Whether Florida's Insurance Laws are Adequate to Respond to the Next Major Hurricane

Report Number 2001-001

October 2000

Prepared for
The Florida Senate

Prepared by
Committee on Banking and Insurance

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Background

During the months that followed Hurricane Andrew in 1992, the Department of Insurance responded with a series of emergency rules and the Legislature convened a special session to address the most immediate insurance problems. Since that time, major changes have been made to Florida's property insurance laws. But certain problems that occurred after Hurricane Andrew and which are likely to occur after the next major hurricane have not been addressed.

This report examines whether Florida's insurance laws provide regulatory officials with adequate authority to respond to consumers' insurance problems following another major hurricane. It reviews the problems that occurred after Hurricane Andrew, the state actions that were taken at that time, the laws that have been enacted since, and evaluates the need for additional legislation.

One problem is the limited funding available to the Florida Insurance Guaranty Association to pay for claims of insurers that become insolvent after a hurricane, which necessitated a special session of the Legislature after Hurricane Andrew. Other problems were addressed by emergency rules adopted by the Department of Insurance, including termination of policies by insurers, delays by insurers in investigating and adjusting claims, and excessive commissions charged by public adjusters.

In May 1993, the Legislature imposed a 180-day moratorium that prohibited insurers from canceling any residential property insurance policies in the state for the purpose of avoiding the risk of a hurricane. In November 1993, the moratorium was revised to limit the number of residential policies that an insurer was allowed to terminate, scheduled to be in effect for 3 years, until November 1996. These limitations were further revised and extended until 1999, and again extended until June 1, 2001. This report also addresses whether the current limitations should be extended or allowed to stand repealed on June 1, 2001, as currently scheduled.

Methodology

Staff reviewed the emergency rules issued by the Department of Insurance after Hurricanes Andrew, Opal, and Erin, the permanent rules related to these issues, the statutes cited for authority for these rules, and major property insurance legislation enacted since Hurricane Andrew. Estimates of assessment revenues were obtained from the Florida Insurance Guaranty Association and summaries of the insurance guaranty fund laws of each state was obtained from the National Conference of Insurance Guaranty Funds. Financial information on Florida insurers was obtained from the Department of Insurance and the Florida Hurricane Catastrophe Fund, and staff reviewed studies of insurer solvency by A.M. Best, the Governmental Accounting Office, and the Wharton School of the University of Pennsylvania. Residual market policy and exposure data was obtained from the Florida Residential Property and Casualty Joint Underwriting Association and the Florida Windstorm Underwriting Association. Legislative history and case law were reviewed regarding the current moratorium statute which limits residential policy terminations. Staff interviewed representatives of the Department of Insurance, the Office of the Attorney General, and insurance companies.

Findings

Limited Resources of the Florida Insurance Guaranty Association to Pay Claims of Insolvent Insurers

Hurricane Andrew resulted in the insolvency of ten insurers. The Florida Insurance Guaranty Association (FIGA), which began operation in 1972, is required to pay claims of insolvent insurers, up to a limit of $300,000 per claim with a $100 deductible. (Ch. 631, part II, F.S.) However, after Andrew, FIGA estimated that it would experience a shortfall of about $500 million. At that time FIGA had a cash balance of $50 million and could collect an additional $63 million by assessing property and casualty insurers up to 2 percent of each insurer's written premium for the prior year. An additional $68 million could be collected the following year, in 1993, from another 2 percent assessment. This clearly posed an emergency, given thousands of policyholders who were waiting for claims payments, many of whom literally had no roofs over their heads.

The Legislature convened a special session in December 1992, and authorized the issuance of up to $500 million in tax-free municipal bonds to fund the FIGA shortfall. To fund the bonds, the Legislature authorized FIGA to impose a special assessment on property and casualty insurers of up to 2 percent of premiums, in addition to the regular 2 percent assessment. Insurers were allowed to pass the assessments on to policyholders through premium increases. A rate filing by an insurer limited to the 2 percent assessment increase was "deemed approved." The law also increased the limitation on FIGA liability for condominium association policies from the $100,000 per policy limit to $100,000 multiplied by the number of units in the condominium. (Ch. 92-345, L.O.F.)

The municipal bond, issued through the city of Homestead, generated $472.6 million. FIGA ultimately paid over $499 million in Andrew-related claims, which is about equal to the total amount FIGA had previously expended since its inception for 98 other insolvencies. The 2 percent special assessment was levied for four years from 1993 through 1996, plus a partial amount in early 1997, collecting $374.3 million. In addition, FIGA levied regular assessments at the maximum 2 percent rate in 1992 ($63 million), 2 percent in 1993 ($68 million), and 0.75 percent assessment in 1994, and allocated most of these revenues to Andrew-related claims. Since then, FIGA has levied a 0.125 percent assessment in 1996 and a 0.125 percent assessment in 1997. No assessments have been collected since 1997.

From inception through 1999, FIGA regular assessments have totaled $743 million, net of refunds. FIGA has also earned $81 million in interest and has received $338 million in recoveries from liquidators of insolvent insurers. Total claims paid through December 31, 1996, on behalf of 135 insolvent insurers, including storm claims paid with bond proceeds, was $1,472,927,800.

The current law still limits FIGA assessments against insurers in any one year to 2 percent of net written premiums for the prior year. The law divides FIGA into three accounts and limits assessments to the premiums written for the types of insurance in each account. One covers auto physical damage claims and another account covers auto liability claims. The third account covers “all other” property and casualty lines, including residential property insurance, commercial property insurance, general liability, malpractice, and other lines. A fourth account was previously established for workers’ compensation, but 1997 legislation transferred this account to a new guaranty association created solely for workers’ compensation.

FIGA is the ultimate reinsurer when a company fails. But, the law does not authorize a bond issue or any other mechanism to cover a shortfall that might occur, as it did after Hurricane Andrew. As of September 30, 2000, FIGA maintained a balance of $51.8 million in its “all other” (non-auto) account, received from the estates of liquidated insurers and earned on investments. An additional $121.6 million could be collected by FIGA by assessing insurers for the “all other” lines of insurance at the maximum 2 percent rate in 2000. FIGA also has the authority to borrow between accounts, and the two auto insurance accounts have combined balance of $21.8 million as of September 30, 2000. These amounts may be insufficient if a hurricane again triggers multiple insurer insolvencies.

Florida’s guaranty fund law is typical of guaranty fund laws enacted in all 50 states and the District of Columbia. Thirty-seven (37) states, including Florida, cap assessments at 2 percent of premium, 13 states cap assessments at 1 percent of premium, and one state caps at 1.5 percent. Florida is also in the majority by being one of 34 states that divide their property and casualty guaranty funds into separate accounts and limit assessments to the lines of insurance within that account. The other 17 states have only one account for property and casualty insurance which provides a broader assessment base (but 2 of these states have a separate fund for workers' compensation.) Most typically, state funds have three accounts for auto, workers' compensation, and all other property and casualty insurance, respectively. Florida is the only state that divides auto insurance into two separate accounts for physical damage and other liability, respectively.

New York is the only state that collects assessments against insurers at the 2 percent rate each year, whether or not insolvencies have occurred. This enables the New York fund to build its cash reserves and provides greater assurance that all claims will be covered. However, on occasion, the New York Legislature has "raided" the fund by making appropriations for other purposes.

It is difficult to determine whether FIGA is presently any more or less vulnerable to unfunded claims after a major hurricane, as compared to 1992 prior to Andrew. This, of course, largely depends on the claims-paying ability of property and casualty insurers in Florida, and the evidence is mixed.

Certain factors that exist today should help mitigate insurers' hurricane losses and shield FIGA. Most importantly, the Florida Hurricane Catastrophe Fund ("Cat Fund"), created in 1993, will reimburse insurers for a portion of their residential hurricane losses. Insurers must purchase reinsurance from the Fund to cover 45 percent, 75 percent, or 90 percent of their hurricane losses, above their retention. Total reimbursement from the Cat Fund in one year is limited to $11 billion for all insurers combined. The total retention for all insurers combined is $3.2 billion in 2000. Each insurer's maximum annual recovery is limited to the insurer's proportionate share of Cat Fund premiums; for example, an insurer that pays 1 percent of total Fund premiums has a maximum recovery of $1.1 billion. In addition to its premium revenue from insurers, the Cat Fund may issue bonds to meet its obligations, financed by up to a 4 percent annual assessment on property and casualty insurers. If necessary to fund multi-year storms, the law allows an additional 2 percent annual assessment.

Hurricane Andrew caused $15.5 billion in insured losses, of which $10 billion were residential losses that would now be partially covered by the Fund. If a hurricane caused $10 billion in residential losses today (and losses were spread evenly to all insurers), insurers would pay a combined retention of $3.2 billion plus $950 million in co-payments, totaling $4.15 billion, and the Cat Fund would pay the remaining $5.85 billion. But an Andrew-like storm would have higher losses today due to inflation and growth. The Insurance Services Office estimates that Hurricane Andrew's $15.5 billion of insured losses would be $22.9 billion, after being adjusted for inflation through 1999, as well as population growth and changes in the amount of property value per person. By this measure, residential losses from Andrew would be $14.8 billion today, rather than $10 billion. For a $14.8 billion storm, the Cat Fund would pay about $10 billion and the insurers would pay $4.8 billion. The Cat Fund would reach its $11 billion limit if insured residential losses totaled $16.1 billion or greater.

Another factor that limits FIGA's exposure, as compared to 1992, is the market share of the residual market. FIGA is not responsible for guarantying payment of losses by either of the two state-created residual market insurers, which have their own assessment mechanisms to fund losses. The Florida Windstorm Underwriting Association (FWUA) has 430,256 policies in force insuring nearly $91 billion in property value as of September 30, 2000. In addition, the Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) has 64,950 policies in force, insuring about $7.3 billion in property value, as of September 30, 2000. In contrast, when Hurricane Andrew struck, the RPCJUA did not yet exist and the FWUA insured only about 62,000 policies statewide and had no policies in Dade, Broward, or Palm Beach Counties. Substantially all of the Andrew claims were against authorized insurers protected by FIGA. This year, the FWUA accounts for 23 percent of the total Cat Fund premiums paid by all insurers, which nearly equates to assuming the risk for 23 percent of the expected residential hurricane losses in the state (but it is somewhat less because of the different coverage options available from the Cat Fund). In addition, the RPCJUA pays 4.2 percent of the Cat Fund premium, so about one-fourth of the state's residential hurricane risk is assumed by the residual market. Most of this exposure is located in Dade, Broward, and Palm Beach Counties, concentrated near the coast. There is great concern about this loss exposure and potential assessments to fund the FWUA and RPCJUA, but this exposure does operate to lessen FIGA's potential liability.

Since Hurricane Andrew, greater recognition has been given by insurers, regulators, and rating organizations of the need for insurers to obtain adequate reinsurance to cover catastrophes. Also, estimated hurricane losses by modeling firms have significantly increased, based largely on the actual losses from Andrew. Best's Insurance Services now requires, as a condition for a satisfactory rating, that an insurer maintain adequate surplus and reinsurance to cover its probable maximum loss for a 100-year period. Also, the annual statement filed with state insurance departments asks insurers whether they have obtained reinsurance to cover their probable maximum loss (although specific information is not required). In Florida, the Department of Insurance requires insurers that take policies out of the residual market to demonstrate that they have obtained reinsurance to cover their 100-year probable maximum loss. However, there is no similar requirement for property insurers generally.

But, there are also indications that FIGA's exposure could be greater than its pre-Andrew status. Many new Florida property insurers have been formed since Andrew. Thirty-four insurers have taken over 927,000 policies out of the RPCJUA. In its report, *Florida Insurers May Be Unprepared for Major Storms,* (Best's Viewpoint, Feb. 7, 2000; revised and corrected Mar.13, 2000), A.M. Best expressed its concerns "that some takeout companies may be insufficiently capitalized and/or are too dependent on reinsurance to survive several smaller events during the same policy year if losses fall below their reinsurance coverage by event or exceed their aggregate cover." The report stated:

> *A.M. Best is concerned that several insurers, not rated by A.M. Best would not survive a single catastrophic event, let alone a second event during the same policy year. This concern is due to their inability to generate capital, as well as the lack of financial flexibility to ensure continuing operations after a catastrophe. . . .Florida has given thinly capitalized, opportunistic insurers incentives – "take-out fees" – to assume the riskiest properties in Florida. These companies are dependent on private and state-sponsored reinsurance and half are not rated by A.M. Best.* (Best's Viewpoint, February 7, 2000)

In its corrected report, Best stated that it "may have over-stated that many of the takeout companies may be impaired by just one or two category 1, 2, and 3 storms," and noted that the Florida Department of Insurance believed that these concerns have been mitigated by safeguards put in place to improve the protection of policyholders including reinsurance cover for a 100-year event.

After Andrew, the state's largest property insurers formed Florida subsidiary corporations in order to protect their parent companies' surplus from the risk of Florida hurricanes, while maintaining a significant statewide market share. State Farm paid out $3.6 billion in claims from Andrew and required an injection of surplus from its parent mutual auto insurance company to remain solvent. Allstate paid $2.3 billion in Andrew claims. Their new Florida subsidiary companies have a lower amount of surplus than their parent companies had to pay for Florida hurricanes, but the subsidiaries have significantly greater reinsurance than their parent companies had at the time of Andrew. The Florida Hurricane Catastrophe Fund provides about $2.9 billion in reinsurance coverage in 2000 for these two insurers combined. State Farm, Allstate, and Travelers, have each formed Florida corporations to insure Florida property. At the time of Hurricane Andrew, State Farm and Allstate together accounted for about one-half of the market share for property insurance in the state. Today, these two insurers insure about one-fourth of the residential hurricane risk, based on premiums paid to the Florida Hurricane Catastrophe Fund. Due to increased writings of the residual market, selective non-renewals, and coverage limitations, the major insurers are less concentrated in high-risk areas and have lowered their exposure to hurricane losses. Coverage limitations include higher deductibles, providing actual cash value coverage rather than replacement cost coverage, reduced limits on collectibles, elimination of coverage for non-attached structures, and limiting additional living expense coverage.

The U.S. General Accounting Office issued a report on February 8, 2000, *Insurers' Ability to Pay Catastrophe Claims.* The report measured the surplus of the property and casualty insurers, but was not able to measure the reinsurance purchased by these insurers except by citing other sources of reinsurance information. The GAO acknowledged that reinsurance is a critical element of the industry's ability to pay claims. The report found that nationwide, property and casualty industry surplus more than doubled in the 1990s. Between 1990 and 1998, total industry surplus grew by about 140 percent in current dollars and about 93 percent in inflation–adjusted dollars. According to the National Association of Insurance Commissioners (NAIC), the nominal increase was from about $177 billion in 1990 to about $427 billion in 1998, but the Insurance Services Office calculated that surplus grew from $138.4 billion to $333.5 billion. But the GAO noted that for any given catastrophe, only a portion of the industry's surplus is available to pay disaster claims. The GAO also obtained data from NAIC on the surpluses of property and casualty insurers that operated in Florida from 1990-98 and found that the surplus increased 152 percent. However, these figures do not reflect the change in surplus that later resulted from the formation of Florida-only subsidiaries of the major insurers.

The GAO reported (but could not verify) that two leading reinsurance firms estimated that about $13 billion to $15 billion of catastrophe, excess-of-loss reinsurance is in force in the U.S. per region, per type of catastrophic event. These estimates were about twice the amount of reinsurance that they estimated was available in 1994.

The GAO obtained catastrophe loss estimates from two firms. One firm estimated that Florida faced a $42.8 billion estimated loss for a 1-in-100-year storm and a $71.5 billion loss for a 1-in-250-year storm. These estimated losses for Florida were over twice as great as the estimated losses for the second highest state, California, which had an estimated $20.3 billion loss for 1-in-100-year earthquake. The second firm estimated losses by region and estimated that the Gulf region, including Florida, faced a $35.2 billion loss for a 1-in-100-year storm and a $47.3 billion loss for a 1-in-250 year storm.

Based on their analysis of insurers' surplus, the GAO determined that in Florida, 45 percent of insurers may experience claims that would exceed 20 percent of their surplus in a 1-in-100-year catastrophe loss. This is the level of surplus loss from a catastrophe that could trigger a rating review by A.M. Best Company. The 45 percent estimate was greater than for any of the ten states reviewed. But the GAO acknowledged that their analysis had substantial limitations. Most importantly, the analysis did not estimate or include recoveries from reinsurance or the $11 billion available from the Florida Hurricane Catastrophe Fund. Also, actual losses would depend on the specific properties insured by a company. The

GAO cited a 1999 study by the Wharton School of the University of Pennsylvania that determined that insurance companies that operated in Florida in 1997 could have paid at least 99 percent of a $20 billion Florida hurricane or at least 90 percent of a $100 billion Florida hurricane, compared to 94 percent and 72 percent at 1991 capitalization levels. But the Wharton study also determined that a $100 billion Florida hurricane would cause either 10 corporate family or 34 individual insurer insolvencies. (*Can Insurers Pay for the "Big One?" Measuring the Capacity of the Insurance Market to Respond to Catastrophe Losses*, Wharton School, University of Pennsylvania), July 14, 1999.)

The potential risk of insolvency for Florida insurers is dependent on many factors. But, even if insurers' claims paying capacity in Florida has improved since Andrew, the limited funding available for FIGA and the hurricane loss scenarios pose a serious threat that FIGA may not be able to fully pay claims in a timely manner after another major hurricane. On the one hand, FIGA may be viewed as a limited safety net that is not intended to fully fund all insolvencies, particularly if a major catastrophe demands federal assistance. But, the Andrew experience indicates that the Florida Legislature is likely to provide some additional funding to meet FIGA obligations. Providing the authority for such funding in advance may eliminate the need to convene a special session and would shorten the time for FIGA to collect needed funds and pay policyholders. For these reasons, the following options should be considered by the Legislature:

1. Increase the maximum 2 percent annual assessment for FIGA's "other insurance" account to 4 percent, which would increase available funding from $121.6 million to $243.2 million, as applied to 1999 premiums;
2. Merge FIGA's 3 accounts into 1 account and apply assessments to all property and casualty lines covered by FIGA (i.e., including auto insurance, but not including workers' compensation) which would increase available funding from $121.6 million to $289.5 million at the 2 percent rate, as applied to 1999 premiums;
3. Pre-fund FIGA by assessing insurers at a 2 percent rate each year (as New York law provides), whether or not an insolvency has occurred, which would enable the Fund to collect and invest about $121 million each year, subject to premium growth, to reserve for future insolvencies; and/or
4. Authorize FIGA to impose a special 2 percent assessment, in addition to the regular 2 percent assessment, if necessary to pay claims after a hurricane, and to issue bonds secured by the special assessment.

A related FIGA issue is whether the RPCJUA should be subject to assessments by FIGA. The law does not expressly address this issue for either the RPCJUA or the FWUA. In actual practice, FIGA has assessed the RPCJUA but has not assessed the FWUA. This seemingly inconsistent approach is the result of the fact that the Department of Insurance issued a certificate of authority to the RPCJUA but not to the FWUA. A certificate of authority was issued to the RPCJUA because of concerns expressed by bond underwriters when the $500 million bond issue was being negotiated for FIGA in 1992. The concern was that authorized insurers would cancel a substantial number of policies, which would be placed in the RPCJUA, which would impair the revenues collected by the special 2 percent assessment unless it applied to the RPCJUA. Therefore, the department issued a certificate of authority to the RPCJUA in early 1993, in order for the association to be an “insurer” for the purposes of FIGA assessments. Last session, the RPCJUA proposed legislation that would have exempted it from assessments imposed by FIGA, except for assessments levied to secure bonds to pay covered claims of insolvent insurers related to any hurricane. An amendment to this effect was approved by the Committee on Banking and Insurance and included in CS/SB 144, which died in the Committee on Agriculture and Consumer Services.

The main argument for not imposing FIGA assessments on either the RPCJUA or the FWUA is that FIGA does not provide any protection for either of these two insurers. They each have their own assessment mechanisms to fund losses independent of FIGA. Also, the RPCJUA is seeking to obtain exemption from federal income taxation and it is believed that an exemption from FIGA assessments would enhance its chances of success. As long as the RPCJUA remains subject to any special assessments that are imposed to fund a bond issue, the bond issue would not be impaired and FIGA’s ability to fund claims of insolvent insurers would not be compromised.

A different approach to the FIGA funding problem would be to increase the funding and coverage provided by the Florida Hurricane Catastrophe Fund, which would act as a stronger buffer to prevent insolvencies and help insulate FIGA. In 1999 the Legislature authorized an extra 2 percent assessment to provide subsequent season coverage for the Fund, if the 4 percent assessment is used to meet the Fund’s obligations for a prior hurricane. (Ch. 99-217, L.O.F.) The bill also limited the Fund’s annual obligation to $11 billion. The bill (SB 1290) had originally provided for a maximum 8 percent assessment, based on estimates that the $11 billion annual limit would effectively limit the assessment for any one hurricane season to about 4 percent, and that an assessment in excess of 4 percent would be necessary only if another hurricane in a subsequent year triggered payment obligations before the first bond issue was retired. The main objective of this legislation was to preserve the Fund’s reinsurance capacity for a subsequent season, in order to prevent or mitigate policy cancellations and rate increases after one major storm. Due to concerns over the level of potential assessments, the final version of the bill maintained the 4 percent limit on assessments for a single storm season, but allowed for an extra 2 percent assessment to cover subsequent seasons, capped at 6 percent total. An option to again consider is authorizing a maximum 8 percent assessment to fund Cat Fund obligations, while maintaining the $11 billion cap, which functionally limits assessments for one storm to about 4 percent. The increased reinsurance capacity for second-season coverage would provide greater protection to insurers and FIGA for a second-season storm and would reduce market disruption, but it would not provide greater protection for the first season storm, which would still be subject to the $11 billion cap. Another option would be to increase the $11 billion cap, which would provide greater protection to insurers and FIGA for the first season storm, but at the expense of preserving reinsurance capacity for subsequent seasons. Other problems with this option is that a cap much in excess of $11 billion, to be realistic, would require an assessment greater than 4 percent. Also, as the maximum limit increases, there is less confidence that the bond market can actually respond.

Limitations on Cancellations and Non-Renewals; Scheduled for Repeal on June 1, 2001

Prior to Hurricane Andrew, there were no laws in Florida that limited the number of property insurance policies that an insurer could non-renew. Insurers were free to non-renew as many policies as they desired. After Hurricane Andrew, many insurers sought to reduce their exposure to hurricane losses in Florida by either non-renewing existing policies or refusing to write new policies, or both. In response, the Department of Insurance issued a series of emergency rules limiting insurers authority to cancel or non-renew certain policies. (4ER92-2, 92-13, 93-18, F.A.C.)

In the May 1993 Special Session, the Legislature imposed a moratorium on non-renewals, by prohibiting insurers from non-renewing any personal lines, residential property insurance policies (homeowners, mobile homeowners, condominium unit owners) for the purpose of reducing hurricane exposure during the 180-day period from May 19 until November 14, 1993. (Ch. 93-401, L.O.F.)

In the November 1993 Special Session, the Legislature enacted a 3-year "moratorium phase-out" that followed the 180-day moratorium, that limited the number of residential property insurance policies that insurers were permitted to non-renew for the purpose of reducing hurricane exposure. The law prohibited insurers from non-renewing more than 5 percent of their policies in the state in any 12-month period, and prohibited insurers from non-renewing more than 10 percent of their policies in any one county in any 12-month period. These percentage limitations applied separately to mobile home policies. Certain exceptions were provided for insurers that could demonstrate an unreasonable threat to their solvency. (Chs. 93-410 and 93-412, L.O.F.)

By its terms, the 3-year moratorium was scheduled to expire on November 14, 1996. But, the 1996 Legislature replaced the "moratorium phase-out" with a 3-year "moratorium completion" that ran from June 1, 1996, until June 1, 1999. The moratorium applied to policies in effect on June 1, 1996, and did not apply to policies written after that date. (Chs. 96-144 and 96-377) This moratorium continued the same percentage limits on non-renewals as in the previous 3-year moratorium and added condominium association policies to its scope (s. 627.7014, F.S.). However, the 1996 law allowed insurers to transfer policies to another authorized insurer without it counting as a non-renewal, and allowed an insurer to apply to the department for approval of an “accelerated exposure reduction program” for non-renewal of the windstorm portion of policies in areas eligible for windstorm coverage from the FWUA. This allowed an insurer to non-renew the windstorm coverage for up to 15 percent of its policies in the state (“accelerating” the 3-year limit of 5 percent per year), with no limit on the percentage of policies that could be non-renewed in any particular county. The department approved such plans for the state’s two largest writers, State Farm and Allstate.

In 1998, the Legislature again extended the limitation on hurricane-related termination of personal lines residential policies, until June 1, 2001, which is the current law in ss. 627.7013 and 627.7014, F.S. (Ch. 98-173, L.O.F.) The extended moratorium continues to apply only to those policies that were in effect on June 1, 1996, and does not apply to policies issued after that date. The current statute contains legislative findings that as of January 1, 1998, the general instability of the market was reflected by the fact that the FWUA had more than 400,000 policies in force, approximately half of which were initially issued after January 1, 1997, and that in spite of depopulation efforts, the RPCJUA still had approximately 500,000 policies in force. The current law provides that the moratorium is repealed on June 1, 2001, but will also cease to operate once the property exposures of the FWUA and RPCJUA, combined, remains below $25 billion for 3 consecutive months. [Sections 627.7013(2) and 627.7014(2), F.S.]

In 1998, the U.S. Court of Appeals for the Eleventh Circuit upheld the facial constitutionality of the moratorium statute, but left open the possibility that the statute could be unconstitutional as applied, in the case of *Vesta Fire Ins. Co. v. State of Florida, Department of Insurance*, (141 F.3d 1427). The lower court, the U.S. District Court for the Northern District of Florida, had upheld the constitutionality of the 1993 moratorium statute which was scheduled for repeal in 1996. By the time the case was heard by the appellate court, the Legislature had extended and modified the moratorium until 1999. The current extension to 2001 had not yet been enacted.

In *Vesta*, the Eleventh Circuit held that the moratorium statute did not violate the Contract Clause of the U.S. Constitution which prohibits a state from passing any law impairing the obligation of contracts. (U.S. Const. Art. 1, sec. 10). The Court, citing prior U.S. Supreme Court decisions, stated that three factors are considered: (1) whether the law substantially impairs a contractual relationship; (2) whether there is a significant and legitimate public purpose for the law; and (3) whether the adjustments of rights and responsibilities of the contracting parties are based upon reasonable conditions and are an appropriate in nature. First, the Court recognized that a substantial impairment to insurance contracts existed. Second, the Court found that Florida demonstrated a legitimate public purpose of protection and stabilization of the Florida economy, particularly the real estate market. Third, the Court cited Supreme Court precedent for the proposition that unless the State itself is a contracting party, courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure. In this case the State was not party to the insurance contracts, so based upon the Legislature's judgment, the statutes' impact on existing insurance contracts was not an unconstitutional impairment.

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

The current limitations on residential policy terminations are scheduled for repeal on June 1, 2001. Legislative consideration of reenactment is not specifically required. The main arguments for allowing these limitations to expire are that they have very limited effect, are no longer necessary, and may be unconstitutional if extended. Those insurers that were seeking to reduce their hurricane exposure after Hurricane Andrew have already taken actions to do so, through a combination of non-renewing policies up to legal limits, restrictive underwriting, forming Florida-only subsidiaries, and adding hurricane endorsements to policies with increased deductibles and other coverage limits. When the 1998 Legislature extended the moratorium, the RPCJUA still had about 370,000 policies, which has now been reduced to about 65,000 policies as of September 30, 2000. During this same period, the FWUA has remained at about 430,000 policies in force. While still significant, the residual market appears to have leveled off. The mere passage of time acts to lessen the impact of the moratorium because it applies only to policies in effect on June 1, 1996, and does not apply to policies written after that time. It is very doubtful that expiration of the moratorium would have any noticeable effect on the market, absent a future hurricane.

If the current limitations expire the question remains as to whether any laws are needed at this time to authorize the Department of Insurance to limit cancellations and non-renewals *after* the next major hurricane if certain market conditions exist. It may be argued that such laws would discourage insurers from writing coverage in Florida, but it can also be argued that insurers expect the state to again restrict non-renewals after the next major hurricane and have already taken this into account in deciding to do business here. It may even be preferable, from an insurer's perspective, to know the extent of the restrictions in advance. Constitutionally, the state may be on sounder footing for legal restrictions on cancellation that are enacted (but not implemented) *prior* to affected policies being written or renewed, because a contract is not impaired by a law in effect at the time the contract is entered. Also, based on the *Vesta* case, the legal test for determining whether a law is an unconstitutional taking of property depends, in part, on the expectations of insurers.

An argument against authorizing the Department of Insurance to order restrictions on policy terminations is that an exercise of the state's police power should be implemented only when the Legislature determines it is actually needed, and having a moratorium statute "on the shelf" may be too easy to implement and may actually weaken constitutional arguments. This concern could possibly be addressed by legislatively authorizing the Governor and Cabinet to order such restrictions, rather than the department alone (which also relates to Cabinet reform issues currently before the Legislature).

Are any restrictions needed? When another major hurricane strikes, will insurers again seek to reduce their hurricane exposure in Florida, or has market restructuring since Andrew resulted in massive cancellations being less of a threat? The fact that many take-out insurers are heavily dependent upon reinsurance makes them vulnerable to price increases and coverage limits by private reinsurers which are likely after a major hurricane. The Florida Hurricane Catastrophe Fund will have a reduced capacity to help fill this void. This could again trigger policy cancellations on a large scale.

When cancellations occurred after Hurricane Andrew, there was no mechanism initially in place to assure that coverage was available. This initially affected owners of damaged homes and policyholders of insolvent companies and soon affected the entire state. The creation of the RPCJUA assured that coverage was available statewide. While important policy issues continue to be debated regarding rates, coverage, and funding, particularly for the FWUA, the current law assures that coverage will be available after the next major hurricane. But, if a major storm results in significantly greater numbers of policyholders in the RPJCUA or the FWUA, this will increase the magnitude of potential future assessments. This will be at a time when substantial assessments will have already been triggered to pay residual market claims and to fund Cat Fund obligations from the first storm. The residual market may be unable to obtain adequate financing to cover a second storm if a large bond issue has already been issued for the first storm.

The state’s interest in reducing potential assessments and assuring that the residual market can obtain financing for a second storm justifies the need to limit insurers’ ability to cancel and non-renew policies after the next major hurricane. The argument for authorizing an executive order limiting policy terminations after a hurricane are: (1) insurers would be put on notice that such restrictions may be triggered, (2) the legal argument may be stronger that such limits do not unconstitutionally impair contracts or constitute a taking of property; and (3) the Legislature would not need to convene a special session to impose such limits, which could be effective as soon as the Insurance Commissioner (or the Governor and Cabinet) issued an order.

The fact that the residual market can provide coverage to persons who are cancelled may argue against the need for executive authority to order an absolute prohibition on cancellations or non-renewals following a hurricane, which would be short-term at best. For nearly 8 years, Florida insurers have been operating under a general prohibition against canceling more than 5 percent of their residential property policies in any 12-month period, or more than 10 percent in a single county, in order to reduce their exposure to hurricane claims. One option is to enact a statute with these same limits that would become effective after a declared state of emergency and only upon order of the Department of Insurance, or, alternatively, the Governor and Cabinet, upon a determination that it was likely that a substantial number of policies would be terminated and that such terminations posed a serious threat to the economy of the state. Like the current law, the limitations could allow insurers to transfer policies to other authorized insurers and to petition the department for approval to exceed these limits, based on significant impairment to solvency. The law could limit the maximum time period the order could be in effect, such as one year, requiring a legislative determination of any extension or modification.

A related issue is that of insurers seeking to withdraw from the state. Section 624.430, F.S., provides that an insurer desiring to surrender its certificate of authority, withdraw from the state, or discontinue the writing or any kind or line of insurance must give 90 days’ notice in writing to the department setting forth its reasons for doing so. After Hurricane Andrew, the department issued an emergency rule that interpreted this requirement as authorizing the department to evaluate the sufficiency of the insurer's reasons, in light of any adverse consequences that may result, and allowing the department to impose such reasonable terms and conditions regarding withdrawal as necessary to prevent or ameliorate such adverse consequences. The rule provided that if the insurer and the department were in disagreement over the terms for withdrawal after 60 days, the insurer could demand a hearing under chapter 120 as to the matter. (Rules 4ER92-11 and 4ER93-5, F.A.C.). In addition to concerns about market disruption and availability of coverage, another concern was outstanding claims of insurers seeking to withdraw. Insurers that are prepared to surrender their certificate and leave the state may have little incentive to resolve their claims in a fair and expeditious manner.

The department adopted a permanent rule establishing procedures for withdrawal, surrender of a certificate of authority, or discontinuance of writing insurance in the state. (4-141.020, F.A.C.) The rule prohibits an insurer from taking any action in furtherance of a reduction, until 90 days after the receipt by the department of the notice required by s. 624.430, F.S. Prohibited actions include sending any notice of cancellation or termination, or notice of intent to cancel or terminate, to any person. The notice to the department must describe what treatment will be given by the insurer to its affected Florida policyholders and what steps will be taken regarding processing of any outstanding covered claims. The rule also provides, "No surrender or attempted surrender of a certificate of authority is effective until accepted by order of the department." The rule interprets the limits of the moratorium statute as taking precedence over s. 624.430, F.S., and lists factors that will be given great weight by the department in evaluating whether a desired reduction is for the purpose of reducing the insurer's exposure to hurricane claims.

The moratorium statutes effectively restrict the right of an insurer to withdraw from the state, at least for purposes of reducing hurricane exposure, but the statutes are scheduled for repeal on June 1, 2001. As mentioned, one option is to authorize the department or Cabinet to issue an order prohibiting insurers from terminating a specified percentage of policies, if certain findings are made following a hurricane. If that option is enacted, further limitations on the right of an insurer to withdraw from the state may not be necessary. If, however, that option is not enacted, other options may need to be considered to limit an insurer's right to withdraw. One option is to amend s. 624.430, F.S., to incorporate key provisions of the department's rule, summarized above, to provide clear legislative authority. Another option is to prohibit any insurer seeking withdrawal from canceling any policy mid-term and requiring that coverage be continued through the end of the policy term. This would at least assure that a large block of policies would not all be subject to cancellation at one time.

Licensing of Emergency Adjusters; Ethical Standards and Commission Limits

The thousands of insurance claims arising from Hurricane Andrew put tremendous strain on the ability of insurers to adjust claims in a timely manner. Section 626.874, F.S., (enacted prior to Andrew), authorizes the department, in the event of a catastrophe or emergency, to issue adjuster licenses to persons "under the conditions which it shall fix and for the period of the emergency as it shall determine." The department adopted emergency rules for the emergency licensure of adjusters after Hurricane Andrew in 1992 (4ER92-1, F.A.C.) and adopted a permanent rule on this subject in 1993 (4-220.001, F.A.C.). The rule permits insurers, independent adjusters, and general lines agents to immediately utilize emergency company adjusters or independent adjusters who they deem to be qualified and who they supervise and assume responsibility for, subject to certain filing requirements and post-licensure by the department. However, *public adjusters* who contract with claimants to negotiate claims on their behalf with insurers, must obtain advance approval from the department on an expedited basis, and are subject to greater restrictions than company adjusters and independent adjusters.

Section 626.878, F.S., requires adjusters to subscribe to a code of ethics adopted by rule of the department, which the department has adopted in rule 4-220.201, F.A.C. Certain provisions relate to problems that can occur after a hurricane. The rule prohibits adjusters from negotiating with a claimant at a time when the claimant may reasonably be expected to be in serious emotional distress as a result of emotional trauma associated with a loss. The rule also requires that a public adjuster's contract with a client be cancelable by the claimant for at least three business days after the contract has been entered.

After Hurricane Erin in 1995, and again after Hurricane Opal in that same year, the department issued emergency rules that limited commissions for public adjusters to no more than 10 percent of any insurance settlement. (4ER95-4 and 4ER95-5, F.A.C.) The emergency rule for Hurricane Erin also required department approval of all contracts by a public adjuster with a claimant regarding total loss to the claimant's residence. For the contract to be approved, the public adjuster had to show that the services provided or to be provided did or may reasonably be expected to result in the claimant obtaining a settlement materially in excess of what could have occurred without the services of the public adjuster. According to the department, based on their experience with Hurricane Andrew, unscrupulous public adjusters took advantage of the vulnerability of the storm's victims by charging unreasonably high fees for their services.

These commission limitations and contract approval requirements for public adjusters in previous emergency rules have expired and are not addressed in the permanent rule. The cited authority for the emergency rules was the same as for the permanent rule, s. 626.878, F.S., which authorizes the department to adopt a code of ethics for adjusters. It may be questioned whether this statutory authority is sufficient if the department adopts similar emergency rules after another hurricane.

One option is for the Legislature to provide more specific statutory authority for the department to adopt rules limiting public adjuster commissions after a catastrophe and for the department to amend its permanent rule to include these requirements. A second option is to specify the limitations in the statute, in order to give legislative consideration to the policy issues involved and to avoid rule challenges. Both options are based on the assumption that if it is unfair for public adjusters to charge in excess of 10 percent of the insurance settlement after one hurricane, it is unfair after any hurricane. Similarly, the merits of requiring department approval of public adjuster contracts if there is a total loss to a claimant’s residence do not appear to depend on the unique situation of a particular hurricane. It may be more appropriate to also address these requirements by statute or by permanent rule, or both, to eliminate the need for adopting emergency rules after each hurricane and to avoid legal challenges.

Investigation of Claims

After Hurricane Andrew, the department issued a bulletin (B92-023) setting forth certain time constraints on insurers to process claims. This was followed by an emergency rule which applied to all personal lines claims that had been filed with an insurer through October 15, 1992, requiring that the insurer complete the following actions by November 10, 1992: have an insurance adjuster visit all claimants; advance appropriate funds to all insureds entitled to additional living expenses; inspect all damage and make an initial assessment; and make a good faith and reasonable effort to settle all claims and, if applicable, begin earnest negotiations toward settlement. (4ER92-20, F.A.C.) Insurers were required to file an affidavit of compliance with this rule. Another emergency rule provided for the department to conduct an examination of an insurer after repeated instances of alleged failure to comply with the time restraints and for the department or its contract examiner to adjust the claims or, alternatively, requiring the insurer to contract with an independent adjuster acceptable to the department to adjust claims. (4ER92-16, F.A.C)

The current law prohibits certain unfair claim settlement practices in s. 626.9541(1)(i), F.S. One of the proscribed practices, if committed or performed with such frequency as to indicate a general business practice is the following:

> *e. Failing to affirm or deny full or partial coverage of claims, and as to partial coverage, the dollar amount or extent of coverage, or failing to provide a written statement that the claim is being investigated, upon the written request of the insured within 30 days after proof-of-loss statements have been completed.*

The above-quoted statute provides some protection to policyholders to help assure that claims will at be investigated within 30 days, but the statute merely prohibits actions that are performed with such frequency as to indicate a general business practice and does not require specific actions that the department required in its emergency rule after Hurricane Andrew, such as requiring an adjuster to visit the claimant within a specified time and requiring an advance of additional living expenses. Nor does the law specifically authorize the department to take actions to have claims adjusted at an insurer's expense if an insurer fails to meet its obligations. The Legislature should consider enacting specific requirements in this regard, which could be limited to hurricane claims, or authorizing the department to adopt such requirements by rule.

Extension of Grace, Claims Filing, Reinstatement, and Miscellaneous Periods

The disruption of mail delivery and displacement of persons from their homes after Hurricane Andrew served as the primary justification for the department's emergency rule that extended any time limit upon an insured in certain counties to perform any act or transmit information or funds with respect to his insurance coverage. Any such act, such as payment of renewal premiums, that was to have been performed on or after August 21, 1992, was extended for 60 days, and a subsequent rule extended this grace period to November 1, 1992, or any longer period deemed reasonable under the specific circumstances. (4ER92-2 and 92-8, F.A.C.) This requirement was in addition to prohibitions against insurers canceling or non-renewing residential policies for certain time periods. The Legislature should consider authorizing the department to adopt such rules if a determination is made that damage from a hurricane has been so extensive as to impair the ability of insureds to comply with contractual time limits.

Alternative Procedures for Resolution of Claims

After Hurricane Andrew, a series of emergency rules provided for mediation of property insurance claims by the Department of Insurance, under specified procedures. (4ER 92-17, 92-26, 93-13, and 93-22, F.A.C.)

In 1993, the Legislature enacted s. 627.7015, F.S., which authorizes the department to adopt by rule a property insurance mediation program and to adopt special rules which are applicable in cases of an emergency. The stated purpose of this law is to provide an informal forum for helping parties who elect this procedure to resolve their claims disputes. The insurer must bear the costs of the mediation, which is non-binding on the parties.

The Department of Insurance promulgated permanent rules establishing the property insurance claims mediation program. (4-166.031, F.A.C) The definition of a “claim” that is eligible for mediation exempt situations where the insurer has a reasonable basis to suspect fraud, or where, based upon agreed facts as to the cause of loss, there is no coverage for the claim. Unless the parties agree to mediate a claim involving a lesser amount, a “claim” involves a request for $500 or more to settle the dispute, or the difference between the positions of the parties is $500.

Spokespersons for the department and various insurers agree that the mediation process has worked well to help resolve property insurance claims in an expeditious, informal, and inexpensive manner. No legislative changes appear to be necessary at this time.

Costs of Repairs and Other Services; “Price Gouging”

After Hurricane Andrew reports of excessive charges by contractors led the department to adopt emergency rules establishing guidelines for construction costs, which reflected fair market value. (4ER 92-5, 92-12, 92-27, 93-14, and 93-23, F.A.C.) The rules did not limit prices that could be charged, but established a schedule of prices for insureds and insurers to use in evaluating reasonable charges for repair and replacements costs arising from damage associated with Hurricane Andrew. Insurers were directed to notify the Attorney General of Florida if the insurer was aware of a contractor charging “unreasonably and without proper justification more than the schedule.” The Office of the Attorney General also received many complaints about “price gouging” by retailers for supplies and services that were in need after the storm.

In the December 1992 Special Session following Hurricane Andrew, the Legislature enacted s. 501.160, F.S., which makes it unlawful after a declared state of emergency by the Governor for a person to rent or sell at an unconscionable price within the area of the emergency, any essential commodity including, but not limited to, supplies, services, provisions, or equipment that is necessary for consumption or use, or any dwelling unit or self-storage facility. It is prima facie evidence that a price is unconscionable if the amount charged represents a gross disparity between the price and the average price charged during the 30 days prior to the emergency, and the increase is not attributable to additional costs incurred or national or international market trends. It is also prima facie evidence that a price is unconscionable if the amount charged grossly exceeds the average price at which the same or similar commodity was readily obtainable in the trade area during the 30 days prior to the emergency, and the increase is not attributable to additional costs incurred or market trends. These provisions are in the Florida Deceptive and Unfair Trade Practices Act in part II of chapter 501, F.S., which may be enforced by the state attorney of a judicial circuit or the Department of Legal Affairs. Penalties include injunctive relief, fines, and restitution and damages to injured consumers. (s. 501.2075, F.S.)

The Office of the Attorney General reports that it has brought numerous actions under this statute which has served as an effective tool to prevent and correct instances of retailers taking advantage of hurricane victims by charging grossly increased prices for their goods and services. A question has been raised by representatives of the hotel and motel industry as to whether the statute applies to charges by hotels and motels in affected areas after a hurricane. A spokesperson for the Office of the Attorney General states that they interpret the statute as applying to hotels and motels and has not had problems enforcing this interpretation, but that the statute could be clarified on this point.

Conclusions and Recommendations

1. The limited funding available for the Florida Insurance Guaranty Association (FIGA) poses a serious threat that FIGA may not be able to fully pay claims after a major hurricane. Providing legislative authority for such funding in advance may eliminate the need to convene a special session and would accelerate the time for FIGA to collect needed funds to pay policyholders. The following options should be considered:

(1) Increase the maximum 2 percent annual assessment for FIGA's "other insurance" account to 4 percent, which would increase available funding from $121.6 million to $243.2 million, as applied to 1999 premiums;
(2) Merge FIGA's 3 accounts into 1 account and apply assessments to all property and casualty lines covered by FIGA (i.e., including auto insurance, but not including workers' compensation) which would increase available funding from $121.6 million to $289.5 million at the 2 percent rate, as applied to 1999 premiums;
(3) Pre-fund FIGA by assessing insurers at a 2 percent rate each year (as New York law provides), whether or not an insolvency has occurred, which would enable the Fund to collect and invest about $121 million each year, subject to premium growth, to reserve for future insolvencies; and/or
(4) Authorize FIGA to impose a special 2 percent assessment, in addition to the regular 2 percent assessment, if necessary to pay claims after a hurricane, and to issue bonds secured by the special assessment.

2. Exempt the Florida Residential Property and Casualty Joint Underwriting Association from assessments imposed by FIGA, except for assessments levied by FIGA to secure bonds to pay covered claims of insolvent insurers related to any hurricane.

3. Allow the current "moratorium completion" statutes [ss. 627.7013(2) and 627.7014(2), F.S.], to be repealed on June 1, 2001, which currently limit the percentage of residential property insurance policies that may be terminated. Replace these provisions with authority for the Insurance Commissioner or, alternatively, the Governor and Cabinet, to issue an order limiting policy terminations after a declared state of emergency if a finding is made that a substantial number of policy terminations are likely and that such terminations pose a serious threat to the economy of the state.

4. Provide specific statutory authority for the Department of Insurance to adopt

rules limiting public adjuster commissions after a hurricane. Alternatively, specify the limitations in the statute, by limiting commissions to ten percent of the insurance settlement.

5. (a) Authorize the department to adopt rules requiring insurers to have an adjuster visit a claimant and make an initial claims adjustment within a specified time, after a hurricane claim is filed.

   (b) Authorize the department to adjust the claim or contract for an adjuster at the insurer’s expense if an insurer fails to meet its obligations.

   (c) Alternatively, enact specific legislation imposing these requirements.

6. Authorize the department to adopt rules that extend any time limit upon an insured to perform any act or transmit information or funds with respect to his or her insurance coverage, if a determination is made that damage from a hurricane has been so extensive as to impair the ability of insureds to comply with contractual time limits.