



# Principle-Based Reforms for Florida's Property Insurance Market

Senate Banking and Insurance Committee

January 16, 2013

Kevin M. McCarty, Insurance Commissioner



# Committee Guidance\*

- Return to a free market approach (within parameters to prevent abuse)
- Enhance Florida's attractiveness as a place for insurers to do business
- Align policyholder risk and reward
- Expand risk-sharing opportunities
- Stimulate additional private sector capital
- Reduce the overall exposure of Citizens
- Ensure policies and coverages are meaningful for Florida consumers

*\*From the meeting of the Senate Banking & Insurance Committee meeting, 12/5/2012*



# Challenges Citizens Property Insurance Corporation Pose to the Current Marketplace

- They are too large and represent over 21% of the total insured value
- They are currently insuring several different categories of risk: wind, sinkhole, and all other residual risks
- Their rates are lower than many private carriers – reducing competition among private carriers
- They write more than 8,000 new policies per week
- Despite increasing depopulation interest and one of the largest depopulation years on record in 2012, only about 60% of the policies approved for removal were actually removed

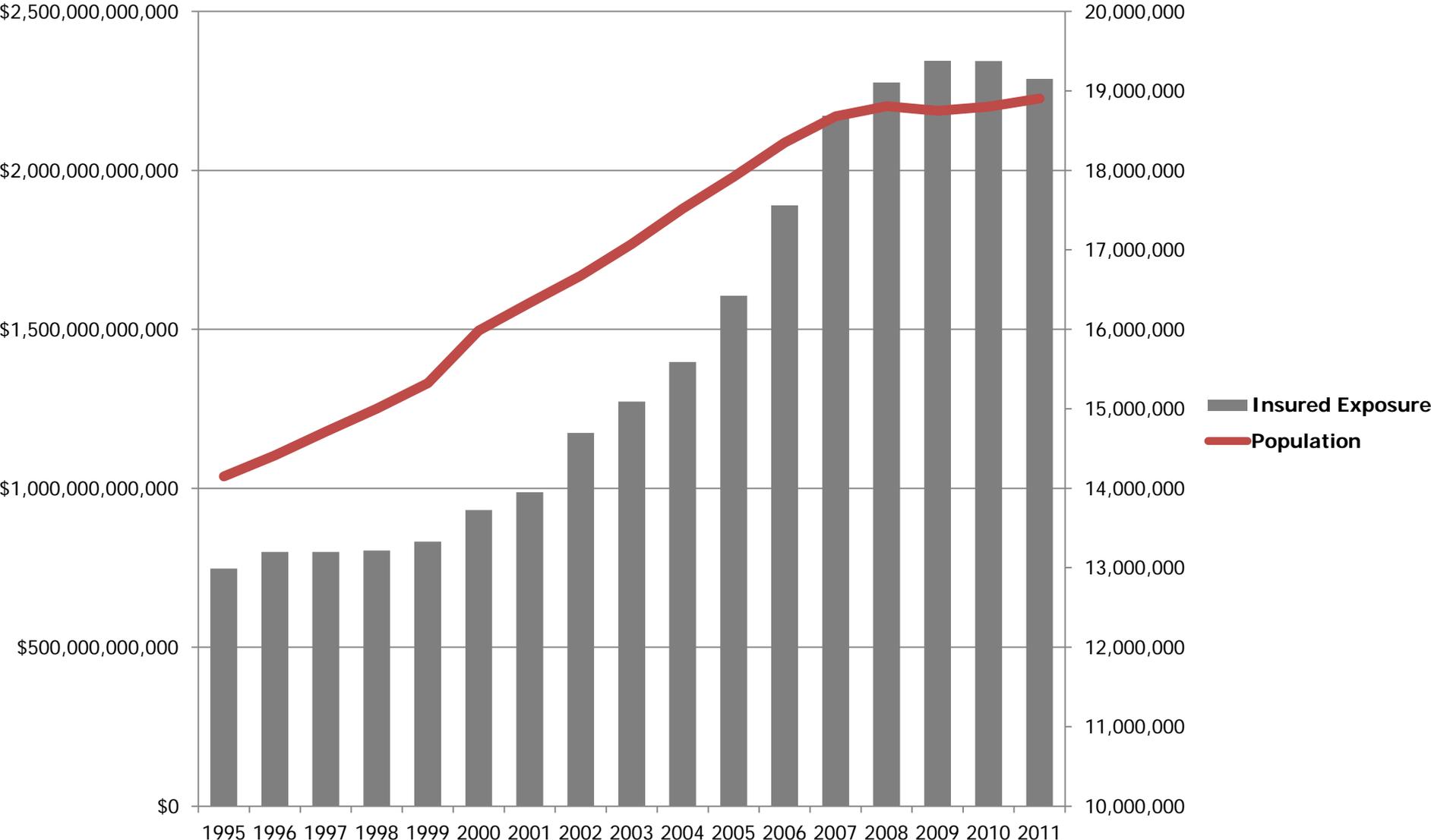


# Desired Outcomes

1. Restructure alternative markets so they become residual markets to provide quantifiable risk management for Florida
2. Maximize the risk-bearing capacity of the private market, including attracting new capital
3. Promote consumer choice, responsibility and market power
4. Enhance meaningful risk mitigation programs



# Growth in Exposure (1995 – 2011)



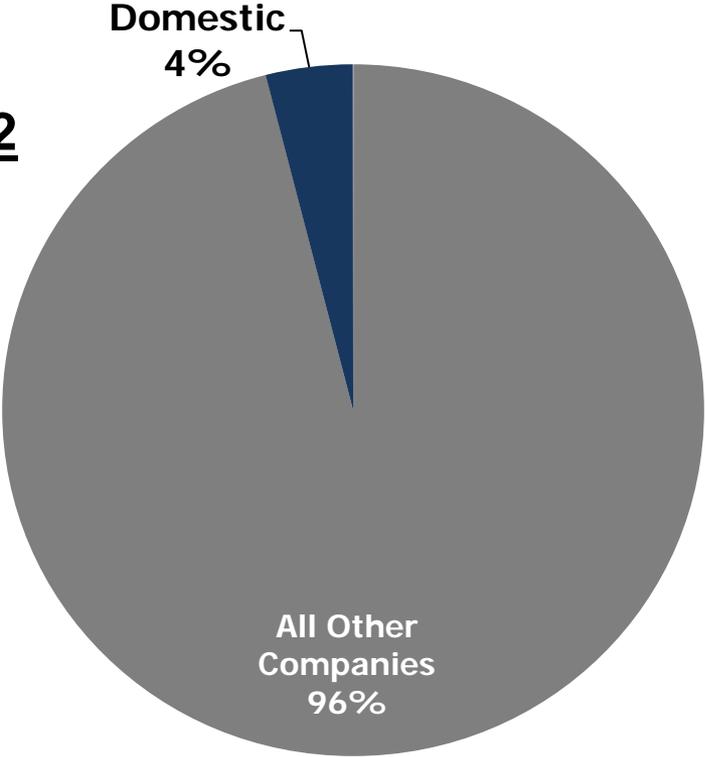
Data from 2012 Florida Hurricane Catastrophe Fund (FHCF) Rate-Making Report  
 Bureau of Economic Research, University of Florida



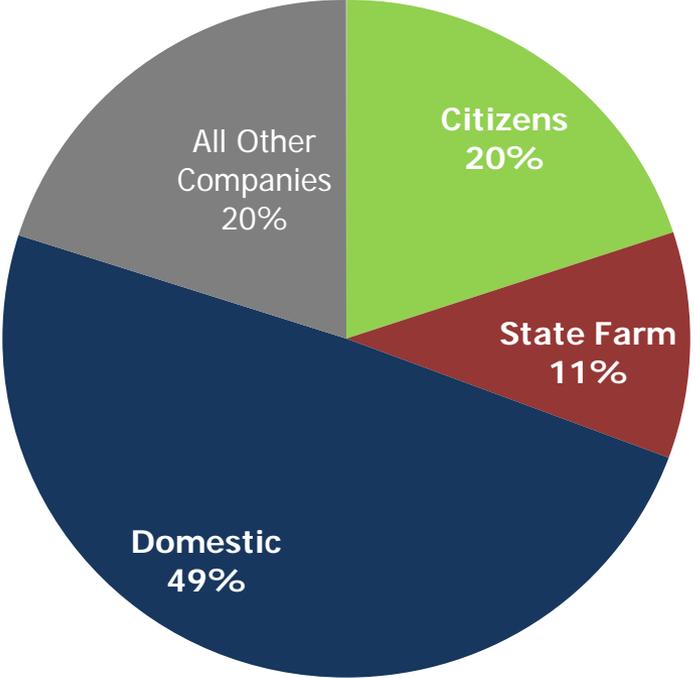
# The Changing Composition of the Insurance Marketplace – Foreign to Domestic

*Based on Written Premium – HO Multi-Peril*

**1992**

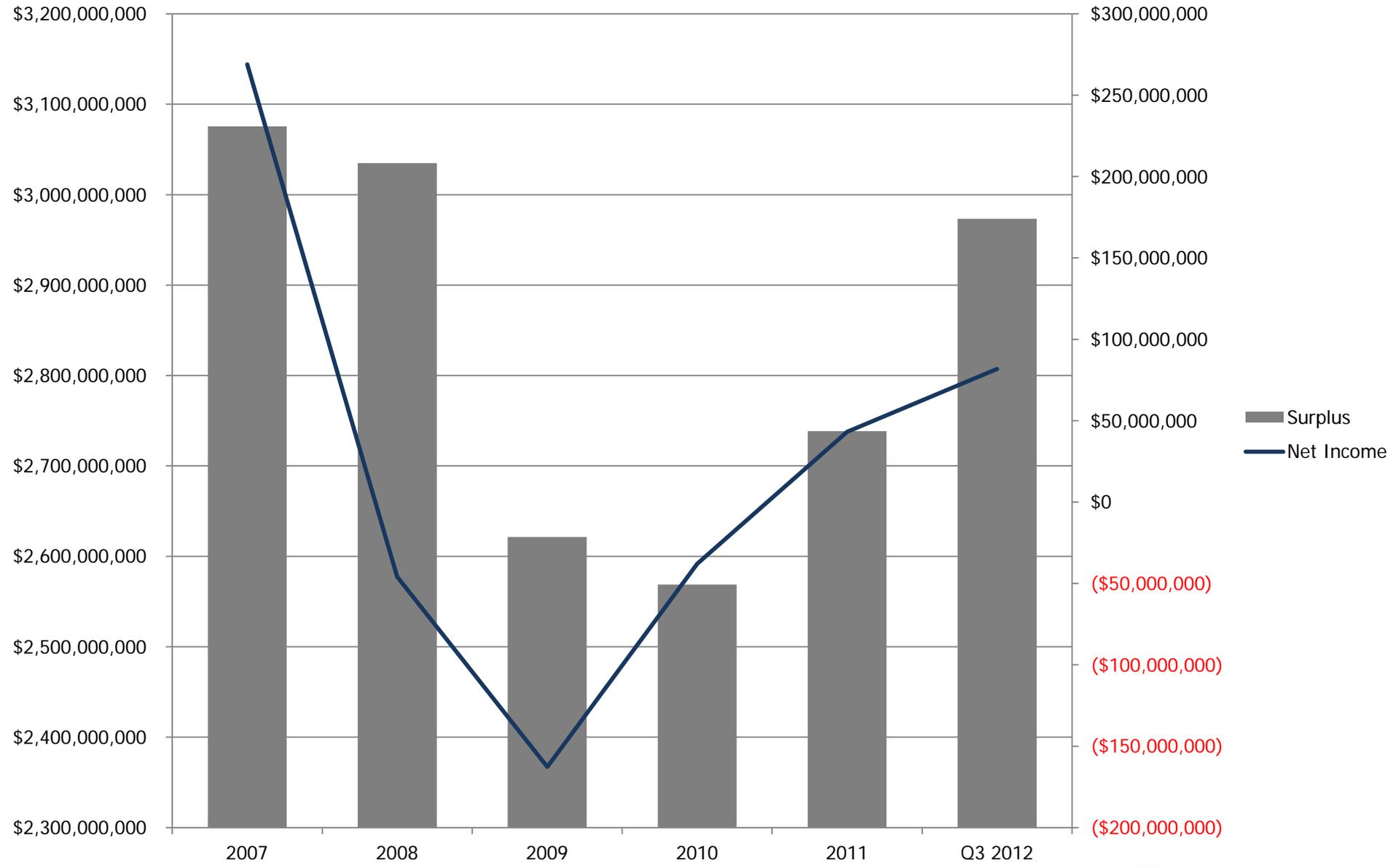


**2011**



-2011 pie chart data is from 2011 Annual Financial Statement  
-1992 pie chart data is from 1/09 presentation by Commissioner McCarty  
-"All Other Companies" in 1992 chart includes State Farm

# Resiliency of Domestic Property Marketplace

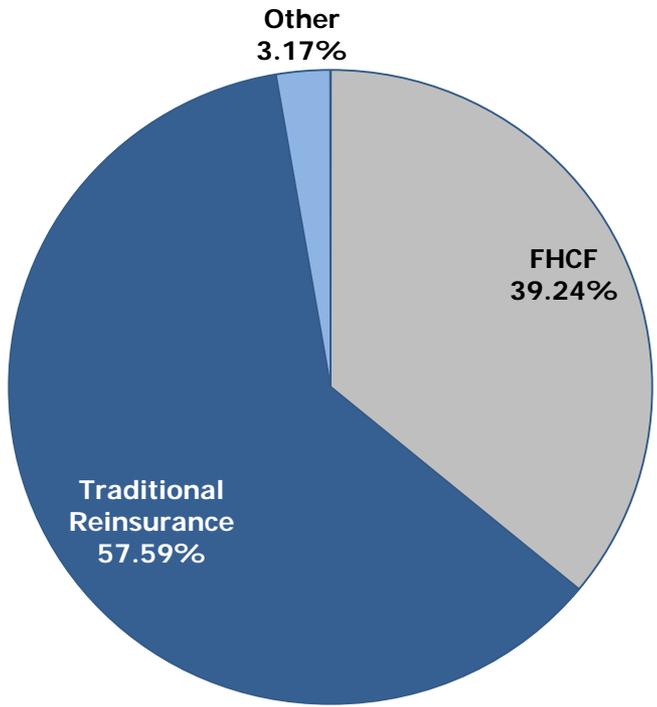


*Florida domestic insurers (excluding Citizens, including Castle Key)  
 Data from insurer annual statements, 2007 – 2011, and 2012 3<sup>rd</sup> quarter financial statement*

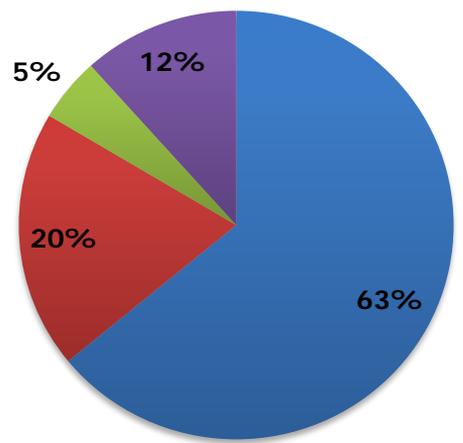


# Reinsurance as Additional Capacity

## \$20 Billion in Risk Finance



## \$2.75 Billion Cost of Risk Finance

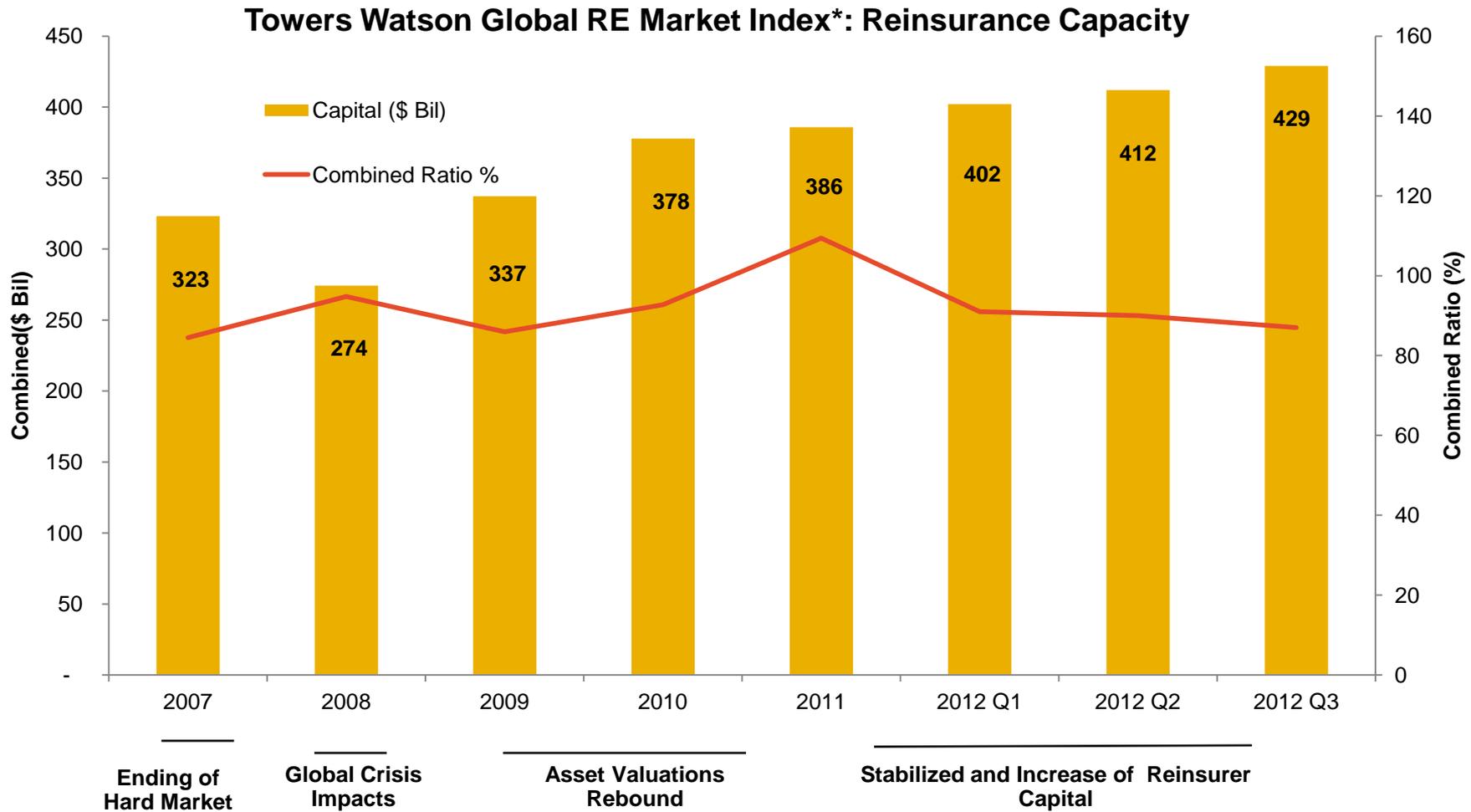


- Cost - Private
- Cost - FHCF
- Affiliates
- Cost - Other

Data from Florida domestic companies participating in the Reinsurance Data Call



# Reinsurance Capital



**Note:** Capital levels represent total adjusted shareholders' funds. Excludes capital markets, catastrophe funds and internal reinsurance capacity.

\*Represents a Towers Watson proprietary list of leading global reinsurers.

**Sources:** SNL Financial, Towers Watson . Graph courtesy of Towers Watson



# Voluntary Market - Large Storm Preparedness

## Reinsurance Purchased:

The Office examines significant property writers in Florida through an Annual Reinsurance Data Call prior to the beginning of storm season.

According to 2012 Data Call submissions:

- 96% of Florida domestics surveyed were reinsured to an 80-year event\*
- 91% of Florida domestics surveyed were reinsured to a 100-year event\*

*\*Based on an accepted model*



# Citizens - Large Storm Preparedness

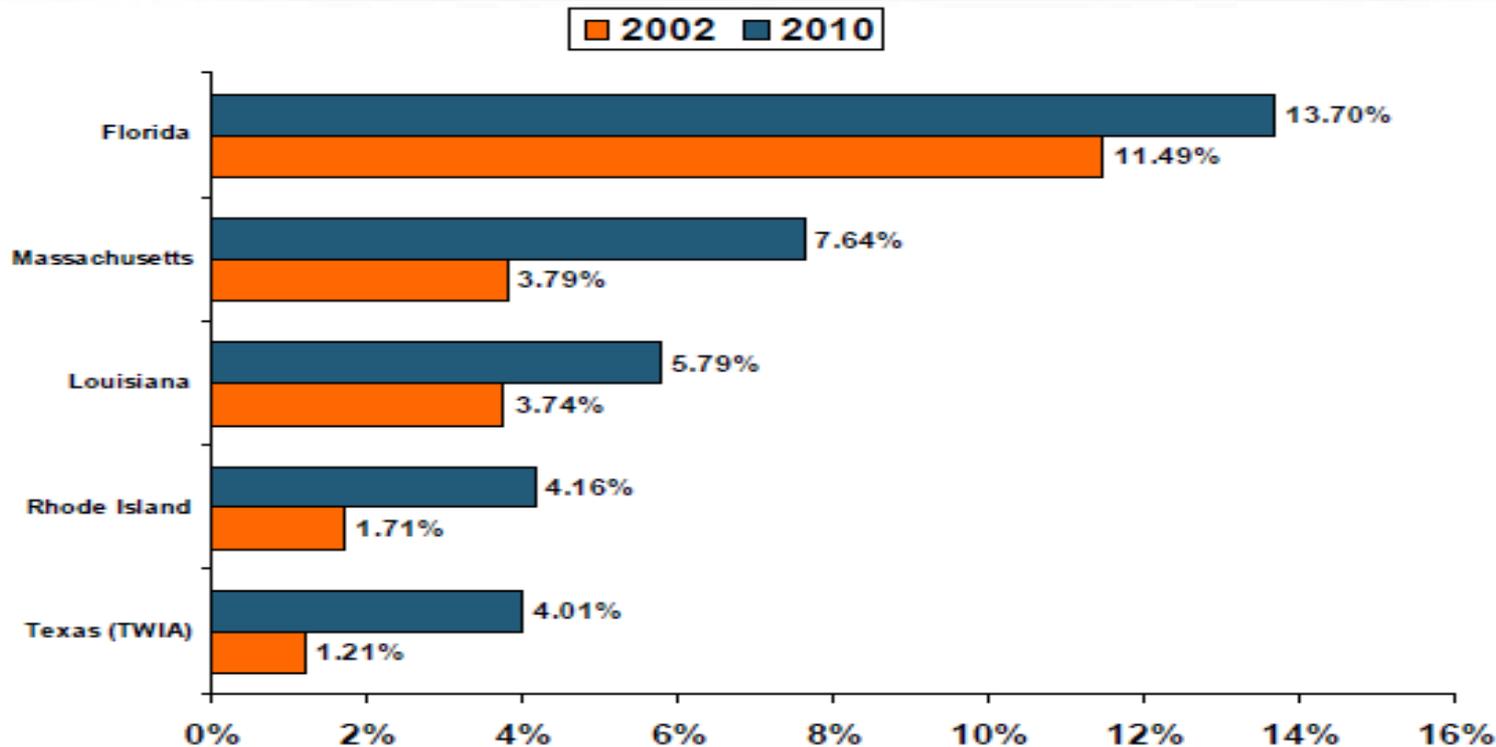
- Coastal Account (Surplus - \$2.9 billion)
  - 100yr Probable Maximum Loss - \$14.8 billion
  - Citizens Policyholder Assessments at 34yr event
  - Regular Assessments at 46yr event
  - Emergency Assessments at 51yr event
  
- Personal Lines/Commercial Lines Account (Surplus - \$3.1 billion)
  - 100yr Probable Maximum Loss - \$9.2 billion
  - Citizens Policyholder Assessments at 58yr event
  - Emergency Assessments at 72yr event

*Data from a presentation by Barry Gilway and Sharon Binnun to the House Insurance and Banking Subcommittee – 12/4/12*



# Fair Access to Insurance Requirements (FAIR) /Beach Plan Earned Premium

## FAIR/Beach Plan Earned Premium as % of Overall Property Market (Top 5 states) 2002 vs. 2010



Source: PIPSO; Insurance Information Institute

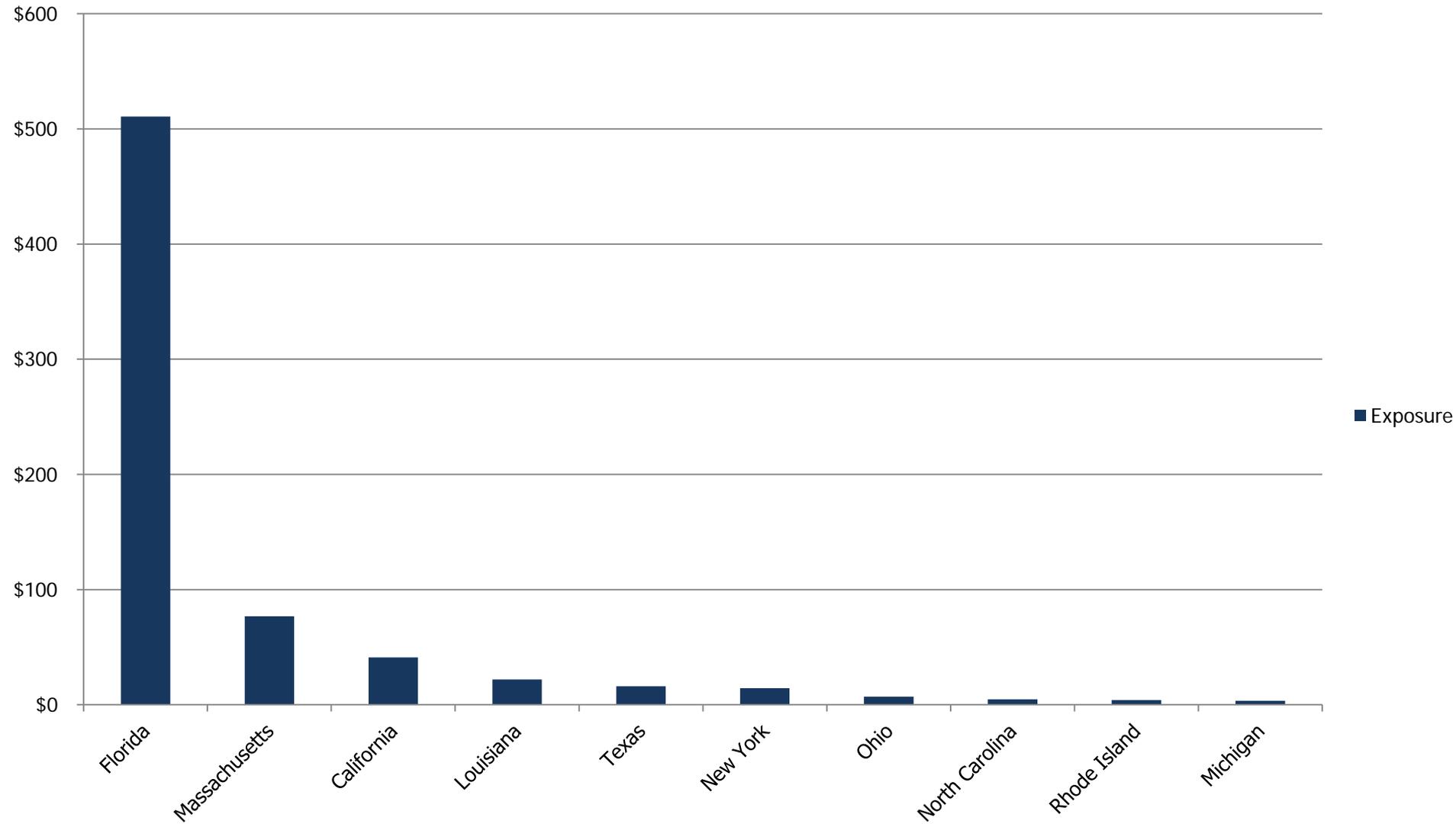
Data from "Residual Market Property Plans: From Markets of Last Resort to Markets of First Choice", Robert P. Hartwig, Ph.D, CPCU, July 2012



FLORIDA OFFICE OF  
INSURANCE REGULATION

# Top 10 FAIR Plan Exposure

As of year-end 2011 (in Billions)



Data from "Residual Market Property Plans: From Markets of Last Resort to Markets of First Choice", Robert P. Hartwig, Ph.D, CPCU, July, 2012



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# Structural Reform to Quantify Risk

- Coastal Account
- Truly Residual Risks
- Sinkhole Facility



# Coastal Account (Beach Plan)

- Separate the Coastal Account
- A focus on wind only allows for a more granularly structured product to lower costs
- Maximize resources in response to a catastrophic event
- Management should consist of technical experts
- Active insurers should have a role as advisors



# Truly Residual Risks

- Separating the Coastal Account would allow Citizens to focus on being a true residual market
- Reestablish Citizens rating plan based on the Top 20 private writers and transitionally adjust the rate cap
- Implement a clearinghouse to further decrease the number of policies entering Citizens and assist consumers in finding homeowners insurance
- Utilize a clearinghouse to better enforce the current law requiring policies with an offer of coverage within 15% of Citizens rates ineligible for Citizens
- Expand the clearinghouse to act as an exchange for all types of property insurance



# How to Stop Digging When You Are in a Hole

- Develop a refined mission for the remaining residual market entity
- Reestablish the Citizens rating plan based on the Top 20 private writers, as previously mentioned
- Prohibit Citizens from writing in the Coastal Building Zone for new construction not meeting a “Code+” Standard
- Language to this effect was previously enacted, but repealed before it took effect



# Risk-Sharing Arrangements

- Allow Citizens to enter into risk-sharing arrangements with the private market
  - Permit various programs encouraging Citizens to share risk with the private industry
  - In order to be successful, consumer opt-outs would need to be kept to a minimum, so these types of arrangements would need to be reserved for companies meeting stringent financial requirements



# Private Market is Willing to Write

- 277,002 policies removed via depopulation in 2012
- Increase in depopulation interest due to new capital entering the marketplace and companies able to acquire the rate needed to make depopulation feasible
- OIR approved the removal of up to 451,643 policies from Citizens in 2012 – only 277,000 were actually removed



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# Other Market Reforms

- Institute a rate band for private carriers – multiple options available
- Companies currently have the ability to consent to rate, which could be modified to allow for more flexibility
- Modify current rating rules to align mitigation credits to a company's modeling results
  - Mitigation should be a function of an expert committee, such as the Florida Commission on Hurricane Loss Methodology



# Reinsurance Pool

- Voluntary participation by insurers
- Would provide opportunity for reinsurers to participate each year in covering a “pool” of wind exposure
- Scale of purchase could result in expanded capacity and/or stabilized pricing for Florida domestics
- Managed by technical experts; active insurers should have role on board
- No assessment capability and is not an agency subject to rulemaking
- Similarly, the FHCF should explore opportunities to mitigate the impact of consumer assessments due to any projected shortfall



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# Continue to promote consumer choice and enhance consumer market power

- Promote consumer ability to select deductibles and coverages appropriate for their risk
- Allow possibilities for tailoring of policies and negotiation of price (consent to rate)
- “CHOICES,” a rate comparison tool for auto and homeowners insurance, is available on the Office website and can be utilized by consumers to enhance their search for insurance products
- Expand consumers ability to find coverage and lower search costs for producers; consider a clearinghouse



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# There are some caveats to this process:

- Timing
- Pricing
- Execution



# Implementing these suggestions:

- Citizens would be less competitive with private carriers, which would maximize privately available capital and attract new capital to the state
- Allows Citizens to no longer focus on several different perils, and focus primarily on being a truly residual market
- Provides consumers with increased choices, market power, and the assistance of a clearinghouse
- Gives more meaningful mitigation credits



## Contact Information:

Kevin M. McCarty, Insurance Commissioner  
Office of Insurance Regulation

Email: [kevin.mccarty@flor.com](mailto:kevin.mccarty@flor.com)

Phone: (850) 413-5914



# APPENDIX



# 2003 Language for Top 20 Rates

**627.351(6)(c)15.(d)2.**

***“For each county, the average rates of the corporation for each line of business for personal residential policies excluding rates for wind-only policies shall be no lower than the average rates charged by the insurer that had the highest average rate in that county among the 20 insurers with the greatest total direct written premium in the state for that line of business in the preceding year, except that with respect to mobile home coverages, the average rates of the corporation shall be no lower than the average rates charged by the insurer that had the highest average rate in that county among the 5 insurers with the greatest total written premium for mobile home owner’s policies in the state in the preceding year.*”**



# Requiring New Construction Insured by Citizens to be Built to a “CodePlus” Standard

## 627.351(6)(a)

*“For properties constructed on or after January 1, 201X, the corporation may not insure any property located within 2,500 feet landward of the coastal construction control line created pursuant to s. 161.053 unless the property meets the requirements of the code-plus building standards developed by the Florida Building Commission.”*



# Summary of Florida Building Commission's Recommendations "CodePlus" Standard

- Single wind speed per county based on 2007 calculations for 500-year recurrence interval hurricane
- High Velocity Hurricane Zone wind-borne debris protection criteria (per Florida building code)
- Building elevations based on FEMA 500-year recurrence interval hurricane flood elevations

[http://consensus.fsu.edu/FBC/FBC\\_docs/FBC\\_Report\\_2008\\_Legislature\\_2-27-08.pdf](http://consensus.fsu.edu/FBC/FBC_docs/FBC_Report_2008_Legislature_2-27-08.pdf)



# Consent to Rate; Excess Rate

## 627.171 (truncated)

*“(1) With written consent of the insured signed prior to the policy inception date and filed with the insurer, the insurer may use a rate in excess of the otherwise applicable filed rate on any specific risk....”*

*“(2) An insurer may not use excess rates pursuant to this section for more than ~~10 percent~~ 15 percent of its commercial insurance policies...or for more than ~~5 percent~~ 10 percent insurance...”*



# Mitigation Reform

## 627.0628 Florida Commission on Hurricane Loss Projection Methodology

**“(3) ADOPTION AND EFFECT OF STANDARDS AND GUIDELINES.—**

**(a) The commission shall consider any actuarial methods, principles, standards, models, or output ranges that have the potential for improving the accuracy of or reliability of the hurricane loss projections and wind mitigation discounts used in residential property insurance rate filings. The commission shall, from time to time, adopt findings as to the accuracy or reliability of particular methods, principles, standards, models, or output ranges.**

**(b) The commission shall consider any actuarial methods, principles, standards, or models that have the potential for improving the accuracy of or reliability of projecting probable maximum loss levels. The commission shall adopt findings as to the accuracy or reliability of particular methods, principles, standards, or models related to probable maximum loss calculations. The commission shall review models for accuracy of use to establish wind mitigation discounts.**

**(c) In establishing reimbursement premiums for the Florida Hurricane Catastrophe Fund, the State Board of Administration must, to the extent feasible, employ actuarial methods, principles, standards, models, or output ranges found by the commission to be accurate or reliable.**

**(d) With respect to a rate filing under s. 627.062, an insurer shall employ and may not modify or adjust actuarial methods, principles, standards, models, or output ranges found by the commission to be accurate or reliable in determining hurricane loss factors for use in a rate filing under s. 627.062. An insurer shall employ and may not modify or adjust models found by the commission to be accurate or reliable in determining probable maximum loss levels pursuant to paragraph (b) with respect to a rate filing under s. 627.062 made more than 60 days after the commission has made such findings.”**



# Mitigation Reform

627.0629 Residential property insurance; rate filings.—

*“(1) It is the intent of the Legislature that insurers provide savings to consumers who install or implement windstorm damage mitigation techniques, alterations, or solutions to their properties to prevent windstorm losses. A rate filing for residential property insurance must include notice of the mitigation discounts offered by the insurer which shall be actuarially reasonable discounts, credits, or other rate differentials, or appropriate reductions in deductibles, for properties on which fixtures or construction techniques demonstrated to reduce the amount of loss in a windstorm have been installed or implemented. Insurers may use the same model used for the rate to determine appropriate mitigation discounts. The fixtures or construction techniques must include, but are not limited to, fixtures or construction techniques that enhance roof strength, roof covering performance, roof-to-wall strength, wall-to-floor-to-foundation strength, opening protection, and window, door, and skylight strength. Credits, discounts, or other rate differentials, or appropriate reductions in deductibles, for fixtures and construction techniques that meet the minimum requirements of the Florida Building Code must be included in the rate filing. ~~The office shall determine the discounts, credits, other rate differentials, and appropriate reductions in deductibles that reflect the full actuarial value of such revaluation, which may be used by insurers in rate filings.~~”*



# Definitions:

## Insurance-Linked Securities & Industry Loss Warranties

- Insurance-Linked Securities (ILS) are financial instruments whose value is linked to insured losses, such as catastrophe bonds.
- Industry Loss Warranties (ILW) are reinsurance contracts that indemnify a purchaser based on losses to the entire industry. An example commonly used for Florida wind risk is CWIL (County-weighted Industry Loss).

