
Teleconference Proceedings

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Suggestions for Increasing Affordability and Availability of Property Insurance in Florida

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Note: Participation in the teleconference should not be interpreted as an endorsement or lack of endorsement of any of the observations or suggestions reported herein by any individual or organization listed above.

Purpose

Florida TaxWatch organized a teleconference with a broadly representative group of stakeholders to develop suggestions for contending with affordability and availability of property insurance. No attempt was made to evaluate or assess any suggestion other than to indicate any advantages or disadvantages that might have been noted by the participant offering a suggestion.

Current Situation

An unprecedented series of eight catastrophic storms over a 15-month period in 2004 and 2005 caused insured damages in Florida of over \$35 billion—an all time high for the state—second only to hurricane Andrew damage in 1992. A number of factors helped Florida recover from these storms.

A “Battle-Hardened” Emergency Management System. This has improved over time with each succeeding disaster.

More Effective Enforcement of Updated Building Codes. Effective enforcement of building codes is essential. After Hurricane Andrew, the State of Florida wisely updated building codes, which proved very efficacious in strengthening home construction so that newer and retrofitted properties could withstand more intense or prolonged exposure to storms.

State-Sponsored Insurance Structures. As illustrated by the chart¹ on page three of this document, the state has three insurance programs to augment private reinsurance and assure, as well as broaden, availability and affordability of property insurance:

- **The Florida Hurricane Catastrophe Fund (CAT Fund)** is a tax-exempt, state government trust fund administered by the State Board of Administration, which was created in 1993² as a source of low-cost reinsurance for residential property insurers. Currently, the CAT Fund could pay out \$15 billion backed by state bonding authority.³ Insurers purchase CAT reinsurance coverage in contracts signed at the beginning of the hurricane season and pay a premium established by the State Board of Administration. The premiums and private insurance costs paid by the companies are included in their rate bases and passed through to the policyholders. If there are seasons without a hurricane, premiums build up the cash reserve in the CAT. The CAT Fund may levy assessments on all property and casualty insurance premiums when bonding authority has been used to cover projected cash shortfalls in the fund.
- **The Citizens Property Insurance Corporation (Citizens)** is a state corporation created in 2002 through the merger of the Residential Joint Underwriters Association, which had been in existence since 1993, and the Florida Wind Storm Underwriting Association, established in 1972. Citizens Corporation provides property coverage for homeowners in high-risk (wind) areas and others who cannot find private property coverage.⁴ Citizens Corporation has experienced a disturbing and rapid rate of growth, which is an indication of a severe problem in availability of coverage. As of August 31, 2006, Citizens had over 1.2 million policies in force with an overall exposure of \$366 billion, up from 775,230 and \$198 billion in 2005. Citizens added 24,555 policies and \$23.3 billion in exposure in August 2006 alone.⁵ About 300,000 of the Citizens policies came about due to the insolvency of Poe Financial Group, which, at the time, was the largest Florida-only insurer.⁶

¹ Chart from State Board of Administration of Florida, “The Role of Private Capital in Florida’s Residential Property Insurance Markets,” September 19, 2006, p.11.

² [FS 2006, Section 215.555.](#)

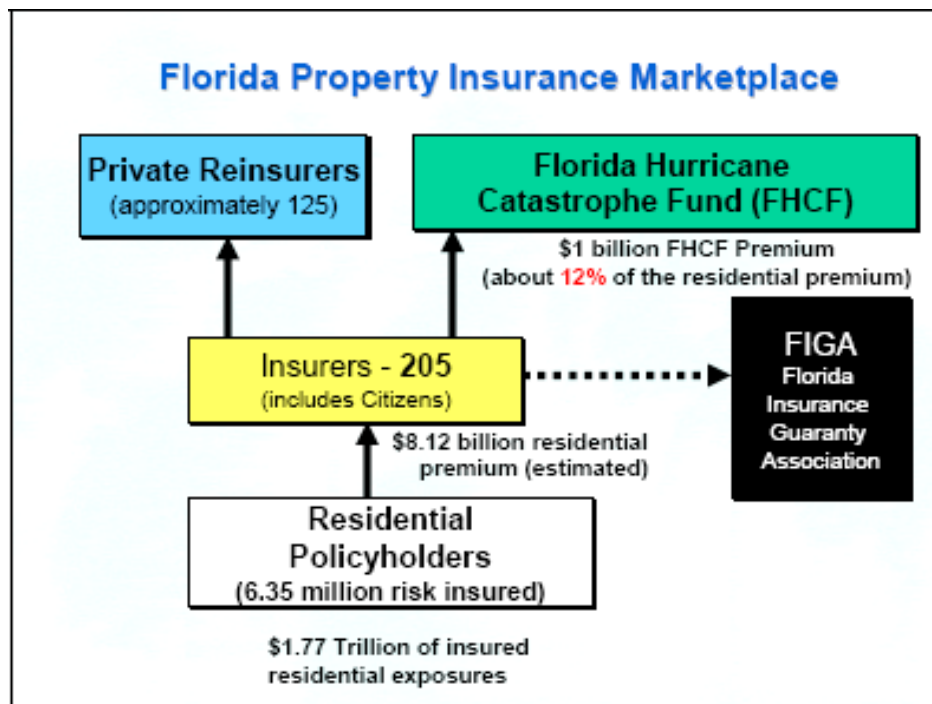
³ See the State Board of Administration, Florida Hurricane Catastrophe Fund website: <http://www.sbafla.com/fhcf/>, Online September 20, 2006.

⁴ See the Citizens website: <http://www.citizensfla.com>, Online September 20, 2006.

⁵ Citizens “Exposure Reports” for 2006 and 2005 available at http://www.citizensfla.com/Exposure_Prem_Reports.asp, Online September 20, 2006.

⁶ State Board of Administration, “Role of Private Capital...”, p. 13.

- **The Florida Insurance Guarantee Association (FIGA).** The state created this non-profit association in 1970 to pay unpaid claims following the insolvency of a property and casualty insurance company.



Factors Contributing to Lack of Availability and Affordability Problem

Natural Factors

- **Florida is hurricane prone.** The state is located in latitudes that expose it more frequently to tropical storms, which begin in tropical zones. One hundred ten (40.3%) of 273 hurricanes making direct hits on the United States from 1854 to 2004 hit Florida. Of the 273 hitting the U.S., 92 were severe storms (categories 3-5) -- 35 of those severe storms (38%) have hit Florida.⁷
- **Florida is a peninsula.** The Atlantic Ocean, Caribbean Sea, and Gulf of Mexico coastlines wrap almost completely around the Florida land mass and hurricanes are primarily coastline catastrophes. Most of Florida's population lives in coastal counties.
- **Catastrophic storms are increasing in number and severity.** Four of the strongest (category 5) storms recorded since 1935 have occurred in the last two years (Katrina, Ivan, Wilma, and Rita).⁸
- **Hurricanes are ruining increasingly more valuable properties.** Due to the combination of a seller's real estate market in the past three years, appreciating Florida property in general, and sharply

⁷ NOAA Technical Memorandum NWS TPC-4: THE DEADLIEST, COSTLIEST, AND MOST INTENSE UNITED STATES HURRICANES FROM 1851 TO 2004 (AND OTHER FREQUENTLY REQUESTED HURRICANE FACTS), by Eric S. Blake, Jerry D. Jarrell (retired), and Edward N. Rappaport, NOAA/NWS/Tropical Prediction Center, Miami, Florida, available at <http://www.nhc.noaa.gov/paststate.shtml>, Online September 20, 2006.

⁸ Mike Theiss website, EYE IN THE TROPICS, <http://www.mthurricane.com/>, Online September 20, 2006.

increased values for property located in natural wind zones, hurricane damage in Florida is becoming increasingly more expensive. Recent Florida hurricanes Ivan, Charley, Wilma, and Andrew, in particular, were among the most expensive in history.

- **More robust storm forecasting models.** As hurricane forecasting models become more sophisticated and sensitive, as a result of more timely and accurate data, the increasing frequency and cost severity of storms affecting Florida have resulted in grim predictions for the state. Reinsurers rely heavily on these models for assessing risk and determining prices.⁹

Market Factors

- **Atypical Reliance on Reinsurance.** Florida property insurance companies rely more heavily on reinsurance, including Florida's CAT Fund, than those in other states. Florida insurers "cede" approximately 50% of private residential insurance premiums to reinsurers, compared to about a third by other U.S. insurers, excluding Florida.¹⁰
- **"Hard Market" for Reinsurance.** According to the State Board of Administration, "Pricing at the beginning of calendar 2006 for private sector Florida hurricane risk reinsurance increased 50-70% from the prior year and increased another 50-100% on July 1, 2006."¹¹
- **Cost and Rate Pressure on Primary Insurers.** As hurricane models predict risks of loss above those which companies had previously planned for and as rating agencies demand that insurance companies provide additional capital to cover this increased risk in Florida or face a potentially lowered financial rating, the companies are placed in a quandary. Because there is little or no capital to commit to a market, which has produced nothing but net losses in recent years, the solution can only be to lay off risk. Thus Florida has an availability problem.

Suggestions and Observations of Teleconference Participants—Random Order and Not Evaluated. *Please Note that Listing of a Suggestion Absolutely Does Not Imply Endorsement by Each Teleconference Participant*

1. Provide more capital in the CAT Fund by raising existing cost from seven cents per \$1.00 of reinsurance coverage for CAT coverage above the first layer of losses that insurers must absorb.
2. Allow insurers to reinsure a higher percentage of losses, i.e., pay additional premiums for the first layer of losses that insurers must now absorb.
3. Expand the CAT Fund, which makes more sense, instead of stimulating investment in private reinsurance because the CAT Fund:
 - a. Is tax-free.
 - b. Does not incur agent commission costs.
 - c. Has no profit or contingency factor.
 - d. Does not represent a complete transfer of risk.

⁹ State Board of Administration, "Role of Private Capital...", p. 3.

¹⁰ Guy Carpenter, "The World Catastrophe Reinsurance Market", September 2006, as cited by State Board of Administration of Florida, "The Role of Private Capital in Florida's Residential Property Insurance Markets," September 19, 2006, p.10.

¹¹ State Board of Administration, "Role of Private Capital...", p.3 citing Credit Suisse (Equity Research Report: Reinsurance, August 21, 2006).

- e. Retains any fund surpluses in Florida and not shifted as profits to international reinsurers.
 - f. Acts as a shock absorber to smooth the cyclical nature of insurance economics and assure adequate short-term capacity to respond to catastrophes. Without something like the CAT Fund, the market would become very unstable.
4. Consider creation of a new joint underwriting assurance mechanism with a wider pool.
 5. Consider a regional pool of insurance coverage including Florida, Mississippi, Louisiana, Alabama and Texas among others, which might provide economies of scale for a solution to the problem.
 6. Consider clarifying coverage for wind and flood damage. Many claims were rejected by the insurance industry because the damage was caused by tidal surges, which are classified as floods instead of wind. Ultimately, this clarification may come about as a result of current litigation.
 7. It is politically unrealistic to expect elected officials not to seek lower rates. State policy therefore cannot be completely rational (i.e., free market) under the circumstances. This must be part of any planning scenario.
 8. There is a price problem and a cost problem. Individuals and businesses need to be exposed to the true price of insurance.
 - a. No one seems to know what portion of premiums cover risk and what covers actual damages experienced. This should be explained to the consumer.
 - b. Affordability and access problems have been exacerbated, because policy owners have not borne the true cost through premiums, and artificial pricing has obfuscated true costs. Those living in interior counties have historically cross-subsidized most policyholders in wind zones. If true risk pricing were put into place, wind zone policyholders would pay more and those living in the interior would pay less. However, this is not just an inland versus coastal issue.
 - c. Reduce the cost of losses by toughening and enforcing building codes and increasing maintenance, and establishing rehabilitation standards for existing properties.
 - d. Consider clarifying coverage for roofs. Establish a life for each type of roof (i.e., tile - 25 years; shingle - 20 years; metal - 30 years). Then establish the value for replacement per square foot. This value should be part of the full replacement value for the entire property. Each year, depending on the type of roof construction, the value is decreased by that pro rata amount (e.g., tile - 1/25th of roof value) and should the claim occur, the deductible is increased by that amount when there is roof damage. Each year this deductible increases until such time as the roof is replaced and then the depreciation cycle starts over. This would encourage the insured to properly care for a roof and replace it when its useful life expires.
 9. Statewide and local development permitting policies must be integrated into any hurricane risk and insurance remedies considered.
 10. The government and private sector should enter into advance purchasing contracts for such items as plywood, fuel, ice, bottled water, portable generators, and similar items to share risks with suppliers.
 11. Insurance companies should offer discounts and other incentives to encourage property owners to hurricane-harden their properties.

12. The Legislature should appropriate much more than the \$250 million already appropriated for house inspections to determine what retrofitting is necessary.
13. Matching grants up to \$5,000 for mitigation should be means tested.
14. Consider encouraging mitigation, as one participant suggested, through a sales tax exemption, possibly on hurricane protection type items.
15. Consider suggestions to the Governor made by State Board of Administration experts concerning attraction of private capital through a risk options exchange.

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