

Working Paper 96

# A Case Study of Florida's Homeowners' Insurance Since Hurricane Andrew

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1997

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This material is based upon work supported by the National Science Foundation under Grant No. CMS-9319422. Any opinions, findings, and conclusions or recommendations expressed in this material are those of the author(s) and do not necessarily reflect the views of the National Science Foundation.

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## STATE INITIATIVE CASE STUDIES

The following case study is one of an expected twelve developed as part of an investigation into the reassessment of state roles in disaster mitigation and management which was funded under the National Science Foundation grant #CMS-9629871. The intent of the study is to use case studies to understand why states have taken the initiative to develop in-state programs, to determine how other states can be encouraged to follow suit, and to determine an appropriate role of the federal government to support state initiatives. When the case studies are completed, a theoretical model of the initiation process presented in the research proposal will be tested.

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## A CASE STUDY OF FLORIDA'S HOMEOWNERS' INSURANCE SINCE HURRICANE ANDREW

### TOPIC: FLORIDA HOMEOWNERS' INSURANCE

Following Hurricane Andrew, which made landfall on the morning of August 24, 1992, property and casualty insurance companies in the state of Florida were faced with over \$16 billion in insured losses, a circumstance the companies thought was highly unlikely and were not prepared for. In reaction, an insurance crisis ensued, broadly characterized as a desire of insurance companies to either withdraw from the Florida market or significantly reduce their exposed risk and a desire of the Florida Department of Insurance and legislature to ensure that affordable insurance would be made available to all homeowners and commercial businesses. How the legislature dealt with this crisis is the subject of this case study.

This case study centers on the development and passage of one of the first pieces of critical insurance related legislation enacted by the Florida legislature after Hurricane Andrew, House Bill No. 89-B, which was introduced on May 27, 1993 in Special Session "B" of the Florida legislature. This special session was called by the governor to resolve issues which had not been adequately dealt with during either Special Session "A" in December, 1992 or the regular session of 1993 legislature that adjourned on April 4 after sitting for two months. Eventually, House Bill No. 89-B was enrolled and signed by the governor as Chapter 93-401, Laws of Florida. Among the elements of the law was the creation of a study commission to examine what actions the state should employ to balance the consumer's needs for accessibility and affordability and the insurer's need to operate profitably in the new insurance market created after Hurricane Andrew.

### APPROACH

This analysis of House Bill No. 89-B begins with a description of Florida's political landscape to place the case study in context. It includes a discussion of those characteristics which have influenced legislative action including the development of housing along Florida's coast exposed to hurricanes and the regulatory environment in which the property and casualty insurance industry finds itself. This is followed by a description of the Florida property and casualty insurance industry prior to Hurricane Andrew. Then a chronological account of the state response to insurance issues raised in the aftermath of Hurricane Andrew is presented. After the preceding background has been laid out, the actions leading to the enactment of Ch. 93-401 are described, highlighted by a list of factors which supported its enactment and a list of factors which argued for its defeat. Finally, in a postscript, the final report of the study commission and subsequent actions based on its conclusions and recommendations are described.

## **THE POLITICAL ENVIRONMENT**

### **Florida's Pro-Development Heritage**

Before Florida became a U.S. territory in 1821, it had been a sparsely populated Spanish colony. Most inhabitants of European descent resided in one of three locations, at the northeast tip of the state along the Atlantic Ocean near Jacksonville, at the southern most tip of the state near Key West, or at the western most end of the panhandle along the Gulf Coast near Pensacola. From its initial colonization, Florida's attractions were its coast and ports while its interior swamps were hostile and forbidding.

According to federal policy, territories could not apply for statehood until they had a minimal number of inhabitants, a number far greater than resided in the new territory. Thus, a focus of the territorial government was to attract new residents so statehood could be achieved. Being a prospective slave state, the initial development of Florida under U.S. rule was concentrated in the north central section of the state where cotton and tobacco could be grown and a plantation culture could be established. The new territory appealed to and attracted members of wealthy slave-holding families from Virginia, the Carolinas, and Georgia.

After being admitted to the Union, Florida, like other states, began receiving federal lands for internal improvements. Eventually the federal government donated over 2 million acres for railroads, 500 thousand acres for canals, and 20 million acres for swamp drainage, totaling just less than 70 percent of the state's total acreage (Public Land Law Review Commission, 1968). This amount was by far the largest donation given by the federal government to any state; by way of contrast, Arkansas, the second largest donee, received 35.5 percent of its acreage from the federal government. As a consequence of federal actions, Florida's vast interior and coastline were made available for exploitation and habitation, and the state became the biggest land developer in the nation.

Prior to the Civil War, the state's development programs were not particularly successful. Florida's population expanded, but not to the same degree as in the western United States. Especially after gold was discovered in California, Florida's offer of cheap land was heeded by comparatively few.

In the post-Civil War period, the state initiated a major effort to develop the state. In the new constitution of the state adopted in 1868, a commissioner of immigration, whose sole job was to attract new settlers, was established as one of the offices in the governor's cabinet. As described in pamphlets and books published by the commissioner, good climate and cheap land were the main inducements for settlers. (See, for example, Florida Commissioner of Immigration, 1870.) At first, however, the state's endeavors proved unsuccessful. There were several reasons making Florida a tough sell. The state had been devastated in the war, recovery was incomplete, many white citizens fought Republican reconstruction policies, and there were insufficient railroads and other means of transportation to the unsettled regions. Making the task more difficult was the national lure of the west and the opening of the transcontinental railroad in 1869. At this time, Florida was perceived as an uncertain frontier and was definitely located in the wrong direction as far as most prospective settlers were concerned.

For the remainder of the nineteenth century and the majority, if not all, of the twentieth century, the state government dedicated itself to overcome its perceived deficiencies so that it might attract private capital, wealthy settlers, and wealthy visitors who would extol the virtues of the state after returning home. To accomplish these goals, the state

gave away or sold at very low prices most of the land donated by the federal government to private individuals intent on profiting from its resale or development. Even parts of the Everglades were sold to those who wished to drain it and plant sugar cane. According to Healy (1976: 109), up to 1970, "the interest of Florida's state government in land use had focused on promoting development -- attracting new industry, improving the highway net, encouraging the opening of new farmlands, and promoting the tourist industry." Not only was this policy successful, it was generally popular. Huckshorn (1991) stated that "unbridled growth was welcomed by most Floridians as an economic boon" (p.3). As a result of its hurry to attract and house people, the pattern of growth in Florida did not follow that of other states; here industry and commerce followed residential development (Dovell, 1964).

Even when the environmental movement reached Florida in the mid-1960's, the state approached the issue with an eye towards development. The state's first conference on environmental quality was called by Governor Kirk in 1967; however, it was planned and carried out in cooperation with the Florida Outdoor Recreational Development Council under the chairmanship of Richard Pope, founder and chairman of Cypress Gardens (Governor's Conference on Environmental Quality in Florida, 1967). Eventually, the legislature questioned the state's previous development and environmental practices and enacted the Environmental Land and Water Management Act of 1972 to protect critical areas of the state from uncontrolled development. However, since its enactment, many developers, often with the assistance of prodevelopment legislators and governors, have devised means to get around the law (deHaven-Smith, 1991). In place of large-scale, highly capitalized developments which could be planned for and regulated, developers substituted fragmented, piecemeal developments, too small to be affected by the law and to be accounted for in a systematic growth management plan. This resulted, not in an orderly and planned development system choreographed by the state which the environmental act sought to accomplish, but with an outbreak of "speculative subdivision" (Healy, 1976: 105). As a measure of the state's inability to control development, Florida officials reported to Popper (1981: 104) that only 10 to 15 percent of the state's development was regulated under the 1972 law.

In his analyses of Florida land policies, DeGrove (1984 and 1992) describes how the state kept enacting laws for twenty years to manage the growth Florida was experiencing. According to DeGrove, the state never attempted to truly limit development, but rather sought to improve the quality of development and balance the needs of growth with environmental concerns. What changed were the rules of accommodation that developers had to adhere to in order to secure construction permits.

Prior to the recent environmental initiatives, the development interests gained a direct ear to the governor during the administration of Ferris Bryant in the early 1960's. Bryant organized a group of leaders from the business community, mostly chief executive officers of Florida-based companies, into the Florida Council of 100 to counsel governors in their efforts to resolve the state's major problems (Butcher, 1976). As a matter of interest to this case study, because the parent companies of the insurance companies with the largest market shares have never been domiciled in Florida, the development industry (developers, realtors, and homebuilders) and the banking industry in the state have been well represented on the council and the property and casualty insurance industry has not. Typically one-third of the 100 members are developers, one-half or more are directly involved in the broader development industry, and none come from the property and casualty insurance industry.

## **Housing Development**

Since first settled, Florida has attracted a majority of its inhabitants to its vast coastline. In recent years, the coastal population in Florida has grown from just under 7.7 million in 1980 to just over 10.5 million in 1993, an increase in 37 percent (IIPLR, 1995). The 1993 coastal population represents 78 percent of the state's total population.

Even though the population has increased by 37 percent over the fourteen year period between 1980 and 1993, the value of insured coastal property exposures has increased more dramatically. In 1980, the value of insured residential property was approximately \$178 billion and in 1993 \$418 billion, an increase of 135 percent. During the same time period, insured commercial property increased from \$155 billion in 1980 to \$453 billion or 192 percent. In the area struck by Hurricane Andrew and neighboring counties (Dade, Broward and Palm Beach) in southeast Florida, \$370 billion of total insured property (42 percent of the state's total) was exposed in 1993 to potential wind damage.

One can conclude from these figures that, as time has gone on, more people and property have been placed in harm's

way, susceptible to high winds from hurricanes and winter storms. To maintain a booming market in commercial construction and home building, the Insurance Institute for Property Loss Reduction (IIPLR , 1995: 33) contends that builders and developers in coastal areas have confided to them that pre-Andrew construction techniques and practices would continue because "building to hurricane-resistant standards is too expensive and will drive too many consumers out of the market."

## **A Taxpayer's Haven**

In 1876, at the end of the Republican reconstruction period in Florida, perceived by white citizens as financially corrupt and profligate, the new Democratic governor George F. Drew, in his inaugural address, stated "That government will be most highly esteemed that gives the greatest protection to individual and industrial enterprises at the least possible expense to the tax-payer." Thus started a tradition of Florida as a promoter of free enterprise and a tax haven.

To attract and hold investment capital in Florida, the citizens in 1924 amended the state constitution to prohibit a state income tax and a state inheritance tax. Both historians (e.g., Dovell [1952]) and avowed promoters of Florida's growth (e.g., Stockbridge and Perry, [1926]) claim these amendments were instituted during the south Florida land boom as an overt appeal to wealthy citizens of other states.

There were several consequences to Florida's elimination of income and inheritance taxes. First, it not only attracted wealthy citizens, it also attracted the elderly and fiscal conservatives, two groups who opposed taxes but who did not necessarily reduce their demand for state services when they became Florida citizens. Second, it limited the services that could be provided by both state and local governments, thereby placing the state in a difficult position, unable to meet citizen demands for service and unable to generate enough additional tax revenues to increase services. MacManus (1991) believes, as in the past, "the central challenge to Florida's public sector will be to raise sufficient revenue to meet expenditure needs associated with continued growth" (p. 273).

## **Public Financing Mechanisms**

Public financing has been a controversial topic in Florida since territorial days when the territorial government obligated itself to the support of three banks by the issuance of "faith bonds" and the repudiation of these bonds when Florida became a state. As a lingering reminder of those days, the state still eschews the issuance of general obligation bonds to finance public endeavors and is loathe to expand the number of state services funded by general revenue.

When Florida was a territory and immigrants who purchased land in the territory required additional capital to cultivate their new lands, there was a long debate concerning whether Florida should issue bonds backed by the full faith and credit of the territory to support the development of private banks within the territory (Dovell, 1955). Until 1828, there were no officially chartered banks in Florida, and the territorial governors typically opposed any and all attempts of the legislature to permit them. Eventually the legislature overturned a governor's veto and began chartering banks. New banks, however, had trouble raising sufficient capital to meet the demand for loans, so they turned to the territory for assistance. In support of their requests, the territory next began issuing bonds to the sum of almost \$4 million in aid of three banks, the Bank of Pensacola, the Union Bank of Tallahassee, and the Southern Life Insurance and Trust Company of St. Augustine. Unfortunately, during the 1830's, banking was a risky business, and the three banks were unable to make sufficient payments to the territory so interest and principal on the bonds could be paid when they came due. As a result of the banks' defaults, the obligation to pay fell upon the territory.

In 1838, following the national Panic of 1837, opponents of territorial supported banks controlled the territorial government and had a majority elected to a convention to write a state constitution that would go into effect when Florida became a state. They included one long article (Article XIII) in the 1838 constitution entirely devoted to banks and other corporations. Provision 13 of Article XIII stated that the "General Assembly shall not pledge the faith and credit of the State to raise funds in aid of any corporation whatsoever." When Florida became a state, the legislature, in accordance with this provision, repudiated the territorial debt and, to this day, outstanding territorial bank bonds have not been redeemed.

After experiencing rising state debts caused by the issuance of reconstruction bonds following the Civil War, conservatives in state government decided to prohibit bonded indebtedness. In the 1885 state constitution, Article IX, Section 6, which remained in effect until 1969, the legislature could only issue state bonds "for the purpose of repelling invasion or suppressing insurrection, or for the purpose of redeeming or refunding bonds already issued, at a lower rate of interest." To surmount these constitutional limitations, the legislature, on a very few occasions, asked the voters to amend the constitution to approve the use of general obligation bonds for specific purposes. For example, in 1963, the voters authorized the sale of state bonds to construct buildings on universities and other schools and also permitted the issuance of bonds to purchase land for conservation purposes (Florida Senate, 1996).

In Florida's current constitution, which became law in 1969, Florida continued to restrict the issuance of general obligation bonds. The "full faith and credit of the state" may only be pledged to capital outlay projects after being authorized by law and then ratified by the electorate.

Without having the opportunity to raise funds through personal income taxes and also having a strong predilection against increasing general revenue obligations or issuing general obligation bonds, three of the most common sources of state revenue, Florida has been forced to rely on revenue bonds (which identify explicit revenue to repay borrowing and do not require voter confirmation) and user taxes as its primary means of public financing or it has consented to increased local taxation and bonding for specific purposes. Starting in the 1920's, precedents have included earmarking the proceeds from automobile licenses and gasoline tax for highway construction and later to finance the Highway Patrol, school construction and other government needs, earmarking a portion of the proceeds from the sale of reclaimed land to redeem Drainage District bonds, and the enactment of a cigarette tax to improve state institutions (Florida Senate, 1996).

After the state income and inheritance taxes were constitutionally abolished, the legislature also began permitting the local governments to issue revenue bonds or raise taxes to support economic endeavors which would accrue to their benefit (Stockbridge and Perry, 1926). In 1925, counties were permitted to issue bonds for the construction of public cold storage warehouses so oranges and other fruit could be stored and sold year round in northern cities. Also in 1925, counties and municipalities were permitted to raise property taxes to create and support publicity campaigns to attract new residents and businesses.

Finally, in 1971, the legislature submitted and the voters ratified an amendment to the state constitution to tax the income of corporations (Florida Senate, 1996).

## **Plural Executives**

In 1885, a state constitutional convention was called to revise the 1868 reconstruction constitution. Among the issues considered for revision was the power of appointment granted to the governor. Many felt that reconstruction governors had abused and that future governors could abuse that power. Consequently, to eliminate the temptation, in the executive article of the new constitution, the governor was stripped of much power. The new constitution provided for "the popular election of six other magistrates endowed with executive power: secretary of state, attorney general, comptroller, treasurer, superintendent of public instruction, and commissioner of agriculture" (Dovell, 1952: 653).

Since 1885, and surviving a constitutional rewrite in 1968, the division of executive functions has remained, and the state has been jointly run by the governor and the six member cabinet (D'Alemberte, 1991). Rosenthal (1990), in his comparative evaluation of state governors and legislatures, concluded that "Florida's cabinet system probably imposes as severe a constitutional limitation on gubernatorial power as exists in the states" (p. 23).

When the state decided to regulate the insurance industry in 1919, the legislature placed the regulatory powers under the treasurer and later renamed the treasurer "the treasurer and insurance commissioner." Under Florida statutes, the treasurer and insurance commissioner has both the power to regulate insurance within the state and also the exclusive executive authority to oversee the insurance industry.

## **Florida's Legislature**

The state has a relatively weak governor and a relatively strong legislature, characterized by Francis (1991) as having a "a tradition of active policymaking" (p. 189) despite the fact that the legislature sits for only two months a year, barely enough time to consider, let alone debate, controversial issues. To manage its brief sessions, the legislature has adopted a number of customs. First, despite any formal restriction for reelection, the speaker of the house and the president of the senate serve only one two-year term as heads of their chambers; consequently, they have only one shot to make their marks on the state. They are elected by the full bodies at organizing meetings prior to the start of the legislative terms and make all committee appointments (both majority and minority party) presumably to increase cooperation and to avoid contentious confrontations. Second, the power to make policy has traditionally resided among the senate and house committee chairs who are able to dominate their committee agendas and control committee staff who are tasked with the production of committee bills, bill analyses, and economic impact statements which accompany major bills. Third, to save legislative time, major bills are written and analyzed in the interims between sessions and can be prefiled before sessions. Much of the give and take inherent in the legislative bill writing and amendment process takes place when the legislature is not in session. Fourth, the senate and house procedural rules do not permit minority obstruction. Fifth, bills which have been argued prior to session typically are not heavily amended after being voted out of committee, and, if amended, are agreed to by the other house. As a consequence, conference committees are not normally required to ensure passage. Sixth, if committee bills remain controversial and agreement over main issues cannot be secured by both houses, the two houses will often create a commission to investigate the controversy and prepare a recommendation by the next session. Seventh, special sessions are commonly called to deal with important unfinished or emergency business.

A critical element which makes the legislative system function effectively is the existence of full-time year-around staff assigned to all standing committees. Many of the committees have been able to attract and retain extremely competent staff, and thus committee bills reflect the expertise of these staff. Prior to Hurricane Andrew, the staff of the House Committee on Insurance contained two experts on property and casualty insurance, the staff director and a staff attorney, who had each been with the committee for a decade or more.

One potential cause of bill derailment is sectional conflict where members of the two legislative bodies from different parts of the state may oppose legislation seen as favoring a specific geographical region. Historically, in the state senate, before the federal judiciary mandated apportionment according to a "one person, one vote" rule, the less populated north was able to rule the senate, leading to a situation where leaders in the senate, called "pork choppers," diverted state funds to projects in their rural districts (Tebeau, 1971). As a legacy from this time, there are unmarked divisions between the northern, central, and southern parts of the state, and bills which are interpreted as benefiting one region have a difficult time gaining sufficient support for passage.

### **Florida's Regulatory Insurance Environment**

Every three years, Conning & Company surveys property and casualty insurance companies to rate states in terms of the relative freedom they permit companies to manage their personal and commercial lines of business. Conning & Company asks companies to consider such factors as the "implementation of rating classifications and territories, setting adequate rate levels, cancellation and non-renewal of risks, [and] involuntary assignments" (Conning & Company, 1994: 90). In 1991, the last survey conducted prior to Hurricane Andrew, Florida was ranked 37th in personal lines and 47th in commercial lines. According to Conning & Company, in those states perceived by insurance companies to limit freedom like Florida, the insurance regulators have been acting as consumer advocates, thereby restricting the operating environment for companies.

### **The Florida Windstorm Underwriting Association**

In the late 1960's, private insurance companies were reluctant to voluntarily insure homeowners who resided in the southern most counties of Florida because of potential losses from hurricanes. Without state intervention, two consequences were looming. First, mortgages could go into default if homeowners did not carry insurance against the wind peril. Second, local economies could be stifled by the curtailment of homebuilding and related developments. To prevent these dire events from occurring, the state legislature enacted a law (Chapter 70-234) requiring Florida insurers to form a windpool, covering the homeowners abandoned by the insurance companies as a group by an equitably

apportioned distribution of the risk from wind. From this legislation, the Florida Windstorm Underwriting Association (FWUA) was created. The FWUA is governed by a board composed of insurance companies and sells only windstorm coverage in areas designated as eligible by the Department of Insurance based on statutorily defined market conditions.

When the state intervened in the personal insurance market to ensure that homeowners located in high wind risk areas were entitled to insurance from wind, it sanctioned the continuing construction of residences in south Florida as well as the right of the state to impose its will over the insurance industry to maintain an orderly insurance market. A precedent was set where consumer and development rights were considered more important than insurance industry rights to determine who, where, and what to insure.

### **Previous Reactions to Hurricanes**

State and local officials have typically been more concerned about the resumption of development following a hurricane rather than addressing the nature of the disaster and what might be done to prevent future damages. An example is what occurred after a major hurricane struck south Florida on September 18, 1926, during a time when Miami was in the midst of a land boom. According to the American Red Cross (1927), there were 372 deaths, 6,381 injured, 43,000 people made homeless, 17,884 families needing aid, over 8,600 homes damaged, and total losses in excess of \$159 million. Despite these catastrophic losses, Mayor E. C. Pomfh was fearful that publicity surrounding the efforts of the Red Cross to raise relief funds would do more lasting damage to the development of Miami than the hurricane. So, six days after the event, he stated publicly, "I want to give positive assurance that our friends will find Miami this winter the same enjoyable, hospitable, comfortable vacation city it has always been. I predict that Miami will make a world record come-back. The people here have the enthusiasm, the will to do, an unshaken faith in the future of this great city in America who are now turning their energies to the work of reconstruction in Miami" (quoted in Tyler, 1926: 33). Almost unbelievably, in his analysis of the city's recovery, most probably a public relations piece, Tyler (1926) concluded, "In less than one month...most of the marks of the storm were gone and south Florida was back at work, harder than ever, ready to resume its place as 'the playground of the world'" (p. 5).

## **THE PROPERTY AND CASUALTY INSURANCE MARKET**

Prior to Hurricane Andrew, private insurance companies in Florida had not factored a hurricane with the loss potential of Andrew into their rate calculations. Before 1993, the largest insured loss ever suffered in the United States had been Hurricane Hugo in 1989 which was just over \$1 million, and Florida had not been hit by a severe hurricane in decades. In its review of rate filings, the DOI had also not insisted that rates be adjusted to account for low probability high consequence hurricanes. According to Rio (1996: 4), after reviewing pre-Andrew conditions, risk evaluation in Florida was a "textbook example of *collective* misevaluation, a 'denial' of risk."

The consequences of the insurance industry's failure to foresee Hurricane Andrew and its losses created a property and casualty insurance market which was highly price competitive and where insurers had excessive concentrations of policies in coastal counties subject to hurricanes where a significant portion of the home market was located. Market share rather than prudent underwriting seemed to guide decisions to insure new properties or not.

Shortly after Hurricane Andrew, the insurance commissioner reported that insurance companies could have asked for larger increases in homeowners' insurance rates in every year from 1985 to 1992, and consequently that approved rates were less than what the DOI had calculated as permissible (Florida Department of Insurance, 1992). He stated that this outcome was "due to vigorous price competition" (p. 2). When asked about these statements, insurance company representatives said that a significant part of the difference could be explained by the existence of investment income which state regulations required be calculated when making rate increase requests and part on different rate formulas employed by the DOI and the insurers.

## **STATE RESPONSE -- CHRONOLOGY**

On August 24, 1992, when Hurricane Andrew struck Florida, there was a lame duck legislature in power. The 1991-1992 term was ending, its last regular session had adjourned sine die in May, and an election to be held in November

would determine all the members of the new house and, because of reapportionment, a majority of the new senate. Although the governor had the power to call a special session of the legislature to consider any Hurricane Andrew issue, there was political pressure to delay such action until after the election. In a rational political world, a special session would follow the organizing meetings of the two houses so new leaders could be elected and committee assignments made.

### **First Response -- The Department of Insurance**

In the real world, Hurricane Andrew instantaneously created a chaotic insurance world. The degree of devastation was beyond the abilities of the insurance companies to handle, and the then existing rules and regulations established by the Department of Insurance (DOI) did not foresee nor sanction the efforts needed to address the extraordinary circumstances nor provide for the continuance of adequate coverage in the affected areas. The first official to recognize that aggressive state action was necessary was the treasurer and insurance commissioner who was empowered by the constitution and state statutes to maintain a viable insurance market in the state.

Less than a week after Andrew, the insurance commissioner established direct communications with the chief executive officers of the fifteen largest insurers in the state (Florida Department of Insurance, 1993A). As a group, under his direction, they toured the devastated area by helicopter so everyone would be alerted to the magnitude of the destruction and the need to work together to find appropriate recovery solutions. A weekly meeting in Miami was established between the department and representatives of the insurers reporting hurricane losses to discuss "claims issues, the exchange of information, the coordination of the implementation of emergency rules and bulletins and the assessment of emerging regulatory issues" (Florida Department of Insurance, 1993A: 8). According to the DOI, "these meetings also helped foster a commitment by the insurance industry and the Department to avoid regulatory infighting" and an acceptance of emergency rules and bulletins when issued (p. 8).

Using statutorily granted emergency powers, the insurance commissioner and his staff began almost immediately to issue emergency rules to overcome problems encountered by insurers and policyholders brought on by the hurricane and to prevent others from occurring. (See Florida Department of Insurance, 1994, for a complete listing and a summary of all emergency rules.) By law, emergency rules expire at the end of 90 days.

The first legal actions of the insurance commissioner took place on August 31, just one week after the hurricane event when two emergency rules were filed. The first emergency rule, 4ER92-1, provided guidelines and stipulated forms for the emergency licensing of adjusters who were needed by insurance companies to inspect damages, estimate losses, and finalize settlements with policyholders. The second emergency rule, 4ER92-2, established a grace period for the payment of premiums due to the disruption to communications and mail, the large number of displaced homeowners, and damages to businesses and financial institutions. Without this rule, the department of insurance believed that unintended cancellations or nonrenewals might occur if premium payments were not received by insurance companies by their required contract dates. Including the first two emergency rules, the department of insurance issued a total of 27 emergency rules in 1992 and 30 in 1993, the last of which remained in effect until December 22, 1993. This was clearly a strong hands-on approach intended to stabilize market mechanisms disrupted by the hurricane.

Many emergency rules profoundly affected the insurance market. Critical among the emergency rules were 4ER92-11 which took effect on November 17, 1992 and 4ER92-15 which became effective on October 15, 1992. These rules came in response to DOI findings that the property and casualty insurance market was no longer providing sufficient coverage to meet the needs of Florida residents. The DOI recognized the existence of a market failure which potentially could cause irreparable harm to the state if left unchecked and interposed itself to help rectify it.

Emergency rule 4ER92-11 established procedures for the withdrawal of any insurance company from the state of Florida after the DOI discovered that insurers were not issuing new property coverage and canceling or nonrenewing existing coverage and that there was insufficient capacity in the remaining voluntary insurance industry willing to write new policies. It mandated that at least 90 days prior to commencing any steps directed toward withdrawal, an insurance company must file a written statement of intent containing details of the reasons for its actions and be prepared to demonstrate that its actions would not be accompanied by adverse effects on the market. The rule was intended to keep insurers in the state and to limit the number of homeowners who would be without and could not find insurance in the



voluntary market.

Emergency rule 4ER92-15 activated the Florida Property and Casualty Joint Underwriting Association (FPCJUA) on a temporary basis to provide residential property coverage to policyholders of insurers that became insolvent as a result of Hurricane Andrew. The FPCJUA had been established to provide commercial coverage when market conditions were such that the voluntary market refused coverage and the state Market Assistance Plan could not place coverage in the voluntary market. Even though activation of the FPCJUA for the purpose of issuing residential coverage clearly had a questionable legal basis, the DOI initiated this action after discovering that the insureds of insolvent insurers could not be placed in the voluntary market through the efforts of the state Market Assistance Plan. Coverage was limited to unrepaired residential properties damaged by the hurricane if the insureds were already making repairs or planned to make repairs and coverage in the voluntary market could not be secured by the Market Assistance Plan. Coverage would terminate in six months or when repairs were completed. Due to the strict eligibility requirements, the DOI believed that state insurance provided by the FPCJUA would be a temporary stopgap measure and would be withdrawn when the circumstances leading to its existence were ameliorated. The severity of the problem and the temporary nature of the solution were such that insurance companies, in a spirit of cooperation, did not challenge the legality of the rule.

## **Second Response -- A Special Session of the State Legislature**

Governor Chiles called a special session of the legislature to be convened one month after state elections and shortly after the organizing meetings of the new house and senate. Of special interest was the selection of Representative John Cosgrove as chair of the house committee on insurance. Representative Cosgrove had extensive knowledge of the insurance industry and resided in the area of south Dade County directly in the path of Hurricane Andrew. While he and his family attempted to ride out the storm inside their dwelling, it was destroyed, but they survived. In the aftermath of the storm, his homeowner's insurance company became insolvent, and he was one of thousands who was unable to collect a monetary settlement satisfying his claim and who was also without insurance until the FPCJUA was activated.

Special Session "A", as it was called, was in session for three days, December 9 to December 11, 1992. In its response to the effects of Hurricane Andrew, the legislature enacted laws both to resolve insurance emergencies created by the storm and also to confront what appeared to many to be the start of a chronic lack of sufficient capacity in the voluntary personal property and casualty insurance market. (Overall, the legislature dealt with 15 resolutions and 15 general bills and their companions in this special session. Although the session was specifically called to deal with disaster-related issues, the members did find the time to amend the Pari-Mutual Wagering Act and authorized the Citrus Department to lower the minimum requirement of anhydrous citric acid for oranges.)

The key piece of legislation, House Bill No. 33-A (Chapter 92-345 after being enrolled and signed by the governor), was written, sponsored, and introduced by Representative Cosgrove. During the month of November, after it was apparent that Representative Cosgrove would become chair of the house insurance committee, he and the committee staff crafted House Bill No. 33-A so it would be ready for passage during the special session. The bill and subsequent law contained three important elements. First, it specifically ratified the emergency fix established by the department of insurance when the legislature activated the FPCJUA for the purpose of insuring unrepaired hurricane damaged properties that had been insured by insolvent insurers. Second, it authorized certain municipalities and counties to issue up to \$500 million in tax free municipal bonds to fund the shortfall in the Florida Insurance Guaranty Fund (FIGA) caused by the storm-related insolvencies. (FIGA had originally been established as a mechanism to cover any unmet obligations of insolvent insurance companies.) To pay off the bonds, the legislature approved a special assessment on insurers of up to 2% of premiums written on all lines of property and casualty insurance, except automobile and workers' compensation, and permitted this assessment to be passed through to their policyholders as premium increases. Third, because of the apparent lack of capacity in the voluntary market to provide homeowners' insurance, the legislature created the Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) to be an insurer of last resort for persons unable to obtain coverage in the voluntary market. All insurers writing homeowners' insurance in the state were mandated to participate in this residual market mechanism and accept liability for any deficit assessments on a market-share basis. Rates were to be set at above-market rates to encourage placement in the voluntary market. The law took effect on December 15, 1992.

One reason the legislature was able to quickly enact this piece of legislation was due to the cooperation of the insurance industry (Florida Department of Insurance, 1993A). In general, all segments of the insurance industry including the primary insurers and the independent agents were able to comment on the bill when it was being drafted and supported the final product.

A second piece of legislation, Senate Bill No. 8-A, later Chapter 92-350, (whose companion bill in the house was sponsored by Representative Cosgrove) addressed the reconstruction of damaged public facilities. It created the Hurricane Andrew Recovery and Rebuilding Trust fund to be funded through increases in the sales tax caused by hurricane recovery expenditures and authorized the governor to transfer money to specified counties, municipalities, and state agencies upon application. It took effect on December 17, 1992.

### **Report of the Dade County Grand Jury**

During the recovery period following Hurricane Andrew, many questions arose concerning building performance, construction methods, and building inspection in Dade County. Field observations by many observers including the Federal Insurance Administration (Federal Emergency Management Agency [1992]), the Wind Engineering Research Council (1992), and the Building Process Committee of the Miami Chapter of the AIA (1992) indicated that poorly designed and constructed buildings had been permitted to be built, thus exacerbating the amount of damage caused by Andrew. Before the hurricane, many people believed that the South Florida Building Code (SFBC) was one of the toughest building codes in the nation, and homes built in south Florida should have fared much better. The Dade County Grand Jury decided "to find the answers to the many questions raised by this disaster regarding the standards, designs, and materials used in our local construction; the oversight and regulation provided to the construction industry; the responsibilities of the construction and insurance industries to our community; and our state of preparedness for the next hurricane" (Dade County Grand Jury, 1992: 1).

After its investigation, in a blanket indictment, the Grand Jury reported many findings and made several recommendations. Among those, the Grand Jury found the SFBC out of date and inadequate. Because it failed to incorporate advanced performance designs based on wind testing research, expert witnesses reported that the building code did not provide protection against 120 mph winds for homes as indicated but more accurately could provide protection for winds around 95-100 mph. The Grand Jury also found that design failures were caused by the lack of structural engineering evaluations for residential homes and the use of approved but inadequate materials. When evaluating code enforcement, the Grand Jury noted that "the effectiveness of this community's building inspection process has been questionable for decades, " subject to "corruption, at worst, and apathy, at best" (p. 10). Previous grand juries, in 1975 and 1989, had criticized the manner and adequacy of Dade County's building inspections, but the system had not been not fundamentally changed despite these findings.

In order to improve construction practices and ensure compliant practices, the Grand Jury made many recommendations. One was that the insurance industry should not remain a passive participant but should play an active role by linking insurance premiums to construction practices, code content, code enforcement, and mitigation practices of homeowners, specifically the use or nonuse of hurricane shutters. The Grand Jury believed that the involvement of the insurance industry would overcome an ingrained problem in the building inspection process which permitted the construction industry to regulate itself.

### **The 1993 Regular Session of the Legislature**

The regular session of the legislature convened on February 2, 1993. Even with the information provided in the reports of the DOI and the Dade County Grand Jury, during the two month session, no significant bills addressing the homeowner's insurance crisis were introduced, and, therefore, none were enacted.

### **Further Actions of the Department of Insurance**

During the regular session of the legislature, several DOI emergency rules including 4ER92-11 were set to expire.

Prior to the expiration of 4ER92-11 on February 15th, the DOI investigated the situation concerning the withdrawal of insurance companies from the state and concluded that an emergency still existed. To maintain an orderly market, the DOI issued a new emergency rule, 4ER93-5, on February 12, thereby extending the regulations pertaining to withdrawal for an additional 90 days until May 12th.

Early in the regular session, the DOI issued a study on Hurricane Andrew's impact on insurance in the state which listed problems caused by the hurricane to the insurance industry, problems in claims services, problems faced by policyholders, departmental responses including emergency rules, long term solutions sought, and recommendations to the legislature for permanent changes to the insurance statutes (Florida Department of Insurance, 1993A). This study provided a detailed examination of the state of property insurance in the state of Florida and enumerated 26 specific recommendations for the legislature to consider. Among the recommendations was a proposal (originally suggested and supported by the two largest private insurers in the state, State Farm and Allstate) to establish a tax free state catastrophe fund to provide reinsurance protection between that provided by the private market and a proposed federal fund which Representative Mineta of California had introduced in Congress. It was believed that the state and federal funds would relieve some of the insurers' concern for their solvencies and eliminate the desire of the insurers to withdraw from the state.

When Governor Chiles called a second special session for five days, May 24 to May 28, 1993, partially to permit the legislature to consider the property insurance crisis, the DOI revised and updated its study on Andrew's impact on the insurance market and added an appendix with suggested legislation to implement its recommendations (Florida Department of Insurance, 1993B). Included in its proposed legislation were new statutes establishing the Florida Catastrophic Property Loss Fund and dealing with the geographic concentration of risk, and amendments to existing statutes dealing with the Florida Windstorm Underwriting Association and reinsurance.

On May 19, 1993, in the interim between the regular session and Special Session "B" the DOI imposed a moratorium on the cancellation and nonrenewal of residential property coverages in Florida for a period of 90 days. This action, emergency rule 4ER93-18, was taken to prevent insurers from carrying out their proposed cancellations and nonrenewals at the start of the new hurricane season.

### **Special Session "B"**

Governor Chiles called a second special session for five days, May 24 to May 28, 1993, partially to permit the legislature to consider the property insurance crisis. According to a report of the Florida House Committee on Insurance (1994), "Concerns about threatened massive nonrenewals of property insurance policies increased in early 1993, especially in the months following the end of the regular legislative session" (p. 3). When the legislature met, no solution to the problem was available that could be accepted by both houses. Without sufficient time in the special session to work out a solution, House Bill No. 89-B (Chapter 93-401) was introduced. It sought to postpone a decision until a study commission could examine the situation in detail and make recommendations to the legislature. It also imposed a temporary moratorium on the cancellation or nonrenewal of policies until the legislature had an opportunity to respond to the recommendations of the study commission.

The logic behind the legislature's decision to impose a moratorium was included in the "Findings and Purpose" of Section 1 "Moratorium on cancellation and nonrenewal of residential property coverages" in the new law. It stated:

The Legislature finds that property insurers, as a condition of doing business in this state, have a responsibility to contribute to an orderly market for property insurance and thus there is a compelling state interest in maintaining an orderly market for property insurance. The Legislature further finds that Hurricane Andrew, which caused over \$16 billion of insured losses in South Florida, has reinforced the need for consumers to have reliable homeowner's insurance coverage; however, the enormous monetary impact to insurers of Hurricane Andrew claims has prompted insurers to propose substantial cancellation or nonrenewal of their homeowner's policyholders. The Legislature further finds that the massive cancellations and nonrenewals announced, proposed, or contemplated by certain insurers constitute a significant danger to the public health, safety, and welfare, especially in the context of a new hurricane season, and destabilize the insurance market. In furtherance of the overwhelming public necessity for an

orderly market for property insurance, it is the intent of the Legislature to impose, for a limited time, a moratorium on cancellation or nonrenewal of personal lines residential property insurance policies.

## **ENACTING CHAPTER 93-401, LAWS OF FLORIDA**

The enactment of House Bill No. 89-B led to the creation of a study commission to examine "the commercial viability and competitiveness of the personal lines property insurance industry and the adequacy of regulation of the reinsurance industry" (Florida House Committee on Insurance, 1993: 5). It followed a tradition in Florida that complex subjects be analyzed by a commission that has the time to generate recommendations for the legislature and governor to consider at a future date. When House Bill No. 89-B came to a vote, it was unanimously approved in both houses of the legislature.

Positive legislative action was the result of many factors, including:

1. a universally recognized insurance crisis which included the existence of insolvent companies, stranded policyholders, the unwillingness of private companies to write new policies or renew old ones, the desire of some companies to withdraw from the state, and a surge of policyholders in the state residual market mechanisms;
2. the recognition by all concerned parties that insurance regulation is a state responsibility and that regulations proceed from statutory law;
3. the recognition by the Department of Insurance that changes were needed to reestablish a healthy property and casualty insurance market in the state and these must emanate from the legislature;
4. the cooperation of the voluntary insurance industry including an agreement by representatives of the insurance and reinsurance industries to serve on the commission;
5. the desire of John Cosgrove, Chair of the House Committee on Insurance, to restore a healthy voluntary personal lines property and casualty insurance market through actions by his committee;
6. the development of House Bill No. 89-B during the interim following the regular session of the 1993 legislature; and
7. the lack of any organized opposition.

Success in gaining enactment was also abetted by the circumstance that no factors existed which argued strongly for the defeat of House Bill No. 89-B. The bill created an opportunity for the state to develop an acceptable partnership between the voluntary insurance industry and the state which would provide property insurance to all qualified homeowners who sought it, including those who might move into future homes constructed along the coast in south Florida. A solution with this goal would not disrupt development and homebuilding in high risk hurricane areas, so it did not raise any objections from the homebuilders. There were also no tax implications implied in the legislation. If individuals or groups were opposed to further state intervention in the private insurance market or opposed any section of the bill, they were silent at this time.

## **POSTSCRIPT**

The passage of House Bill No. 89-B helped foster a landslide of property and casualty insurance "reforms" enacted in Special Session "C" which was called by the governor and held November 1 to 10, 1993 (Florida House Committee on Insurance, 1994: 24). In this section, the *Report of the Study Commission on Property Insurance and Reinsurance* will be discussed and will be followed by highlights of legislation enacted in Special Session "C" and subsequent sessions of the Florida legislature through the regular 1997 session which adjourned in May. The section will conclude with a brief assessment of the state of property and casualty insurance in Florida in 1997, focusing on whether actions taken by the legislature have succeeded in making wind insurance available to all qualified homeowners and in decreasing

the chances of insurance company insolvencies following future hurricanes and winter storms.

## **The Report of the Study Commission on Property Insurance and Reinsurance**

Appointments to the Study Commission created by the state legislature were made by the governor. It was composed of 13 members and attempted to balance the views of the insurance industry and consumers. Co-chairing the commission were Representative John Cosgrove, Chairman of the House Insurance Committee, and state Senator John Grant, Chairman of the Senate Commerce Committee which oversaw insurance matters in the state senate. In addition, members of the commission included the insurance commissioner or his designee, two additional legislators, four persons representing insurance consumers, one primary insurance representative, one insurance agent, one reinsurance representative, and one mortgage lender.

The commission began its work on July 15, 1993 and completed its final report on September 15, 1993, giving legislators six weeks to develop legislation that would be introduced in Special Session "C" in November. During this time, it was informed by the Department of Insurance that 44 companies had submitted plans to withdraw either partially or totally from the Florida market, and, as a consequence, approximately 840,000 policies would be canceled or nonrenewed, potentially swelling the Residential Property and Casualty JUA to over 950,000 policies, making it the second largest insurer in the state after State Farm.

The Study Commission reviewed proposed legislation submitted by the DOI, the house insurance committee, members of the commission, and interested others. However, to accomplish its task, it concentrated on developing recommendations that would most likely alleviate "the anticipated crisis of policy cancellations once the moratorium expires in mid-November" (Study Commission on Property Insurance and Reinsurance, 1993: i). According to the report, these policy recommendations would guarantee affordable insurance to consumers and reduce the insurers' exposure to catastrophic hurricane losses.

Over 40 recommendations were suggested by the commission. Of these, key recommendations included:

1. a phaseout of the moratorium over three years to permit market stabilization; insurers would be limited to canceling or nonrenewing 5 percent of in-force policies in any single designated "risk" district during any one calendar year;
2. authorization of the DOI to adopt a hurricane computer model to assist in reviewing the appropriateness of insurance premium rate requests and the amount of funds required for reserves for losses, thus establishing a mechanism of determining whether rates are not excessive or inadequate;
3. requiring insurers to offer premium discounts for structural mitigation improvements, such as hurricane shutters, which can be proven to reduce the likelihood of property damage, and permitting insurers to adjust rates for the relative strength or weakness of local building code enforcement practices;
4. requiring insurers to offer replacement cost coverage and law and ordinance coverage to pay for higher costs of construction required due to changes in building codes and other laws when policies are offered;
5. the establishment of a state catastrophe fund "to fill the void between currently available private sector reinsurance and the proposed federal catastrophic fund program;" the fund would be a trust-funded state agency under the control of the State Board of Administration (composed of the Governor, the Treasurer, and the Comptroller) payments from which would be triggered by a hurricane which caused damages greater than four times the prior year's aggregate statewide gross written premium for covered property and which would promise to reimburse insurers for 75 percent of covered losses in excess of the trigger amount with the proviso that the fund would not be obligated beyond the sum of its surplus and its borrowing capacity; and
6. authorization of the Board of Governors of the RPCJUA to provide credits and other proposals to depopulate the RPCJUA and return policyholders to the voluntary market.

## **Special Session "C"**

When the legislature met in Special Session "C" in the first week of November, 1993, it enacted virtually all of the recommendations from the Study Commission with minor alterations. The lead was provided by Representative Cosgrove and the staff of the House Committee on Insurance. Except for the creation of the Florida Hurricane Catastrophe Fund, which was separately introduced as House Bill No. 31-C and enacted into law as Chapter 93-409, the changes to the insurance laws were all introduced as part of the Committee Substitute for House Bills No. 33-C and 43-C and enacted into law as Chapter 93-410. Subsequently, clarifying amendments to the moratorium phaseout were introduced as House Bill No.131-C which was enacted into law as Chapter 93-411.

The moratorium phaseout prohibited an insurer from canceling or nonrenewing more than 5 percent of its homeowner's policies in the state in any 12-month period and 10 percent of its policies in any county. The phaseout became effective on November 14, 1993 and was set to expire three years later on November 14, 1996.

At an unspecified date, the Department of Insurance was mandated to adopt by rule a standard hurricane loss exposure model to evaluate catastrophic loss factors in residential property insurance rate filings. The model must meet accepted actuarial, scientific, and insurance industry standards.

Effective July 1, 1994, rate filings for residential property insurance were required to reflect windstorm mitigation improvements. In the language of the law, rate filings must "include appropriate discounts, credits, or other rate differentials, or appropriate reductions in deductibles for properties on which fixtures actuarially demonstrated to reduce the amount of loss in a windstorm have been installed."

Prior to June 1, 1994 for issuing a new homeowner's insurance policy and on or after June 1, 1994, prior to the first renewal of a policy on or after June 1, 1994, insurers were required to offer a policy or an endorsement which adjusts losses on the basis of replacement costs and to offer a policy or an endorsement which provides law and ordinance coverage which may be limited to 25 percent of the dwelling limit.

The legislature created the Florida Hurricane Catastrophe Fund (FHCA) to be administered by the State Board of Administration. As part of its reimbursement contract with participating insurance companies, insurers must annually pay the FHCA actuarially determined premiums for its coverage in each zip code. Furthermore, the FHCA promises to reimburse an insurer 75 percent of its losses from covered events in excess of two times the insurer's gross direct written premium from covered policies from the prior year.

No action was taken to establish means to depopulate the RPCJUA. In an almost opposite logic, the legislature repealed the existing rate setting rules of the association which envisioned a temporary association and instituted new ones which envisioned a more permanent association. Specifically, it repealed rules which required rates be based on the costs of the five largest residential insurers by premium volume in the state, plus a catastrophe loading factor and projected expenses, and a 25 percent increment for presumed adverse selection. These were replaced by rules which provided that rates for coverage by the association be actuarially sound and eventually be based "on the association's loss experience and expenses, together with an appropriate catastrophe loading factor that reflects the actual catastrophic exposure of the association." By this action, the RPCJUA could be considered a competitive insurer and not the insurer of last resort.

## **Actions from 1994 to 1997**

Because Special Session "C" ended just months prior to the regular 1994 legislative session and laws enacted in that session exhaustively dealt with recommendations proposed by the study commission, no significant property insurance bills were introduced or passed in 1994. However, in every regular session from 1995 to 1997, the Florida legislature enacted insurance bills with elements aimed at enhancing, expanding, or "tweaking" the insurance reforms of 1993. These were based on an analysis of the property insurance market conducted by the Florida House Committee on Insurance (1994) two years after Hurricane Andrew and subsequent evaluations such as that conducted by the Academic Task Force on Hurricane Catastrophe Insurance (1995) which concluded that the crisis in availability and affordability of property insurance had not diminished but persisted, justifying further state intervention in the

insurance markets.

As a measure of the state's increased regulation limiting the freedom of private insurers, the results of Conning & Company's 1994 survey of state regulatory practices indicated that Florida had dropped from 37th in 1991 to 47th in personal lines and from 47th to 51st in commercial lines, 51st being the lowest of all the states and Puerto Rico. According to the nation's insurance companies who responded to the survey of Conning & Company (1994), the Florida department of insurance had become one of the most restrictive regulators in the nation.

Instead of listing all the insurance bills chronologically and describing their contents, significant changes to the six major reforms listed in previous sections will be described.

*Moratorium phaseout.* In 1996, prior to the expiration of the three year moratorium phaseout, the legislature replaced the existing law with a similar one for three years becoming effective on June 1, 1996 and remaining in effect for three years until June 1, 1999 (Senate Bill No. 2314, Chapter 96-194 referred to as the Hurricane Insurance Affordability and Availability Act of 1996). The legislature further expanded the moratorium phaseouts to include condominium association or master policies. The latter action resulted from the recommendations of a completed study conducted by the DOI which was mandated by law in Chapter 93-410.

*Hurricane computer model.* Instead of continuing to permit the DOI to adopt by rule a hurricane loss exposure model at a date uncertain, the legislature in 1995 mandated a procedure for the adoption of such models. As provided in House Bill No. 2619, Chapter 95-276, the legislature established the Florida Commission on Hurricane Loss Projection Methodology as a panel of experts to determine the accuracy and reliability of computer models as applied to property insurance rate filings. Upon its findings, insurers could employ "actuarial methods, principles, standards, models, or output ranges found by the commission to be accurate or reliable" in rate filings. The commission was given a July 1, 1996 deadline to set standards for determining the acceptability of computer models.

On June 3, 1996, the Florida Commission on Hurricane Loss Projection Methodology (1996) issued a report of its activities which included all findings made by the commission to date including principles adopted by the commission, the commission's evaluation process, standards for the specification of computer models, and the process for determining the acceptability of a computer model. At that time, the commission was in the process of evaluating several models submitted by private concerns.

*Rate setting in relation to wind mitigation and code enforcement.* In 1995, rate factors for residential property insurance rate filings were modified to "reflect standards adopted by a particular jurisdiction and the manner in which the code and enforcement thereof addresses the risk of wind damage" rather than the quality of the local code enforcement. The insurance commissioner was also given the power to appoint a windstorm loss mitigation committee to provide advice to the insurance department based on its review of new technologies, building designs, loss mitigation studies, or other relevant information.

In 1996, to provide more understandable hurricane coverage and rates, the legislature mandated that effective January 1, 1997, insurers submit rate filings for residential property insurance that separate rates into two components, one for wind coverage and one for all other coverage. Additionally, premium notices sent to homeowners must also separate the two premiums and coverages.

Although not directly linked to rate setting or code enforcement, the legislature in 1997 stated its intent to provide a program for homeowners to obtain an evaluation of their homes with respect to preventing damage from hurricanes and then to obtain recommendations to upgrade their homes to better withstand hurricane force winds (Senate Bill No. 794, Chapter 97- 55). If funds were provided in the appropriations process, then the program would go into effect and be administered by the Florida Windstorm Underwriting Association.

*Replacement cost coverage and law and ordinance coverage.* No further actions were taken with respect to either replacement cost coverage or law and ordinance coverage in the offering of homeowners insurance.

*Florida Hurricane Catastrophe Fund.* After enactment of the 1993 law establishing the Florida Hurricane Catastrophe Fund (FHCF), the State Board of Administration (SBA) applied to the federal Internal Revenue Service (IRS) for a tax

exemption, thereby allowing the fund to grow without having to pay taxes on its receipt of annual premiums and investment earnings, estimated to be 35 percent of the total (Florida House Committee on Insurance, 1995). The IRS ruled that if the state were to spend \$10 million or 35 percent of its investment income annually on mitigation programs, it would qualify for tax-exempt status. Thus, in 1995, the state enacted House Bill No. 719, Chapter 95-1, which provided that "no less than \$10 million and no more than 35 percent of the investment income from the prior fiscal year" be provided "to support programs intended to improve hurricane preparedness, reduce potential losses in the event of a hurricane, provide research into means to reduce such losses, educate or inform the public as to means to reduce hurricane losses, assist the public in determining the appropriateness of particular upgrades to structures or in the financing of such upgrades, or protect local infrastructure from potential damage from a hurricane." The first moneys would be available for appropriation in fiscal year 1997-1998. As a result of this action, the IRS ruled favorably on Florida's request for tax-exempt status.

At the end of the 1997 legislative session, a budget agreement was reached between the Senate President and the House Speaker, both Republicans from the Orlando area. In this agreement, the first \$10 million received from the FHCF was distributed as follows:

1. approximately \$4 million was transferred into a fund to match federal funds spent on disaster relief after Hurricane Opal;
2. approximately \$3 million was provided to improve the wind resistance of residences; and
3. approximately \$3 million was provided for dune restoration, most in areas not struck by recent hurricanes.

Representative Cosgrove, no longer the chairman or even a member of the House Committee on Insurance, and others objected that dune restoration was not a proper use of these funds, and, if the IRS agreed with their contention, the FHCF could lose its federal tax-exempt status. In his veto message, dated May 28, 1997, the governor agreed with their argument, stating "funding of these projects from [the FHCF] would set the wrong precedent; these funds should be for the purpose of enhancing residential mitigation."

*Depopulating the RPCJUA.* As long as the property and casualty insurance companies in Florida believed that their solvency was threatened by expanding their market share and the legislature continued to prevent any voluntary withdrawal from the state, they were unwilling to add new policies in high wind risk areas to their portfolios. Consequently, the RPCJUA was forced to add all homeowners who were unable to secure policies in the voluntary market. By 1995, the RPCJUA has grown so large that the legislature enacted a program to encourage private insurers to remove policies from the association. As part of House Bill No. 2619, Chapter 95-276, the legislature found:

that the Residential Property and Casualty Joint Underwriting Association has written an amount of policies beyond legislative expectations and has become, by virtue of its size, a significant impediment to the restoration of a stable and competitive residential property insurance market in the state; that the public policy of this state requires the maintenance of a residual market for residential property insurance; and that extraordinary measures, beyond implementation of eligibility criteria and noncompetitive rates, are required to reduce the number of policies written by the Residential Property and Casualty Joint Underwriting Association to a reasonable level. It is the intent of the Legislature to provide a variety of financial incentives to encourage the replacement of the highest number of Joint Underwriting Association policies written by admitted insurers at approved rates.

As its premier financial incentive, the legislature created a "take-out bonus" which authorized the RPCJUA to pay \$100 to an insurer for each wind risk that the insurer takes out of the association. Furthermore, if an insurer removed 50,000 or more wind risks from the association in any calendar year, it would be exempt partially or totally from any deficit assessments the association might issue over a three year period.

By the time of the next regular session of the legislature in 1996, the legislature had determined that the financial incentives were insufficient to totally eliminate the need for both the FWUA and RPCJUA. What was now needed was a permanent residual market mechanism which would replace the FWUA and RPCJUA but still permit the private insurers to dominate the property and casualty insurance market. Being unable to agree on such a replacement, the legislature enacted a law (Senate Bill No. 2314, Chapter 96-377) creating a Working Group on Residual Property



Insurance Markets within the legislature to develop recommendations and submit a final report by January 1, 1997.

As part of the same law, the legislature expanded its take-out plans to include condominium association policies. Because of differences among condominiums, take-out bonuses would be determined by the association board on an individual basis.

The Legislative Working Group on Residual Property Insurance Markets was co-chaired by Representative Cosgrove and Senator Grant, both of whom co-chaired the Study Commission on Property Insurance and Reinsurance in 1993, and contained members representing the Insurance Commissioner, domestic property insurers, mortgage lenders, real estate agents, home builders, and consumers. In its final report, the Legislative Working Group on Residual Property Insurance Markets (1996) recommended that the FWUA and the RPCJUA should remain separate until the RPCJUA could reduce its policies to 100,000 but work together to achieve better coordination and eventual consolidation.

Evidence presented to the working group by the FWUA and the RPCJUA indicated that the FWUA had 253,307 policies in force as of July 31, 1996 and the RPCJUA had 922,625 policies in force as of the same date in coastal counties and 99,387 policies in force in noncoastal counties. Despite financial take-out policies, the RPCJUA had grown to become the second largest insurer in the state after State Farm. According to the RPCJUA, however, it expected to remove at least 453,000 policies by February 15, 1997.

One reason the residual market mechanisms continued to grow was the failure of the federal government to establish a national hazards insurance program which was expected to provide reinsurance for catastrophic events. The reluctance of the federal government to take on this obligation was expressed to the state legislators in November, 1993, when Representative Joseph Kennedy, Chair of the House Subcommittee on Consumer Credit and Insurance, at a field hearing in Melbourne, Florida, told Representative Cosgrove that a federal program was unlikely because it would establish an unfunded liability and potentially create a situation similar to the savings and loan debacle (U.S. House, 1994).

Prior to the start of the 1997 legislative session, the RPCJUA had tagged approximately 600,000 policies for removal, had successfully removed more than 500,000, but still continued to add policyholders each week (Florida Senate, 1997). As of January 31, 1997, the RPCJUA contained 678,809 policies.

During the 1997 session, the Senate Committee on Banking and Insurance introduced Senate Bill No. 794 (later enacted as Chapter 97-55) to make a number of modifications to the statutes specifying the operations of both the FWUA and the RPCJUA. Many of the changes were based on recommendations of the Legislative Working Group on Residual Property Insurance Markets. No permanent new residual market mechanism replacing the two existing mechanisms was suggested or approved.

### **Property and Casualty Insurance in 1997**

Almost five years after Hurricane Andrew, the state of Florida was still embroiled in a property and casualty insurance crisis. With the intention of strengthening the private market so it would continue to provide affordable insurance to all qualified homeowners, the state imposed moratorium on policy cancellations and withdrawals from the state by insurance companies has prevented an even more massive transfer of policies from the private market to the Residential Property and Casualty Joint Underwriting Association. An increase in areas covered by the Florida Windstorm Underwriting Association has permitted private firms to voluntarily offer full coverage less wind. As a result of these actions and the creation of the Florida Hurricane Catastrophe Fund which provides a measure of reinsurance for private insurers, thereby allaying some insolvency worries, there is a tenuous equilibrium (caused by the state taking on an increasing risk from wind) propping up a home building industry which continues to build in high wind risk areas to meet a seemingly insatiable demand. When the current moratorium expires in June, 1999, there is no guarantee that the crisis will have worked itself out and the need for another extension will vanish.

To reduce the potential danger from hurricanes and the potential losses of insurers, the state has undertaken aggressive mitigation programs designed to retrofit existing structures and to encourage the future construction of hurricane-resistant structures. These programs may have beneficial results. However, because of the overwhelming support in the

legislature for continued development in high wind risk areas of the state and the lack of sufficient state statutes and local ordinances to limit construction, the question of where construction should occur and the possible restriction in the most risky areas is unlikely to be asked, let alone be answered. Thus, despite efforts of the state to resolve the insurance crisis, the situation may get worse as the value of properties exposed to potential wind damage continues to grow unabated.

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May 22 , 1998