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DATE: February 18, 1998

**HOUSE OF REPRESENTATIVES
COMMITTEE ON
FINANCIAL SERVICES
BILL RESEARCH & ECONOMIC IMPACT STATEMENT**

BILL #: HB 3665 (PCB FS 98-03)

RELATING TO: Property Insurance

SPONSOR(S): Committee on Financial Services, Rep. Safley, and others

COMPANION BILL(S):

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

(1) FINANCIAL SERVICES YEAS 9 NAYS 0

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I. SUMMARY:

More than 5 years after Hurricane Andrew caused over \$16 billion in insured losses, Florida's private sector market for homeowners' insurance and other forms of residential property insurance remains unstable. As of January 1, 1998, Florida's two state-created property insurers of last resort, the Florida Windstorm Underwriting Association (FWUA) and the Residential Property and Casualty Joint Underwriting Association (RPCJUA), have a combined total of more than 900,000 policies in force, representing approximately \$135 billion in exposure. This bill addresses several aspects of this market instability.

In 1997, the FWUA law was amended to freeze the FWUA's geographic eligibility boundaries through October 1, 1998. This bill would extend the freeze indefinitely.

Since 1993, Florida laws have limited insurers' ability to terminate residential property coverage for reasons of reducing hurricane loss. The current versions of the moratorium on hurricane-related cancellations and nonrenewals (one version covers personal lines residential policies, and the other covers condominium association policies) expire on June 1, 1999. The bill would extend them until June 1, 2001.

All residential property policyholders are subject to assessments to cover deficits of the FWUA and the RPCJUA, and to fund bonds issued by the Florida Hurricane Catastrophe Fund. The bill would require all applications for residential policies and all residential renewal premium notices to contain or be accompanied by a specified notice of the insured's potential assessment liability.

II. SUBSTANTIVE RESEARCH:

A. PRESENT SITUATION:

More than 5 years after Hurricane Andrew caused over \$16 billion in insured losses, Florida's private sector market for homeowners' insurance and other forms of residential property insurance remains unstable. As of January 1, 1998, Florida's two state-created property insurers of last resort, the Florida Windstorm Underwriting Association (FWUA) and the Residential Property and Casualty Joint Underwriting Association (RPCJUA), have a combined total of more than 900,000 policies in force, representing approximately \$135 billion in exposure. These two insurers, which form the "residual" market for property insurance, cover approximately 14 percent of all residential properties statewide (measured by insured value), and more than 25 percent of all residential properties in Dade and Broward Counties.

Florida Windstorm Underwriting Association (FWUA) eligibility

The Florida Windstorm Underwriting Association was created in 1970 by subsection 627.351(2), Florida Statutes. The FWUA writes policies that cover only losses caused by windstorm, and writes these policies only in certain limited coastal areas. After Hurricane Andrew, the Insurance Department expanded FWUA eligibility to include Dade and Broward Counties east of I-95. Because of an amendment to FWUA eligibility in the 1996 property insurance law, properties east of I-95 in Palm Beach County and in coastal areas of Pasco County became eligible for the FWUA in 1997.

The FWUA provides personal lines and commercial lines property insurance policies (including both residential and non-residential policies) providing windstorm coverage to applicants who are unable to obtain coverage from an insurance company. In 1997, Chapter 97-55, Laws of Florida, (CS/SB 794) froze any further geographic expansion of the FWUA until October 1, 1998.

The FWUA charges premiums for the coverage it provides, but, as with the RPCJUA, when the premiums and other resources of the FWUA are not sufficient to pay claims, the FWUA has the power to levy assessments on insurance companies and their policyholders to generate the revenues necessary to cover the deficit. The FWUA has the power to issue bonds and other debt instruments, and to pledge its premiums, assessments, and other resources to pay off the debt. One of the purposes of the freeze on geographic expansion of the FWUA is to limit the potential size of future FWUA assessments.

The FWUA's exposure grew rapidly in 1997. As of the end of year, the FWUA had 417,342 policies in force, representing combined insured values of \$75.4 billion. The year-end 1997 policy count reflects an increase of 134,518 policies since year-end 1996, and the value of insured properties reflects an increase of \$26 billion in insured values since year-end 1996. Dade, Broward, and Palm Beach Counties accounted for 52 percent of the total policies in force and 53 percent of the insured values, and accounted for 59 percent of the FWUA's 1997 increase in policy count and 61 percent of the FWUA's 1997 increase in insured values.

Moratorium on hurricane-related cancellations and nonrenewals of residential policies

Soon after Hurricane Andrew, insurers began to reevaluate their Florida exposures, raising the possibility of a mass exodus from the Florida private sector residential property insurance market. Florida law, since May of 1993, has restricted the ability of insurers to use the possibility of hurricane losses as the basis for canceling or nonrenewing personal lines residential policies (i.e., homeowners', mobile home owners', condominium unit owners', and similar policies), and has, since June, 1996, applied similar restrictions on the cancellation or nonrenewal of condominium association policies.

In November 1993, a six-month absolute moratorium on hurricane-related cancellations and nonrenewals of personal lines residential policies was replaced by a three-year "moratorium phaseout," which was subsequently replaced by a "moratorium completion" that expires on June 1, 1999. The condominium association moratorium also expires on that date.

Subject to certain exceptions, the moratorium statutes prohibit an insurer from canceling or nonrenewing the policies it had in force on June 1, 1996, for the purpose of reducing hurricane losses, except that an insurer is allowed to cancel or nonrenew up to 5 percent of the policies statewide, or up to 10 percent in any county, during any 12-month period. The percentages apply separately to homeowners' policies, mobile home policies, all personal lines residential policies combined, and condominium association policies.

One of the exceptions created in the 1996 extension of the moratorium allows an insurer to take three years' worth of nonrenewals in one year, provided that the nonrenewals are limited to properties that are eligible for windstorm coverage from the FWUA, and provided that it does not take any further hurricane-related nonrenewals during the period. The approval of the Department of Insurance is required for these "accelerated exposure reduction plans."

Constitutionality of the moratorium

The constitutionality of the current personal lines moratorium was upheld by the U.S. District Court for the Northern District of Florida in the case of Vesta Fire Ins. Co. v. State of Florida, Department of Insurance.¹ The U.S. District Court's decision has been appealed to the U.S. Court of Appeals for the Eleventh Circuit, which has scheduled oral argument for February 13, 1998.

The plaintiffs in Vesta argued that the moratorium was unconstitutional by requiring involuntary servitude in violation of the Thirteenth Amendment, depriving the plaintiffs of substantive due process in violation of the Fourteenth Amendment, impairing obligations of contract in violation of Article I, and taking property without just compensation in violation of the Fifth Amendment.

¹Order granting defendants' motion for summary judgment, slip opinion, case number TCA 95-40138-WS, October 25, 1996.

The District Court upheld the law against each of these charges, as follows:

Involuntary servitude: The court relied on long-standing federal case law to hold that the prohibition of involuntary servitude applied only to slavery and similar forms of compulsory labor.

Substantive due process: The court found that, under controlling decisions of the U.S. Supreme Court:

In the absence of any infringement upon fundamental rights,² legislative acts affecting the benefits and burdens of economic life will survive substantive due process scrutiny if such acts are supported by a “legitimate legislative purpose furthered by a rational means.” Indeed, economic legislation is *presumed* valid until the one complaining of a due process violation establishes that the legislation effects the deprivation of a constitutionally protected interest by means that are arbitrary, capricious, and without any rational basis.³

The court held that “the Legislature acted, not in an arbitrary and capricious manner as Plaintiffs suggest, but in a rational way to ameliorate a significant danger to Florida’s welfare.”⁴

Impairment of obligations of contract: The plaintiffs claimed that the moratorium unconstitutionally impaired their pre-existing contractual right to cancel or nonrenew insurance policies. The District Court relied on a three-part test established by the U.S. Supreme Court in 1983: in order for a state law to be upheld in spite of the prohibition on impairment of contract, the law must in fact operate as a substantial impairment, the legislation must serve a significant and legitimate public purpose, and the “adjustment of the contracting parties’ rights [must be] based upon reasonable conditions and [must be] of a character appropriate to the public purpose.”⁵

As factors establishing a significant public purpose, the court cited the destruction caused by Hurricane Andrew, the number of insolvencies caused by Andrew, the threats from insurers to nonrenew substantial number of policies or withdraw from the state, and the consequences these actions would have for the state’s economy in general. As factors establishing that the conditions were reasonable and of an appropriate character, the court cited the moratorium’s limited nature (in that it did

²For example, the rights conferred by the First Amendment have been held to be “fundamental rights,” and legislation affecting those rights must meet a higher substantive due process standard.

³Slip op. at 12, citations omitted, emphasis in original.

⁴Slip op. at 13.

⁵Slip op. at 15.

not prohibit non-hurricane-related cancellations), the ability of insurers to seek solvency-related waivers of the moratorium or approval of alternative plans, and the time limitation on the burdens imposed.⁶ The court noted that the duration of the moratorium had, at that point, been extended to six years, but did not comment on the question of what time limitations might be considered unreasonable conditions of a character inappropriate to the public purpose.

Taking without just compensation: The plaintiffs argued that the moratorium was a taking because it forced insurers to commit capital to Florida and because, taken together with the Catastrophe Fund law, the moratorium required insurers to pay money to the Catastrophe Fund. The court found that the intrusion on the plaintiffs' rights did not go so far as to be a taking, because the insurer still received the benefit of its insurance policies, could still cancel them for non-hurricane-related reasons, and could still withdraw completely from the state over time. The court found that the moratorium "constituted a valid exercise of the state's police power -- that is, the power was intended to, did, and still does, address a legitimate state purpose by means rationally related to the desired end."⁷ The court also found that the creation of the Catastrophe Fund was neither irrational nor arbitrary, and insurers receive something of value (the functional equivalent of reinsurance) in exchange for the premiums they pay to the Catastrophe Fund.

Assessments and surcharges

Three of Florida's state-created insurance entities have the power to levy assessments on insurance companies or their policyholders when premiums and other revenues are insufficient to meet their obligations. When the FWUA or the RPCJUA sustains a deficit, it levies assessments on insurance companies to cover the deficit ("regular assessments"); when the deficit is large enough to require the issuance of bonds, the regular assessments are followed in subsequent years by "emergency assessments." Regular assessments are levied on insurance companies, which have the ability to pass the assessments along to their policyholders as surcharges, and emergency assessments are levied on policyholders and collected by insurance companies. Policyholders of the FWUA and RPCJUA are also subject to "market equalization surcharges" in the same percentage as the FWUA's or RPCJUA's assessments on voluntary market policyholders. In addition, the Florida Hurricane Catastrophe Fund, a reinsurance pool designed to reimburse insurers for a portion of their losses from major hurricanes, also has the ability to levy assessments of up to 4 percent on all property and casualty insurance premiums other than workers' compensation premiums.

In 1996, the RPCJUA levied regular assessments of \$40.5 million to cover its accumulated deficit through year-end 1995; the assessment represented approximately 2.2 percent of the RPCJUA's assessment base. In 1995, the FWUA levied \$117 million in assessments as a result of Hurricanes Erin and Opal; the assessment represented approximately 3.2 percent of the FWUA's assessment base. The Catastrophe Fund has

⁶Slip op. at 16.

⁷Slip op. at 20.

not yet levied any assessments; Catastrophe Fund assessments would not be required until the total of residential insured losses from a hurricane exceeded \$5 billion.

For a detailed discussion of assessments and surcharges, please see the House Financial Services Committee staff report, *Consumer Impacts of Property Insurance Surcharges in Florida*, issued October 24, 1997.

B. EFFECT OF PROPOSED CHANGES:

This bill addresses the issues described above as follows:

Florida Windstorm Underwriting Association (FWUA) eligibility: The bill would prohibit further expansion of the geographical eligibility boundaries of the FWUA.

Moratorium on hurricane-related cancellations and nonrenewals of residential policies: The bill would extend until June 1, 2001, the current moratoriums on hurricane-related cancellations or nonrenewals of both personal lines residential policies and condominium association policies. The bill would also remove authority for insurers to petition the Department of Insurance for approval of "accelerated exposure reduction plans."

The bill would allow the moratoriums to be terminated before June 1, 2001, if the market situation improves dramatically. The moratoriums would cease to operate once the property exposures of the FWUA and RPCJUA, combined, remained below \$25 billion for three consecutive months.

Assessments and surcharges: The bill would require that residential property insurance applicants and policyholders be informed of the possibility that they may be subject to assessments. The following notice would be required on, or along with, all residential property insurance application forms and renewal premium notices:

POTENTIAL ASSESSMENT LIABILITY.--All Florida residential property insurance policyholders are potentially subject to assessments or surcharges to defray deficits of the Residential Property and Casualty Joint Underwriting Association (RPCJUA) or the Florida Windstorm Underwriting Association (FWUA), or to fund bonds issued by the Florida Hurricane Catastrophe Fund (FHCF).

C. APPLICATION OF PRINCIPLES:

1. Less Government:

a. Does the bill create, increase or reduce, either directly or indirectly:

(1) any authority to make rules or adjudicate disputes?

No

(2) any new responsibilities, obligations or work for other governmental or private organizations or individuals?

No.

(3) any entitlement to a government service or benefit?

No.

b. If an agency or program is eliminated or reduced:

(1) what responsibilities, costs and powers are passed on to another program, agency, level of government, or private entity?

N/A

(2) what is the cost of such responsibility at the new level/agency?

N/A

(3) how is the new agency accountable to the people governed?

N/A

2. Lower Taxes:

a. Does the bill increase anyone's taxes?

No.

b. Does the bill require or authorize an increase in any fees?

No.

c. Does the bill reduce total taxes, both rates and revenues?

No.

d. Does the bill reduce total fees, both rates and revenues?

No.

- e. Does the bill authorize any fee or tax increase by any local government?

No.

3. Personal Responsibility:

- a. Does the bill reduce or eliminate an entitlement to government services or subsidy?

Yes. The bill substantially eliminates the possibility that insurers' methods for recouping premiums paid to the Florida Hurricane Catastrophe Fund will force some consumers to subsidize this portion of the insurance costs of other consumers.

- b. Do the beneficiaries of the legislation directly pay any portion of the cost of implementation and operation?

N/A

4. Individual Freedom:

- a. Does the bill increase the allowable options of individuals or private organizations/associations to conduct their own affairs?

N/A

- b. Does the bill prohibit, or create new government interference with, any presently lawful activity?

N/A

5. Family Empowerment:

- a. If the bill purports to provide services to families or children:

- (1) Who evaluates the family's needs?

N/A

- (2) Who makes the decisions?

N/A

(3) Are private alternatives permitted?

N/A

(4) Are families required to participate in a program?

N/A

(5) Are families penalized for not participating in a program?

N/A

b. Does the bill directly affect the legal rights and obligations between family members?

N/A

c. If the bill creates or changes a program providing services to families or children, in which of the following does the bill vest control of the program, either through direct participation or appointment authority:

(1) parents and guardians?

N/A

(2) service providers?

N/A

(3) government employees/agencies?

N/A

D. STATUTE(S) AFFECTED:

Sections 627.351, 627.7013, 627.7014, 627.7019 (created), F.S.

E. SECTION-BY-SECTION RESEARCH:

Section 1 amends s. 627.351, F.S., to prohibit further geographic expansion of FWUA eligibility.

Section 2 amends s. 627.7013, F.S., to extend the moratorium on hurricane-related cancellations and nonrenewals of personal lines residential policies until June 1, 2001, and to delete provisions relating to accelerated exposure reduction plans.

Section 3 amends s. 627.7014, F.S., to extend the moratorium on hurricane-related cancellations and nonrenewals of condominium association policies until June 1, 2001, and to delete provisions relating to accelerated exposure reduction plans.

Section 4 creates s. 627.7019, F.S., to require applications and renewal premium notices for residential property insurance to contain a specified notice of potential assessment liability.

Section 5 provides that the act will take effect on October 1 of the year in which enacted.

III. FISCAL RESEARCH & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE AGENCIES/STATE FUNDS:

1. Non-recurring Effects:

None.

2. Recurring Effects:

None.

3. Long Run Effects Other Than Normal Growth:

None.

4. Total Revenues and Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS AS A WHOLE:

1. Non-recurring Effects:

None.

2. Recurring Effects:

None.

3. Long Run Effects Other Than Normal Growth:

None.

C. **DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:**

1. Direct Private Sector Costs:

The bill continues for an additional two years the moratorium on hurricane-related cancellations and nonrenewals of property insurance policies, which imposes on insurers the burden of maintaining some insurance policies that they might otherwise not maintain.

2. Direct Private Sector Benefits:

The bill continues the prohibition on future geographic expansion of the FWUA; curtailing growth of the FWUA prevents unlimited growth of the FWUA's potential for assessments on insurers and policyholders.

The continuation of the moratorium delays until at least 2001 the possibility of massive insurer withdrawals from Florida that could result in significant growth of the FWUA and RPCJUA, and attendant growth in their potential assessments on insurers and policyholders.

3. Effects on Competition, Private Enterprise and Employment Markets:

See above.

D. **FISCAL COMMENTS:**

N/A

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

A. **APPLICABILITY OF THE MANDATES PROVISION:**

N/A

B. **REDUCTION OF REVENUE RAISING AUTHORITY:**

N/A

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

N/A

V. COMMENTS:

N/A

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VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

N/A

VII. SIGNATURES:

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