BACKGROUNDER

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# Florida's Four Walls of Insurance Reform

## Practical Market-Based Solutions to Reduce Cost Drivers and Strengthen Florida's Insurance Market

By **Christian R. Cámara** *Senior Fellow and Co-Founder, R Street Institute*
*Adjunct Scholar, The James Madison Institute*

## Introduction

For many years, Floridians struggled to purchase insurance coverage—whether it be for their properties, vehicles or employees—in ways that sometimes became a drag on the state's economy.

In the early 2000s, Florida's business community reeled from rising workers' compensation insurance rates, due in no small part to a cottage industry of fraudsters and unscrupulous individuals who exploited the state's rules. The cost of workers' compensation threatened job growth during what was otherwise a period of economic growth nationally. The issue became the subject of a 2003 special session of the Legislature, during which lawmakers approved and then-Governor Jeb Bush signed a reform package[1] that successfully curtailed litigation and fraud. By 2008, Florida's workers' compensation insurance rates had dropped by 60 percent.[2]

Just as the workers' comp market began to stabilize, the state's property insurance market was thrown into a tailspin when Florida was battered by seven back-to-back major hurricanes in 2004 and 2005. By 2006, the rising cost to insure property in Florida became the top political issue in that year's gubernatorial and legislative elections.

Knee-jerk insurance reforms undertaken by the Legislature and newly-elected Gov. Charlie Crist in 2007 sought to suppress the rate increases artificially. In fact, these changes only exacerbated the state's shaky property insurance market, as major property insurers scaled back or even exited the state market altogether. The state-backed Citizens Property Insurance Corporation ballooned to become the largest homeowners insurer in the state and the Florida Hurricane Catastrophe Fund extended reinsurance promises that advisers warned it might not be able to keep.

By the time Rick Scott was elected governor in 2010, the Legislature had come to accept that their 2007 reforms were unsustainable. They ushered in positive, market-freeing reforms to liberalize insurance rates and shrink both Citizens and the Cat Fund. Combined with a hurricane-free decade,[3] these changes helped to restore health to the state's property insurance environment.

The state's unprecedented hurricane drought came to an end Sept. 2, 2016, when Hurricane Hermine made landfall in St. Marks, just south of Tallahassee. The following month, Hurricane Matthew skirted much of Florida's eastern shoreline and eventually made landfall in South Carolina. These two storms combined to cause approximately $950 million in insured damages and 135,000 claims statewide.[4] Things could have been far more damaging for the Sunshine State. Had Matthew tracked just 20 or more miles to the west, the full force of a Category 4 hurricane would have raked the region's most densely populated shoreline. Instead, losses were relatively small and Florida insurers and their reinsurers are fully expected to absorb and cover existing claims without much impact to the state's property insurance market.

In addition, Florida has in recent years caught another lucky break via the global capital markets. Given that hurricanes, earthquakes and other catastrophes strike at random, uncorrelated with the ups and downs of the rest of the economy, capital has flooded into the reinsurance and catastrophe bond markets ever since the 2008 global economic crisis. This has resulted in new and innovative risk-transfer products and competition among traditional reinsurers, which has helped produce historically-low reinsurance rates. Despite major losses in Japan and elsewhere in recent years, experts believe global reinsurance pricing will continue to soften.[5] Indeed, reinsurance prices fell an additional 3.7 percent in January 2017.[6]

Florida has benefited handsomely from this buyers' market. New insurers have entered the state to write policies.[7] The government-run insurer of last resort, Citizens Property Insurance Corp. (Citizens), has shed more than 1 million policies since 2012[8] and lowered its overall exposure by more than 60 percent over the past four years.[9] This is due both to the organic migration of policies to private companies and to active depopulation efforts. Between 2014 and 2016, more than 758,000 Citizens policies were transferred to private companies.[10] Today, Citizens holds just slightly more than 472,000 policies[11] down from a high of 1.5 million in 2012.[12] Additionally, Citizens itself has taken advantage of low reinsurance rates to transfer some of its enormous hurricane risk to the private market, allowing it to purchase more coverage for less[13] and eliminating its once-ominous threat of assessments on state taxpayers.[14]

Yet despite a remarkable streak of combined luck, including: a decade free of hurricane activity, two unremarkable storms last year and the lowest reinsurance rates in recent memory, average property-insurance premiums are still on the rise in many parts of Florida.[15] Consumers and their representatives in Tallahassee both have legitimate concerns when they ask why this is the case, given the favorable weather and reinsurance market conditions in recent years.

Human behavior, encouraged by Florida law, appears to be the culprit. The New York-based Insurance Information Institute reports that non-catastrophe claims have increased roughly 17 percent per year over the past decade[16] in Florida and are growing rapidly both in frequency and in severity. Separately, after more than a decade of rate reductions, workers' compensation insurance premiums are also on the rise, due to Florida Supreme Court rulings that reversed some key provisions of the 2003 reforms.[17]

High insurance rates are appropriate when they reflect actual risks. Costs inherent to a particular industry or regional market may be impossible to remedy. However, it is apparent that the rate increases Floridians are being faced with in both the property and workers' compensation insurance realms stem from practices, behaviors and even cottage industries born out of vulnerabilities in the law exploited by bad actors. In short, the cost drivers stem from the very laws that govern those insurance products.

This should concern state lawmakers, as property insurance and workers' compensation insurance are both regulated at the state level. Nearly every Floridian is affected by the cost of property insurance, since mortgage lenders require property owners to carry coverage, the cost of which is also usually passed on to renters. Florida law also requires all employers to carry workers' compensation coverage, but for very few exceptions.[18]

The following paper describes how the Florida Legislature could address vulnerabilities in the law to curtail cost drivers that needlessly and artificially inflate rates for these insurance products. Additionally, it will identify ways to harness the benefits of a favorable global reinsurance market to further strengthen the state's property insurance market ahead of less sunny days. Throughout, the focus is on reforms that could reasonably be implemented during the 2017 regular legislative session that would make a meaningful difference shortly thereafter.

## Workers' Compensation Insurance Reform

Under the workers' compensation system in place in every state except Texas, all employers are responsible to compensate employees for workplace-related injuries or illnesses on a no-fault basis. Workers' comp insurance is coverage that employers and businesses purchase to transfer the risk of those costs to a third party.

In 2000 and 2002—the two years in which there were workers' comp insurance rate filings before the 2003 reforms—Florida had the highest and second-highest rates in the nation,[19] respectively, with rates increasing by 21.5 percent in 2002 alone.[20] By most accounts, attorney fees were the leading cost drivers before the reforms. Not only did the actual costs of the fees rise, but rising fees offered incentives for attorneys to pursue more litigation and to extend the timeframe for resolving claims. Observers also noted various knock-on effects that further served to increase costs, including delaying employees' return to work and increasing lost-time claims.

As summarized in a report on workers' comp litigation published by the Office of the Judges of Compensation Claims:

> *Attorneys' fees are widely and correctly seen as a key driver of workers' compensation costs, in part because of their direct cost but more fundamentally because of the nature and amount of litigation that result from the litigation incentives built into the system… it became commonplace for litigation to be commenced over very small stakes, with lawyers on both sides devoting hours of legal work out of proportion to the value of the benefits in controversy, often resulting in a concession by the carrier having little or no value to the claimant, but resulting in a fee predicated on an hourly rate of $200 to $300 for the attorney.*[21]

In response to this ever-growing crisis, the Legislature passed and Gov. Jeb Bush signed Senate Bill 50-A in 2003, overhauling the state's workers' compensation system to increase affordability and availability of coverage. The reform package contained several provisions aimed at tackling fraud. It also increased medical reimbursements for physicians and surgical procedures, as well as revised indemnity benefits and procedures for claimants.[22]

The provisions related to attorneys' fees ultimately are credited with reducing the costs in the system and, by extension, slashing workers' compensation insurance rates by 50 percent in just the first three years.[23] The reforms enacted a statutory formula that tied attorney fees to the amount of benefits secured by the claimant,[24] rather than an hourly rate that encouraged a protracted process. In response to a Florida Supreme Court decision that the requirement to use the attorney fee formula was ambiguous in statute, the Florida Legislature passed House Bill 903 in 2009 to clarify that attorney fees are to be calculated solely on the statutory fee schedule, except in certain medical-only cases.[25]

By 2014, Florida had just the 28th highest workers' comp rates in the nation.[26] In 2015, the Florida Office of Insurance Regulation (OIR) issued a report finding the state's workers' comp market to be "competitive, well-capitalized and robust" and that it was served by a "large number" of private market insurers. [27]

However, in April 2016, the Florida Supreme Court again addressed the issue of attorney fees in workers' comp cases. In *Castellanos v. Next Door Company*, the court ruled the statutory fee formula unconstitutional under the Florida and U.S. Constitutions as a violation of due process. The court held that the formula is invalid because the statute offers an "irrebuttable presumption" that whatever amount the formula ultimately produces as an attorney fee is reasonable with no way for the claimant to refute it.[28]

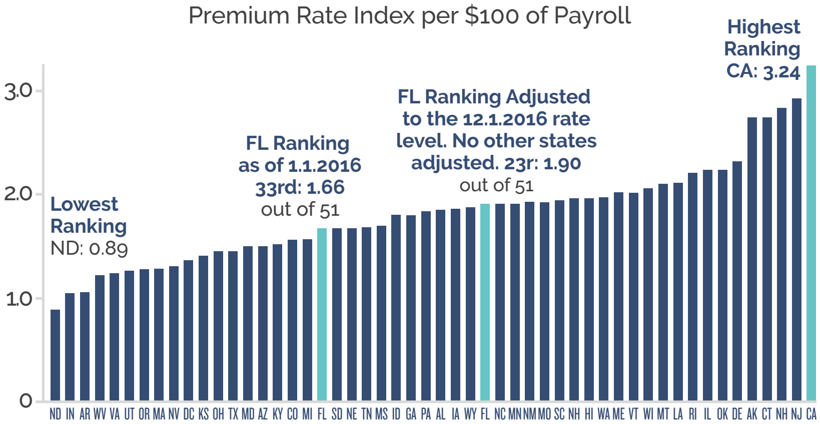
Until the Legislature amends the law, determinations of attorney fees now revert to the last constitutionally-accepted version of the statute, which contains the word "reasonable." Therefore, a judge of compensation claims is no longer required to apply the statutory fee and can now approve a fee above the formula if he or she deems it "reasonable." The ruling appears essentially to render the statutory fee schedule as a starting point, giving incentives for attorneys to prolong the claims-resolution process to inflate their invoices.

The effects of the *Castellanos* ruling have been immediate. A survey conducted between June and July 2016 of 10 large Florida workers' comp insurers, who wrote a combined 66.5 percent of the Florida market, revealed they already had seen higher rates of attorney involvement with higher hourly fees; an increase in reopening old claims; and increased depositions. In short, the survey revealed a spike in litigious activity. Indeed, the numbers corroborate these findings: there was a 22 percent increase in average claimant attorney fees per award in the months after the 2016 *Castellanos* decision compared to the same period in 2015.

In response to the expected increase in litigation, attorney fees and other costs, the OIR approved a 14.5 percent rate increase, which took effect Dec. 1, 2016.[29] From January to December 2016, Florida went from the 33rd to 23rd highest workers' comp rates in the nation.[30]

Florida Ranking Change as of 12/1/2016
2016 Oregon Study

Premium Rate Index per $100 of Payroll




Source: NCCI

After the 2008 Florida Supreme Court decision that threatened the 2003 reforms' much-needed rate relief, the Florida Legislature acted quickly the following session to pass a fix into law and ward off another rate crisis. Although the *Castellanos* decision was handed down less than a year prior, signs already point toward an explosion in litigation and resultant rate increases that may not only undermine the state's workers' comp market, but also threaten Florida's fragile economy and job growth. As such, it is important that the Legislature act as quickly as it did in 2009.

No effective, long-term solution can ignore the issue of attorney fees. A statutory cap on attorney fees that is tied to the benefits collected by an injured worker not only reduces the direct cost associated with those fees, but also removes incentives to prolong claims resolution. A law that encourages a protracted, litigious claims-resolution process not only goes against the financial interests of employers and their insurers, but of injured workers who are naturally interested in resolving their cases quickly. Such policies would only serve to promote potential conflicts of interest between attorneys seeking higher fees and clients who want swift and efficient resolution to their cases.

In order to address the court's constitutional concerns, the Legislature can and should explore ways to craft an exceedingly narrow exception, whereby a claimant may appeal to have his or her attorney's fees covered at a higher rate in extreme and rare circumstances.

Additionally, lawmakers should bear in mind that keeping costs low while protecting injured workers should be their overriding goal. Preserving those key features of Florida's workers' comp system that have been proven sustainable and beneficial should be a priority. The system's "exclusive remedy" framework has functioned effectively, allowing employers to provide medical and wage-loss benefits regardless of who is at fault for the injury in exchange for injured workers waiving their rights to file a lawsuit.[31] Indeed, the Florida Supreme Court recently upheld this statutory provision in a separate case.[32]

## Assignment Of Benefits Reform

No insurance rate increases have been greater in recent years than in Florida's property insurance sector. Despite the lack of hurricanes and historically-low reinsurance rates, Floridians in many parts of the state are still slammed with ever-increasing rates, be they from private insurers or Citizens. These rate increases are a result of non-catastrophe claims, mainly involving non-weather-related water damage from broken pipes.

Florida has seen an increase of almost 50 percent over the past five years in these types of water claims.[33] This spike has not come as a result of some environmental deterioration or unexplained weather phenomena afflicting only the state of Florida. Instead, it has largely been caused by an exploitation of laws and court decisions governing an insurance practice known as "assignment of benefits."

An assignment of benefits allows a third party – such as a contractor, a water-extraction company or other vendor – to assume a policyholder's benefits and collect payments directly from the insurance company for a covered loss. The policyholder also transfers to the third party the right to negotiate and adjust such claims. Hence, no payments are made directly to the policyholder.

Most health insurance and personal injury protection (PIP) auto policies function under this arrangement, which allows health care providers to collect insurance payments directly for covered medical services. Benefits can be assigned either before a claim happens (pre-loss assignment) or after a specific first-party loss occurs (post-loss assignment).

Florida law allows insurers to include policy language restrictions that prohibit pre-loss assignments without an insurer's consent.[34] However, the courts have held that such prohibitions cannot prevent a policyholder from undertaking post-loss assignments. Once a loss occurs, the policyholder has the right to assign his or her policy benefits for the specific loss in question,[35] including the benefit in Florida law that allows policyholders to sue an insurance company and have their attorney fees covered by the insurer, also known as the "one-way attorney fees" provision.[36]

The vast majority of contractors and other professionals in the construction, repair and restoration business who receive assigned benefits from policyholders conduct themselves appropriately and skillfully complete the projects for which they were hired. However, there is significant anecdotal evidence that a small cohort of bad actors abuse these assignments, contributing to what has become an emerging cost driver that results in higher rates for consumers. For example, unscrupulous vendors may require policyholders to sign over benefits as a condition to begin repairs or perform other work. In water-related claims, homeowners who are desperate to prevent further damage and get their homes dried before mold sets in may hastily or reluctantly agree to sign over their rights to water-extraction companies.

With the policyholder having surrendered control of the claim, contractors commandeer the policy, billing the insurer directly for payment and suing for bad faith if that payment is not rendered promptly. The process grants them leverage to inflate their bills, charging for repairs that were unnecessary or unrelated to the specific loss and/or at rates far above reasonable standards. In some cases, contractors partner up with a trial lawyer as a matter of practice, availing themselves of bad-faith rules that were designed with ordinary consumers in mind. A specific case cited by Florida's former state-appointed insurance consumer advocate included billings that totaled more than the house was worth.[37]

Such lawsuits were rare in Florida 10 years ago. Between 2004 and 2005, there were just slightly more than 9,400 assignment-of-benefits related suits filed statewide. In the years since, they have multiplied by nearly 1,000 percent, with 92,000 such suits filed between 2013 and 2014.[38] In 2013, water losses represented 50 percent of new claims against Citizens and 75 percent of the state-run insurer's litigation.[39] Among the most striking pieces of evidence that the system is being abused is the prevalence of vendors who retain counsel before they've even filed a claim, much less given the insurance company a chance to settle it. According to Citizens, eight percent of the lawsuits filed against it in 2009 were filed at first notice of loss; by 2014, the figure had jumped to 24 percent.[40] This has resulted in exponential growth in the volume of lawsuits filed against Citizens. In 2011, only 12 percent of claims went into litigation; by 2016, 45 percent of Citizens claims went into litigation with over 800 new lawsuits filed each month,[41] even though the company has only about a third of the policies it had just a few years ago.

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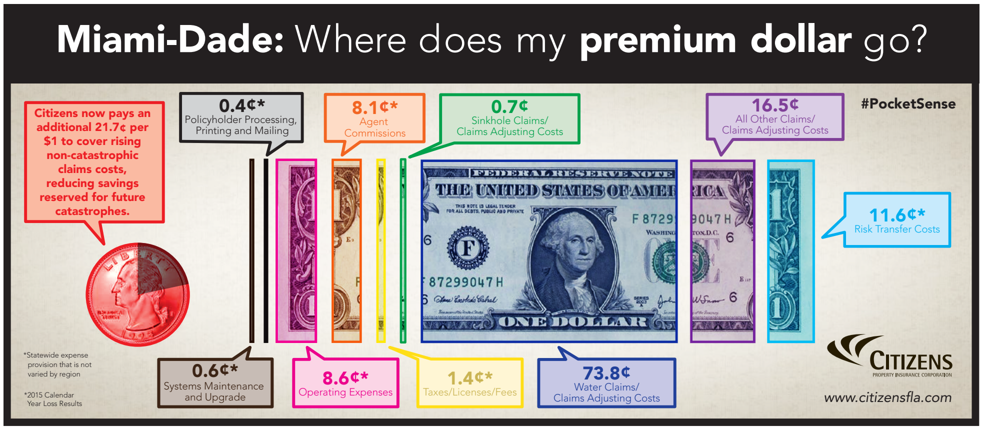
Given this hyper-litigious environment, many insurance companies (including Citizens) simply opt to pay the claims – even when they believe they are excessive – to avoid further litigation costs. This, of course, is paid out of the insurance company's surplus, and ultimately is recovered through higher insurance premiums paid by other consumers.

In 2015, Barry Gilway, Citizens' president and chief executive, testified that "…water losses are THE major reason Citizens is seeking rate hikes for the coming year, especially in South Florida. Were it not for water loss, even South Florida policyholders would see rate reductions" (emphasis his).[42]

South Florida – in particular Miami-Dade County – is "ground zero" for this type of insurance fraud. In 2014, more than 56 cents of every insurance premium dollar paid by the county's Citizens policyholders went toward water claims and related costs; in 2015 that figure jumped to almost 74 cents. The statewide average in 2014 was roughly 33 cents, representing the largest proportion of every premium dollar paid to Citizens. It increased to 46 cents the following year. [43]




Source: Citizens Property Insurance Corp.

Consequently, policyholders in Miami-Dade County experienced a countywide average rate increase of 7.6 percent in 2016.[44] Had Miami-Dade's water claims experience been in line with the rest of the state, Citizens customers would have actually experienced an average countywide rate decrease of 8.5 percent.[45] Therefore, last year's rate increase was, in effect, a "trial lawyer tax" that amounted to a 16 percentage point swing in average rates. This year, average rates in Miami-Dade County are increasing by an even steeper eight percent countywide.[46]

The effects are not limited only to Citizens policyholders in South Florida. Inflated water claims and the litigation to fight them are hurting consumers by driving rate increases and reducing competition in many parts of the state.[47] In 2014, only 37.6 percent of approved insurance rate filings had requested increases; in 2016, 73 percent requested increases,[48] despite continued reductions in the cost of reinsurance. If these rate increases from private insurers persist, policies will begin migrating back to Citizens, after years of successful depopulation efforts. Private insurers are required by law to charge actuarially sound rates, while the state-run insurer is bound by a 10 percent annual cap on rate increases known as the “glidepath,” which creates an imbalance between private insurance rates and those charged by Citizens. Indeed, some private insurers have already begun nonrenewing policies and refusing to write new ones in areas experiencing high volumes of water claims.[49] The trend also is expected to spread into more parts of the state, barring meaningful reforms.

Demotech Inc. — a national ratings agency with an extensive focus on Florida insurers — notes that while assignments of benefits are relatively common nationwide, the extent of abusive behavior and litigation truly is unique to Florida,[50] where the average costs of assigned benefit claims are three times as great as other claims. Demotech has warned that, if left unaddressed, the issue may prompt the withdrawal or downgrade of dozens of insurance carriers in Florida, undermining the state's still-fragile insurance market.

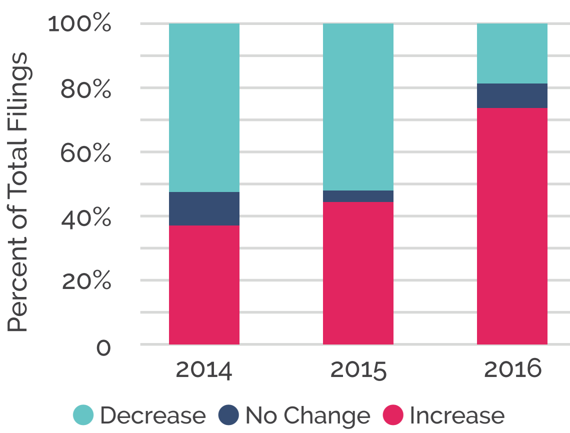
Indeed, even reinsurers are taking note of this issue due to valid concerns that, should a major hurricane strike the state, they will be on the hook for artificially-inflated claims stemming from assignment-of-benefits abuse and excess litigation.[51] This is a signal that if this issue is not resolved, it may eventually be reflected in future reinsurance pricing, causing further hikes in primary insurance rates.

The factor contributing the most to this litigious environment is Florida's "one-way attorney fee" law. State law permits plaintiffs' attorneys to collect payment for their legal fees from the defendant insurer if they win, but does not allow insurers to do the same if they are victorious.[52] The law was intended to create balance between aggrieved consumers who usually cannot afford high-priced legal representation and insurance companies who can. Unfortunately, it appears to have provided sufficient incentive for the birth of a veritable cottage industry of vendors and trial lawyers who "sue first and ask questions later," knowing they will be owed attorney fees even if the insurer does not fight the claim.

This helps to explain why law firms have taken the time and incurred the expense to hold free seminars

Share of Rate Filings 2014-2016*

Based on Approved Rate Changes




*2016 Data is through november 30, 2016

Source: OIR

around the state in recent years for restoration contractors, mold remediators and other vendors interested in learning about "creative tactics" to grow their businesses using assignment of benefits. One such firm bills itself the "Johnny Appleseed of Assignment of Benefits."[53]

Legislation has been filed in recent sessions that would allow insurers to prohibit policyholders from entering into assignment-of-benefits agreements altogether.[54] The bills, or their assignment-of-benefits provisions, all ultimately failed to pass.

In a free market, an individual's right to enter into contractual relationships should be preserved. However, the original insurance policy also is a contract entered into by the insurer and the insured. When benefits are assigned to a third party, the conditions for payment also should be assumed. That is, any third party to whom benefits are assigned should be bound by the original policy requirements for recovery and for allowing the insurer to conduct its investigation, such as requiring the third party to provide proof of loss, supporting documentation and to submit to examination under oath, if necessary.

Additionally, before executing an assignment, vendors should be required to provide an itemized, written estimate to policyholders for their review and signature, and submit the signed estimate, assignment of benefits and claim to the insurance company within a statutorily specified time. Policyholders should also be afforded an opt-out period to rescind an assignment of benefits. This would help to avoid situations where a policyholder may have felt compelled into signing over their insurance benefits under duress or pressure by a vendor or the stressful circumstances surrounding a claim.

In order to reduce unnecessary litigation, vendors should be required to submit their claims to insurers within a statutorily specified number of days before filing a lawsuit on an insurance policy. A 60-day period would give the insurer reasonable time to investigate the claim, request additional information if necessary and have it processed before lawyers need to get involved.

Finally, and most importantly, the rules for attorney fees in assigned-benefit disputes should be revisited. Existing law appears to be a catalyst for unnecessary litigation, providing ample incentives to file suit even in cases where a claim is unwarranted. Consumer access to prevailing party or “one-way” attorney fees should be preserved, but trial lawyers should not avail themselves of it when representing third-party vendors as a result of an assignment, especially when the policyholder has surrendered control of the policy. If a vendor’s grievance against an insurer has merit, there will be attorneys willing to take the case on a contingency-fee basis or through conventional payment.

## Florida Hurricane Catastrophe Fund Reform

Before Florida's spike in non-catastrophe and assignment of benefits-related claims, one of the chief drivers of the state's high property insurance rates long had been the cost of reinsurance. While reinsurance is far more affordable for Florida property insurers than it was in years past, it continues to be an important factor in the calculation of insurance rates.

The Cat Fund is a state-run corporation that is the single largest provider of property reinsurance in Florida. Like private reinsurers, the Cat Fund provides insurance to insurance companies. When insurers' losses from large events (or their aggregate losses over a contract period) exceed certain levels, the Cat Fund, like private reinsurers, promises to cover a portion of the risk. In return for these promises, the Cat Fund collects ceding premiums from insurers.

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While virtually all private reinsurers of any size have an international scope, the Cat Fund covers only Florida windstorm risks. Where a private company would balance the risk of hurricanes in Florida by taking on, for example, the risk of earthquakes in New Zealand or tsunamis in Japan, the Cat Fund does not. In sum, the Cat Fund turns the principle of diversification on its head by concentrating Florida's peak hurricane risk within the state, rather than spreading it around the world. This means that, even assuming the Cat Fund has management talent and investing opportunities equal to reinsurers in the private sector, it would have to charge a much higher risk load than its private counterparts if it hopes to break even in the long run.

In fact, the Cat Fund was established by the state purposely to charge rates lower than the private sector for comparable coverage. As such, it is not required to actually keep on hand the funds needed to pay the kinds of claims it reasonably can expect to receive. Instead, if it runs short on money, it has the authority to issue bonds, which it repays by imposing assessments on policies in a way similar to Citizens.

All residential property insurers doing business in Florida are required to purchase coverage from the Cat Fund. Participating insurers may select coverage levels of 90 percent, 75 percent or 45 percent. The vast majority of companies have always chosen the 90 percent coverage level,[55] since selecting lower coverage levels would require them to substitute such coverage from the private reinsurance market, which ordinarily would be more expensive.

However, given the previously discussed flood of capital into the global catastrophe markets, private reinsurance rates have fallen to levels that are competitive with those charged by the Cat Fund. This has prompted more Florida property insurers to select the Cat Fund's lower coverage options over the past few years. During the 2015/2016 contract year, for example, six companies shifted to the 75 percent level, while 20 shifted to the even lower 45 percent level.[56] For the most recent 2016/2017 year, even more companies opted for the lower levels: three chose the 75 percent level, and 47 elected the 45 percent level.[57]

Thus, 50 insurers have replaced much of their Cat Fund-provided reinsurance coverage with private reinsurance at better prices. If private risk-transfer rates continue dropping as projected, the number of insurers procuring more of their reinsurance from the private market instead of the Cat Fund is almost certain to increase.

This creates a unique opportunity for Florida as it seeks to lower property insurance rates while also reducing the enormous liabilities of its state-sponsored insurance mechanisms. Florida law should not and need not force insurance companies to purchase coverage from the Cat Fund at rates that are higher than those found in the private market. The Legislature should consider giving insurers greater flexibility by creating a 25 percent coverage level option, as well as the option to eschew Cat Fund coverage altogether. This change would allow insurers to better negotiate risk-transfer deals with private carriers at rates potentially even lower than the Cat Fund's and to extend those savings to policyholders.

Even if current projections prove to be off and the cost of private risk transfer increases in the future, this would not preclude insurers from going back to previously-purchased levels of Cat Fund coverage. In the meantime, they could take greater advantage of the global reinsurance market's attractively-priced coverage.

This proposal would also help establish a needed surplus protection mechanism for the Cat Fund. Currently, the Cat Fund is required to use all of its cash on hand before it can issue debt to cover its liabilities. While it currently has the resources to cover a significant hurricane event, the Cat Fund would be left bare and potentially unable to meet its $17 billion obligation in the subsequent hurricane season. Such a shortfall would have disastrous consequences. In 2012, the OIR estimated that if the Cat Fund experienced a shortfall of just 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, represented approximately 35 percent of the market and serviced more than 2.2 million policies at the time.[58]

Therefore, Cat Fund surplus protection for subsequent seasons should remain a priority for the Legislature. Under the proposal outlined above, the Legislature may consider dedicating part or all of the unused capacity resulting from insurers selecting the proposed 25 percent and 0 percent coverage options to the subsequent season.

Additionally, the Legislature should consider authorizing the Cat Fund's managers to negotiate reinsurance and other forms of private risk transfer directly. For two years, the State Board of Administration (SBA) empowered the Cat Fund to negotiate a risk-transfer package. It ultimately signed off on transactions that resulted in $1 billion in reinsurance coverage each year, which made the fund fully liquid.[59] In order to secure the best risk-transfer deals, the Cat Fund should have the ability to enter the market and negotiate with greater flexibility, so that it may have more and better options to present to the SBA for final approval. Indeed, the SBA should maintain its authority to approve or reject proposed deals, but the Cat Fund's professional staff should not be impeded from effectively negotiating by having to seek approval for every step of the negotiation process.

Florida lawmakers at the state and federal levels should also monitor and oppose proposals in Congress that seek to impose a punitive tax on reinsurance coverage purchased from offshore companies, which provide approximately 93 percent of Florida's private reinsurance protection.[60] A tax on this coverage would be paid for by consumers through higher primary insurance rates, which would further undermine Citizens depopulation efforts and increase demand on the Cat Fund, both of which would concentrate more risk inside the state and onto taxpayers.

## Disaster Mitigation

Florida's vulnerability to natural disasters will always play a key role in its property insurance rates. The state's position as a low-lying tropical peninsula jutting 500 miles into the most hurricane-active waters in the world is the same today as it was 10 years ago or 100 years ago, and many scientists believe that climate change likely will increase the severity and incidence of storms in the future.

Although Florida's geography and risk profile have not changed, its built environment and the number of lives and amount of property at risk of hurricanes have grown dramatically. The state's population has tripled since 1970 and continues to grow. At roughly 20.5 million residents, Florida recently surpassed New York to become the third-most-populous state in the nation.[61] Florida's total coastal exposure now stands at more than $2.9 trillion,[62] with more property at risk than all of the other "hurricane alley" states (Louisiana, Virginia, Texas, North Carolina, South Carolina, Georgia and Mississippi) combined.[63]

Given this concentration of lives and property along Florida's high-risk coastal areas, lawmakers can and should take proactive steps to fortify the state's built environment. My Safe Florida Home, a program created in 2006, provided no-cost home inspections for Floridians and helped residents of modest means reinforce their homes against storms.[64] Although the program seemed to help, it was canceled two years later due to problems with the inspection process and a lack of funding.[65] Similar programs have proven their effectiveness around the nation: in general, every dollar spent on disaster mitigation can be expected to save at least $3 (and perhaps as much as $7) in future insurance loss costs.[66] The Legislature should consider resurrecting this or a similar program and funding it with perhaps a small home mortgage closing surcharge.

Sen. Jeffrey Brandes (R-St. Petersburg) has introduced legislation to provide local governments with matching grants to assist in implementing flood-hazard risk-reduction policies and other projects.[67] This assistance from the state would help local governments mitigate against flooding, which will not only help lower their residents' National Flood Insurance Program (NFIP) rates and reduce loss of life and property due to floods, but will also encourage the expansion of a private flood insurance market.

Sand dune erosion in St. Augustine, FL. Source: USGS

The state can and should look for other creative ways to encourage mitigation, including by discouraging development in high-risk areas. In 2013, the Legislature passed and Gov. Rick Scott signed a bill prohibiting Citizens from extending coverage to new construction within the state's most hazardous areas, specifically within federally-designated and protected wetlands, and most beachfront properties.[68] This provision does not infringe on property rights, as landowners are free to build, but must simply obtain their coverage from the private market or otherwise self-insure, so as to not foist their enormous risk onto the state's taxpayers.

This concept, based on a 2013 R Street Institute study,[69] can be expanded to include other extremely hazardous areas, including certain categories inside the Florida Building Code's Windborne Debris Regions and High-Velocity Hurricane Zones, or quite simply by expanding the radius of areas already restricted by the 2013 law.

## Conclusion

Given Florida's streak of combined luck from Mother Nature and the global markets, the 2017 legislative session offers state lawmakers an enormous opportunity to enact insurance reforms needed to address cost drivers that are needlessly driving up rates, while also strengthening the state both financially and physically ahead of the gathering storm.

The Legislature should act with assertiveness, as it did in 2009, to get ahead of the looming explosion of unnecessary litigation and consequent rate increases in the workers' comp system. Doing nothing will guarantee higher costs on employers, which will undermine the job gains Florida has made in recent years.

Lawmakers also need to address the explosion in the number and cost of non-catastrophe claims that, if left unaddressed, will continue needlessly driving up rates during a time when Floridians should be experiencing rate relief. In particular, the state needs to take steps to stop the rampant assignment-of-benefits abuse that serves as a windfall to a few unscrupulous vendors and their lawyers, to the detriment of all consumers.

For the past several years, some lawmakers have successfully blocked commonsense, bipartisan property insurance reforms because they feared a political backlash if they increased rates on consumers. Many times, even modest reforms were rejected if there was just a small chance of a negligible rate increase. Meanwhile, the rampant fraud and abuse that have been allowed to run amok related to assignment of benefits have contributed more to rising rates than any law proposed in the past several years would have.

The Legislature should also take the new state of the global catastrophe markets into account and modernize the Cat Fund. Insurers who can find comparable coverage in the private reinsurance market at lower rates should be free to pass those savings on to their policyholders. Additionally, lawmakers should take advantage of the Cat Fund's fiscal health by restructuring it to ensure it has the resources necessary to cover losses from subsequent hurricane seasons.

Finally, Florida should continue finding ways to mitigate against the natural hazards inherent to its geographic position. Public policy should encourage and facilitate the strengthening of the state's built environment, as well as discourage building in areas that are extremely hazardous—especially through indirect, taxpayer-backed subsidies such as underpriced government insurance.

Although the reforms outlined in this study would not solve all of Florida's insurance-related problems, they would put a halt to unnecessary rate increases, protect taxpayers, promote market-based solutions, and ensure future generations are not perpetually on the hook for the decisions we should have made but failed to.

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