Appendix 5
Detailed Recommendations for Homeowners and the Private and Public Sectors

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(1) Homeowners.

Homeowners in Florida need and deserve adequate hurricane catastrophe insurance coverage at affordable rates. Their interests are and should be paramount in the minds of the private insurance and banking industries, who depend on homeowners as customers, and in the minds of public officials, who depend on homeowners as taxpayers, voters and good citizens.

Homeowners are the most important people in determining whether Florida can reestablish a sound, competitive private insurance industry which serves the interests of homeowners by offering adequate coverage at affordable prices. Homeowners have substantial responsibilities for making the insurance system work. First among these responsibilities is the task of understanding the true scale of hurricane catastrophe risks facing the region of Florida in which they live and the consequences of those risks for the availability and cost of adequate insurance coverage. Well-informed homeowners can be a powerful force in revitalizing the property and casualty insurance market in Florida and making it truly competitive. Realistic demands by homeowners, based on good information about insurance requirements and availability, are much more effective **long-term** controls on private marketplace behavior than government regulation.

The well-informed homeowner in Florida needs to understand and demand flexible coverage limits, deductibles and co-payments from insurance companies in order to reestablish adequate insurance availability in the State and in order to slow or considerably reduce policy rates. Basic policy rates for Florida's homeowners have increased since Hurricane Andrew and some are likely to increase even more in the short-term. But, with increased competition and increased flexibility of rates, deductibles and co-payments, informed homeowners should and will have choices which they can make to keep rates affordable.

One of the most important choices for homeowners is a decision to take steps to prevent and mitigate damage. After Hurricane Andrew, many more mitigation choices have become available for homeowners - better roofs, windows, doors, garage enclosures and other improvements. Homeowners should demand financial credits from insurance companies and from their mortgage bankers for these preventive steps which, after all, protect the insurance and banking industries as well as the homeowner. Homeowners also need to demand that their local governments establish and enforce good building codes to try to prevent the inactions of others from damaging neighboring properties. They should insist on a good community assessment and rating system which can reduce their individual insurance costs.

To make good choices, homeowners will need standardized insurance products and good information. They need clearly defined and explained coverage options, cost differences and service choices which should be easily available in every public library, city hall and insurance agent's office in the state. Regional comparisons should be available with "real time" updates on every Internet/Freenet system across Florida.

Homeowners also should insist on better ways of finding reliable people to repair their homes after a hurricane catastrophe. A "managed repair" program can assist in identifying reliable workers and procedures, arrange for pre-positioned supplies and set high and efficient performance standards for post-catastrophe repairs.

Figure 1 illustrates the roles and responsibilities of homeowners in the "Balanced Equation for Florida's Future."

Figure 1: Florida Hurricane Catastrophe Insurance:
A Balanced Equation for Florida's Future - Homeowners Responsibilities

Homeowners' Responsibilities

Coverage
- Flexible coverage limits
- Revolving financing mechanisms for copayments and deductibles

Rates
- Rates based on individualized risk assessment
- Flexible deductibles
- Flexible copayments
- Mitigation credits and penalties

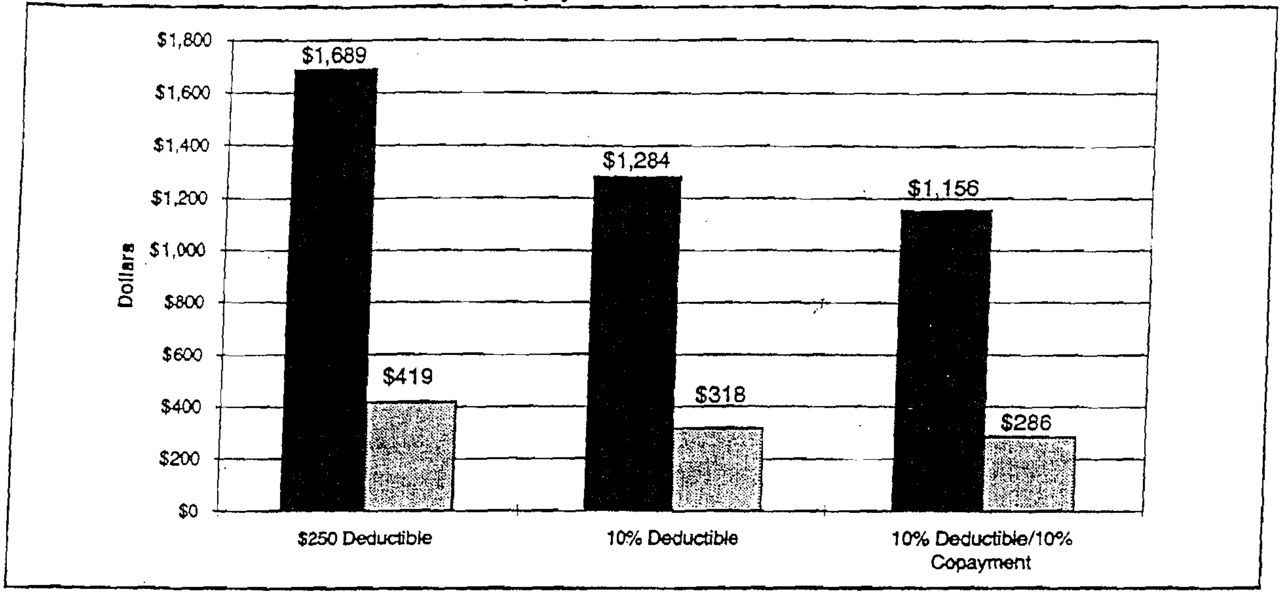
Risk Exposure
- Pre- and post-event mitigation actions
- Support for community assessment and rating
- "Managed" inspection and repair

Education
- Incentives to understand:
  - mitigation options and responsibilities
  - risks and costs of different levels of coverage
  - cost and service advantages of competing primary providers

This educated consumer will also more likely to recognize the short run need for marginal policy premium rate increases in high risk areas to allow the market to reasonably deal with the growing hurricane risks facing their community. This better informed consumer must also be made aware of economic incentives available to **considerably reduce** policy coverage costs (short and long term) through mitigation, copays, deductibles and other methods previously described.

As an example Figure 2 provide estimates of reductions in property casualty annual insurance premium costs for a $150,000 home in Miami and Tampa at different deductible and copay levels. Note that the $250 deductible annual premium of $1,689 falls by 24% - to $1,284 when a 10% deductible is put in place. That rate falls another 7% to $1,156 when a 10% copay is added to the 10% deductible option. Final policy annual reduction is 31% from implementing these two policy options alone.

Figure 2: Miami and Tampa Casualty Insurance Cost comparison at Various Deductible and Copay Levels $150,000 Frame House



(2) **Private Sector: The Insurance Industry.**

The private insurance industry historically has assumed the primary responsibility for distributing catastrophic and non-catastrophic damages among large groups of homeowners, making reasonable profits in the process. Property risk typically is spread by insurers across a wide range of natural and man-made risks, including fire, rain, hail, theft and other events which occur at random but, if measured with accurate data over a long period of time, may offer an insurer some minimal confidence of predictability of the numbers, types and sizes of different kinds of events which might occur during a certain period of time.

This "bundle of aggregate risks" in a single multiple-peril homeowners' insurance policy helps to defuse and cross-subsidize any single disaster payment by every other risk covered. The ability to calculate the probability of a single event (or the combined occurrence of and losses from joint events) allows insurance companies to charge rates to policyholders which create profits through healthy cross-subsidization. For example, a single payout for a burglary to a policyholder can be offset by many years of payment for fire, wind and hail damages which have not occurred. The calculation and pricing of these various risks across product lines by insurance companies is a key task which they perform in order to make a profit.

Until Hurricane Andrew, insurers in Florida had collected hurricane catastrophe premiums from homeowners, as a portion of general multiple-peril policy rates, for many years without substantial payouts. Hurricane catastrophe premiums, in effect, helped to subsidize losses from other events, such as fires. The lack of major hurricane damage for many years also encouraged insurers to keep their overall rates low, and low rates permitted aggressive insurance companies to increase the numbers of their policyholders and their overall market share by large numbers. When Hurricane Andrew occurred, several companies consequently suffered huge catastrophic losses and immediately began to reassess their exposures in Florida.

Several large companies now want to separate out hurricane catastrophic exposures from other kinds of coverage offered in the multiple-peril homeowners' policy and to transfer the hurricane exposure to a State-sponsored corporation.

The Academic Task Force has taken a different position and has prepared a program which emphasizes the collective responsibility of the private insurance industry to pay out the "first dollars" in the event of a hurricane catastrophe, to become more competitive and to responsibly reduce unusual risk exposures in high-risk geographic areas.

Figures 3 and 4 illustrate the roles and responsibilities of the private insurance industry.

Figure 3: Florida Hurricane Catastrophe Insurance: A Balanced Equation for Florida's Future - Insurance Industry

INSURANCE INDUSTRY

Coverage

- Greater competition resulting from better managed risks: limits on risky geographic concentration, realistic rates, community rating, individualized risk assessment
- Flexible rates with variable options to encourage limits on geographic concentration
- Incentive payments from overconcentrated private companies to other private companies to reduce risky portfolio; swaps
- Depopulation of all JUAs through innovative market options such as swaps, auctions and higher incentive payments
- Agent incentives to write in the voluntary market and to encourage reduction of private company geographic risks; disincentives to write in non-voluntary market
- Expansion of Cat fund capacity
- Reinsurance "profit-sharing"

Rates

- Variable competitive market rates with flexible copays and deductions
- Substantial JUA rate increases to reflect higher non-voluntary market risks
- Standard rate comparisons
- Rate discounts for effective mitigation

Figure 4: Florida Hurricane Catastrophe Insurance: A Balanced Equation for Florida's Future - Insurance Industry

INSURANCE INDUSTRY

Risk Exposure
- Aggressive mitigation incentive systems
- "Managed" inspection initiatives for all property actions tied to insurance adjuster standards
  - Initial mortgage financing inspection
  - Pre-event rating inspection
  - Post-event damage control
- "Managed" repair initiatives for all property actions
- Fiscal soundness for companies in relation to risk; no outstanding and ongoing JUA debt
- Standardized community mitigation community rating systems

Education
- Aggressive consumer education programs
- Standardized product lines
- Standardized rate comparisons
- On-line Internet access to rates, services, options, coverage characteristics

The most important of the roles and responsibilities of the private insurance industry are to:

- support rapid depopulation of the JUA's (especially by stopping immediately any policy cancellations or non-renewals which end up in the JUA's), JUA rates which reflect more accurate risk assessments and immediate liquidation of outstanding JUA debts;
- reduce large market shares in high-risk areas by selling policies to, or swapping policies with, other financially sound private companies by limiting geographic concentrations in the future;
- offer agents incentives to refer homeowners to the private voluntary market;
- implement standardized policies and rate comparisons;
- increase consumer awareness and offer variable competitive market rates with flexible deductibles, co-payments and mitigation incentives;
- expand the Cat Fund capacity.

The private insurance industry also has major roles to play in promoting individualized risk assessments which go far beyond the kinds of risk analysis on which they now rely. Perhaps the most detailed risk assessment now being used is the zip code analysis prepared by the Florida Hurricane Catastrophe Fund. Although some insurance companies claim that an individualized house-by-house system would be too cumbersome and costly, a carefully managed inspection program, linked to inspections conducted for home sales and mortgage financing and to local building and zoning inspections, could be part of an overall community rating system. These combined risk assessment changes could reduce risks, identify mitigation opportunities, hold down rates and expand capacity.

Private insurance companies also need to hold down costs by taking the lead in developing and carrying out "managed repair" programs to rebuild more inexpensively after a hurricane catastrophe. Working with local governments, the construction industry labor organizations and the new International Center for Hurricane Damage Prevention and Mitigation, at Florida International University in Miami, insurance companies can identify repair teams, pre-position supplies and develop standard repair and inspection procedures for rapid use after a storm.

Insurers need to take adequate steps to provide sufficient insurance coverage for minorities and low income homeowners, adequate settlement levels to minority and low income policyholders and adequate information to the state which is relevant to identifying possible ethnic and income level inequities.

(3) **Private Sector: The Banking Industry.**

The banking industry in Florida has a substantial stake in encouraging a healthy, competitive insurance industry which can provide reliable multiple-peril coverage for mortgaged homes.

Mortgage bankers are on the front line in encouraging adequate coverage at reasonable rates for most homeowners whose homes are financed. Lenders usually require insurance in the amount of the mortgage; they can encourage borrowers to buy more coverage and to keep rates reasonable by using and financing deductibles and co-payments. Lenders can arrange for appraisals and frequently insist on roof and termite inspections; they can combine these individual home inspections with damage prevention inspections for insurance risk assessment purposes, provide incentives for borrowers to reduce rates by taking advantage of mitigation credits and provide financing for retrofits and mitigation actions.

Bankers in Florida also need to encourage secondary mortgage markets to change their reluctance to purchase mortgages with flexible deductibles and co-payments. They need to take the lead in educating regulators and other financial institutions outside of Florida about the need for much greater flexibility in mortgage financing related to hurricane risk.

Banks can expand their cash flow financing of private insurance companies, the JUA's and the Florida Cat Fund for payouts after a storm and continue to be flexible, as they were with many homeowners after Hurricane Andrew, in meeting cash flow requirements for rebuilding.

Figure 5 outlines the roles and responsibilities of the banking industry.

Figure 5: Florida Hurricane Insurance:
A Balanced Equation for Florida's Future - Banking Industry

BANKING INDUSTRY

Coverage
- Mandatory catastrophe insurance coverage to obtain mortgage financing
- Expanded bank cash flow financing (e.g. lines of credit) for private companies, Cat Fund

Rates
- Easier resale of mortgages with flexible co-pays and deductibles on secondary market
- Financing of variable co-pays and deductibles

Risk Exposure
- Financing of mitigation/retrofits
- Coordination of mortgagor inspections (appraisals, roof, termite) with insurance risk assessments of individual dwellings
- Credits against mortgage points of fees for mitigation/retrofits

Education
- Mortgagee education materials

(4) **Private Sector: Capital Markets.**

International, national and regional capital markets can assist the private insurance industry to obtain new capital, and consequently to expand capacity to provide insurance for hurricane catastrophic risks, by developing innovative new financing products, such as various forms of packaging and marketing catastrophic insurance risk derivatives.

To do so, they will need to encourage the insurance industry and regulatory agencies to prepare and use standard homeowners' insurance policies and practices which can be securitized, similar to the way in which standard home mortgages are securitized and resold in whole or part on secondary markets.

Capital markets (see Figure 6) also can do much more to educate themselves about the property and casualty insurance industry so that they will be prepared to provide more "risk capital" when opportunities arise. They can encourage prevention and mitigation activities by including community ratings and the existence of mitigation programs as part of their analyses of the strength of municipal bonds which are linked to hurricane catastrophe insurance programs, such as those issued for use of the JUA's and the Cat Fund.

Figure 6: Florida Hurricane Insurance:
A Balanced Equation for Florida's Future - Capital Markets

CAPITAL MARKETS

Coverage
•Innovative risk capital products (e.g., securitization of catastrophic risk insurance)
•Standardized risk exposure financial products to encourage securitization

Rates
•Flexible treatment of deductibles and co-pays in secondary financing markets

Risk Exposure
•Inclusion of community ratings and mitigation incentives in risk analysis of financial products

Education
•Market\investor understanding of risk profiles and portfolio advantages to encourage new financial products (e.g., securitization)

(5) **Public Sector: Local Government.**

Of all public sector agencies, local governments are likely to be affected most directly and most adversely by a hurricane catastrophe. They must organize evacuations prior to an emergency and arrange shelter, food, water and clothing afterwards. They must rebuild roads, schools, fire stations and other public facilities which may have been damaged or destroyed. All of this must be accomplished within the framework of a damaged economy and tax base, the need to maintain normal services while providing emergency assistance, the lack of any significant resources to aid individual homeowners to rebuild and the fact that local government employees, who are needed to do all of this work, may themselves be among the most adversely affected by a catastrophe.

Emergency planning and assistance is a proper function for local governments and, after Hurricane Andrew, many are now much better prepared than before to manage these duties. But the best way for local governments to cope with hurricane catastrophes is to help prevent damage in advance.

The basic tools which local governments have to mandate and encourage prevention and mitigation activities are their local building and zoning codes. Although some local governments have good codes, such as the South Florida Building Code or the new Dade County Code, most do not. Even local governments which have good codes are not enforcing them adequately.

The lack of good building and zoning codes, and of strong enforcement, is the single most important defect in Florida's plans for coping with hurricane catastrophes. Hurricanes are not going to disappear; they are fact of life in Florida, more so than for any other State. Floridians MUST remember this basic fact and live accordingly.

Overbuilding of expensive, but unprotected, homes, condominiums and apartments on coastal areas and in other high-risk areas leads inevitably to the kinds of insurance problems which the State now is experiencing. Adequate coverage at affordable prices is an unreachable goal if Floridians do not begin to pay serious attention to hurricane damage prevention and mitigation. Local governments have no more important task in hurricane damage control and in assisting their local homeowner-citizens in keeping insurance prices affordable.

Local governments should support Florida's new building code rate factor plan, enacted by the 1995 Legislature, which will reflect the quality of enforcement of building codes and permit the quality of enforcement to be part of an insurer's rate structure. Better enforcement can lead to more affordable rates for local homeowners.

Local governments also can cooperate with insurance companies and banks in building a system of individualized inspections of homes, related to hurricane damage prevention and mitigation assessments. These individualized inspections eventually can result in more realistic, tailored risk analyses for individual homeowners with appropriate rate adjustments.

The Academic Task Force's plan calls for an emergency building/construction tax or fee which could help to fund hurricane damage rebuilding programs. The existence of such a tax or fee at the high end of the sources of payments needed after a catastrophe may help to encourage local governments to pay more attention to prevention and mitigation so that the tax or fee is not needed.

Figure 7 lists recommended roles and responsibilities for local governments.

Figure 7: Florida Hurricane Insurance:
A Balanced Equation for Florida's Future - Local

LOCAL GOVERNMENT

Coverage
- No subsidies for uninsured properties
- Emergency building/construction taxes

Rates
- Aggressive risk reduction measures to improve community rating and homeowner rates

Risk Exposure
- Aggressive mitigation programs
- Adoption of superior, uniform building codes
- Effective building code enforcement programs
- Standardized community risk assessment program
- Standardized "managed" inspections

Education
- Consumer/citizen education programs
- Incentives for mitigation (e.g., energy-saving rebates)

(6) **Public Sector: State Government.**

State government, through the Insurance Commissioner and the Department of Insurance, has the primary responsibility for authorizing private insurance companies to do business in the State, for monitoring and examining them and for enforcing State laws which seek to protect policyholders and the public interest. The State's major legal duties are to ensure the solvency of companies which insure Floridians and to review and approve rate requests from private companies so that rates are not excessive, inadequate or unfairly discriminatory.

State government has taken dramatic steps since Hurricane Andrew to assist homeowners to continue to obtain coverage at affordable rates. Some of these steps are succeeding well, especially the Hurricane Catastrophe Fund. Others should succeed but are too new to evaluate, such as the new Hurricane Loss Projection Methodology Commission, the building code rate factor plan, increased deductibles for homeowners' policies, JUA take-out bonuses (but only to the extent that such take-outs do not exclude windstorm coverage), bonding and lines of credit for the JUA's and the Cat Fund, mitigation funding, new insurer incentives and various consumer protection initiatives.

The State can continue to build on these positive actions by increasing its efforts to depopulate the JUA; encouraging more realistic distributions of market shares in high risk regions of the State; by standardizing hurricane/windstorm policies and requiring coverage by all homeowners; permitting more flexible competitive rate-setting, reviewing rates more much more quickly and increasing homeowner options for deductibles, co-payments and mitigation credits; "sunsetting" the Residential JUA and limiting the Windstorm JUA to the "truly uninsurable"; and conducting a major statewide education program about insurance options and mitigation benefits.

Figure 8 outlines the State's roles and responsibilities.

Figure 8: Florida Hurricane Insurance:
A Balanced Equation for Florida's Future - State

STATE GOVERNMENT

Coverage
- Standardized hurricane/windstorm insurance policies
- Possible mandatory minimum coverage (e.g., automobile coverage)

Rates
- Flexible competitive rate-setting
- Variable deductibles and co-pays
- Rapid processing of requests for regulatory actions

Risk Exposure
- Sunset Resid. JUA/ Limit Windstorm JUA to "truly uninsurable"
- Expanded Cat Fund: increased revenue collection and diversified assessment options
- Standard non-voluntary underwriting criteria

Education
- Standardized coverage products
- Major statewide education program about roles of homeowner, private insurers
- Cat Fund, JUA's and governments

(7) **Public Sector: Federal Government.**

The Federal government plays an important role in helping Floridians cope with the damages caused by a hurricane catastrophe. Funds provided through the Federal Emergency Management Administration (FEMA), the National Flood Insurance Program and special appropriations from Congress normally have been available in large amounts to provide emergency assistance during and immediately after a hurricane catastrophe. The Federal government needs to continue its role and to institutionalize its provision of emergency funding by the creation of a national program which could accumulate tax-exempt funds on a national level for major disasters, similar to Florida's Hurricane Catastrophe Fund.

The Federal government also should conduct a thorough study about how it can promote a return to a healthy, competitive property and casualty insurance industry around the country, including the possible creation of additional tax-exempt reserves (either as part of a national program or as part of State-created programs, such as Florida's Cat Fund), and including major mitigation incentive programs to contain the dramatically-increased levels of risks which insurance and reinsurance perceive.

Incentives for bankers in the Community Reinvestment Act (CRA) and incentives for the major national secondary mortgage market organizations (Fannie Mae and Freddie Mac), as outlined previously in this Report, are important for encouraging adequate coverage at affordable prices.

Figure 9 outlines roles and responsibilities for the Federal government.

Figure 9: Florida Hurricane Insurance: A Balanced Equation for Florida's Future - Federal

FEDERAL GOVERNMENT

Coverage

- Expanded tax exempt pre-funding, including favorable tax treatment for private company catastrophe reserves (perhaps part of Cat Fund)
- National Disaster Fund
- Continuation of mandatory national flood insurance program

Rates

- Community Reinvestment Act (CRA) credits and favorable regulatory attitude for bankers who finance co-pays, deductibles and mitigation incentives
- Expanded tax exempt pre-funding as rate subsidy to homeowner

Risk Exposure

- Major FEMA prevention and mitigation programs and grants
- CRA credits for banker involvement in mitigation financing and education programs
- Possible mandatory mitigation incentives as part of secondary market analysis of mortgage portfolio risks

Education

- Financing of education programs by state and local governments

APPENDIX 6

Reducing Statewide Market Concentrations

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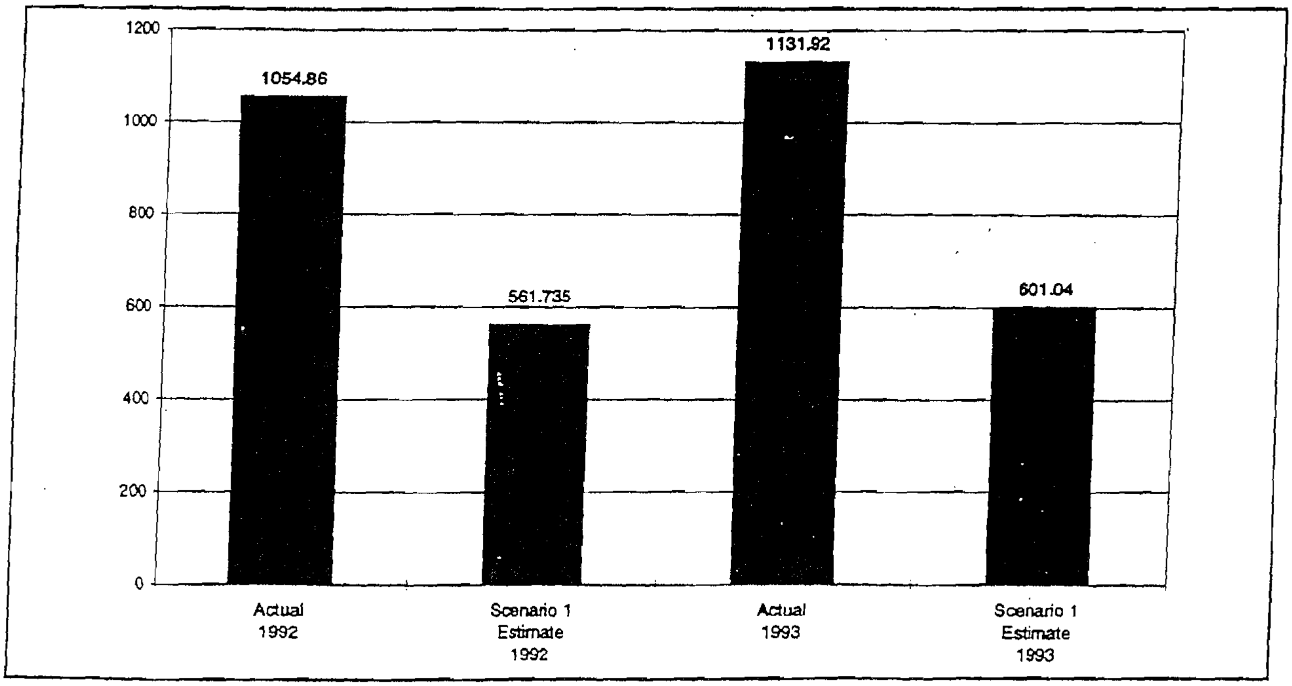
The following analyses evaluate the likely increase in market competitiveness if Allstate and State Farm reduce their Florida market shares by transferring policies to their competitors in order to build a more competitive market in the state. Each of these analyses assumes that these two dominant industry leaders reduce their market share to other industry competitors and not to the Residential or Windstorm JUA's.

Scenario 1: Reduce Allstate and State Farm Market Share by 50%

Figure 1 is a profile of the Herfindahl Index for the Florida property and casualty industry for 1992 and 1993, assuming that Allstate and State Farm, respectively, reduced their market shares by 50% proportionately and the other top 3 to 8 firms in the market proportionately absorbed these shares through swaps and trades. Allstate's market concentration would drop from 26% to 13% in 1992 and 28% to 14% in 1993 respectively. Allstate would drop almost 9% in each of these years from 18% to 9% in each year. As Figure 1 illustrates, the Index drops by almost half from 1055 and 1132, respectively, in 1992 and 1993 to 561 and 601 in each of these years, easily below the 1,000 high concentration levels.

Figure 1: Scenario 1 Estimates of the Change in the Herfindahl Index

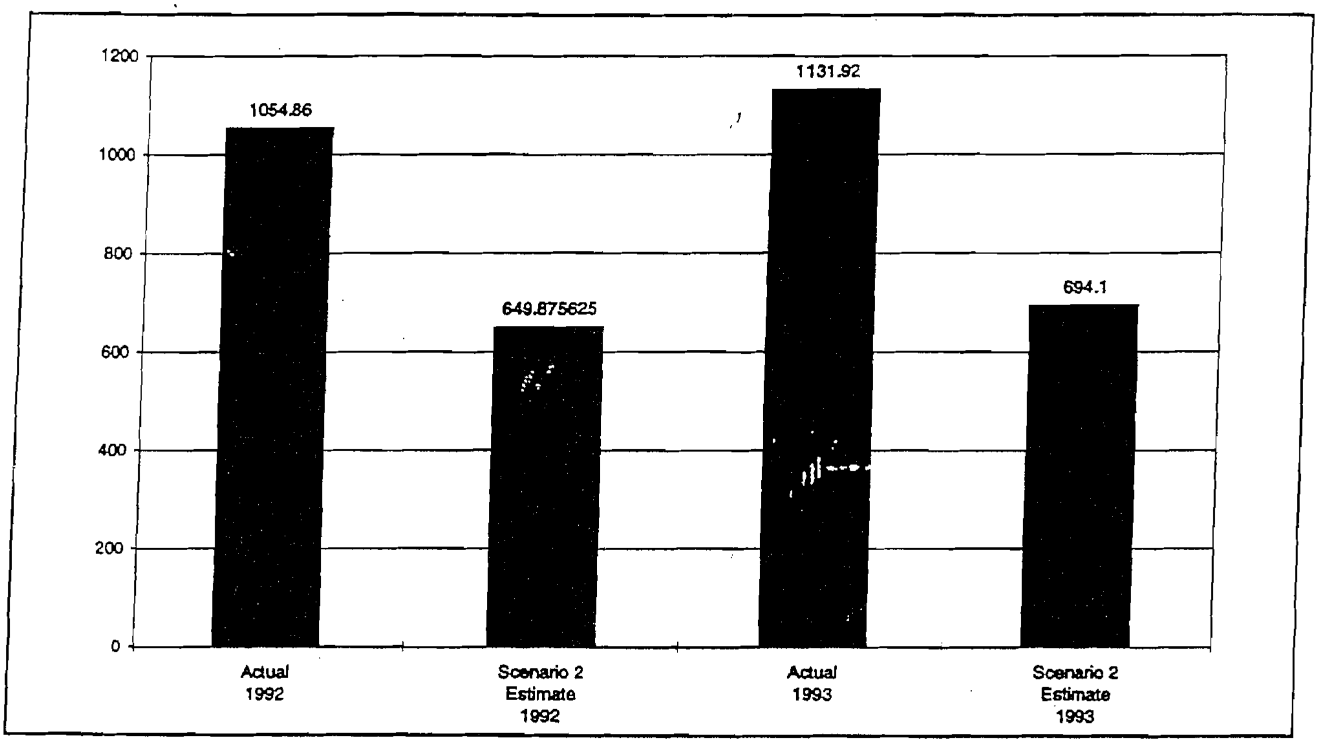


Scenario 2: Reduce Allstate and State Farm Market Share by 25%

Figure 2 is a profile of the Herfindahl Index for the Florida property and casualty industry for 1992 and 1993, assuming that Allstate and State Farm, respectively, [illegible]duced their market shares by 25% proportionately to the other top 3-to-8 firms [illegible]e market. Allstate's market concentration would drop from 26% to [illegible] in 1992 and [illegible]% to 21%

in 1993 respectively. Allstate would drop almost 4.5% in each of these years from 17.7 % to 13.3%. As Figure 2 illustrates the Index drops by almost half from 1055 and 1132,

Figure 2: Scenario 2 Estimates of the Herfindahl Index



respectively, in 1992 and 1993 to 650 and 694 in each of these years, easily below the 1,000 high concentration levels.

Scenario 3: Reduce Allstate and State Farm Market Share by 10%

Figure 3 is a profile of the Herfindahl Index for the Florida property and casualty industry for 1992 and 1993, assuming that Allstate and State Farm, respectively, reduced their market shares by 10% proportionately to the other top 3 to 8 firms in the market. Allstate's market concentration would drop from 26% to 24% in 1992 and 28% to 25% respectively in 1993. Allstate would drop only 1.7% in each of these years. As Figure 7 illustrates, the Index drops by approximately 200 points from 1055 and 1132, respectively, in 1992 and 1993 to 880 and 943 in each of these years, easily below the 1.000 high concentration levels.

Figure 3: Scenario 3 Estimates of the Herfindahl Index