

**Adopted Minutes of September 28, 2005 Meeting of
Task Force on Long-Term Solutions
for
Florida's Hurricane Insurance Market**

The Task Force on Long-Term Solutions for Florida's Hurricane Insurance Market convened its second meeting on Wednesday, September 28, 2005, at 10:00 a.m. in 110 Senate Office Building, Tallahassee, Florida.

Chair **Kevin M. McCarty**, Commissioner, Office of Insurance Regulation, called the meeting to order and recognized a quorum.

In addition to Chair McCarty, attending were the following Task Force members: **Richard Cain**, Vice President, State Farm Insurance Company; **Leslie Chapman-Henderson**, President/CEO, Federal Alliance for Safe Homes, and Vice-Chair of the Task Force; **Dave Cobb**, President, Freedom Insurors, Inc.; **Randy Dumm**, Ph.D., Associate Professor of Risk Management and Insurance, Florida State University; **Blair Glenn**, Mortgage Banking Executive and Senior Vice President, Wachovia Mortgage Corporation; **George Grawe**, Counsel, Allstate Floridian Insurance Company; **Robert P. Hartwig**, Ph.D., Senior Vice President & Chief Economist, Insurance Information Institute; **Harold Humphrey**, Vice Chairman, InSource, Inc.; **James Wurdeman**, President/CEO, Poe Financial Group, **Steve Burgess**, Insurance Consumer Advocate, State of Florida and **Tony Grippa**, Executive Vice President, Brown & Brown . Absent was **Dan Gilmore**, President, Florida Homebuilders' Association.

Chair McCarty welcomed members of the Task Force, staff and members of the public who were attending. He noted that the meeting had been called in full compliance with Florida's "Government-in-the-Sunshine Act", Section 286.11, Florida Statutes. Public notice of the meeting had been published, members of the public were invited and were attending, and minutes of the meeting were being taken and would be made available publicly.

Chair McCarty asked the newest Task Force members to introduce themselves and to make comments about the work of the Task Force.

1. **Approval of Minutes of August 24, 2005, Task Force Meeting.** Task Force members unanimously approved written minutes of the Task Force's initial meeting on August 24, 2005.
2. **Citizens Property Insurance Corporation.** Mr. Bob Ricker, President and Executive Director of Citizens Property Insurance Corporation ("Citizens") and Suzanne Murphy, Corporate Counsel of Citizens addressed the Task Force. Mr. Ricker reviewed the 2004 storms in Florida, the current financial status, organizational structure, claims operations, rates, rating process and reinsurance provisions of Citizens.

Mr. Ricker noted that Citizens was created in 2002 as a merger of the Florida Windstorm Underwriting Association (FWUA) and the Florida Residential Property and Casualty Joint Underwriting Association (FRPCJUA) to offer wind-only and all-perils property insurance coverage to Floridians without private insurance options. He observed that Citizens is an "important safety net for Floridians" because it is required by law to accept all applicants who are otherwise insurable but cannot find coverage in the voluntary market. Although Citizens requires applicants and their insurance agents to sign an affidavit that they do not have a voluntary insurer to insure them, Mr. Ricker recognized that the system was not "fool-proof".

As a result of these requirements, Citizens has heavy concentrations of coverage, and related risks, in coastal areas, sinkhole areas, southeast Florida, older homes, manufactured housing and mobile homes and other residences that cannot find private insurance coverage. In addition, its coverage frequently is limited to high risk wind-only coverage, leaving lower risk non-wind coverage to the private market. Citizens is not able to balance its portfolio with auto and other lines of business. Within its high risk portfolio, Citizens has substantial commercial real estate exposure (condominium and apartment buildings). Citizens has the highest risks, and concentrations of risk, of any provider of property insurance. According to Mr. Ricker, “Citizens is required to insure more loss exposure than any private insurer would ever consider...and ends up insuring the ‘toughest’ risks’.”

Mr. Ricker noted that Citizens provides coverage in three major accounts: Personal Lines Account (PLA), Commercial Lines Account (CLA), and High Risk Account (HRA) and provided information about operating activities for the three accounts.

The Task Force discussed Citizens issues and Mr. Ricker and Ms. Murphy responded to questions about the operation and role of Citizens pursuant to the charge of the Task Force.

- How to ensure that the corporation operates as an insurer of last resort which does not compete with insurers in the voluntary market, but which charges rates that are not excessive, inadequate, or unfairly discriminatory. Mr. Ricker noted that Citizens requires applicants and their insurance agents to submit an affidavit that they do not have a voluntary insurer that will insure them. He observed that it was an ongoing problem to put “teeth” into the requirement that Citizens be an insurer of last resort and not compete with voluntary insurers. Although some have proposed that Citizens impose a requirement that applicants produce evidence of three declinations from voluntary insurers, he did not think that was practical or would be effective. Ms. Murphy stated that applications are submitted electronically with premiums paid and coverage is already bound so Citizens does not have an opportunity or methodology for marketing an application to determine if coverage is available by another carrier. She also noted that the statements by agents about the lack of private coverage were specific to that agent (that the agent could not personally place coverage) rather than statements about private market availability. Several Task Force members expressed the opinion that voluntary insurers were unwilling to provide coverage because of a lack of financial capacity in the Florida market and in the worldwide market for insurance and reinsurance, driven by rates in Florida. Chair McCarty stated that Florida’s process of rate review was in the mainstream of the way most states reviewed rates and would be thoroughly considered at a future Task Force meeting. Chair McCarty also noted that Citizens had a difficult dilemma in following its legislative mandate because it both needed to put itself out of business and, at the same time, offer effective and efficient coverage and service. He also noted that Citizens had to avoid competition with insurers in the voluntary market while keeping rates that were adequate, nondiscriminatory and not excessive. Citizens now sets its rates by establishing a floor of rates charged by the “Top 20” voluntary market insurers in Florida. It is moving toward actuarially sound rate. Several Task Force members asked whether the “Top 20” was the right mix to use for finding Citizens’ rate floor. Mr. Ricker noted that Citizens is trying to become more “granular” in targeting its rating territory so that individual risks could be more accurately assessed and rates charged accordingly. Ms. Murphy observed that rates change quickly and that Citizens cannot also ensure that its rates are non-competitive due to timing differences of company rate filings. Ms. Murphy was requested to provide a copy of their base rates by territory.
- Whether the bonuses paid by the corporation to carriers taking policies out of the corporation provide a cost-effective means of reducing the potential liability of the corporation. Ms.

Murphy noted that approximately 1.3 million policies were taken out by companies from the old JUA to Citizens. She observed that the “take-out” or depopulation policy was successful and that bonuses contributed to that success. Companies must keep policies for a minimum of three years to qualify for a bonus. The remaining question is whether these policies will be retained by voluntary market companies. Ms. Murphy noted that it was impossible for Citizens to track policies that have been taken out but that the Office of Insurance Regulation could ask companies to report on how long they kept such policies. Mr. Ricker noted that most “take out” policies were assumed by specially organized “take out” companies and not by the large national companies. He noted that most “take-out” policies have been assumed from the PLA. Several new insurance companies have been formed, both independent companies and those sponsored by larger companies, to take Citizens policies. Chair McCarty said that most of these “take-out” companies remained solvent and had brought new capital into the state because of a very rigorous process of screening the financial strength of such companies, backed by the Florida Market Assistance Plan. Only one company had become insolvent for reasons that may have been unrelated to its hurricane risk coverage profile. Ms. Murphy was asked to provide the Task Force with analyses, ideas and suggestions about improving the “keep out” program.

- Whether the “Consumer Choice” law should be repealed or amended to ensure that the corporation serves as the insurer of last resort. Mr. Ricker estimated that the “Consumer Choice” law has reduced consumer complaints and policyholder confusion arising from take-out, but has resulted in a 10-15% reduction in the number of policies taken out.
- Whether coverage amounts should be limited. Mr. Ricker indicated that he believes some risks may need to be “capped” so that very high value properties, for instance, would not be covered for more than a pre-established “cap”, such as \$1 million, and would have to pay surcharges or seek reinsurance for any additional coverage. Mr. Ricker noted that of the \$1.8 billion in HRA losses in 2004, \$24.4 million can be attributed to claims on residential properties insured for more than \$1 million, representing a little more than 1% of Citizens’ total HRA losses in 2004. Citizens now insures about 5,500 homes valued at \$1 million or more each, out of about 421,000 policies now in the HRA account. “Caps” also could apply to second, or vacation, homes as opposed to primary residences. Mr. Ricker thought that about 75% of all residences covered by Citizens were primary homes but was asked to provide the Task Force with recommendations on what various “caps” might apply to particular situations. Several Task Force members asked whether Citizens could charge different rates for the primary homes of Florida residents and the secondary or vacation homes of non-residents. Mr. Ricker thought that might be “unfairly discriminatory”.
- Whether the corporation has hired an adequate level of permanent claims and adjusting staff in addition to outsourcing its claims-adjusting functions to independent adjusting firms. Mr. Ricker acknowledged that Citizens experienced difficulties following the multiple storms in 2004, just as private companies did in having enough trained and experienced adjusters available to do the work required. He stated that Citizens is now managing the entire claims process to ensure efficiency and is integrating three separate computer operating systems and has created a new claims tracking system so that it could better monitor and manage the claims process. Insurance agents could be used as temporary adjusters but it would be a huge undertaking to manage the training required. Mr. Ricker said that Citizens does not currently have the infrastructure to accelerate this process but wanted to do so in the future. He thought Citizens’ problems with adjusters during the last year were related more to not having enough trained people – rather than with the kinds of contracts Citizens had with its adjusters. He noted that the complexities of Citizens’ mix of claims also requires more expertise than less complicated claims. Mr. Ricker said he has heard CFO Tom Gallagher note that the state

currently has approximately 50% fewer adjusters available than it had after Hurricane Andrew in the early 1990s. Another complicating factor is the re-opening of claims that may require additional adjusting and action. Mr. Ricker also noted that Citizens is providing incentive and penalty clauses in its contracts with adjusters and was working with the Department of Financial Services Division of Fraud and various state attorneys' offices to bring formal actions in cases of suspected fraud. Ms. Murphy noted that they have brought some E & O [*Errors and Omissions*] cases against some of their contractors. Mr. Ricker said that they are recommending a legislative change to require companies that write ex-wind policies to adjust hurricane losses. Ms. Murphy noted that Citizens now has a marriage of outsourced contracts and internal management. They have hired team leaders and team managers who are responsible for production and management of adjusters assigned. They have a 30-35 person catastrophe oversight leadership that is housed in Jacksonville and outsourced contracts with about 25 vendors.

- The effect of reducing or expanding the areas that are eligible for coverage in the high-risk, wind-only account. Mr. Ricker advised that nearly 25% of all Citizens policies and 29% of the dollar exposure in the PLA and CLA are in Miami-Dade County. According to Mr. Ricker, Citizens is by law the most concentrated property insurer in the most catastrophe-exposed state in the world and will continue to face financial and operational challenges without significant systemic changes to the Florida homeowner's insurance market. Ms. Murphy noted that if you reduce the size of the wind only territory, companies would have to write the entire risk or the entire risk would come to Citizens, instead of them just having the wind only exposure. This would increase the amount of coverage provided and premium received, but not affect the number of policies in force. Chair McCarty noted that major changes may be required to reduce Citizens' wind exposure, including introducing a multi-peril policy that had additional premiums, substantial mitigation incentives that emphasized homeowner responsibility, strictly enforced building codes, and a national backstop fund.
- Whether the corporation should purchase reinsurance or take other actions that reduce the potential for debt financing and deficit assessments. Mr. Ricker noted that Citizens has obtained reinsurance and, after continuing analysis, may supplement its existing coverage. Ms. Murphy noted that Citizens has a statutory mandate to assess the value of purchasing reinsurance and that she would provide the Task Force with updated charts to show their reinsurance purchases. Mr. Ricker reviewed the history of assessments by the FWUA and the FRPCJUA, noting that they had 11 regular assessments from 1975 until 1998. As a result of the storms in 2004, Citizens incurred more than \$1.8 billion in HRA losses, resulting in a shortfall of approximately \$516 million. Under Florida law, Citizens must recoup this shortfall by a one-time assessment on property insurance companies statewide. These companies then file with the Office of Insurance Regulation to add a one-time surcharge to their policyholders' annual premiums to recoup amounts paid to Citizens. Citizens also applies a surcharge to its own policyholders.
- An evaluation of the infrastructure and administration of the corporation and how to improve customer service, claims handling, and communication and the exchange of information with agents of policyholders of the corporation. Mr. Ricker reviewed improvements made in the last year, including significant expansion of Citizens' Catastrophe Claims Department. It has changed its adjuster management philosophy and directly manages a mix of outside, contractual adjusters and company employees in the processing and payment of claims. It is establishing a regional claims office in Miami-Dade County where it has large concentrations of policyholders and risks. It has added enhanced technology and increased customer service staff for its consumer hotline. Mr. Ricker reviewed a number of management changes now underway, including direct management over its claim adjustment processes, modifications to

its Plan of Operations and implementation of a claim tracking system. Ms. Murphy noted that Citizens has reached out to improve communications with its insurance agents and providing them with additional information the make them better able to provide assistance to their customers.

Mr. Ricker and Ms. Murphy also addressed several additional issues at the request of the task force:

- Does coverage by Citizens subsidize high risk properties by charging rates that are not tailored to specific risks? Mr. Ricker noted that Citizens is becoming more “granular” in its rating territories in order to reduce or eliminate any “cross-subsidies” that may exist. He noted that unless more premium is charged for policies that cost more in claim dollars, those policies will be subsidized by all the other policyholders. Examples of such subsidies, where policyholders may not be paying premiums that reflect risk accurately, include older homes, sinkhole properties and coastal properties. Lack of adequate credits for mitigation also results in subsidies of properties that have not taken appropriate mitigation steps.
- Sinkholes. Mr. Ricker noted that sinkholes have contributed significantly to policy growth, especially in the Tampa Bay area, including Hernando, Hillsborough, Pasco and Pinellas counties. The PLA is receiving an average of 72 sinkhole claims per month. If the trend continues, Citizens expects 894 new sinkhole claims in 2005. Sinkhole losses make up approximately 7% of Citizens’ non-catastrophe loss ratio.
- Mitigation. Mr. Ricker, Ms. Murphy and others observed that mitigation incentives were small. There was general consensus that strongly enforced building codes were essential and that they would like to address this issue in greater depth at future meetings.

At the conclusion of her presentation, Ms. Murphy summarized that she would provide the Task Force charts on the amount of reinsurance available and obtained, a copy of their mitigation credits and the notice they send to policyholders regarding mitigation credits, a copy of their organizational chart, Citizens’ base rates by territory, recommendations for coverage caps they think should be considered and ideas on how to improve the “keep-out” and “Consumer Choice” programs.

Mr. Bruce Douglas, Chair of the Board of Governors of Citizens, addressed the Task Force to express Citizens’ desire to cooperate fully. He noted that Citizens has a new Board of Governors as of August 4, 2005, and that the new Board has utmost confidence in its president, Mr. Ricker, and his staff. He stated that Citizens would present a plan to train insurance agents as adjusters and geographically manage them. He said their target date for implementation is January 2006.

3. **Consumer Issues Relating to Citizens.** Mr. Rick Mahler, Deputy Chief of Staff for the Department of Financial Services, briefed the Task Force on consumer issues relating to Citizens. He noted that approximately 1800 complaints had been received during October, 2004. As of July of this year, the number of complaints had been reduced to 161 for the month, which is within the norm for the marketplace. With no additional major storms, he thought that it is reasonable to deduce that Citizens’ complaints would continue to decrease.

4. **Florida Hurricane Catastrophe Fund.** Dr. Jack Nicholson, Senior Officer for the Florida Hurricane Catastrophe Fund (CAT Fund) presented information on the CAT Fund to the Task Force. He described the CAT Fund, provided an historical perspective, outlined losses during the 2004-05 hurricane seasons, and summarized its current financial status.

In 2004, the CAT Fund experienced \$3.611 billion in losses compared to \$20.934 billion in all insured losses for all events during 2004. It also has experienced much smaller losses in 2005.

The CAT Fund currently has a projected 2005 year-end cash balance of \$3 billion with additional bonding capacity of \$12 billion.

Mr. Nicholson noted that the CAT Fund can keep growing and that there is a greater need in Florida for additional capacity, partly because of a scarcity of reinsurance. He discussed the CAT Fund's ability for "rapid cash build-up" and noted that is desirable unless the CAT Fund's assets are allocated otherwise by the Legislature. The Fund may need to be "locked up" permanently, perhaps by amending the Florida Constitution, to prohibit access to these funds except for clearly defined catastrophe purposes. Mr. McCarty opined that the solution is to lock up the CAT Fund monies permanently in the Florida Constitution and that he would like to see the Task Force support the concept.

5. Comprehensive National Catastrophe Plan. Ray Spudeck, Senior Research Economist, Office of Insurance Regulation, outlined the key components of a comprehensive national catastrophe plan. He presented a three-layered national plan. The first layer would consist of private insurance and reinsurance with tax-deferred reserves for insurance companies and disaster savings accounts for individual policyholders. The second layer would be a state catastrophe fund, similar to Florida's CAT Fund, supplemented by regional funds of cooperating states with mandatory participation by all companies and policyholders. The third layer would be a national disaster fund for mega-catastrophes. All would require personal mitigation actions by policyholders, strictly enforced land use and building codes, and other requirements to protect property and limit risk exposures. Participation in the national fund would require that states establish the first two layers of coverage. All policyholders would have "all perils" policies and one adjuster for all claims and complaints. Dr. Spudeck noted that Floridians now pay 41% of federal flood insurance premiums and receive about 10% of the benefits. Similarly, all other states should share in the risks of all states' citizens and residents, including Floridians.

6. Public Testimony. Scott Johnson, Executive VP, Florida Association of Insurance Agents, reported that his organization was partnering with the Florida Insurance Council to establish the Florida Alliance on Hurricane Insurance to develop a consensus on issues. They are studying residual markets across the United States, including the National Flood Insurance Program, to see if any are worthy of replication in Florida. They are trying to address "take-out", "keep-out", "Consumer Choice" and other issues to find new approaches that might work. He hoped to be able to share a report and recommendations with the Task Force by December.

7. Meeting Schedule. Chair McCarty announced the next meeting of the Task Force on October 26, 2005, at Tradition Hall, Alumni Center, the University of South Florida, Tampa, beginning at 10 a.m.

Chair McCarty adjourned the meeting at 2:30 p.m.