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Ten Reforms to Fix Florida's Property Insurance Marketplace — Without Raising Rates

R.J. Lehmann
Senior Fellow and Public Affairs Director
R Street Institute, Washington, D.C.

INTRODUCTION

Florida's property insurance system remains broken and in need of significant changes. Past studies from the James Madison Institute have demonstrated the challenges that Florida's unstable property insurance market poses to the state government's fiscal situation and to the state's overall economy. The market is plagued by uncertainty, government intrusion, and regulatory overreach. Moreover, the ongoing risk that multiple government agencies might levy assessments on property insurance policies after a major storm or a series of lesser storms poses a meaningful risk to the state's post-disaster economic recovery.

Over the past few years, legislative action and private sector innovation have somewhat diminished these risks, but more remains to be done. Some of the remaining reforms may be somewhat painful to those who benefit from the status quo, but a failure to act could exacerbate the kinds of pain that would occur following a major storm.

It is not news that Florida has been struck by more hurricanes than any other state. The state is a low-lying tropical peninsula jutting 500 miles into the most hurricane-active waters in the world, just as it was 20 years ago and 100 years ago. It has also experienced some of the most powerful and damaging storms. Indeed, the strongest hurricane to make landfall in the United States was the "Labor Day Hurricane" that struck Florida in 1935.[1]

Damage was widespread on St. George Island after Hurricane Dennis in 2005. (Aerial photo by Tom Meares)

As of this writing, Florida had enjoyed eight years in which no hurricane made landfall. That was the longest such "drought" on record, but it is no cause for complacency.[2]

Despite its storm risks, Florida has seen its population and its built environment grow dramatically. Indeed, the state's population has almost tripled since 1970, growing from 6.7 million residents to more than 18 million. Even during the new century's first decade, when many perceived a slump in Florida, the state still added more than three million residents and grew 17.6 percent.[3]

This growth has increased Florida's total coastal exposure to $2.9 trillion, the most of any state.[4] Indeed, Florida has more property at risk than all of the other "hurricane alley" states (Virginia, North Carolina, South Carolina, Georgia, Alabama, Mississippi, Louisiana, and Texas) combined.[5]

Florida's geographic location and the concentration of property in the state's riskiest coastal areas are fundamental realities that can't be changed. But they also have relatively little to do with the decisions by many major property insurers not to expand their business in Florida, and nothing to do

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Trusted Solutions for a Better Florida

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TO CONTACT US

By Mail:
The James Madison Institute
The Columns
100 N. Duval Street, Tallahassee, FL 32301

By Phone:
In the Tallahassee area; 850-386-3131
Toll-Free from anywhere; 866-340-3131
Via e-mail:
jmi@jamesmadison.org

Web Site: jamesmadison.org.

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Ten Reforms to Fix Florida's Property Insurance Marketplace — Without Raising Rates

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with the instability of the state's property insurance market. What makes Florida truly unique is not the meteorological risk it faces, but its political, regulatory, tort, and judicial environment.

According to the New York-based Insurance Information Institute, non-catastrophe claims in Florida have increased roughly 17 percent per year over the past decade. The cost passed on to consumers to cover these claims is exacerbated by legal loopholes that have led to unscrupulous claims practices, increased litigation, and fraud.

Moreover, the deliberate, interconnected policies pursued by the Legislature, previous governors, and the Office of Insurance Regulation (OIR) have led to a dysfunctional property insurance system that has distorted pricing, undermined competition, and placed a heavy burden on the state's taxpayers. This has been accomplished through Florida's two property insurance mechanisms: the Citizens Property Insurance Corp. and the Florida Hurricane Catastrophe Fund (Cat Fund).

For too long, Florida has bet its public safety and fiscal health on the weather, but the state's ongoing statistically implausible winning streak[6] cannot continue indefinitely. The risk of collapse is simply too great to put off fundamental changes any longer. This study outlines pragmatic reforms that would have a meaningful effect on stabilizing the Florida property insurance market without requiring big hikes in primary insurance rates.

Citizens Property Insurance

Former Gov. Charlie Crist's 2007 insurance reforms allowed Citizens — the state-backed "insurer of last resort" — to offer policies to any Floridian who received a quote for coverage from a private insurer more than 15 percent greater than Citizens' rates.[7] This imposed a *de facto* price control on Florida's property insurance market. Additionally, the 2007 legislation required Citizens to roll back its premiums to 2006 rates and freeze them at that level.[8] These changes transformed Citizens from an insurer of last resort to an active competitor with an unfair advantage.

Subsequent legislation eased the rate freeze by replacing it with a "glide path" that allows annual rate increases of up to 10 percent until rates reach an actuarially sound level, which will take several years.

Citizens is able to underprice its coverage because it has the unilateral authority to impose a form of taxation on nearly every insurance policy issued in the state. For example, when Citizens runs a deficit, it must first impose surcharges on its own policyholders (Citizens Policyholder Surcharge), but it may subsequently impose assessments on every property and casualty insurance policy issued in the state except for medical malpractice and workers' compensation policies. The latter charge is known as the Emergency Assessment.[9]

This "hurricane tax" could add as much as 30 percent to the cost of each insurance policy paid by the roughly 80 percent[10] of homeowners, renters, vehicle owners, boaters,

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businesses, charities, and civic organizations statewide — individuals and entities that derive no benefit from Citizens' subsidized, underpriced rates. These assessments could stretch over multiple years, during which time the state could be hit by one or more additional storms, thereby compounding the problem.

The "Cat Fund"

With its imposing size and its power to levy assessments to cover its own shortfalls, Citizens ultimately places Floridians on the hook for its hundreds of billions of potential losses. This serious threat to Floridians is exacerbated by the extent to which Citizens relies on another taxpayer-backed entity — the Florida Hurricane Catastrophe Fund — to provide most of its reinsurance support following a catastrophe.

Like private reinsurers, the Cat Fund provides insurance to insurance companies operating in Florida. When insurers' total losses exceed certain levels, the Cat Fund promises to cover a portion of the risk. In return, the Cat Fund collects premiums from insurers. However, unlike private reinsurers, the Cat Fund does not actually keep on-hand the funds necessary to pay the claims it can reasonably expect to receive. Instead, if its resources run short, it has the authority to issue bonds, which it repays by imposing assessments on policies in a way similar to Citizens. Floridians are still paying a 1.3 percent assessment on their insurance policies to pay off the Cat Fund's bond debts from the 2004 and 2005 hurricane seasons.[11]

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The Cat Fund turns the principle of diversification on its head by concentrating Florida's hurricane risk within the state, rather than spreading it around the world, as private reinsurers do. This means that, even assuming the Cat Fund has management talent and investing opportunities equal to those in the private sector, it must charge rates higher than private reinsurers if it hopes to break even in the long run. Instead, it charges substantially lower rates than the private sector for comparable coverage.

The result is that the Cat Fund, unless reformed, will ultimately cost the state of Florida a massive amount of money.

Solutions

The quickest and most effective solution to reduce or eliminate the risk of assessments by Citizens and the Cat Fund would be to allow them to charge rates that are market-based and actuarially sound. This would require a dramatic increase in Citizens' premiums, while private insurers would pass on the higher cost of Cat Fund coverage to their customers. Such a shift would level the playing field, allow private insurers to better compete in Florida, spread the risk among more companies and, ultimately, lower premiums over time.

Another potential solution — albeit one that would cause very significant short-term disruptions — would be to abolish both Citizens and the Cat Fund and allow the private market to fill their voids, charging market rates.

Notwithstanding the political realities that render both of these solutions impossible to enact, executing them would almost certainly spark an unprecedented shock in the market that could very possibly plunge the state into crisis. Because of this, R Street, the James Madison Institute and other proponents of reform have recommended more measured proposals in recent years that have generally called for a gradual, phased-in implementation of market-based rates, among other solutions to allow the market time to adapt.

However, most of these commonsense solutions have been rejected by the Legislature because of concerns that they would increase the rates paid by consumers. In some cases, proposals were entirely rejected even when the possibility of a rate impact was remote or the magnitude of any increase was negligible.

Therefore, in an effort to craft a reform plan that lawmakers can and should embrace, this paper explores and describes ten ways to improve Florida's property insurance marketplace without raising the average premiums paid by consumers. They are listed here, and an explanation of each will follow.

1. Implement the Hager incremental Cat Fund reduction plan.
2. Establish requirements for "assignment of benefits" provisions.
3. Implement incremental Citizens eligibility reform with a "circuit breaker."
4. Allow excess and surplus lines carriers to do voluntary take-outs from Citizens.
5. Remove non-primary residences from Citizens and continue reduction of Citizens' maximum coverage to $500,000.
6. Expand 2013's coastal preservation concept to bar other state programs from providing coastal subsidies.
7. Implement tough new Citizens and Cat Fund conflict-of-interest policies and make protecting taxpayers a focus of both entities.
8. Create an expert panel to advise the state on the use of RESTORE Act funds
9. Establish fair settlement procedures.
10. Require an annual report on the combined post-storm bonding capacity of Citizens, the Cat Fund, and the Florida Insurance Guaranty Association.

We will now turn to examine each of the proposed solutions. We believe that each of these reforms could be enacted during the 2014 legislative session and thus could begin to make a meaningful difference in the state's property insurance system to benefit the millions of residents who rely on it.

Solution 1: Implement the Hager incremental Cat Fund reduction plan.

In its current form, the Cat Fund poses the greatest danger to Florida's insurance system, as well as the state's ability to recover quickly after a major hurricane. Should its cash reserves become depleted, the Cat Fund would secure the necessary funds to pay claims by issuing bonds. Those bonds are paid down over time by laying assessments on virtually every insurance policy in the state. Depending on the severity of the storm and the size of the bond issue, these assessments substantially increase Floridians' cost of insurance for a number of years.

But the threats posed by the Cat Fund go beyond potentially large assessments. According to its own managers, the Cat Fund may not be able to issue enough bond debt to cover its obligations in the wake of a major storm season. Cat Fund officials have stated publicly that the fund likely would have fallen roughly $1.5 billion short had a sufficiently bad hurricane season required it to pay out its full statutory coverage limit of $17 billion[12] in 2012. Simply put, Florida law required the Cat Fund to sell more reinsurance coverage than it could pay for.

This year, the outlook is somewhat improved. Thanks to Florida's unprecedented eight-year reprieve in hurricane strikes,[13] the Cat Fund is estimated to have a cash balance of $9.77 billion at the end of this year, an estimated ability to issue up to $7.3 billion in bonds, and access to $2 billion in other liquidity resources.[14] Therefore, the Cat Fund's total claims-paying capacity is currently estimated to be $19.07 billion, enough to cover all of its obligations.

But tapping all of its resources after a particularly active hurricane season would exhaust much or all of the Cat Fund's cash reserves, seriously hindering its ability to meet its obligations in subsequent years. Such a shortfall would have disastrous consequences. In 2012, the OIR estimated that if the Cat Fund experienced a shortfall of 25 percent, 24 of the state's top 50 insurers would "have less than the statutory minimum of $5 million, which would result in some type of action being taken to increase surplus." These 24 insurers, the OIR said, represent approximately 35 percent of the market and service more than 2.2 million policies.[15] In short, a Cat Fund shortfall would cause the insolvencies of nearly half of the state's property insurers at the same time that thousands of storm-ravaged Floridians would be depending on them to get their claims paid and their lives rebuilt.

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The insurance rating agency A.M. Best has likewise stated that it "remains concerned regarding the ability of the [Cat Fund] to fund all obligations in the event of a severe hurricane."[16] This has been reflected in its ratings of property insurers in Florida, and it likely serves as a disincentive for national insurance companies looking to expand into Florida.

Given these realities, the Cat Fund must be right-sized. No insurance regulator would allow a private insurer or reinsurer to sell coverage without appropriate claims-paying resources. The Cat Fund should be held to the same standard.

Rep. Bill Hager R-Boca Raton, filed bills during the 2012 and 2013 regular legislative sessions that would have, over time, reduced the amount of coverage Florida law requires the Cat Fund to offer. His proposal received wide support from the insurance industry, environmentalists, center-right groups and consumer advocates,[17] interests that seldom agree on many other issues. However, opponents of Hager's proposal were successful in convincing lawmakers that shrinking the Cat Fund would force Florida insurers, including Citizens, to obtain more expensive coverage in the private market, passing on those costs to consumers in the form of higher insurance premiums.

All reliable data indicate reinsurance rates are on the decline, despite the recent major claims stemming from "Superstorm" Sandy and the earthquake and tsunami in Japan. The state's insurance consumer advocate, Robin Westcott, who resigned effective November 1, forecast Hager's proposal to shrink the Cat Fund by $1 billion would have no rate impact due to decreasing global reinsurance rates.[18]

Given current market dynamics, we think the Legislature could trim the Cat Fund's mandatory coverage by $3 billion — to $14 billion from the current $17 billion — without noticeable rate impact on consumers. We would recommend a gradually escalating three-year phase-in of this $3 billion reduction, shrinking the Cat Fund by $500 million in the first year, $1 billion the second year and $1.5 billion the third year.

Legislative language could include an emergency "override" that would allow the Cat Fund to go back to offering up to $17 billion in coverage in an emergency situation or if private reinsurance rates spike. The override would be triggered by a vote of the Financial Services Commission (Governor, Attorney General and Chief Financial Officer) to authorize a temporary, one-year increase in the fund's capacity should there be an interruption in private reinsurance capacity or other such emergency.

To help guide the Financial Services Commission's decision, we recommend revamping the current nine-member Cat Fund Advisory Council to include financial advisors, actuaries, and other experts. The goal would be for the Legislature to set a reasonable capacity for the Cat Fund, while granting flexibility to expand or contract that capacity, within statutory limits, as the need arises.

A Cat Fund that can't realistically meet its obligations amounts to nothing more than a state-sanctioned Ponzi scheme that places Florida at-risk of mass insurer insolvencies, with entire regions of the state suffering because of unpaid claims and an ensuing crisis that could very well bring Florida's economic recovery to a halt.

The declining cost of private reinsurance provides the Legislature with a golden opportunity to reform the Cat Fund — reducing the risk and severity of assessments, enabling the fund to meet all of its obligations, and stabilizing the state's insurance market—all without adversely impacting consumers. But the Legislature must act quickly before private reinsurance rates once again stabilize and start to harden.

Solution 2: Establish requirements for "assignment of benefits" provisions.

The spike in non-catastrophe claims over the past several years, along with the consequent rise in insurance premiums, has been exacerbated by the exploitation of laws governing "assignment of benefits."

An "assignment of benefits" allows a third party, such as a contractor or water extraction company, to assume a policyholder's benefits

and directly collect insurance proceeds owed to policyholders. Assignment also grants third parties the right to negotiate and adjust such claims. Most health insurance and personal injury protection policies function under this sort of arrangement, allowing a health care provider to bill directly for insurance payment for covered medical services.

Assignment of benefits traditionally can be made before a claim happens (pre-loss assignment) or after a particular first-party loss occurs (post-loss assignment). Florida law allows insurers to require policyholders to receive the company's consent before entering into pre-loss assignments.[19] However, Florida courts have ruled against prohibitions on post-loss assignments. [20]

Most contractors and other professionals in the construction, repair, and restoration industries who are assigned benefits by the policyholders conduct themselves appropriately, skillfully complete projects for which they were hired, and save their customers a great deal of hassle. However, there are those who have abused assignment of benefits agreements, which has become an emerging cost driver that contributes to rising rates.

Imagine a hypothetical claim in which a broken water pipe floods part of a home. Once the pipe is fixed, the homeowner contacts a water extraction company to clean and dry the house. The company compels the homeowner to sign an authorization form to deal with his or her insurer directly, and refuses to start work without that assignment. The homeowner complies, desperate to get his home dried before mold sets in.

With the assignment of benefits duly executed by the policyholder, the water extraction company quickly does its job. So quickly, in fact, that the insurer never had an opportunity to inspect the damage. The extraction company then submits charges that are much higher than the industry standard. The insurer may dispute the amounts billed, and in return, the extraction company may threaten a lawsuit, in some cases even placing a lien on the policyholder's property.[21]

In extreme cases, unscrupulous vendors have reportedly "repaired" areas that were unaffected by the initial loss and needed no repair, amounting to a remodeling project. One recently cited case involved charges that amounted to more than the home's market value.[22]

How does this happen? Insurance policies ordinarily provide authority for an insurer to investigate and adjust claims (e.g., requiring policyholders to file proof of loss, to produce records, and to submit to examinations under oath). But vendors who obtain an assignment of benefits may insist that they agreed only to take over the policy's benefits and that they did not agree to the requirements it places policyholders.

During Florida's 2013 legislative session, a bill was filed that would have allowed insurers to prohibit policyholders from entering into an assignment of benefits agreement altogether.[23] The bill ultimately failed to pass.

Our view is that, in a free market, an individual's right to enter into a contractual relationship should be preserved. However, an insurance policy is also a contract entered into between the insurer and the insured. If benefits are to be assigned to a third party, the conditions for payment of benefits contained in the original contract (policy) should also be assumed. That is, if a third party enters into an agreement with a policyholder and is assigned his or her policy benefits, the third party should also be bound by the same original requirements as the policyholder would have been.

In addition, as a measure of consumer protection, assignment of benefits agreements should include an opt-out period for consumers who may have felt compelled into signing over their insurance benefits under pressure by a vendor or the stressful circumstances surrounding a claim.

Finally, we would encourage further examination of the consequences of proposals requiring that a state license — or supervision by a licensed contractor — should be a prerequisite for water extraction contractors and other vendors to receive an assignment of benefits. Consumers who hire unlicensed

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vendors or vendors whose particular trade does not legally require a license largely lack the ability to seek recourse or damages for poor workmanship or unscrupulous practices. Requiring a water extraction company to have a licensed contractor that is responsible for the work, for example, would give a consumer and insurance company recourse, and would force companies to self-regulate for fear of losing their license.

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Solution 3: Implement incremental Citizens eligibility reform with a "circuit breaker."

During the 2013 Legislative Session, lawmakers approved a series of reforms to slow the influx of policies into Citizens Property Insurance. These reforms included the creation of a "clearinghouse" that will be established by Jan. 1, 2014.[24]

The clearinghouse will essentially enforce the existing 15 percent eligibility standard by making a property ineligible for Citizens coverage if any private company offers a new policy within 15 percent of Citizens' rates for similar coverage. Renewal policies offering coverage at the same rate from a private insurer will also be ineligible for Citizens.

Though the clearinghouse offers a step in the right direction, the system continues to impose *de facto* price controls on the market that former Governor Crist's ill-conceived 2007 reforms established. The inevitable result has been to encourage the steady flow of new policies into Citizens.

However, abolishing the 15 percent eligibility standard altogether and replacing it with the pre-2007 requirement that a property owner must be unable to secure coverage from a private company as a condition for Citizens coverage likely would result in politically unacceptable rate increases on many current Citizens policyholders. Instead, the Legislature should explore an incremental approach to reform Citizens eligibility.

For example, the current 15 percent threshold could be gradually increased by 2.5 percent per year until it reaches 100 percent, a process that would take 34 years to complete. To avoid rate increases beyond the current 10 percent Citizens "glide path," an annual "circuit breaker" would require that the 2.5 percent hike in the eligibility requirement takes effect only in years in which overall prices decline. This would, in essence, shrink Citizens' very slowly over time without impacting the rates of any incumbent customers.

Solution 4: Allow excess and surplus lines carriers to do voluntary take-outs from Citizens.

The surplus lines market handles insurance risks for which coverage is unavailable from standard insurance companies operating in the regulated, admitted market. Some risks may simply be too large, unusual, or complex for standard insurance companies to cover; in these cases, surplus lines carriers can issue policies specially designed for such risks.

Surplus lines carriers receive less stringent regulation of rates and forms from the OIR. However, they are generally required to maintain a surplus of $15 million or more in order to be eligible to transact business in Florida. Those formed outside of the United States must maintain a trust fund containing at least $5.4 million.[25]

Although the OIR may revoke the eligibility of a surplus lines carrier if it finds it to be in an unsound financial condition or if it fails to pay reasonable claims promptly, surplus lines policies are not covered by the Florida Insurance Guarantee Association.[26] Therefore, policyholders receive no protection from the state should they suffer financial losses or delays in claims payments due to the insolvency of a surplus lines carrier.

Because surplus lines carriers are not admitted insurers, they are not legally allowed to participate in the Citizens depopulation program. Legislation has been proposed in recent years to allow such participation,[27] but opponents have cited concerns over consumer protection due to the lack of rate regulation and FIGA protection.

The Legislature should nevertheless explore ways to open the Citizens depopulation program to surplus lines carriers. This would

increase competition, spread risk, and protect taxpayers by reducing the size and potential liability of Citizens. Surplus lines insurers that choose to participate in Citizens' depopulation efforts should be subject to additional criteria to protect consumers.

To ensure consumer protection, only surplus lines insurers meeting strict financial criteria should be allowed to take policies out of Citizens. To participate, they should: maintain at least $50 million in surplus (surplus lines insurers are currently required to maintain only $15 million in surplus to transact business in Florida); receive or maintain an A.M. Best Financial Strength Rating of A- or better (surplus lines insurers are not currently required to be rated by A.M. Best); maintain resources to cover a 100-year probable maximum loss at least twice in a hurricane season (through surplus and/or reinsurance coverage); and agree to provide coverage substantially similar to that of the Citizens policy.

In addition, any surplus lines carrier that wants to assume policies from Citizens should provide an OIR-approved notice to any affected policyholders detailing the company's A.M. Best ratings and financial resources, as well explanations that the policy will not be covered by FIGA, regulated by the state for rates, or subject to Citizens, Cat Fund, or FIGA assessments. The notice should also include explanations of any differences in coverage, online and telephone contact details for any consumer questions, and a clear opt-out period.

Allowing surplus lines carriers to assume Citizens policies accomplishes the goals of increasing choices for consumers and shifting liability away from the state's taxpayers and onto the private market.

Solution 5: Remove non-primary residences from Citizens and continue reduction of Citizens' maximum coverage to $500,000.

During the 2013 Legislative Session, lawmakers enacted a series of reforms to limit Citizens' exposure. These reforms included gradually reducing the maximum Citizens' policy limit by $100,000 a year for three years, from the current $1 million to $700,000.[28] This is a good start, but it does not go far enough to eliminate the taxpayer subsidy for wealthy homeowners who can afford to cover their own risk. Hardworking renters, homeowners, and vehicle owners should not be on the hook for assessments and hurricane taxes to make up a Citizens shortfall caused, in part, by damage to mansions.

Therefore, the Legislature should consider continuing this annual reduction for two additional years, ultimately reducing the maximum Citizens policy limit to $500,000. To the extent that higher-valued properties may face difficulty finding coverage in the private market, the existing 2013 law already allows the OIR to exempt counties it determines lack a reasonable degree of insurance competition.

Furthermore, the Legislature should examine an effective way of removing non-primary residences from Citizens. According to figures released by Citizens officials, roughly 360,000 policies are issued for non-owner-occupied homes in the state. Among those, about 192,000 have billing addresses listed outside of the state of Florida, and in many cases, outside of the United States.[29]

According to a 2013 American Consumer Institute study, the median Florida home price paid by foreigners was $194,700, which is well below the eventual $700,000 Citizens policy limitation. The study further reports that 82 percent of foreigner-purchased homes in Florida were paid upfront, with no mortgage. Canadians, the report states, are the biggest buyers, with 90 percent of those buyers paying cash for the properties.[30]

Therefore, if most foreign and out-of-state buyers have the financial means to purchase property in Florida without a mortgage, it stands to reason they can afford the actual, non-subsidized cost of insurance.

Solution 6: Expand 2013's coastal preservation concept to bar other state programs from providing coastal subsidies.

Another positive reform enacted during the 2013 Legislative Session was the "Coastal

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Preservation through Citizens Reform" concept.[31] Conceived by R Street policy analysts, the proposal was modeled after the 1982 Coastal Barrier Resources Act, which designated certain coastal areas as off-limits to federal subsidies.

The Florida version essentially prohibits Citizens from writing policies for any buildings constructed after July 2014 if they lie seaward of the Coastal Construction Control Line, or if they are built within the federally designated Coastal Barriers Resources System. Developers may still obtain coverage in the private market or may simply self-insure.

The risk of building in these storm- and flood-prone areas will therefore be borne by the owners or by private insurers, and not by Citizens or Florida taxpayers. As such, the added risk and expense will likely reduce such development and help preserve these areas' ecological integrity, as well as their ability to protect mainland areas from storms.

Florida can and should do more, however. The Legislature should consider expanding this concept by barring other state programs from providing certain subsidies or other government-funded incentives for development seaward of the CCCL and in areas lying within the Coastal Barrier Resources System, with exceptions for public safety, wildlife protection. and recreation.

This should not be construed as an endorsement of any additional regulation or prohibition on the development of private property. Indeed, government should not erect any more barriers preventing private citizens from developing their own land at their own risk and at their own expense. However, government should not fund, subsidize, or otherwise encourage development in high-risk and/or environmentally sensitive areas.

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Solution 7: Implement tough new Citizens and Cat Fund conflict-of-interest policies and make protecting taxpayers a focus of both entities.

To ensure that Citizens and the Cat Fund both receive sound, unbiased financial advice, the Legislature should explore enacting standards similar to those in the federal Sarbanes-Oxley Act. That federal law requires auditor independence for publicly traded firms. Companies responsible for auditing a public firm's books are prohibited from subsequently doing business with the firm in other fields—for example, by participating in stock and bond offerings.

Currently, nothing in Florida law or in Citizens' or the Cat Fund's plans of operation forbids financial firms from advising these public agencies on their bonding capacity and subsequently participating in, and earning fees from, bond issuances that follow such a study. This situation presents an obvious conflict of interest and potentially deprives Citizens and the Cat Fund of truly unbiased advice. For example, an audit conducted by a firm that is also in the bond business might refrain from discouraging a reliance on taxpayer-funded bonding after a disaster when bolstering upfront capital and a back-up risk transfer (i.e., reinsurance) would have been the more prudent course of action.

In that vein, the Legislature should also reexamine both Citizens and the Cat Fund's core missions to include protecting taxpayers as a focus of each organization. This may include taxpayer-protection clauses as part of the job descriptions of all senior management; requiring an annual hearing on taxpayer protection to be conducted; and requiring an independent report on taxpayer protection each year that examines discretionary expenditures and organizational actions taken to reduce the likelihood or severity of post-hurricane assessments.

Solution 8: Create an expert panel to advise the state on the use of RESTORE Act funds.

Passage of the Resources and Ecosystems Sustainability, Tourist Opportunities and Revived Economies of the Gulf Coast States Act of 2012 (RESTORE Act) provided Florida with a unique opportunity to invest in wetlands

restoration and mitigation to make the Gulf Coast safer against future hurricanes.

The RESTORE Act dedicates a portion of the civil and administrative penalties levied against those responsible for the 2010 Deep Water Horizon oil spill to the affected states. In addition to clean-up and economic rehabilitation of impacted areas, the act allows these funds to be used for a wide range of projects, including the restoration of coastal wetlands, [32] which can act as natural barriers or buffers to wind and storm surge.[33]

To take full advantage of this potential benefit, the Legislature should create an *ad hoc* panel of experts and task them with advising the state on how to best invest RESTORE Act funds on eligible projects that yield the greatest hurricane mitigation benefits. Maximizing these funds to directly or indirectly strengthen Florida's coastline and built environment will reduce insurance losses when the wind blows and could eventually make property insurance coverage in those areas more affordable.

Solution 9: Establish fair settlement procedures.

Bad faith insurance laws are intended to deter insurers from unreasonably delaying or denying payment of valid claims. Florida's bad faith law, however, is prone to significant and widespread abuse by plaintiffs' attorneys, some of whom employ a variety of tactics to prevent insurers from promptly settling claims — even where an insurer is willing to pay the full policy limits — in order to generate lawsuits to recover damages far in excess of policy limits.

Florida's bad faith law is particularly problematic with regard to so-called "third party" claims. Third-party claims are generally made when an insured injures another person (i.e. third party), and that injured party sues the insured's carrier for failing to settle a claim in a timely manner. Attorneys can deliberately delay the insurer's efforts to adequately investigate a claim's validity to guard against fraud. For instance, plaintiffs' attorneys may ignore an insurer's attempts to settle, return checks sent for policy limits, or deliberately avoid offering specifics on the claim or the remedy sought, all in order to cause delays and trigger a bad faith lawsuit.[34]

Current law also allows plaintiffs' attorneys to include conditions for settlement with third-party payment demands, which, if not met, can similarly be used to claim bad faith.[35] This gives attorneys incentives to devise conditions that are essentially impossible to meet.

Florida court decisions created the opportunity for this type of gamesmanship. In a 1991 case, a Florida appellate court allowed a bad faith claim to proceed and awarded $250,000 in damages on a $10,000 auto insurance policy where the third-party claimant made no settlement demand whatsoever.[36] More recently, Florida courts have issued rulings that make it difficult for an insurer to know whom to contact to offer a settlement,[37] what to offer, [38] and how long the insurer has to make a fair offer.[39]

In one recent case, an insurer attempted on multiple occasions to obtain from the mother of a third party injured in an automobile accident the contact information for her son's attorney, but was repeatedly denied. The insurer contacted the mother because the accident victim was initially left in a coma, and no guardianship had been established. Nevertheless, because the retained attorney was not promptly contacted and no settlement offer presented to the comatose victim, the court permitted a bad faith lawsuit.[40]

Such tactics drive up insurance rates for all Floridians. As Justice Charles Wells recognized in a case involving a mail delay resulting from an incorrect zip code, "When an insured purchases and pays premiums on $20,000 of insurance, but the insurer pays $2.5 million in claims, someone has to fill the pool. Initially, this amount may come out of an insurer's profits, but eventually the someones are the other insureds, whose premiums are increased." [41]

Moderate, commonsense changes to Florida's bad-faith law could eliminate the gamesmanship. The Florida Legislature has declined to sensibly treat first- and third-party claims in the same manner. This would

"This gives attorneys incentives to devise conditions that are effectively impossible to meet."

include requiring all claimants to submit written notification to the Florida Department of Financial Services of an insurer's failure to pay a claim, waiting at least 60 days before filing a lawsuit alleging bad faith, and permitting the insurer to "cure" the alleged bad faith during this period by tendering either the amount demanded in the notice or the applicable policy limits.[42]

An alternative, and perhaps more modest solution, would be to require third-party claimants to provide basic notice to an insurer of his or her loss and establishing a set, reasonable time frame — such as 45 days — for an insurer to pay either an agreed-upon amount or the policy limits. Should an insurer fail to address the claim during this period, the claimant's lawyer could then file a bad faith lawsuit. This reform would establish a fair settlement process for all.

"Regardless, insurance companies recover the assessment from their policyholders at renewal or issuance."

Solution 10: Require an annual report on the combined post-storm bonding capacity of Citizens, the Cat Fund, and the Florida Insurance Guaranty Association.

As previously discussed, Citizens and the Cat Fund both have the unilateral authority to issue bonds should their cash reserves fall below the amount needed to cover potential or imminent claims. However, the Florida Insurance Guaranty Association is another state-backed entity with authority to issue bonds and levy assessments to cover those bonds.

When insurers are on the verge of insolvency, they must either be rehabilitated or liquidated by state government. When they are liquidated, FIGA assumes and pays any outstanding claims so that consumers who bought an insurance policy in good faith are not left with their claims unpaid. Unlike the Federal Deposit Insurance Corporation, which charges annual premiums to banks and keeps a cash reserve, FIGA obtains its funding to pay claims primarily in two ways: through the liquidation of assets of insolvent insurers and by levying assessments on insurance companies.

Like Citizens and the Cat Fund, FIGA may levy assessments onto almost every property/casualty insurer in the state. Only medical malpractice and workers compensation policies are exempted. Specifically, FIGA may levy an assessment up to 2 percent of the premium for each of the two accounts it has, for a maximum of 4 percent a year. When the FIGA board determines the need for an assessment, the OIR approves it and orders each insurance company to pay the assessment upfront to FIGA within 30 days.[43]

If it is an "emergency" assessment (due to a hurricane), the board at its discretion may spread the assessment over 12 months or collect it upfront, depending on whether it needs the funds quickly. "Regular" (or non-hurricane) assessments must be paid upfront within 30 days. Regardless, insurance companies recover the assessment from their policyholders at renewal or issuance.[44]

However, Florida law also authorizes municipalities and counties to issue bonds "to assist the Florida Insurance Guaranty Association in expediting the handling and payment of covered claims of insolvent insurers." [45]

All three of these entities—FIGA, Citizens Property Insurance, and the Cat Fund—essentially would go to the same municipal bond market to issue their bonds following a sufficiently bad hurricane season. As discussed in Solution 1, its own managers have estimated that the Cat Fund would have likely faced a shortfall due to an inability to issue enough bonds in recent years. It seems reasonable to ask whether FIGA and Citizens, which would need to tap the same source of capital, could encounter similar hardships.

Given this potential inability to borrow sufficient funds on the bond market, the Legislature should direct the Investment Advisory Council of the State Board of Administration to provide an annual report estimating the bonding capacity of Citizens, the Florida Hurricane Catastrophe Fund (Cat Fund), and FIGA, taking into account the possibility that all would seek to execute bond issues in close proximity to one another following a hurricane season that adversely impacted Florida.

CONCLUSION

Taken together, the 2014 legislative session and the unprecedented length of time Florida has gone without a hurricane strike offer Florida lawmakers an enormous opportunity to enact needed insurance reforms.

In particular, the Legislature should act to shrink its state-run, taxpayer-backed entities—Citizens Property Insurance and the Cat Fund—to decrease the likelihood or severity of post-hurricane taxes that could threaten to impair the state's economic recovery. The Legislature should also take steps to address the cost drivers that are adversely impacting consumers, even during these hurricane-free years, and ultimately find market-based ways to discourage risky development in coastal areas so as to make Florida more physically resistant to storms.

For years, some lawmakers have successfully blocked commonsense, bipartisan reforms of property insurance because they feared a political backlash if and when those reforms increased the cost of property insurance. In fact, they even resisted modest reforms in cases where the possibility of a rate impact was remote or the potential increase was negligible.

Although the 10 proposals outlined in this study would not solve all of Florida's insurance-related problems, they could make significant headway without raising rates on consumers during a fragile economic recovery.

ABOUT THE AUTHOR

R.J. Lehmann is senior fellow, public affairs director and co-founder of R Street. He is an award-winning business journalist who spent nine years covering the insurance, banking, and securities industries. He is author of R Street's "2012 Insurance Regulation Report Card" and the forthcoming 2013 edition, and numerous other briefs and policy studies.

Prior to joining R Street, he served as deputy director of the Heartland Institute's Center on Finance, Insurance and Real Estate. He previously was senior industry editor with SNL Financial, leading the news service's coverage of the Dodd-Frank Act, the Patient Protection and Affordable Care Act, and legislative and regulatory developments at both the state and federal level. Prior to that, he spent six years with the A.M. Best Co. as manager of its Washington bureau.

He is a three-time award winner from the American Society of Business Publication Editors and was the youngest-ever winner of a first place prize from the New Jersey Press Association. His writings have appeared in the *San Francisco Chronicle*, *Wall Street Journal*, *Townhall.com*, *RealClearPolicy*, *American Spectator*, *Travel Weekly*, the *South Florida Business Journal*, and *Folio* magazine, among other publications.

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"For years, some lawmakers have successfully blocked commonsense, bipartisan reforms of property insurance because they feared a political backlash if and when those reforms increased the cost of property insurance."

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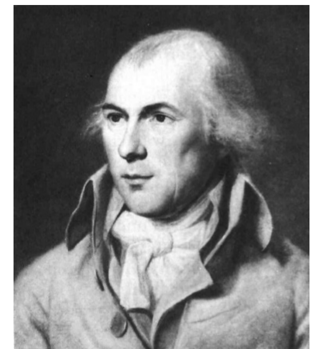

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