

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

BILL: CS/SB 1418

SPONSOR: Banking and Insurance Committee and Senators Garcia and Campbell

SUBJECT: Property Insurance

DATE: February 25, 2002 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Emrich</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Favorable/CS</u>
2.	_____	_____	_____	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

Currently, there exist two state-created associations providing property insurance to persons unable to obtain coverage from an authorized insurance company: the Florida Windstorm Underwriting Association (FWUA) and the Florida Residential Property and Casualty Joint Underwriting Association (JUA). The FWUA provides coverage for the perils of windstorm (including hurricanes) and hail in specified coastal areas. The JUA provides full homeowners' and similar coverages statewide, except that it is prohibited from providing windstorm coverage in areas eligible for the FWUA. These associations comprise what is known as the "residual market" for property insurance in Florida.

Both the FWUAs' and the JUAs' resources for the payment of claims after major hurricanes include a combination of premiums paid by their respective policyholders, recoveries from the Florida Hurricane Catastrophe Fund (Fund) after major hurricanes, and assessments levied against property insurance companies and their policyholders statewide. Both entities also have the power to borrow, including the issuance of revenue bonds backed by these assessments, when other resources are not sufficient to pay claims.

Committee Substitute for Senate Bill 1418 would change the structure of these two residual market associations by merging them into a single entity, named the "Citizens Property Insurance Corporation" (Citizens). The bill would rename the JUA as the Citizens Property Insurance Corporation, provide that all JUA policies, obligations and liabilities belong to Citizens, and transfer all FWUA policies, obligations, and liabilities to Citizens, effective July 1, 2002.

Under the bill, Citizens is structured to meet IRS requirements so that its income will be exempt from federal income taxation and it will be able to issue tax-free bonds. On February 20, 2002,

the Department of Insurance received an IRS “private letter ruling” stating that Citizens, as structured under this legislation, and if operated consistently with such legislation, would be tax exempt and be able to issue tax-free bonds. The bill would further provide for the following:

- Citizens would offer personal residential and commercial residential full coverage, all perils policies on a statewide basis (excluding FWUA eligible areas) and offer wind-only coverage for personal residential and commercial residential and commercial nonresidential risks in current FWUA-eligible areas;
- The capacity of Citizens to pay claims and service debt would be strengthened by assessing authorized insurers writing specified subject lines of business and by assessing surplus lines policyholders to pay regular and emergency assessments. The Florida Surplus Lines Office would be responsible for identifying surplus lines premiums subject to assessments and verifying and collecting such assessments;
- Citizens would offer a “quota share primary insurance program” to authorized insurers for hurricane coverage within FWUA areas, whereby the corporation and each insurer would be each solely responsible for a specified percentage of hurricane coverage of an eligible risk as provided for in the quota share agreement (entering into such a program would be voluntary and at the discretion of the authorized insurer);
- The Treasurer would appoint a 7-member Board of Governors (3-year terms) to operate Citizens, along with the appointment of a technical advisory group;
- The current JUA and FWUA rating law provisions would apply to Citizens, wherein rates for personal lines residential policies, excluding wind-only policies, are based upon the rates of the top twenty insurers in the same manner as the JUA rate formula for personal residential policies, and rates for personal lines residential wind-only policies must be actuarially sound and not competitive with approved rates charged by authorized insurers in the same manner as the FWUA rate formula for such policies; and, rates for commercial lines coverage would be subject to the rate standards under s. 627.062;
- Specifies that the transfer of policies, assets and obligations from the JUA and the FWUA to Citizens will not impact coverage of policies by the Florida Hurricane Catastrophe Fund;
- Provides that the same public records and open meeting exemptions which are currently in place for the JUA apply to Citizens;
- Limited apportionment company status for small insurers currently allowed under the FWUA law is also provided for in Citizens;
- Deletes the arbitration provision for Citizens which means that the administrative hearing procedure under ch. 120, F.S., would be the only avenue to litigate rate filing disputes with the corporation;

- Citizens could impose and collect an amount equal to the premium tax from policyholders to augment its financial resources;
- Citizens would be exempt from corporate income tax;
- Furnishes a statement of legislative intent to preserve the existing financial obligations of the JUA and the FWUA in the newly created Citizens;
- The department may, by order, postpone the July 1, 2002, effective date if it finds the effectuation of such date cannot be accomplished due to emergency conditions;
- A policyholder's right or "choice" to select and maintain an insurance agent would be provided for under Citizens pursuant to specified depopulation programs. Also, commissions to producing agents would be increased under such depopulation programs;
- Provides authority for the Florida Hurricane Catastrophe Fund to cover losses attributable to additional living expense (ALE) coverages.

This bill substantially amends the following sections of the Florida Statutes: 627.351 and 215.555. This bill creates section 627.3517, Florida Statutes.

II. Present Situation:

Guaranteeing Availability of Property Insurance through Residual Market Insurers: *Florida Windstorm Underwriting Association (FWUA) and the Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA)*

Two state-created associations provide property insurance to persons unable to obtain coverage from a private authorized insurer - the Florida Windstorm Underwriting Association (FWUA) and the Florida Residential Property and Casualty Joint Underwriting Association (JUA) -- both commonly referred to as "residual market" insurers.¹ These two associations are often called "insurers of last resort" because they offer the last opportunity for persons to obtain insurance coverage.

The *Florida Windstorm Underwriting Association (FWUA)*, created in 1970, provides windstorm and hail coverage for residential and commercial property only in those geographical areas of the state determined by the Department of Insurance as meeting statutory criteria of eligibility (s. 627.351(2), F.S.). In order to obtain coverage for other perils such as fire, theft, and liability, a policyholder must obtain a separate "ex-wind" policy from another insurer.

¹ The "residual market" for insurance is typically a nonprofit state-created mechanism that provides insurance coverage to persons who are insurable but unable to obtain coverage from any of the licensed insurance companies that compose the "voluntary" market." Florida has created residual markets for automobile, medical malpractice, and property insurance. These entities are also referred to as insurance risk apportionment plans under s. 627.351, F.S. The Legislature has also created a residual market mechanism for workers' compensation insurance.

Currently, as of January 31, 2002, the FWUA has 409,955 policies representing an exposure of \$98 billion with a probable maximum loss (PML) of a 100-year storm of \$4.7 billion. Approximately, 65 percent of the 409,955 policies are located in Dade, Broward, Palm Beach, and Monroe counties.

Coastal areas of 29 of Florida's 35 coastal counties are currently eligible for FWUA coverage, generally within a distance of 1,000 feet from the coast, but in Dade, Broward, and Palm Beach counties, the area east of I-95 is eligible, which extends as far as 5 miles from the coast. The entire area of Monroe County is eligible. Further expansion of eligible areas is currently prohibited. The boundaries of the FWUA directly affect the obligation of private market insurers to provide windstorm coverage. Outside the FWUA eligible areas, insurers must include windstorm coverage in every residential property insurance policy they write. Inside FWUA areas, insurers are free to write policies that exclude windstorm coverage.

In May 1999, the FWUA filed a rate increase for its residential property, which was ultimately approved by an arbitration panel at 96 percent. This percentage represents an overall statewide average, which is being incrementally implemented: the maximum rate increase is capped at 20 percent for the first year, 30 percent for the second year, and 40 percent for each subsequent year. The FWUA is required to apply discounts, thus lowering the amount of premium paid, for loss mitigation to policyholders who mitigate their homes. The rate increase is already fully phased in for 24 percent of the FWUA homeowners (that is, 24 percent of FWUA homeowners will see no further rate increases under the current plan). Another 30 percent of FWUA homeowners will be at their full rate by June 30, 2003. By June 30, 2004, 94 percent of FWUA homeowners will be at their full, actuarially indicated premium. According to representatives with the FWUA, they have not implemented a rate increase for their commercial property for at least 10 years.

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

The *Florida Residential Property and Casualty Joint Underwriting Association (JUA)*, created in 1992 after Hurricane Andrew, provides residential property insurance coverage in all areas of the state, (s. 627.351(6), F.S.).² The policies provide coverage for all perils covered under a standard residential policy, subject to certain underwriting requirements. The JUA policies exclude windstorm coverage on property located in an area eligible for windstorm coverage from the FWUA. The JUA operates pursuant to a plan of operation approved by the department, and is governed by a board consisting of seven members representing insurers and six members representing non-insurer interests, including consumers.

² The RPCJUA offers two lines of policies - personal lines residential which applies to homeowners, tenants, condominium unit owners, dwelling fire, and mobile home policies and commercial lines residential which applies to condominium association, apartment building and homeowner association policies.

As of January 31, 2002, the JUA had a total of 110,796 policies representing an exposure of approximately \$20 billion with a probable maximum loss (PML) of \$1.24 billion.³ Ninety-nine percent of its personal lines residential policies are located in Dade, Broward, and Palm Beach counties while 84 percent of its commercial lines residential policies are located in those same three counties.

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

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

The JUA is governed by a 13-member board consisting of 8 members appointed by the Insurance Commissioner (the Insurance Consumer Advocate, 5 consumer representatives, and 2 insurance industry representatives) and 5 members appointed by the insurance industry. The members serve 3-year terms and may be removed only for cause.

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

Tax Status

The FWUA is currently subject to federal income taxation, and it is not able to issue bonds on a tax-free basis. (Tax-free bonds carry a lower interest rate than taxable bonds, and the ability to issue tax-free bonds would therefore represent a substantial saving to the issuing entity.)

³ November 30, 2001, was the last estimate of the 100-year PML for the JUA.

The JUA sued the Internal Revenue Service (IRS) to obtain a tax exemption after attempts at negotiation with the IRS failed. On February 7, 2002, the U.S. District Court for the Northern District of Florida ruled that the JUA was entitled to an exemption from income taxes.⁴ The ruling was largely based on the court's findings that the JUA board was under the control of the Insurance Commissioner and that the JUA largely functioned as if it were a part of the Insurance Department. The ruling did not address the issue of tax-free bonding. Based on the totality of the circumstances, the court found the JUA to be an integral part of state government. The IRS has 60 days from the date of the trial court's ruling to appeal.

The Florida Hurricane Catastrophe Fund received an exemption from income taxes and the right to issue tax-free bonds after negotiation with the IRS based on its status as an integral part of state government. The basic factors the IRS relied on, in negotiations and in private letter rulings were: control by a governmental entity (the State Board of Administration), a broad funding source for a limited benefit (all property and casualty policies except for workers' comp are subject to assessment to pay property insurance losses), state financial contributions to the fund, use of some investment earnings of the fund to support state activities (hurricane loss mitigation), and the reversion of moneys in the fund to the state upon dissolution of the fund.

On February 20, 2001, the Internal Revenue Service (IRS) in a private letter ruling to the Department of Insurance and after reviewing the provisions of this bill determined that the Citizens Property Insurance Corporation (Citizens) would be tax exempt.⁵ This will allow the corporation to collect revenues tax-free and issue tax-free bonds. In accordance with an analysis obtained by the Department of Insurance from J.P. Morgan, this could reduce debt service costs by as much as \$1 billion on a \$2.5 billion 20-year bond.⁶

Florida Senate Banking and Insurance Interim Report on Achieving Tax-Exempt Status and Efficiencies of Operation for Florida's Residual Market Property Insurers

In September 2001, the Senate Banking and Insurance Committee issued a report which examined the issue of merging the FWUA and the JUA into a single entity.⁷ That report reviewed the current status of the two entities, their current operating costs, the arguments for and against merger, and the potential for cost savings. The report issued the following recommendations:

- The Legislature should consider merger of the FWUA and the JUA into a single, permanent residual market entity. There is no reason to have two entities providing property insurance coverage. A merger is likely to achieve modest expense savings and would better enable the Legislature and regulators to achieve consistent public policy

⁴ *Florida Residential Property and Casualty Joint Underwriting Association v. United States of America*, Case No. 4:00cv351/RV.

⁵ IRS Index Number: PLR-163640-01. This ruling was in response to a letter dated October 26, 2001, from the Department of Insurance requesting the ruling.

⁶ Analysis prepared reflecting market conditions as of February 28, 2001.

⁷ See Report Number 2002-119, September 2001. This report was written *prior* to the U.S. District Ct. decision involving the tax-exempt status of the JUA, or the private letter ruling to the Department of Insurance as to the tax exempt status of Citizens.

objectives. The relatively stable insurance market makes it an opportune time to implement a merger.

- The acquisition costs and underwriting expenses of the FWUA, as a percentage of premium, are much lower than those of the JUA, due primarily to in-house servicing, rather than contracting with private carriers. Expense savings by merger of the FWUA and JUA could be achieved by in-house servicing. However, such savings would be modest compared to overall costs, and are not likely to result in premium reductions to consumers. Greater expense savings could be achieved by even a small reduction in agent commissions paid by the FWUA.
- Obtaining tax-exempt status for the residual market would provide significant savings and should be aggressively pursued, but this can be attempted either for a merged entity or separately for the FWUA and the RPCJUA. Legislation may not be necessary if federal legislation is passed that would classify both the FWUA and JUA as tax-exempt entities. The JUA also has a pending lawsuit against the federal government seeking tax-exempt status. Tax-exempt financing by both associations can likely be obtained under current Florida law which authorizes municipalities to issue bonds backed by FWUA and JUA assessments. The key factors to obtaining tax-exempt status for any entity as an “integral part of the state” are state control and a substantial state financial commitment.
- Implementing a merger of the JUA and FWUA is made much more difficult if the new entity is faced with the additional change to “coinsuring”⁸ or sharing the hurricane risk with private carriers. Merger could be accomplished relatively seamlessly, with fewer potential adverse consequences, by maintaining the types of coverage currently provided -- full coverage in non-FWUA areas and wind only (or, hurricane-only) in FWUA areas. Many complexities are inherent in the coinsurance concept, which could also raise concerns in the financial markets. A more viable option to provide additional incentive to insurers to write hurricane coverage is to reduce the size of the FWUA-eligible areas to force carriers to either write full coverage or no coverage. This could be limited to new policies to mitigate the financial impact on carriers currently writing non-wind policies in the affected areas.

The Florida Surplus Lines Service Office

On October 1, 1997, the Florida Surplus Lines Service Office was established as a not-for-profit association of all Florida surplus lines agents. The purposes of the Service Office are to protect consumers seeking insurance in this state, permit surplus lines insurance to be placed with approved surplus lines insurers, establish a self-regulating organization which will promote and permit orderly access to surplus lines insurance in this state, enhance the number and types of insurance products available to consumers in this state, provide a source of advice and counsel for the benefit of consumers, surplus lines agents, insurers, and government agencies concerning the operation of the surplus lines insurance market, and protect the revenues of this state.

⁸ This provision is termed the “quota share primary insurance program” under this bill.

Surplus lines agents must, as a condition of holding a surplus lines license, be deemed a member of the Service Office Association and shall report to and file with the service office a copy of or information on each surplus lines insurance policy or document as provided in the plan of operation. The Service Office is required to receive, record and review all surplus lines policies or documents, maintain records of the information reported to the service office and prepare monthly reports for the Florida Department of Insurance. The Service Office is also required to prepare and deliver to each surplus lines agent monthly and quarterly reports of each surplus lines agent's business and collect a 0.3 percent service fee, along with the surplus lines premium tax as provided in ss. 626.932, and 626.9325, F.S. According to representatives with the Service Office, the 2001 premium volume for specified real or personal property insurance written according to the provisions of the Citizens bill, is \$184,868,292, with policies totaling 199,396. The total premium volume for all surplus lines is \$1.37 billion, with 753,165 policies. Currently, premiums for surplus lines insurance are not subject to assessments to fund deficits of either the JUA or the FWUA.

Binding Arbitration

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

If the Department of Insurance disapproves a rate filing, the insurer, including the Florida Windstorm Underwriting Association (FWUA), may either request an administrative hearing under the Administrative Procedures Act (ch. 120, F.S., A.P.A.) or seek binding arbitration (s. 627.062(6), F.S.).

In 1996, the law was amended to allow insurers to request binding arbitration of a rate filing as an alternative to an administrative hearing. After the department issues a notice of intent to disapprove a rate filing, the insurer may request arbitration before a panel of three arbitrators. The panel is chosen as follows: one is selected by the insurer, one by the Department, and the third is chosen by the two other arbitrators. An arbitrator must be certified by the American Arbitration Association and may not be the employee of any insurance company or insurance regulator. The procedures outlined in the Arbitration Code (chapter 682, F.S.) are applied to rate arbitration and the costs of arbitration are paid by the insurer. The decision of the panel, which must be made within 90 days, constitutes the final approval of a rate filing.

There is no appeal per se of the panel's decision to a higher court, as there would be under the APA. However, either party to the arbitration proceeding may apply to the circuit court to vacate or modify the panel's decision under limited conditions. In general, grounds for vacating include corruption or fraud, evident partiality by a neutral arbitrator, and action beyond the arbitrators' powers or jurisdiction. Grounds for modification include miscalculations, errors as to form, and actions on matters not submitted for arbitration. Upon initiation of arbitration, the insurer waives all rights to challenge the action of the Department of Insurance under the APA or any other law; however, these rights are restored to the insurer if the arbitrators fail to act within 90 days after initiation of arbitration.

The Florida Market Assistance Program

Created by the Legislature in 1985, the Florida Market Assistance Program (FMAP) is a private non-profit service organization primarily dedicated to helping consumers find property and casualty insurance coverage for both residential and commercial properties from authorized insurers in the private market (s. 627.3515, F.S.). It is funded from annual assessments on property and casualty insurers in Florida. FMAP also assists in depopulating the RPCJUA by providing reports of RPCJUA policies to subscribing insurance agents.

The Florida Hurricane Catastrophe Fund (Fund)

The Florida Hurricane Catastrophe Fund (Fund), created in 1993 following Hurricane Andrew, is a state trust fund administered by the State Board of Administration (SBA) that reimburses insurers for a portion of their hurricane losses in the state (s. 215.555, F.S.). Each insurer that writes residential property insurance in Florida must enter into a contract with the State Board of Administration (SBA) each year to purchase reimbursement coverage from the Fund. The definition of "losses" under the Fund as specified in s. 215.555 (2)(d), F.S., means, "direct incurred losses under covered policies, excluding losses attributable to additional living expense (ALE) coverages and excluding loss adjustment expenses." ALE is a typical coverage in homeowners' policies and in private reinsurance contracts.

III. Effect of Proposed Changes:

Section 1. Amends s. 627.351(6), F.S., relating to insurance risk apportionment plans, to provide for the following:

1. **Creates the "Citizens Property Insurance Corporation" (CITIZENS) and recites findings of Legislative purpose in creating CITIZENS.** Specifically, the Legislature finds that:

- actual and threatened catastrophic losses to property in Florida from hurricanes have caused insurers to be unwilling or unable to provide property insurance coverage to the extent sought and needed;
- it is in the public interest and a public purpose to assist in assuring that property in the state is insured to facilitate reconstruction of damaged or destroyed property to reduce or avoid the negative effects resulting to public health, safety and welfare;
- it is necessary, therefore, to provide insurance to applicants who are in good faith entitled to procure insurance through the voluntary market, but are unable to do so;
- property insurance be provided through an entity organized to achieve efficiencies and economies to fulfill this public purpose;
- it is essential for the corporation to have maximum financial responses to pay claims following a hurricane; and
- therefore such income of the corporation be exempt from federal income taxation and that interest on the debt obligations issued be also exempt from federal income taxation.

2. **Renames the JUA as CITIZENS:** Effective July 1, 2002, CITIZENS will provide insurance for residential and commercial property for applicants who are in good faith entitled, but are unable, to procure insurance through the voluntary market.
3. **Assessable Insurers and Assessable Insureds:** are those subject to assessment by the CITIZENS, as insurers authorized to write one or more “subject lines of business.” Also, insurers writing one or more subject lines of business pursuant to part VIII of Chapter 626 (surplus lines insurers) are *not* assessable insurers, but insureds who procure one or more subject lines of business under part VIII of Chapter 626 are subject to assessment and referred to as assessable insureds.

“Subject lines of business” is defined as (using current definition applicable to the FWUA): “insurance written by assessable insurers or procured by assessable insureds on real or personal property, as defined in s. 624.604, including insurance for fire, industrial fire, allied lines, farm owners multiperil, homeowners multiperil, commercial multiperil, and mobile homes, including liability coverage on all such insurance but excluding inland marine as defined in s. 624.607(3) and *excluding* vehicle insurance as defined in s. 624.605(1), other than insurance on mobile homes used as permanent dwellings.

4. **CITIZENS will be divided into three accounts:**
 - **personal lines account:** for personal residential policies issued by CITIZENS or the JUA and renewed by CITIZENS on risks *not located* within the areas eligible for coverage in the FWUA area as that area was defined on January 1, 2002; and
 - **commercial lines account:** for commercial residential policies issued by CITIZENS or by the JUA and renewed by CITIZENS on risks *not located* within areas eligible for coverage in the FWUA; and,
 - **high risk account:** for personal residential, commercial residential and commercial nonresidential property policies issued by CITIZENS or transferred to it on risks that are located in FWUA areas as defined on January 1, 2002. The high risk account also includes quota share primary insurance.

The three accounts may be merged into a single account after financing obligations are no longer outstanding. For federal income tax purposes, the bill specifically states that revenues of CITIZENS are revenues necessary to meet the requirements set forth in the documents authorizing the issuance of bonds by CITIZENS. Also, that no part of income of CITIZENS may inure to the benefit of any private person.

5. **Assessments/Florida Surplus Lines Service Office:** When there is a deficit in an account, assessable insurers and assessable insureds are subject to regular assessments. Emergency assessments are collected from policyholders of assessable insurers and from assessable insureds.

The bill creates a role for the Florida Surplus Lines Service Office to play in the collection of any assessment levied by CITIZENS to pay covered losses. If CITIZENS levies an assessment, such assessment will be collected from surplus lines policyholders by the surplus lines agent, who will forward the assessment to the Service Office which will transfer the funds to CITIZENS.

6. **CITIZENS must adopt specified forms for approval by the department:**
- Residential property and casualty insurance policy forms and commercial residential and nonresidential property insurance forms which must be approved by the department;
 - Standard and basic personal lines policy forms, and commercial lines residential and commercial lines nonresidential property insurance policy forms.
7. **Quota share primary insurance agreements for hurricane coverage:** Within the current FWUA areas, CITIZENS must adopt a quota share program whereby it enters into an agreement with an authorized insurer to coinsure “hurricane coverage” as that term is defined in s. 627.4025(2)(a) for “eligible risks,” i.e., those risks located in current FWUA areas. (Quota share primary insurance agreements means an agreement between CITIZENS and an authorized insurer wherein each is severally responsible for a specified percentage of the hurricane coverage for an eligible risk as set forth in the quota share agreement. Entering into such an agreement is voluntary and at the discretion of the authorized insurer.)
- Citizens may enter into such agreements with authorized insurers at corporation coverage levels of 90 percent and 50 percent. This means that if an authorized insurer entered into a quota share agreement with the corporation, the minimum hurricane coverage the insurer would be responsible for would be 10 percent and the corporation would be responsible for 90 percent. Also, such a program:
- may be established at different levels by CITIZENS, but not to exceed 90 percent, if necessary to maximize participation in the program;
 - must be approved by the Department;
 - must provide for separate and accurate reporting to the Florida Hurricane Catastrophe Fund (Fund) of quota insured eligible risks by the insurer and CITIZENS;
 - provide that the rates charged by CITIZENS for covering eligible personal lines residential risks under quota share primary insurance agreements for coverage levels must be derived from the corporations’ wind-only rates.
8. **Validation of bonds:** The Corporation is authorized, but not required, to seek judicial validation of its bonds or other indebtedness under chapter 75.
9. **CITIZENS shall be governed by a 7-member Board of Governors appointed by the Treasurer:**
- Members must be from diverse geographical areas of the state and the Treasurer must designate one member as chair;
 - Members serve three-year terms at the pleasure of the Treasurer;
 - The Treasurer must appoint the members of the board of governors by July 1, 2002, to permit the board to coordinate with the existing Residential Property Insurance Market Coordinating Council on appropriate implementation, organizational, operational, and financial matters relating to formation of CITIZENS;

- The Treasurer is given specific authority, after consultation with the Council, to postpone the implementation of specified provisions of the act relating to the operation of CITIZENS for a period not to exceed 180 days, however, such postponement must not affect the financial arrangements of the FWUA or JUA;
 - Executive director and senior managers of CITIZENS shall be “engaged” by the Treasurer and serve at the pleasure of the Treasurer.
10. **Technical Advisory Group will be appointed by the Treasurer:** This group will provide information and advice to the Bd. of Governors of CITIZENS.
 11. **Offers of coverage from authorized insurers:** Provides that offers of full coverage at the insurer’s approved rate for a basic or standard policy, renders the risk ineligible for coverage by CITIZENS.
 12. **Rights of producing agents to commissions under depopulation programs for personal and commercial lines:** With respect to personal lines residential risks, if a risk accepts an offer of coverage through the market assistance plan or through a mechanism established by CITIZENS, either before a policy is issued or within the first 30 days of coverage (keep-out program), and the producing agent who submitted the application is not appointed by the insurer, the keep-out insurer must pay to the producing agent of record an amount that is the greater of the insurer’s or the corporation’s usual and customary commission for the first year, or offer to allow the agent to continue servicing the policy for a period of not less than 1 year and pay the agent the greater of the insurer’s or corporation’s commission. If the agent is either unwilling or unable to accept the appointment by the new insurer, the insurer must still pay the agent the greater of the insurer’s or corporation’s commission. This provision is made subject to the “consumer choice” provisions under s. 627.3517, F.S. (Section 2 of the bill). (Note: the term “unable” is taken to mean an agent who is an exclusive agent or direct writer for an insurance company.)

With respect to commercial lines risks, if a risk accepts an offer of coverage through the market assistance plan or through a mechanism established by CITIZENS, the same provisions as to producing agent commissions applies as noted above.
 13. **Provides for market equalization surcharge for CITIZENS policyholders.**
 14. **Rates:** for personal lines residential policies, excluding rates for wind-only policies, are based upon the rates of the top twenty insurers in the same manner as the JUA rate formula for personal residential policies. Further, rates for personal lines residential wind-only policies must be actuarially sound and not competitive with approved rates charged by authorized insurers in the same manner as the FWUA rate formula for such policies.
 15. **Deletes the arbitration provision for CITIZENS:** The effect of this provision is that the administrative hearing procedure under ch. 120, F.S., would be the only avenue to litigate rate filing disputes with the corporation

16. **Provides for limited apportionment corporation status:** for insurers in the High Risk account in the same fashion as the FWUA limited apportionment provisions.
17. **Premium tax:** Provides that CITIZENS shall impose and collect an amount equal to the premium tax from policyholders to augment its financial resources.
18. **Filing of financial reports:** Requires the corporation to file quarterly financial reports and an annual financial statement with the department.
19. **Sanctions for surplus lines agents:** Such agents will be disciplined for failing to collect and remit regular or emergency assessments from assessable insureds.
20. **Authority to CITIZENS to adopt programs:** These programs involve the reduction of new and renewal writings of the corporation, subject to approval by the department.
21. **Exemption from corporate income tax:** Provides that CITIZENS will be exempt from such tax. and that premiums, assessments and other revenues of the corporation shall not be considered taxes.
22. **CITIZENS is not required to hold a certificate of authority from the Department:** also provides that it is not required to participate as a member insurer of the Florida Insurance Guaranty Association (FIGA). CITIZENS is nonetheless required to pay assessments pledged by FIGA to secure bonds issued or other indebtedness incurred to pay claims arising from insurer insolvencies resulting from hurricane losses.
23. **Provides further legislative intent:** Provides that bonds issued by the corporation and income there from shall be free from state and local taxation; that bonds will not be considered "state bonds;" and that the corporation is not subject to procurement provisions or the administrative procedures law under ch. 120.
24. **Effective July 1, 2002:**
 - all policies, assets and liabilities of the JUA shall become policies of CITIZENS;
 - all policies, assets and liabilities of the FWUA are transferred to CITIZENS;
 - the transfer of FWUA policies, obligations, and assets to CITIZENS and the policies, obligations, and assets of the JUA as incorporated into CITIZENS shall in no way affect coverage of those policies by the Florida Hurricane Catastrophe Fund.
 - Public Records/Open meetings: records of CITIZENS will have the same public records exempt status as for the JUA and meetings of CITIZENS are subject to the Sunshine Law in the same fashion as the JUA.
25. **Postponing of effective date:** The department may, by order, postpone the July 1, 2002, effective dates if it finds the effectuation of such dates cannot be accomplished due to *emergency conditions*.
26. **Existing credit structures:** The bill contains a statement of legislative intent that recognizes the existence of financing arrangements entered into by the FWUA and the

JUA, and provides that nothing in the legislation should be construed to compromise, diminish or interfere with the rights of creditors under such financing arrangements.

Section 2. Creates s. 627.3517, F.S., entitled “Consumer Choice,” to provide that no provisions of ss. 627.351, 627.3511, or s. 627.3515 shall be construed to impair the right of any insurance risk apportionment plan policyholder, upon receipt of any keep-out or take-out offer, to retain his or her current agent, so long as that agent is duly licensed and appointed by the insurance risk apportionment plan or otherwise authorized to place business with such plan.⁹

Provides that this right can’t be canceled or compromised by any rule, plan of operation, or depopulation plan of any insurance risk apportionment plan, including plans described under s. 627.351, s. 627.3511, or s. 627.3515. It provides that if a policyholder’s agent is unable or unwilling to be appointed by the keep-out or take-out insurer, the policyholder is not disqualified from participating in the insurance risk apportionment plan because of an offer of coverage in the voluntary market. (Note: the term “unable” is taken to mean an agent who is an exclusive agent or direct writer for an insurance company.)

It further provides that any plan of operation or depopulation of any risk apportionment plan under s. 627.351(2) (FWUA) or s. 627.351(6) (CITIZENS) is subject to the agent commission payment provisions of s. 627.351 (2)(b) (FWUA), s. 627.351(6)(c) (CITIZENS), and s. 627.3511(4) (agent bonus provision). (See Related Issues below.)

It also authorizes the Department of Insurance to adopt rules to cause insurance risk apportionment plans or market assistance plans to demonstrate their plans of operation to not interfere with the rights created under this section.

Section 3. Amends s. 215.555, F.S., relating to definitions under the Florida Hurricane Catastrophe Fund (Fund), to provide authority for the Fund to cover losses attributable to additional living expense (ALE) coverages. ALE is a typical coverage in homeowners’ policies and in private reinsurance contracts. The bill amends the term “losses” to mean direct incurred losses under covered policies, including up to 20 percent of the value of the residential structure or up to 40 percent of the value of the residential contents for losses attributable to ALE coverages on mobile homes and personal residential exposures, but excluding fair rental value losses associated with personal and commercial residential exposures, business interruption losses associated with commercial residential exposures, and also excluding loss adjustment expenses.

Including coverage for ALE in the Fund will simplify the loss reimbursement process and help coordinate the Fund coverages with private reinsurance companies. According to the Department

⁹ The insurance risk apportionment plans under s. 627.351 refer to the six joint underwriting associations which include the FWUA and the JUA (under the provisions of this bill, the JUA policies become the policies of CITIZENS and the FWUA policies are transferred into CITIZENS). Of the other four apportionment associations, two are not currently operating (Casualty Insurance Risk Apportionment Plan, applies to political subdivisions in the state, and the Property and Casualty Insurance Risk Apportionment Plan); and two are operating, but have no current depopulation programs (Motor Vehicle Insurance Risk Apportionment Plan and the Medical Malpractice Insurance Risk Apportionment Plan). Section 627.3511 refers to the JUA depopulation statute and s. 627.3515 applies to the Florida Market Assistance Program.

of Insurance, this change has been approved by the State Board of Administration which governs the Fund.

Section 4. Provides for an effective date of July 1, 2002.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

The bill provides that records of CITIZENS will have the same public records exempt status as for the JUA and meetings of CITIZENS are subject to the Sunshine Law in the same fashion as the JUA.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

As noted above, the Internal Revenue Service has determined that Citizens would be tax exempt under a recent private letter ruling dated February 20, 2002. This will allow the corporation to collect revenues tax-free and issue tax-free bonds. Further information on this issue is provided in Private Sector, below.

B. Private Sector Impact:

Based on the IRS private letter ruling, Citizens would be exempt from income taxation. By comparison, the FWUA paid \$46.7 million in income taxes for 2000 and \$21.0 million for 1999. The JUA paid income taxes totaling \$149.9 million for 1996, 1997, and 1998 combined, but is now entitled to a refund of these amounts as a result of the recent federal district court ruling that the JUA is tax-exempt. It appears that the tax exemption for Citizens' revenues would result in greater reserves for Citizens to pay claims. It is not clear that such savings would directly result in a reduction in premiums paid by policyholders of Citizens. The bill specifies the method for determining premiums for Citizens: rates for personal lines residential policies, excluding wind-only policies, are based upon the rates of the top twenty insurers in the same manner as the JUA rate formula for personal residential policies, and rates for personal lines residential wind-only policies must be actuarially sound and not competitive with approved rates charged by authorized insurers in the same manner as the FWUA rate formula for such policies; and, rates for commercial lines coverage would be subject to the rate standards under s. 627.062.

With regard to premiums charged by Citizens, the major change is due to the apparent nullification of the current rates approved for the FWUA. An arbitration panel approved an average 96 percent statewide increase for residential coverage in the FWUA in 2000, which is being incrementally implemented: the maximum rate increase is capped at 20 percent for the first year, 30 percent for the second year, and 40 percent for each subsequent year. The board of Citizens would have the authority to file for a new rate for the wind-only policies formerly covered by the FWUA, subject to approval by the department. The arbitration process would not be an allowable option for Citizens.

There should be some economies of scale achieved under one entity (Citizens) and thus lower administrative costs as opposed to the current two board structure (JUA and the FWUA).

There is much uncertainty as to the effect of the quota share primary insurance program with Citizens. This is an entirely new concept, by which Citizens and a private insurer would each be solely responsible for a specified percentage of hurricane coverage for an eligible risk at corporation coverage levels of 90 and 50 percent. This means that if an authorized insurer entered into a quota share agreement with the corporation, the minimum hurricane coverage the insurer would be responsible for would be 10 percent and the corporation would be responsible for 90 percent. Entering into such an agreement is voluntary and would be at the discretion of the authorized insurer.

In entering into the quota share agreement, the corporation and the insurer are likely to have different rating plans with different credits, possibly different deductibles, and/or different coverage exclusions. It appears that two policies for this coverage would be necessary, but this is not clear under the provisions of the bill. It is also unclear as to what coinsurance levels will be made optional to a private carrier. It is also unclear if Citizens has the authority to provide additional financial incentives to the private carrier, in addition to the premium charged to the policyholder, to take a specified portion of the wind coverage. Also, reporting exposures by Citizens and the private carrier to the Florida Hurricane Catastrophe Fund, for purposes of determining fund premiums and coverage levels, is made difficult under this concept.

The assessment base for funding deficits of Citizens includes surplus lines insurance premiums, which are not currently subject to assessment for FWUA or JUA deficits. This will potentially increase premiums for surplus lines policyholders in the event of a hurricane that triggers assessments, but should reduce the magnitude of the assessment for authorized insurers and their policyholders. Commercial multi-peril and commercial liability insurance premiums are also subject to assessment for deficits of Citizens (for all three of the accounts). Such policies are currently subject to assessment for the FWUA, but are not subject to assessment for the personal lines residential policy account of the JUA. This could result in higher premiums for commercial policyholders, but could reduce the assessments for residential policyholders. Assessing both surplus lines and commercial policies enables Citizens to obtain greater level of debt financing in the event of a catastrophe.

By being able to issue tax-free bonds, Citizens would have lower financing costs and greater debt capacity to fund deficits after a major storm. An analysis obtained by the Department of Insurance from J.P. Morgan in 2001 indicated that tax-exempt bonds could reduce debt service costs by as much as \$1 billion on a \$2.5 billion 20-year bond.

C. Government Sector Impact:

The Department of Insurance will incur increased costs in implementing this bill, but the amount of such costs is unknown.

VI. Technical Deficiencies:

None.

VII. Related Issues:

The bill provides under Section 1, that the Treasurer perform various duties under Citizens, including appointing the 7 member Board of Governors. However, on January 7, 2003, the office of the Treasurer will be abolished and the new office of Chief Financial Officer will be created.

Under the “consumer choice” provisions of the bill (Section 2), reference is made that the Citizens depopulation provisions must be subject to the insurance agent commission payments under s. 627.3511(4) (agent bonus plans). However, s. 627.3511(4), F.S., has not been amended by this bill and appears to create a conflict between the keep-out commissions that must be paid to the producing agent of record under s. 627.351(6)(c)5., and the take-out commissions paid to the producing agent of record pursuant to s. 627.3511(4). It was the apparent intent of this bill to amend s. 627.3511(4), as amended in CS/SB 1126 (the “Insurance Policy Holder Protection Act”).

VIII. Amendments:

None.