Executive Summary

A BALANCED EQUATION FOR FLORIDA'S FUTURE
September 30, 1995

If Florida experiences another Hurricane Andrew, or a series of catastrophes that equal or exceed Andrew's damage, how are Florida's homeowners going to pay for the damage?

That's the central question which faced the Academic Task Force on Hurricane Catastrophic Insurance -- a blue ribbon panel of educators, economists and insurance experts created by the 1995 Florida Legislature.

The Academic Task Force has proposed a plan to revive the collapsing homeowners' insurance market in Florida, and to make sure there is a way to insure against a $22 billion hurricane -- a storm about twice as damaging as the $10.2 billion in insured residential losses from Hurricane Andrew. The Task Force plan projects that this catastrophe repayment level will double in ten years to almost $44 billion, barring a major hurricane striking the state.

In its plan, called **"A Balanced Equation for Florida's Future,"** the Academic Task Force rejects the call by some for a State-sponsored insurer and instead calls on private homeowners' insurance companies to continue to pay for most hurricane catastrophe damages.

But drastic changes will have to be made in order to re-establish a healthy, competitive insurance market that will provide adequate and affordable hurricane risk coverage to Florida homeowners. And bringing those changes about will require the cooperation of not only private insurers but of individual homeowners, the banking industry, private capital markets, and local, State and Federal governments. No one of these participants "wins" or "loses" more than the others with this program. Everyone assumes a fair share of mutual responsibility and **all gain** from implementing these shared efforts.

Major components of "A Balanced Equation for Florida's Future", recommended by the Academic Task Force, include:

(1) **Cap insurance industry loses at $20.4 billion.** Private insurance companies will be responsible for paying out the "first dollar" for insured properties in the event of hurricane damage. However, this exposure should be capped initially at $20.4 billion and will be indexed so that it grows over time to reflect higher property values and other factors.

(2) **Permit more flexible rates for homeowners.** Rates for homeowners' policies in high-risk areas have increased significantly -- as much as 65% -- since Hurricane Andrew. Under the "Balanced Equation" plan, policies in these high-risk areas may need to increase an additional 20 to 40 percent more.

Consumers can offset these higher rates by choosing higher deductibles and co-payments, and by earning credits for preventive measures such as storm shutters. Cooperation from banks and mortgage lenders will be required to assist homeowners with increased insurance costs and with pre-catastrophe prevention repairs. Eventually, greater diversification of geographic risk and larger numbers of financially healthy insurance companies in Florida will increase competition and decrease rates.

(3) **Encourage flexible insurance products** based on mandatory minimum hurricane/windstorm coverage which provide options for homeowners to choose.

(4) **Strengthen the Florida Hurricane Catastrophe Fund.** The "Cat Fund" is a tax-exempt trust fund administered by the State. Created by the Florida Legislature in 1993, the Cat Fund reimburses insurance companies for catastrophic losses. The Cat Fund has been a major incentive for private insurers to remain in Florida.

The Fund should continue to operate as it does now, with a $3 billion trigger. The Academic Task Force further recommends that a significant portion of homeowner policy rate increases and other revenue sources go to the Fund so that its capacity will grow more rapidly.

The Fund's projected growth over the next several years will be a major contributor to keeping insurance costs and rates more affordable. The Cat Fund catastrophic payment capacity currently stands at about $5.2 billion and is expected to expand to $8.3 billion by 1999 if Florida sustains no major hurricane losses. Over the next ten years, barring a major hurricane, the Fund can grow to $18 billion.

The Cat Fund alone may be able to provide enough funds to provide for the maximum damage projected for the size of a storm that occurs only once in 100 years.

(5) **Shrink the State created residential and windstorm underwriting associations (JUA).** The State currently operates the third largest insurer, the Residential JUA, with over 800,000 policies. The Windstorm JUA has another 200,000 policies. These policies should be reserved only for the "truly uninsurable." The Residential JUA should "sunset" at the end of 1997 with all of its policyholders transferred to private companies by that date. The Windstorm JUA should reduce its policyholders by 50% by the end of 1998.

(6) **Diversify geographic risk concentrations.** Two large private insurance companies and the Residential JUA have dangerous over-concentrations of risks in a limited number of high-risk areas of the State. A major hurricane strike in one or more of these high-risk areas could financially cripple those insurers. More private companies need to write larger market shares in these regions. This will allow the potentially higher costs of a major strike to be spread over far greater and more resilient assets of a larger number of private companies.

(7) **Individualize risk assessments.** The Academic Task Force recommends that companies individually evaluate homes for their levels of risk, that the State continue and strengthen its recently-enacted program to establish community

rating systems as a means of encouraging sound building and zoning codes and that the State require adequate enforcement of those codes by local governments

(8) **Aggressively provide incentives for mitigation programs.** Preventive actions by homeowners, encouraged by financial incentives and partly mandated by government action, can reduce overall exposure substantially. If pursued aggressively and proactively, these programs can reduce total exposure by as much as 40 percent.

(9) **Promote Federal responses.** A Federally-sponsored disaster program, funded with part of every property and casualty premium in the country and accumulated on a tax-free basis, should be a major part of the nation's and Florida's catastrophe insurance program in the future.

(10) **Create a state or local emergency tax or fee** to provide limited funds for homeowners after the private industry cap has been reached.

(11) **Actively involve mortgage bankers.** The State's real estate mortgage industry is dependent on a healthy private insurance market which can pay homeowners' claims in full after a disaster. Banks in the State must become actively involved in carrying out the recommendations in this Report and in finding new solutions for the future.

(12) **Promote new capital market solutions.** The Academic Task Force has reviewed some very promising ways to raise additional capital for private companies, such as "Act of God Bonds" and securitization of catastrophic risks.

(13) **Carry out proactive education program.** An aggressive, proactive education program should be directed towards Florida homeowners emphasizing damage prevention and mitigation techniques. In addition, homeowners should receive clear information about insurance rates and options for deductibles, co-payments, credits and coverage characteristics.

(14) **Monitor progress to determine if moratorium should be continued at least until November 1996 expiration or continued beyond that date.** The State should not willingly give up the existing moratorium on withdrawals from the homeowners' market before it expires in November of 1996 unless the State sees substantial progress toward meeting the characteristics of a strong, healthy private market at an earlier date.

(15) **If substantial progress has not been made toward creating a strong, healthy private market, establish a "Fair Share" program which will take effect in late 1996.** Under a "Fair Share" program, companies who write homeowners' policies in Florida would be able to continue to write other lines of personal property and casualty insurance if they maintained their "Fair Share" of Florida's homeowners' market. Companies who write other lines of personal property and casualty insurance in Florida, and who write homeowners' policies in other states but not in Florida, would have to assume their "Fair Share" of Florida's homeowners' market in order to continue to write other lines.

Summary

Once the Academic Task Force's "Balanced Equation" proposal is approved by the Florida Legislature, the goal is to re-establish a healthy, competitive private insurance market within two to five years. The major characteristics of a "healthy, competitive private insurance market" will be defined as:

a) Coverage by financially strong private companies of most of Florida's homeowners for hurricane risks;
b) Affordable, competitive rates consistent with widespread coverage of homeowners by private companies;
c) Low numbers of the "truly uninsurable" in a single remaining Windstorm JUA;
d) A strong Hurricane Catastrophe Fund; and
e) Reasonable maximum market shares for any one company in high-risk regions of the state.

The "Balanced Equation" approach has the following benefits:

- Focuses on private sector solutions and keeps government in a supporting role.
- Increases capacity for coverage.
- Attracts more companies, more reinsurance and more risk capital to Florida.
- Reduces risk exposure for any one participant to manageable levels.
- Emphasizes mitigation and prevention.
- Requires participation by homeowners by offering education, incentives and choices.
- Offsets rate increases with deductibles, co-pays and mitigation credits.
- Expands the state's Catastrophic Insurance Fund.
- Builds on what we've already done and learned.
- Stays flexible to respond differently if private market fails to strengthen adequately.