratemaking, Citizens is also required to use the public hurricane loss model developed by Florida International University as the minimum benchmark for determining its windstorm rates after the public model has been found to be accurate and reliable by the Florida Commission on Hurricane Loss Projection Methodology (Commission). Because the public model has not been submitted to the Commission yet, Citizens is not yet required to use it in ratemaking.

Issue #2: Citizens' Rates
Options:

49. Require the Office of Insurance Regulation to set rates for Citizens on a quarterly basis, based on the highest rate approved for the voluntary market.

50. Shorten or lengthen the time period by which Citizens' rates for its High Risk Account must reach the 1 in 100 year PML.

51. Require Citizens' rates to cover a higher or lower PML.

52. Require a more gradual increase in Citizens' rates to fully fund its 100-year PML.
    - e.g., require Citizens' rates to cover its average annual expected loss plus a "capital accumulation" or "assessment reduction" factor, as determined by Citizens and approved by OIR. Alternatively, require a specific capital accumulation factor of 10% or 20% of the average annual expected loss until Citizen has sufficient surplus and reinsurance to cover its 100-yeear PML.

53. Require Citizens to purchase reinsurance for a specified PML event for each account or for specified account(s).

54. Require the PLA rates to be higher than the highest approved voluntary market rate rather than the "top 20 insurer" standard.

Issue #3: Assessments and Surcharges for Funding Deficits in Citizens

Current Law:
If a deficit is incurred in any Citizens' account, the board must levy an immediate assessment on each non-homestead property (as defined in statute) of up to 10 percent of the premium. If this is insufficient to eliminate the deficit, the board must levy an additional assessment against all Citizens' policyholders (including non-homestead policyholders), collected upon renewal, of up to 10 percent of premium. Any remaining deficit is funded by regular and emergency assessments, either recouped from, or directly paid by, non-Citizens' policyholders of property insurance. The regular assessment against insurers could still be imposed as soon as a deficit is determined, but must be reduced by the amounts estimated to be collected from the two 10 percent surcharges.

Lines of business that are subject to Citizens' deficit assessment include insurance for: fire, industrial fire, allied lines, farmowners multiperil, homeowners multiperil, commercial multiperil, and mobile homes, and includes liability coverage on all such insurance except for inland marine and certain vehicle insurance other than the insurance on mobile homes used as permanent dwellings.

Issue #3: Assessments and Surcharges for Funding Deficits in Citizens
Options:

55. Expand Citizens' assessment base to include other lines of insurance.
    - Note: Can expand it to correspond to the FHCF assessment base (all property & casualty *(including auto)* except workers' comp and med mal until 2007) or expand it to include only specified lines.

56. Require any Citizens' deficit to be defrayed by Citizens' policyholders only. (i.e. no pass through of deficit assessments to other Florida homeowners)

57. Increase or decrease the deficit assessment percentage levied on Citizens' policyholders (homestead and non-homestead) before deficit assessment is levied on all other Florida homeowners.

58. Request the Legislature to use excess revenue to defray Citizens' deficits by appropriating funds directly to Citizens.

59. Require the State to send a check to every Florida homeowner for use by the homeowner in paying a Citizens' deficit assessment.

Issue #4: Citizens Oversight, Internal Controls and Standards of Conduct

Current Law:

Citizens operates under an eight member board of governors with the Governor, the CFO, the President of the Senate, and the Speaker of the House or Representatives appointing two members each. The Financial Services Commission (Governor and Cabinet), rather than the Office of Insurance Regulation (OIR), approves Citizens' plan of operation. Beginning July 1, 2006 Citizens' Executive Director is confirmed by the Senate.

Significant changes to Citizens' internal controls were made in 2006 by SB 1980. SB 1980 required Citizens to have an internal auditor and requires OIR to do a market conduct examination of Citizens every two years. In addition, the Auditor General is required to conduct an operational audit of Citizens every three years.

SB 1980 also made significant changes regarding Citizens' standards of conduct. Specifically, Citizens is required to have competitive bidding on contracts of $25,000 or more, with exceptions, and board approval of contracts of $100,000 or more. OIR

background checks of applicants for senior management positions are required. The Citizens' board members and senior managers are subject to the code of ethics and financial disclosure requirements applicable to public officials. Also, all Citizens employees must annually submit a statement attesting that no conflict of interest exists. Board members and employees are prohibited from accepting any gift from any person or entity under contract with Citizens or under consideration for a contract. Citizens is prohibited from retaining lobbyists, but allows employees to register as lobbyists. Citizens' senior managers are prohibited, for two years following termination of employment, from representing any person or entity before Citizens, or from being employed or under contract with an insurer that received a take-out bonus from Citizens. Citizens is required to conduct a cost-benefit analysis of using legal services provided by in-house (employee) attorneys, or to contract with outside attorneys.

Citizens is also required to establish a fraud unit or division to investigate possible fraudulent claims or repairs and to meet the same anti-fraud requirements imposed on authorized insurers. Citizens' employees are required to notify the Division of Insurance Fraud within 48 hours of having information that would lead a reasonable person to suspect that fraud may have been committed by an employee of Citizens.

Issue #4: Citizens Oversight, Internal Controls and Standards of Conduct
Options:

60. Recommend Legislature continue its oversight responsibility over Citizens and determine if other external review is necessary.

61. Establish a meaningful set of uniform performance metrics to be reported by Citizens to OIR.

62. Require OIR to establish an ongoing reporting structure highlighting claims-handling performance using metrics similar to those used in OIR's disaster reporting framework.

Issue #5: Depopulation of Citizens

Current Law:

Since 1995, Florida law has expressed the Legislature's intent to provide a variety of financial incentives to encourage the replacement of the highest possible number of policies written in the state's residual market with policies written by admitted insurers at approved rates. There is specific authority for Citizens to pay a "take-out bonus" to insurers of up to $100 for each policy removed from Citizens, under certain conditions. However, Citizens has implemented greater bonuses under conditions approved by its board and the OIR. In its 2006 operational audit of Citizens, the Auditor General found the bonus amount paid or escrowed for each policy taken out of Citizens averaged $148, although Citizens had several takeout programs paying take-out bonuses of $300 per policy.

Citizens adopted a new depopulation program in December 2005. This program has non-bonus and bonus components in it. Only policies taken out with wind coverage are eligible for a bonus. Take-out companies must assume a minimum number of policies or a minimum total insured value of the take-out policies under either the bonus or non-bonus component. Policies must be taken out for three or five years in order to be eligible for a bonus. Base bonus amounts range from 5% to 12.5% for dwelling policies; however, some policies are not eligible for bonuses. Base bonuses for condo unit/tenant contents and mobile home policies have different ranges. Take-out companies can receive an additional bonus amount for assuming a greater number of policies or for taking a policy out for 5 years. The additional bonus amounts range from 0% to 10%, depending on the number of bonus eligible policies or the total insured value of policies taken out.

In 2005, 480,319 policies were removed from Citizens reducing Citizens' exposure by almost $92.5 billion.

It has been questioned whether the take-out bonuses provide a cost-effective method for reducing Citizens' potential liability. On the one hand, payment of cash bonuses to insurers reduces Citizens' surplus to pay claims and may be a windfall to an insurer willing to take out a policy at its approved rate without the bonus. On the other hand, a take-out bonus may be viewed as a form of "reinsurance" that transfers 100% of liability for a policy for the period that a take-out insurer must continue to renew the policy, and reduces potential assessments on the entire market.

Beginning on January 1, 2008, SB 1980 limits the bonus amount to $100 per policy and requires any take-out bonus paid to an insurer be conditioned on the insurer keeping the policy for five years. Citizens must evaluate the cost-benefit of approved take-out plans for which a take-out bonus is paid, by tracking whether properties removed from Citizens are later insured by Citizens.

Issue #5: Depopulation of Citizens
Options:

63. Develop a "keep-out" program for Citizens designed to encourage properties to be written by the private market before being bound by Citizens.
    - Can involve relaxed rate regulation by OIR for insurers who keep policies out of Citizens.

64. Allow authorized insurers to write non-homestead Citizens' policies on an individual risk rate basis.

65. Require the OIR to deem approval of a private insurer's rate for a property in the HRA if the private insurer's rate is lower than Citizens' filed rate.

66. Eliminate take-out bonuses.

67. Increase or decrease take-out bonuses.

68. Allow consumers to choose whether or not to stay in Citizens if the take-out company's rate exceeds those of Citizens by 25% or some other specified percentage.

69. Permit take-out companies taking 50,000 or more policies out of Citizens to charge Citizens' rates for a period of three years after take-out.

Issue #6 Agent Issues

Current Law:

One of the challenges to depopulating Citizens is the "Consumer Choice" law, enacted in 2002, the same year that Citizens was created. The prior law for the Residential Property and Casualty Joint Underwriting Association (RPCJUA) had provided that a policyholder was not eligible for coverage in the RPCJUA if an offer of coverage was made by an authorized insurer. But, the Consumer Choice law provides that a Citizens policyholder who receives an offer of coverage from an insurer in the voluntary market is not required to accept that offer and may remain in Citizens if the current agent of that insured is "unable or unwilling to become appointed for the takeout insurer." Therefore, the standard for eligibility for coverage from Citizens is no longer dependent on whether other coverage is available in the voluntary market, but on the status of the agent.

Citizens has adopted procedures in conjunction with OIR to comply with the Consumer Choice law while continuing to encourage the removal of policies from Citizens. Agent representatives associations assert, and Citizens representatives acknowledge, that the Consumer Choice law is much less disruptive to a Citizens policyholder and his or her agent and allows for a smoother transition to a take-out company, if the current agent is appointed by the take-out insurers. But, Citizens also reports that the law operates to reduce the number of policies taken out. Citizens estimates that for 2004, when about 158,000 policies were taken out of Citizens, an additional 39,000 policies were not taken out due to the provisions of the Consumer Choice law.

The Consumer Choice law is amended beginning July 1, 2007. As of July 1, 2007, Citizens has a 10-day waiting period for new applications. If an authorized insurer offers coverage during this period, the applicant is not eligible for coverage in Citizens regardless of whether the insurer appoints the agent who submitted the application.

Issue #6 Agent Issues
Options:

70. Provide insurance policy transparency

- provide the specific assessment information (CAT Fund, Citizens, FIGA, or PCJUA (if applicable)) by specific % and dollar amount. Contain no abbreviations for the entities.
- provide specific mitigation discounts by specific % and dollar amount for home mitigation by type of mitigation.
- provide insurance premium tax information by specific % and dollar amount.
- provide the agent's commission on the bill by specific % and dollar amount.

71. Repeal "Consumer Choice" or amend "Consumer Choice."
    - for new business only

72. Require the insurance agent to disclose the specific premium differential between the offer of coverage from the take out company and continuing coverage in Citizens with the same insurance agent.

73. Reduce agent commissions paid by Citizens.

74. Reduce agent commissions paid by Citizens for renewals only.

75. Do not apply the amount of a rate increase for calculating the agent's commission on renewal policies.

76. Change Citizens' agent commissions to a flat fee (fixed dollar amount).
[Similar to the Hawaii Hurricane Relief Fund's $25 flat fee]

77. Create statutory grounds for agent discipline (suspension, revocation or administrative penalties or fines) if an agent places a risk in Citizens without making reasonable efforts to keep it out of Citizens.

Issue #7: Citizens' Policy Issuance, Service, and Administration

Current Law:

Under current law, private market insurers can voluntarily adjust Citizens' wind-only policies if the insurer writes the other perils policy for the Citizens policyholder. SB 1980 required Citizens to report to the Legislature by February 1, 2007 on the feasibility of requiring insurers providing the non-wind coverage to issue and service Citizens' wind policies. In addition, beginning June 1, 2007, insurers writing the non-wind coverage are required to contract with Citizens to provide claims adjusting services for the wind coverage provided by Citizens in the high risk account.

Agents collect a commission for the sale of insurance and continued support associated with the insurance. Agent commissions are generally paid as a percentage of premium. The current commission levels filed by Citizens are: 10% for PLA (multi-peril residential), 10% for HRA residential (wind-only residential), 12% for CLA (multi-peril

commercial residential), and 12% for HRA commercial residential and HRA commercial (wind-only commercial residential and commercial).

Builder's risk insurance covers buildings and structures under construction, remodeling, or repair. It typically covers the same types of things as regular property insurance, such as damage from theft, fire, vandalism, wind, hail, and other accidental loss or damage to the property. Coverage usually extends until the building or structure is completed and/or accepted by the owner. It does not cover losses that occur before the project is started or after it is completed. This coverage is typically purchased by the building owner, rather than the contractor.

Currently, Citizens writes builder's risk policies in the high risk account only. The policy count is about 6,400 and the estimated insured value of the policies is $4.5 billion. In response to an inquiry from the OIR regarding why Citizens was writing builder's risk policies, Citizens reviewed the law and rules on the subject and determined it did not have statutory authority to write these policies. Therefore, Citizens' Board decided to discontinue writing such policies on July 15, 2006 and to non-renew existing policies as of November 1, 2006. After Citizens announced its decision to discontinue writing builder's risk policies, it learned this type of coverage was unavailable in the private market. Thus, in July Citizens made a filing which OIR approved, to renew existing builder's risk policies until December 31, 2006, but only with actuarially sound rates; to write new policies up to December 31, 2006 with actuarially sound rates; not to cancel any existing policies other than for standard cancellation reasons; and to review Citizens' underwriting policy on builder's risk insurance in November.

Issue #7: Citizens' Policy Issuance, Service, and Administration
Options:

78. Require insurers providing the non-wind coverage to issue and service Citizens' wind policies.
    - Note: Current law only requires insurers to adjust Citizens' wind policies beginning June 1, 2007.

79. Provide statutory authority for Citizens to write builder's risk policies in the high risk account.

80. Provide statutory authority for Citizens to write builder's risk policies in all Citizens' accounts rather than the high risk account only.

81. Prohibit Citizens from writing new builder's risk policies as of January 1, 2007.

82. Prohibit Citizens from writing new commercial-commercial insurance policies as of March 1, 2007.

IV. Market Issues

Issue #1: Insurance Capital Build-Up Incentive Program

<u>Current Law</u>:
Senate Bill 1980 appropriated $250 million from General Revenue to the State Board of Administration (SBA) for lending state funds in the form of "surplus notes" to residential property insurers, under specified conditions:

- The insurer must contribute new capital to its surplus at least equal to the surplus note and must apply to the SBA by July 1, 2006.
- If the insurer applies after July 1, 2006, but before June 1, 2007, the surplus note is limited to one-half of the new capital contributed by the insurer. No applications are permitted after June 1, 2007.
- The amount of the surplus note may not exceed $25 million or 20 percent of total funds available for the program (resulting in a $50 million cap).
- The combination of surplus, new capital, and the surplus note must be at least $50 million.
- The surplus note must be repayable to the state, with a 20-year term, at the 10-year Treasury Bond interest rate (with interest-only payments for the first 3 years). The Insurance Commissioner must approve the payments on the surplus note, unless he determines the payment would substantially impair the financial condition of the insurer.
- The insurer must meet a minimum writing ratio of net written premiums to surplus of at least 2 to1 for the term of the surplus note, for residential property insurance in Florida covering the peril of wind. (The SBA has allowed flexibility on this requirement, based on its authority to increase the interest rate on the surplus note if the 2 to 1 ratio is not met.)
- The SBA may approve issuance of a surplus note to an applicant, unless the SBA determines that the financial condition of the insurer and its business plan place an unreasonably high level of financial risk to the state of nonpayment in full of the interest and principal.

Current Status: As of 9/28/06, a total of ten insurers have applied for $225.5 million in surplus notes. The SBA has approved the issuance of surplus notes of $20 million each to two insurers and $25 million to one insurer, with seven applications pending, requesting between $20-$25 million each.

<u>Options:</u>

83. Provide additional funding (e.g. $250 mil. - $500 million) for the program for 2007.

84. Lower the total surplus requirement (counting the surplus note) for an eligible insurer from $50 mil. (e.g., to $30 million or $40 million).

85. Give the OIR the discretion to approve, in conjunction with the Administrators of the program, the ability to approve a smaller company's business plan that may seek an amount of combined surplus at a level less than 50 million (perhaps a minimum of 20 million of combined surplus).

86. Relax the requirement that insurers maintain a 2 to 1 ratio of net premiums to surplus. For example, lower the minimum writing ratio to 1.5 to 1. Alternatively, establish a minimum "gross premium" rather than "net premium" to surplus ratio. (Net Premiums = Gross Premiums minus reinsurance premiums ceded)

87. Give the OIR the discretion to loosen the 2:1 ratio on a case by case basis (perhaps up to a 6:1 gross premium to surplus).

88. Provide that the date of application for a surplus note and the date of issuance of such funds must be prior to April 1, 2007. (Prior to the 2007 storm season and in time to purchase reinsurance)

Issue #2: Rate Regulation

<u>Current Law</u>:
"File and Use" or "Use and File" -- Property insurers are required to file rates for approval with OIR either 90 days before the proposed effective date ("file and use") or 30 days after the rate filing is implemented ("use and file"). Under the "use and file" option, an insurance company may be ordered by OIR to refund to its policyholder that portion of the rate found by OIR to be excessive. The insurer has the burden of proof in a rate filing to demonstrate that the rate is not excessive, inadequate, or unfairly discriminatory.

Arbitration -- If OIR disapproves a rate filing, the insurer may request an administrative hearing before an Administrative Law Judge of the Division of Administrative Hearings, who issues a recommended order to OIR. The final order by OIR may reject or modify the conclusions of law in the recommended order, but may not substitute findings of facts which were supported by competent substantial evidence. An insurer may then appeal OIR's final order to the First District Court of Appeal.

As an alternative to an administrative hearing, an insurer may request binding arbitration of a rate filing before a panel of three arbitrators -- one selected by the insurer, one by OIR, and the third by the other two arbitrators. The decision of the arbitration panel constitutes final agency action, but either party may apply to the circuit court to vacate or modify the panel's decision under limited grounds.

Reinsurance Costs -- Current law allows an insurer to recoup its "reasonable" costs of reinsurance, but the burden is on the insurer in a rate filing to demonstrate that its proposed rate is not excessive, inadequate, or unfairly discriminatory.

Million Dollar Homes -- SB 1980 placed the burden on OIR to establish that a proposed rate is excessive for personal lines residential coverage with insured value of $1 million or more.

Flex Rating -- SB 1980 provided that in those areas for which OIR determines that a reasonable degree of competition exists, an insurer may increase or decrease rates for residential property insurance by up to 5 percent on a statewide average, or 10 percent for any territory, without being subject to a determination by OIR that the rate is excessive or unfairly discriminatory. This may be used by an insurer once in a 12-month period. (Effective July 1, 2007).

Profit Factor -- SB 1980 required OIR to approve a rating factor that provides an insurer a reasonable rate of return that is commensurate with the risk of covering hurricane losses, for that portion of the rate for which the insurer has exposed its capital and surplus and has not purchased reinsurance.

Recoupment of Assessments -- Insurers are allowed to recoup from their policyholders regular assessments levied for deficits by Citizens, pursuant to a recoupment rate filing approved by OIR. If an insurer is reducing its premium writings (i.e., non-renewing policies or limiting new writings) this results in the insurer recouping a higher percentage assessment from its policyholders, compared to the percentage assessment paid by the insurer (based on the insurer's premium writings in the year prior to the deficit being incurred), in order to fully recoup the dollar amount it was assessed. However, the law limits the assessment factor to no more than 3 percentage points above the insurer's percentage of the assessment (based on premium writings in the year the assessment is paid). If the insurer fails to collect the full amount of its assessment, the insurer may carry forward the amount of the uncollected assessment to subsequent years.

Options:

89. Repeal the "use and file" option that allows an insurer to implement a rate increase prior to approval, subject to an order to refund amounts determined to be excessive.

90. Repeal arbitration (which allows an insurer to submit a rate filing to an arbitration panel for final resolution, as an option to an administrative hearing).

91. Move towards a deregulated, market-based rate setting structure, focusing on regulating the insurer's overall risk-adjusted rate of return on equity, recognizing the risk of catastrophe in Florida.

92. Allow insurers to include the cost of reinsurance in their rates with the burden of proof on OIR to prove the reinsurance costs added are excessive.

93. Expand flex rating by allowing residential property insurers to increase or decrease rates by up to 5 percent on a statewide average, or 10 percent for any territory, without being subject to a determination by OIR that the rate is excessive or unfairly discriminatory (i.e., delete the current requirement that this applies only in areas for which OIR determines that a reasonable degree of competition exists).

94. Prohibit an insurer from recouping a Citizens regular assessment from its policyholders at a percentage of premium that exceeds the percentage of premium that was levied on the insurer. (This would prevent insurers from fully recouping an assessment if its premium writings decrease. This would not affect insurers whose premium writings increase or remain constant.)

Issue #3: Solvency

Current Law:

Property insurers are required to have $5 million in surplus in order to obtain a certificate of authority. After licensure, the insurer must maintain a surplus of not less than the greater of $4 million or 10 percent of its total liabilities.

A property insurer's written premium to surplus ratio may not exceed 4 to1 for net written premiums, or 10 to 1 for gross written premiums. (Net Premiums = Gross Premiums minus reinsurance premiums ceded.)

OIR requires that a property insurer have surplus and reinsurance sufficient to cover its estimated 100-year probable maximum loss, based on an approved hurricane loss projection model, but this requirement is not in the statutes or in rule.

Options:

95. Increase the minimum surplus requirement for property insurers from $5 million to $10 million.

96. Statutorily require that a property insurer have surplus and reinsurance sufficient to cover its estimated 100-year probable maximum loss, based on an approved hurricane loss projection model.

Issue #4: Reinsurance and Capital Markets Alternatives

Current Law:

Florida law (s. 627.610, F.S.) allows for insurers to receive credit on their financial statements for reinsurance ceded to (purchased from) a reinsurer, referred to as the "assuming insurer" only if the assuming insurer is:

(a) authorized (licensed) in Florida;

(b) authorized or licensed in another state and has a surplus of at least $20 million (and meets certain other requirements); or

(c) an insurer (such a non-U.S. insurer) that maintains a trust fund in a qualified U.S. financial institution in an amount not less than the insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers (i.e., a 100% "collateral" requirement), plus at least $20 million (or $100 million for a group of underwriters, such as Lloyds). Such insurers must also submit to U.S. jurisdiction and to certain examination and filing requirements of U.S. regulators.

Options:

97. Reduce or eliminate the trust fund (collateral) requirement for non-U.S. insurers based on a determination by the OIR of the adequacy of regulation of the country of licensure and the financial strength of the assuming insurer.

98. Amend the reinsurance law to give insurers credit on their financial statements for other risk transfer or capital markets instruments, provided there is a fully funded transfer of risk.

99. Promote and facilitate the use of capital markets risk transfer alternatives by amending the insurance laws to authorize OIR approval of Special Purpose Reinsurance Vehicles for the securitization of an insurers' risk (NAIC Model Act).

100. Establish a state facility (e.g., within the State Board of Administration) to hold and invest funds invested (risked) by non-insurance entities, such as pension funds or individuals, covering specified hurricane losses for Florida insurers.

101. Authorize the Florida Hurricane Catastrophe Fund to use catastrophe bonds, sidecars, and other capital markets alternatives to transfer the risk of Cat Fund coverage.

102. Establish an insurance exchange in Florida to securitize and market to investors specified levels of hurricane catastrophe risk of insurers. Alternatively, work with existing exchanges that trade risk transfer products (e.g., the Chicago Mercantile Exchange) to determine if a Florida hurricane risk contract can be structured.

Issue #5: Tax Deductibility of Catastrophe Reserves

Current Law;

U.S. tax law does not allow for an insurer to deduct from income taxation, as an expense, amounts established as a catastrophe reserve. Only reserves for known or incurred losses may be deducted.

Option:

103. Seek an IRS opinion allowing insurers to deduct catastrophe reserves if such reserves are deposited with and maintained by the state (such as the State Board of Administration).

104. Seek an IRS opinion allowing insurers to deduct a "catastrophe premium equalization tax" charged and held by the state in a segregated account for the benefit of insurers for use in the event of a catastrophe.

Issue #6: Required Writing of Property Insurance

Options:

105. Prohibit an insurer from writing any type of property or casualty insurance in Florida unless the insurer also writes property insurance. This would apply only to those insurers which write property insurance in another state, or whose parent company writes property insurance in another state.

Issue #7: Florida Domestic Subsidiaries of National Companies

Current Law:

This is currently not addressed in the Florida law specifically. However, between 1996 and 1999, then–Insurance Commissioner Bill Nelson issued Consent Orders allowing the formation of Florida subsidiaries for First Florida (Travelers), State Farm Florida, Allstate Florida and other national companies.

Options:

106. Prohibit the licensure of a Florida domestic property insurance company that is a subsidiary of an insurance company writing property insurance in other states. (Apply prospectively)

107. Require that the parent company (national writer) guarantee the payment of claims for a Florida domestic subsidiary that is rendered insolvent. (Apply prospectively to policies issued or renewed after effective date.)

108. Alternatively, if the parent company does not cover the claims of an insolvent Florida subsidiary company, revoke the certificate of authority of any affiliated insurer.

Issue #8: Commercial Property Insurance

Current Law:
The only commercial, non-residential, coverage provided by Citizens is wind-only coverage for commercial properties located in the designated "high-risk"

territories. Coverage is limited to $1 million (i.e., a building valued over $1 million is eligible for coverage up to $1 million.)

Pursuant to an emergency rule adopted by the Financial Services Commission, the OIR recently activated the Florida Property and Casualty Joint Underwriting Association (FPCJUA), to write windstorm-only coverage for commercial property insurance statewide, other than in the high-risk territory of Citizens. Under the current plan, only buildings valued at $1 million or less are eligible for coverage. Any deficits are assessed against commercial property insurers, limited to 10% of net written premium. The assessment base is about $1.3 billion, which limits annual assessments to $130 million. (In comparison, each account of Citizens has an assessment base of about $8 billion.)

Options:

109. Expand the authority for Citizens to write commercial property insurance, rather than PCJUA. (One entity – Citizens) Considerations:

a. Whether full coverage or wind-only coverage should be provided.
b. Whether coverage should be offered statewide or only in designated areas.
c. Whether coverage should be limited to a specified amount or whether eligibility should be limited to a building valued at or below a specified amount.
d. One account for commercial, assessments for deficits, solely to commercial insureds.

110. Expand the authority for PCCJUA to write commercial property insurance, rather than Citizens (in wind and non-wind areas). Prohibit Citizens from writing builders risk or commercial-commercial policies. Revise and update the PCJUA statute. (One entity – PCJUA)

111. Clarify whether Citizens is authorized to issue builders risk policies. (See also #81)

112. Require Citizens commercial-commercial rates to be at a similar level as the PCJUA by June 1, 2007. (See also # 82)

113. Require Citizens agent commissions for commercial-commercial policies to be no higher than the PCJUA agent commission percentage.

114. Require Citizens commercial-commercial rates to consider surplus line rates along with the top five commercial insurers' rates.

115 Expand the assessment base for the FPCJUA to be the same as the assessment base for Citizens (all property insurance, rather than just commercial property insurance).

116. Determine what changes to the FPCJUA law may be necessary in order to achieve tax-exempt status (Similar to Citizens).

117. Adopt statutory changes to allow risk pooling for windstorm property coverage for public hospitals and (Safety-net Alternative risk Pool).

118. Adopt changes to the captive insurer law (pursuant to 10/26 presentation).

119. Revise the Florida Market Assistance Plan (FMAP) to provide for more efficiency and separation of duties between Citizens and FMAP. Refine FMAP duties for residential and commercial insurance.

120. Expand the CAT Fund to include commercial insurers on a temporary basis at a "near market" rate. (See also # 13)

V. Consumer Issues

Issue #1: Insurance Consumer Advocate

Current law:

Section 627.0613, F.S., provides the powers and duties of the Consumer Advocate. The Consumer Advocate is appointed by the Chief Financial Officer (CFO) to represent the general public before the Department of Financial Services (Department) and the Office of Insurance Regulation (OIR). The Consumer Advocate can appear in any proceeding before the Department or the OIR, such proceeding before the Division of Administrative Hearings or an arbitration panel. The Consumer Advocate has access to all files, records or data in the Department or the OIR. The Consumer Advocate can examine any rate or form filing. Finally, the Consumer Advocate can hire consultants as necessary to fulfill its duties.

The total current budget of the Office of Consumer Advocate is just under one million dollars. Senate Bill 1980 appropriated $250,000 to the Office of the Insurance Consumer Advocate. Legislation in 2005 appropriated an additional $350,000 to this Office.

Options

121. Grant the Consumer Advocate discovery rights in proceedings.

122. Provide the Consumer Advocate specific authority to *initiate* proceedings.

123. Provide the Consumer Advocate specific authority to challenge OIR written orders.

124. Grant the Consumer Advocate specific authority to review and challenge the underlying assumptions in the public hurricane loss projection model.

125. Clarify the Consumer Advocate's independent authority.

126. Authorize the Office of the Public Counsel (who is under the Legislature and represents the public in utility hearings) to represent the public in insurance rate hearings (rather than the Insurance Consumer Advocate appointed by the Chief Financial Officer). Therefore, relocate the Insurance Consumer Advocate into the current Office of Public Counsel.

127. Authorize the Office of the Consumer Advocate to be under the Financial Services Commission (Cabinet) rather than the CFO.

128. Increase funding to the Office of the Insurance Consumer Advocate.

129. Provide a specific rate request trigger (10%, 20%, 30%, etc) or total premium amount impact (by aggregate dollar amount) that would determine when the Consumer Advocate would have jurisdiction IF AND ONLY IF additional powers are granted to the Consumer Advocate (See 121 – 124).

Issue #2: Restrictions on Non-Renewal

<u>Current Law</u>:

Insurers are generally allowed to non-renew policies in order to reduce the insurer's hurricane exposure or to non-renew particular policies pursuant to underwriting rules filed with OIR. However, the law prohibits insurers from non-renewing policies due to property insurance claims that are the result of an "act of God" unless the insured has failed to take actions reasonably necessary to prevent recurrence of damage The law also prohibits nonrenewal solely because of race, color, creed, marital status, sex, or nation origin.

Insurers are required to give policyholders 90 days' notice of cancellation or nonrenewal of a residential property insurance policy, except that 10 days' notice is required if cancellation is due to non-payment of premium.

Insurers are prohibited from canceling or nonrenewing a residential property insurance policy during the duration of a hurricane, until 72 hours after the last hurricane watch or warning is issued anywhere in the state. Insurers are also prohibited for canceling coverage for a dwelling damaged by a hurricane until 90 days after the dwelling has been repaired, with certain exceptions.

Options:

130. Require insurers to provide a longer notice period prior to nonrenewal (e.g. 6 months or one year, rather than 90 days) for a policyholder who has been insured for at least 3 years, without any claims.

131. Prohibit non-renewal solely due to the age of the dwelling. (This would not restrict non-renewal based on specific structural conditions).

132. Prohibit the use of "age of home" as the sole underwriting reason for denying coverage. All homeowner mitigation and building code upgrades must be considered by carriers in reviewing whether coverage will be provided.

Issue #3: Excluding or Limiting Windstorm Coverage; Deductibles; Other

Current Law:
Current law requires residential property insurance policies to cover windstorm and hurricane losses, unless the policy is issued in the high-risk territory of Citizens.

Insurers must offer residential hurricane deductibles of 2%, 5%, and 10% of policy limits, but for homes valued under $100,000, the insurer must also offer a $500 hurricane deductible. The maximum allowable deductible is 10% of policy limits, except that no limit applies to homes valued in excess of $500,000 and higher deductibles are allowed for certain programs that were "grandfathered in." The secondary mortgage market where mortgages are bought and sold may restrict residential hurricane deductibles. For example, Fannie Mae, a secondary mortgage market company, accepts hurricane deductibles only up to 5%.

Options:

133. Allow (or require) insurers to offer a policy that excludes windstorm coverage from a residential property insurance policy if the policyholder signs a written rejection of such coverage on a form approved by OIR with appropriate disclosures. Insurers would still be required to offer a policy that includes windstorm coverage. (In windstorm and non-windstorm areas of the state)

134. Require insurers to offer dwelling limits for windstorm coverage that only covers the outstanding balance of the mortgage.

135. Eliminate maximum allowable deductibles. That is, allow insurers to offer deductibles of any amount in addition to the 2%, 5%, and 10% deductibles that must be offered.

136. Provide a state loan guarantee program as an incentive for the private sector to provide loans for homeowners who elect large deductibles (e.g. 10%). The

State would be liable if the homeowner defaults on the loan, in which case the State would have a lien on the property.

137. Allow (or require) insurers to guarantee renewal if the policyholder elects a specified hurricane deductible (e.g., 5% or 10% of policy limits, rather than 2%).

138. Allow insurers to offer policies that provide no personal contents coverage.

139. Require insurers to offer coverage limits which are less than the full replacement cost of the dwelling. (less than the full replacement cost of the dwelling, when no mortgage exists.) NOTE: Residential claim payments will be prorated by the % of value insured unless this was restricted by law.

Issue #4: Disclosure of Premium Costs ("Transparency")

Current Law:

The premium notice for a residential property insurance policy must specify the amount of the premium that is for windstorm coverage.

Insurers must notify policyholders upon application and renewal of the availability and range of premium discounts for mitigation techniques and describe generally what actions the policyholders must take to obtain the discounts.

Insurers are allowed but not required (due to the law being silent) to itemize in the premium renewal notice the amounts recouped for assessments by Citizens, the Florida Hurricane Catastrophe Fund, or the Florida Insurance Guaranty Association.

For homeowners policies, insurers must provide a comprehensive checklist of coverage on a form adopted by the Financial Services Commission and an outline of coverage. The outline of coverage must include a description of the principal benefits and coverage and an itemization of the applicable premium. The outline must also include a description of the credit or surcharge plan that is being applied and the reason why the policy is being surcharged or is receiving a credit. The checklist must include discounts applied to the premium.

Options:

140. Require the premium notice to specify premium credits available for that particular policyholder for each mitigation measure and for a combination of various mitigation measures, in a format specified by OIR.

141. Require that the premium notice to identify amounts recouped for assessments by Citizens Property Insurance Corporation, the Florida Hurricane Catastrophe

Fund, or the Florida Insurance Guaranty Association, respectively. Prohibit abbreviations.

142. Require the premium notice to identify the amount of any premium increase that is due to a rate increase and the amounts that are due to coverage changes.

143. Require the premium notice to include the amount (by dollar and percentage) of the agent's commission.

Issue #5: Consumer Issues

<u>Options</u>:

144. Provide state payments to low-income and moderate-income policyholders (e.g., 120% of median income) to subsidize the cost of increased insurance costs. Possible limitations:

a. Limit to homestead property valued under a specified amount (e.g. $300,000).
b. Require that current premium, compared to prior year, increased more than a specified percentage (e.g. 1%) of the policyholder's annual income (e.g. a policyholder with a $30,000 annual income must have at least a $300 increase).
c. Limit grant amounts to a specified percentage (e.g., 50%) of the annual premium increase, subject to a maximum amount (e.g. $1,000).
d. Allocate grant funds to counties based on number of homestead properties and average premium increases in the county.
e. Possible revenue source: Affordable Housing Trust Fund (surplus of about $500 million).

145. Require insurers to offer quarterly and semi-annual payment premium payment plans. (SB 1980 required Citizens to do this.)

146. Require insurers to pay claims for Additional Living Expense within 72 hours of the claim.

147. Require the OIR to approve for Citizens an Age of Home debit/surcharge plan that is no less than the Age of Home debit/surcharge plan approved by OIR for any one of the top 20 insurers with the greatest direct written premium in the state.

148. Create a reverse mortgage program that allows a homeowner to access home equity to pay their homeowners insurance premiums for homeowners with home equity that exceeds the difference in fair market value less the current mortgage amount owed subject to lending restrictions.

149. Adopt recommendations in the area of manufactured housing related to insurance policy options for manufactured home owners and providing carrier

incentives related to the Insurance Capital Build-up Program funds for carriers who write manufactured homes.

VI. Federal Issues

CURRENTLY FILED

- H.R. 4366, introduced by Congresswoman Brown-Waite, establishes the Consumer Hurricane, Earthquake, Loss Protection (HELP) Fund to pay for payments to covered purchasers under contracts for reinsurance coverage for eligible losses. (S. 3117 by Senator Nelson)

- H.R. 4836, introduced by Congressman Feeney, creates tax-exempt catastrophe savings accounts that allow account holders to make tax-free withdrawals to pay expenses resulting from a Presidentially declared disaster. (S. 3115 by Senator Nelson)

- H.R. 5587, introduced by Congressman Meek, creates a Catastrophic Disaster Risk and Insurance Commission to assess the property and casualty insurance and reinsurance markets in the aftermath of Hurricanes Katrina, Rita, Wilma, and the four hurricanes of 2004, and the ongoing exposure of the United States to natural disasters. (S. 3114 by Senator Nelson)

- H.R. 5891, introduced by Congresswoman Wasserman-Schultz, creates a Catastrophic Disaster Risk and Insurance Commission to assess the property and casualty insurance and reinsurance markets in the aftermath of Hurricanes Katrina, Rita, Wilma, and the four hurricanes of 2004, and the ongoing exposure of the United States to natural disasters. (S. 3114 by Senator Nelson)

- S. 3116, introduced by Senator Nelson, allows insurance companies (other than life insurance companies) to make tax deductible contributions to a tax-exempt policyholder disaster protection fund for the payment of policyholders' claims arising from catastrophic events.

NOT CURRENTLY FILED

- Amend Federal law to offer a federal income tax credit for all expenses directly used to retrofit homes (mitigation) or pay consumer insurance premiums with state funds. Similarly, during the 1970 – 1980 time period the Federal Tax Laws allowed tax credits to reduce the use of energy.

Options:

150. Approve a Motion endorsing H.R. 4366, H.R. 4836, and S. 3116. And endorse the filing of legislation that provides federal income tax credit for all home retrofitting expenses (mitigation) or premium grants provided by State or local government.

PROPERTY & CASUALTY INSURANCE REFORM COMMITTEE INITIAL RECOMMENDATIONS

(11/15/06)

Residential Insurance Market/Consumer Issues

1. Transparency for consumers (residential and commercial). Require the *premium notice and policy* to

   - specify premium mitigation discounts available (by dollar amount) for each policyholder on each mitigation measure and for a combination of various mitigation measures, in a format specified by OIR.

   - identify amounts recouped for assessments by Citizens Property Insurance Corporation (Citizens), the Florida Hurricane Catastrophe Fund (CAT Fund), or the Florida Insurance Guaranty Association (FIGA), respectively. Prohibit abbreviations.

   - identify the amount of any premium increase that is due to a rate increase and the amounts that are due to coverage changes.

   - identify the amount (by dollar) of the agent's commission.

   - identify the amount of insurance premium tax by dollar amount.

   - require plain language in insurance policies

2. Move the Office of the Consumer Advocate under the Financial Services Commission (Cabinet) rather than the Chief Financial Officer for oversight. Request the Legislature review the authority currently vested in the Consumer Advocate regarding independence and effectiveness for Florida consumers.

3. Require insurers to offer a policy that excludes windstorm coverage from a residential property insurance policy if the policyholder signs a written rejection of such coverage on a form approved by OIR with appropriate disclosures. Insurers would still be required to offer a policy that includes windstorm coverage. (In windstorm and non-windstorm areas of the state)

4. Require insurers to offer dwelling limits for windstorm coverage that only covers the outstanding balance of the mortgage.

5. Require insurers to offer policies that provide no personal contents coverage.

6. Eliminate maximum allowable deductibles. That is, allow insurers to offer deductibles of any amount in addition to the 2 percent 5 percent, and 10 percent deductibles that must be offered.
7. Revise the Florida Market Assistance Plan (FMAP) to provide for more efficiency. Refine the FMAP guidelines to allow that during the 10 day waiting period applicable to Citizens policies, that an exclusion is in place for any potential insured who has a real estate closing during the 10 day waiting period.

Florida's Commercial Insurance Market/Property Casualty Joint Underwriting Association (PCJUA)

8. Develop a plan to depopulate Citizens commercial risks to either the PCJUA or create a new statewide entity for all commercial risks. Prohibit Citizens from writing builders risk or commercial-commercial policies. Revise and update the PCJUA statute or new entity by expanding and updating the assessment base for the PCJUA. Seek to achieve IRS tax-exempt status for the PCJUA (Similar to Citizens).

9. Begin state funded research concerning mitigation of commercial structures. Evaluate whether strengthening the state's building code for commercial structures should be considered and the grading of commercial structures.

10. Adopt statutory language to allow risk pooling for windstorm property coverage all "like" entities such as public hospitals. (Safety-net Alternative Risk Pool proposal).

11. The Legislature shall review the market needs for adding commercial carriers to the CAT Fund and consider optional CAT Fund coverage to commercial insurers, for a limited time period.

Florida Building Code

12. Put a uniform statewide building code in place that requires American Society of Civil Engineers (ASCE) wind lines to be adopted and prohibit any changes in future statewide building codes unless such a change enhances the structural integrity of the code as it relates to wind protection.

13. Develop a code plus standard that the insurance industry would recognize for maximizing premium discounts.

14. Encourage local governments to promote and advocate for code plus structures by providing incentives to builders like density bonuses, lower impact fees, and concurrency credits when new construction is built at *higher levels* than the current approved building code.

Mitigation

15. Maintain and expand the commitment to the Mitigation Program being administered by the Department of Financial Services. Earmark a portion of future mitigation funding to be used for Citizens policyholders.

16. Require the modeling firms (RMS, AIR, ARA, EQE and FIU) to recalibrate their models to take into account the results of mitigation in Florida.

17. Require uniform mitigation verification inspection forms to be developed for all insurers. Specify the length of time an executed form is valid (spoilage).

18. Ensure that insurance companies appropriately adjust premiums for homeowners when meaningful and verifiable mitigation measures are undertaken. (Premium discounts) Standardized or uniform credits with smaller ranges should be developed while allowing market competition in the credit process.

19. Authorize the creation of a not-for-profit corporation to raise funds from the private sector for additional mitigation grants.

20. Recommend an appropriation from the Legislature SOLELY for free inspections to encourage more homeowners to mitigate regardless of whether matching grants are available.

21. Create a Sales Tax Rebate Program where consumers can apply to the Florida Department of Revenue for sales tax credits/rebates for approved mitigation materials and supplies. Require the filing of a mitigation verification inspection form as proof of purchase with the Department of Revenue.

22. Ensure insurance companies and agents are providing specific information to homeowners who want to know the premium discounts available for various mitigation options and the means for obtaining the discounts (e.g., continuing education requirements for agents).

23. Develop public/private partnerships to educate homeowners regarding the advantages of fortifying their homes.

24. Adopt and fund a uniform grading system for evaluating the hurricane strength of homes and commercial buildings.

25. Require wind mitigation inspectors to be licensed or certified by the state with exceptions for licensed contractors. Licensed contractors shall be exempt, if a continuing education course in mitigation is completed.

26. Encourage local governments to participate in the state mitigation program.

Florida Hurricane Catastrophe Fund (CAT Fund)

27. The Legislature should maintain the current retention level but consider offering coverage below the retention level/attachment point (first layer of coverage) on a voluntary basis to all admitted companies participating in the CAT Fund. Any change should only be temporary/short-term. The rate for the temporary, below the current retention level, CAT Fund coverage should be increased to a "near market rate" but still allowing for savings which can be passed to consumers.

28. Investigate raising the upper limit (currently $15 billion) to foster greater participation and determine how this modification will effect availability and affordability of premiums and determine what the private market's needs are above the upper limit of the CAT Fund.

29. Research moving the renewal date (sometime before June) to increase flexibility and maximize carrier participation in the CAT Fund. Review whether such a date change could produce premium savings to consumers.

30. Amend the State Constitution to limit the use of the assets of the CAT Fund (i.e., restrict legislative appropriations) to the purposes currently required by statute. Require that any appropriation from the CAT Fund in excess of $10 million be in a separate bill for that purpose only and be approved by a super-majority (e.g., three-fourths) of the membership of each house of the Legislature.

Reinsurance Market

31. Amend the reinsurance law to give insurers credit on their financial statements for other risk transfer or capital markets instruments, subject to the approval of OIR, provided there is a fully funded transfer of risk.

32. Reduce or eliminate the trust fund (collateral) requirement for non-U.S. insurers based on a determination by the OIR of the adequacy of regulation of the country of licensure and the financial strength of the assuming insurer.

Citizens Property Insurance Corporation (Citizens)

33. Require the Office of Insurance Regulation to set rates for Citizens on a semi-annual or annual basis, based on the highest rate approved for the voluntary market, thus, eliminating the need, cost and time delay of rate filings.

34. Allow Citizens to write the full policy. Do away with the wind boundaries and the distinction of wind and ex-wind policies in the wind boundaries.

35. Require Citizens policyholders to upgrade their homes to meet the statewide building code over some period of time or risk higher hurricane deductibles applicable to their policies. An exception should be made for low income policyholders. Or alternatively, permit Citizens to surcharge properties until they are retrofitted to meet building code requirements.

36. Allow authorized insurers to write non-homestead Citizens' policies on an individual risk rate basis.

37. Allow as an incentive for companies taking out substantial numbers of policies (10,000 or more) from Citizens to charge Citizens' rates for a period of three years after such take-out.

38. Clarify the requirements in SB 1980 regarding the offer of quarterly and semi-annual payment premium payment plans to Citizens policyholders.

Market Incentives/Barriers

39. Provide additional funding to the Insurance Capital Build-up Incentive Program for 2007 with some capital being set aside for insurers specifically writing manufactured housing policies. The Legislature should consider lowering the total surplus requirement for an eligible insurer from the current $50 million. The Legislature should also consider relaxing the requirement that insurers maintain a 2 to 1 ratio of net premiums to surplus. Finally, the Legislature should consider providing that the date of application for a surplus note and the date of issuance of such funds must be prior to April 1, 2007. (Prior to the 2007 storm season and in time to purchase reinsurance)

40. To protect insurance policyholders, the minimum surplus requirement for property insurers (currently $5 million) should be evaluated for a possible upward revision.

41. Promote and facilitate the use of capital markets risk transfer alternatives by amending the insurance laws to authorize OIR approval of Special Purpose Reinsurance Vehicles for the securitization of an insurer's risk (NAIC Model Act).

42. Provide authorization for a state facility (e.g., within the State Board of Administration) to hold and invest funds invested (risked) by non-insurance entities, such as pension funds or individuals, covering specified hurricane losses for Florida insurers. (Protected cell)

43. Authorize the CAT Fund or State Board of Administration to use catastrophe bonds, sidecars, and other capital market products to transfer the risk of CAT Fund coverage.

44. Allow for state participation in an insurance exchange or possibly the establishment of an insurance exchange in Florida to securitize and market to investors specified levels of hurricane catastrophe risk of insurers. Alternatively, work with existing exchanges that trade risk transfer products (e.g., the Chicago Mercantile Exchange) to determine if a Florida hurricane risk contract can be structured.

45. Adopt changes to the captive insurer law to liberalize Florida law and encourage the maximum use of captives by Florida's businesses and the maximum formation of captives in Florida, where appropriate.

46. Seek an IRS opinion allowing insurers to deduct catastrophe reserves if such reserves are deposited with and maintained by the state (such as the State Board of Administration). Seek an IRS opinion allowing insurers to deduct a "catastrophe premium equalization deduction" charged and held by the state in a segregated account for the benefit of insurers for use in the event of a catastrophe.

47. Request the Legislature to review the Federal Emergency Management Act's (FEMA) reimbursement procedure for public school facilities and determine how the state university system's facilities are insured under Florida law as compared to public school facility structures.

Federal Issues

48. Endorse H.R. 4366 (national CAT Fund), H.R. 4836 (tax exempt CAT savings account), and S. 3116 (tax exempt CAT reserves). Endorse the filing of legislation that provides federal income tax credit for all home retrofitting expenses (mitigation) or premium grants provided by State or local government.

49. Seek federal funding of windstorm analysis/studies equivalent to federal funding for earthquake analysis/studies.

50. The Governor, President of the Senate and Speaker of the House of Representatives will write to our Congressional leadership supporting these federal issues.

EXHIBITS

1. Executive Order 06-150 dated June 27, 2006
2. Press Release dated July 26, 2006
3. Press Release dated August 7, 2006
4. Committee Agendas and Minutes
   (August 8 & 24, September 7 & 21, October 4, 12 & 26, 2006)
5. Hurricane Loss Chart – Summary Data by Event and CY (2004-2005)
6. Top 20 writers – Residential Market
7. Top 20 writers – Manufactured Housing Market
8. Citizens Premium and Exposure Chart
9. Top 20 writers – Commercial Market
10. Public School Facility – Insurance Survey/Summary
11. Builders Risk policy chart by county (Citizens)
12. Windstorm Boundary Map
13. Insurance Capital Build-up Program Summary

*** Note – Exhibits will be available in the final report.**