

Workable Solutions for Florida's Challenging Insurance Problems

Eli Lehrer

*Vice President, The Heartland Institute
Adjunct Scholar, The James Madison Institute*

R.J. Lehmann

*Deputy Director, The Heartland Institute Center on Finance, Insurance and Real Estate.
Adjunct Scholar, The James Madison Institute*

Introduction

The ways that Floridians purchase coverage to protect their property and insure their vehicles has, increasingly, placed a significant drag on the state's economy. Both the state's automobile insurance system — particularly the "no-fault" personal injury protection (PIP) portions of it — and the state's homeowners insurance system have very serious flaws that threaten the state's business climate and, indeed, the financial well-being of all its citizens. Some of Florida's problems, particularly those that relate to property insurance, stem from its location. But nearly as many result from deliberate, interconnected policies pursued by the Legislature, previous governors, or the Office of Insurance Regulation. As it convenes for its 2012 session, the Florida Legislature should consider major reforms in its homeowners and vehicle insurance



systems. Florida, quite simply, faces a dual crisis in its insurance markets and needs to make serious changes to overcome it.

All of this matters to state government because property and casualty (P&C) insurance is, by a large margin, the largest area of economic activity regulated almost entirely at the state level.¹ Consumers typically interact with the P&C market when they buy two products, vehicle insurance and homeowners insurance. Most consumers, furthermore, must buy these products. Florida law requires that all drivers secure vehicle insurance, and mortgage lenders almost always require individuals to secure property insurance. Although the two products are quite distinct, about 60 percent of consumers nationally buy both from the same companies.

(Continued on Page 3)

The James Madison Institute

Trusted Solutions for a Better Florida

Founded in 1987, The James Madison Institute is a non-partisan policy center dedicated to the free-market principles of limited government, individual liberty, and personal responsibility.

President and Chief Executive Officer: **J. Robert McClure III, Ph.D.**

BOARD OF DIRECTORS

Chairman: **Allan Bense**, Panama City

Vice Chairman: **J. Stanley Marshall**, Tallahassee

MEMBERS OF THE BOARD OF DIRECTORS

Glen Blanch, Naples; **Jacob F. Bryan**, Jacksonville;

Charles E. Cobb, Coral Gables; **Mark Crosswhite**, Pensacola; **Rebecca Dunn**, Palm Beach;
George W. Gibbs III, Jacksonville; **Robert H. Gidel**, Orlando; **L. Charles Hilton**, Panama City;

John Hrabusa, Lakeland; **John F. Kirtley**, Tampa; **Fred Leonhardt**, Orlando;
J. Robert McClure III, Tallahassee; **Thomas K. Sittema**, Orlando; **Jeffrey V. Swain**, Tallahassee

THE JAMES MADISON INSTITUTE STAFF

Amar Ali, Research Associate; **Tanja Clendinen**, Communications Director;

Francisco Gonzalez, Development Director; **Keri Gordon**, Administrative Assistant to the President;

Becky Liner, Operations Director; **Jill Mattox**, Grant Writer; **William R. Mattox, Jr.**, Resident Fellow;

Will Patrick, Capitol Reporter; **Thomas Perrin**, Public Affairs Director; **Robert F. Sanchez**, Policy Director;

Jenny Stone, Donor Relations Manager; **Laura Ward**, Finance and Human Resources Manager

TO CONTACT US

By Mail:

2017 Delta Boulevard, Suite 102

Tallahassee, FL 32303

Our Website:

www.jamesmadison.org

By Phone:

In the Tallahassee Area: 850-386-3131

Toll-Free From Anywhere: 866-340-3131

Via e-mail:

jmi@jamesmadison.org

About JMI's Research: Our Pledge to You

Research topics are selected by JMI's Committee on Public Policy, with input when appropriate from members of our Research Advisory Council. Published research focuses on topics relevant to Florida and the Institute's mission of promoting free-market principles and robust debate concerning Florida's current problems and future challenges.

The findings and conclusions in JMI's publications are those of the authors and do not necessarily reflect the views of JMI's members, staff, or Board of Directors. JMI does not conduct sponsored research at the behest of donors, nor do the providers of research grants exercise control over the methodology, findings, or conclusions of the research. When a peer review of an author's methodology or conclusions is deemed appropriate, a draft may be submitted to a Research Advisory Council member.

THE RESEARCH ADVISORY COUNCIL OF THE JAMES MADISON INSTITUTE

Dr. Susan Aud, Senior Fellow, Milton and Rose Friedman Foundation;

Dr. Michael Bond, Professor of Finance, The University of Arizona;

Dr. Marshall DeRosa, Professor of Political Science, Florida Atlantic University;

Dr. Thomas V. DiBacco, Professor Emeritus, American University;

Dr. Dino Falaschetti, Professor, Florida State University College of Law;

Dr. James Gwartney, Professor of Economics, Florida State University;

Dr. Bradley K. Hobbs, BB&T Professor of Free Enterprise, Florida Gulf Coast University;

Dr. Randall Holcombe, Professor of Economics, Florida State University;

Dr. Barry Poulson, Professor of Economics, the University of Colorado;

J.B. Ruhl, J.D., Professor of Law, Florida State University College of Law;

Peter Schweizer, Research Fellow, The Hoover Institution, and

James M. Taylor, J.D., Senior Fellow, The Heartland Institute.

Workable Solutions for Florida's Challenging Insurance Problems

(Continued from front cover)

The costs and features of these products are a problem. The prices that Florida consumers pay for homeowners insurance are the highest or second highest in the country; the prices they pay for vehicle insurance are now among the highest in the Southeast. (See Table 1 for automobile insurance comparisons; see Table 2 for homeowners insurance comparisons.) High insurance costs are not necessarily bad per se when they reflect actual

risks, but they certainly can strain family finances. Florida's median household income is \$44,755, which means that nearly 10 percent of a typical family's income goes simply to pay for these insurance policies. If Florida legislators want to make an economic difference for the people they represent, they should start by looking at insurance.

Although activities relating to these two forms of insurance pass through the same legislative committees and are overseen

Table 1: Florida Vehicle Insurance Rates Compared to Rates in Other Nearby States

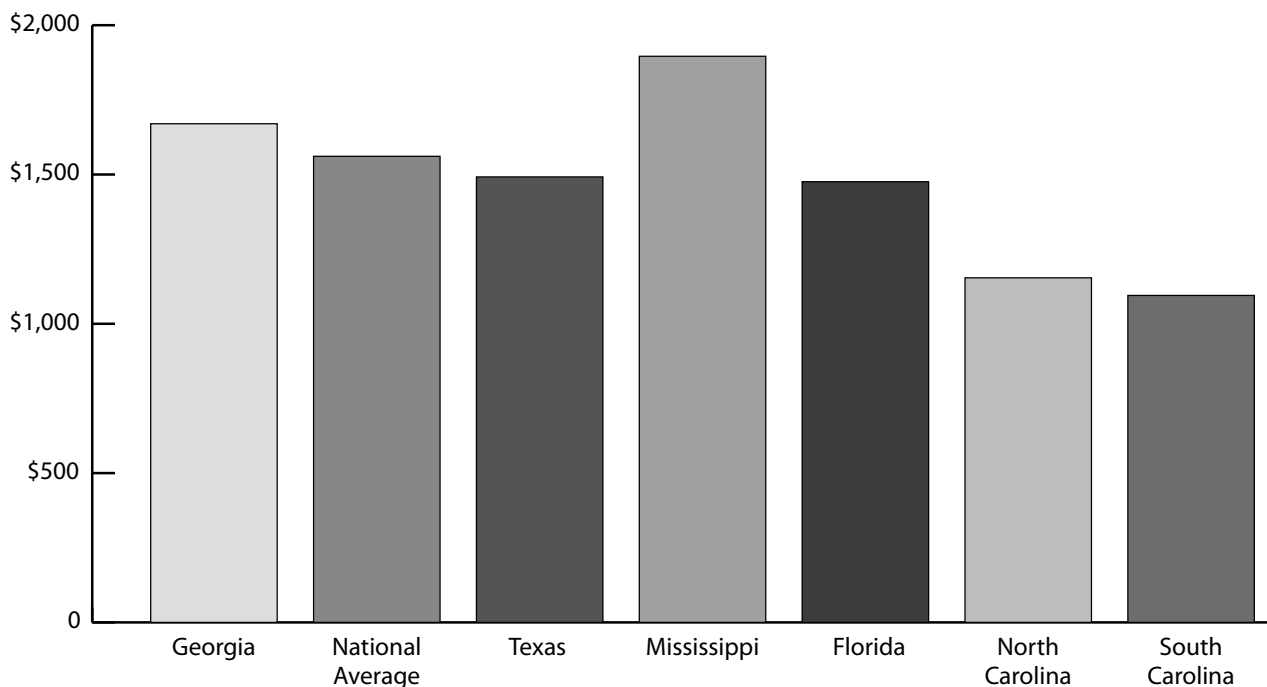
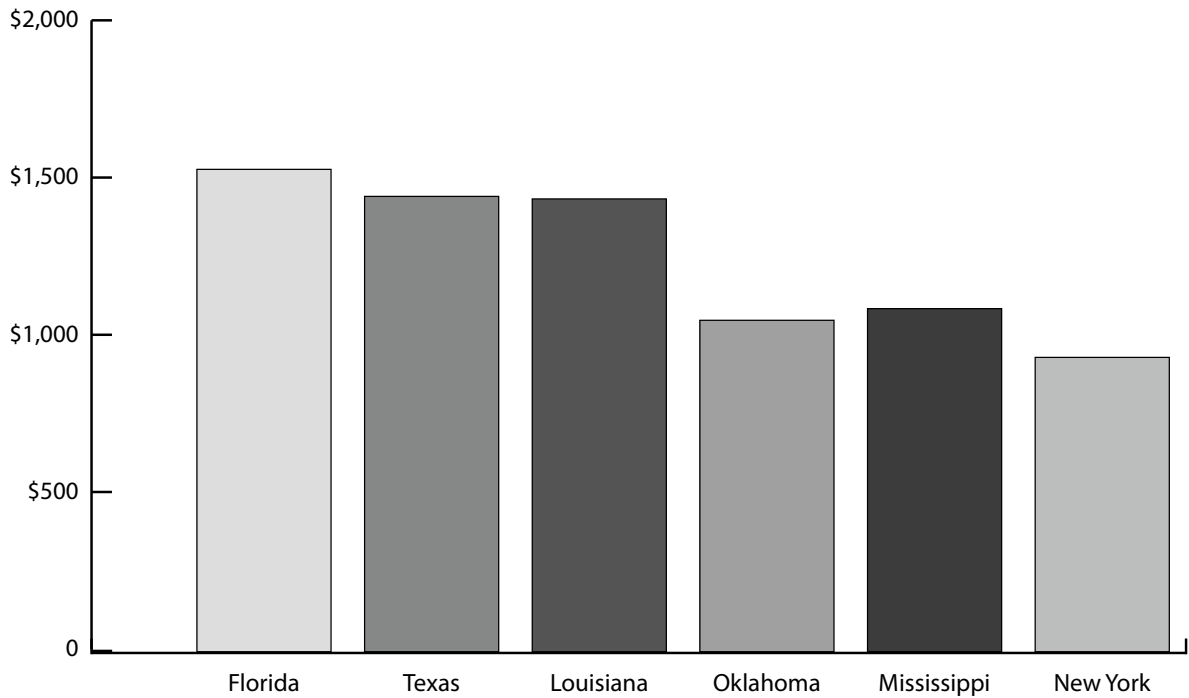


Table 2: Florida Homeowners' Insurance Rates in National Perspective



Sources: National Association of Insurance Commissioners

in the same offices, the ongoing crisis in property insurance and the emerging crisis in vehicle insurance have very different underlying causes, so they are best discussed separately.

Therefore, the following paper describes why and how the Legislature could go about its tasks of insurance reform in each of these categories. Following this introduction, this paper consists of two sections that outline the cases for reforming the vehicle and homeowners insurance systems, respectively. A conclusion sums up the paper's findings. The paper, throughout, focuses on reforms that could reasonably be implemented in the 2012 legislative session and thus could begin to make a meaningful difference in Floridians' lives very shortly thereafter.

Part I Vehicle Insurance

The Problems:

Florida vehicle insurance policies, like those in 11 other states, are sold on a partly no-fault basis. This means that, rather than filing a tort claim or trying to bill the at-fault driver's insurance company, Florida motorists who get into crashes file claims with their own insurers. Every policy sold in the state must include at least \$10,000 in "personal injury protection" (PIP), to cover injuries to drivers and to others, and an equal amount of "property damage liability" to cover repairs. The policies are sold under these terms.² This keeps minor accidents out of court, but motorists who

want to buy more coverage may do so. Likewise, those who sustain serious or very expensive injuries may typically sue. With one brief lapse in 2007, this system has existed since 1971.³ Bills to make significant reforms failed in 2011 when data about the severity of certain problems were not as clear, but Florida's new Governor and Chief Financial Officer have pledged their support for further reform in 2011.⁴

In some respects, the current PIP system serves the state well. Nearly all nationally known automobile insurance carriers write insurance in the state, consumers who get into minor crashes always get paid with a minimum of paperwork, all but the very worst drivers can find multiple carriers to bid for their business, and innovations like pay-per-mile automobile insurance are generally available to Florida consumers.⁵ Despite all these apparent advantages, however, Florida's automobile insurance environment faces three closely inter-related and very grave challenges: quickly rising insurance rates that are disconnected from obvious risk factors, rising rates of fraud, increased numbers of lawsuits in a "no-fault system," and a financial environment for automobile insurers that could eventually result in significant reductions in consumer choices.

Even as incomes have stagnated and even fallen in Florida, auto insurance rates have risen enormously in the state. Although premiums, which average \$1,457 according to insure.com, are not particularly high by national standards, they have been rising very quickly — about 20 percent since 2008 alone on a statewide basis.⁶ The PIP portion of the premium, the main topic of discussion in this paper — has risen nearly 66 percent during the same period and, according to the state's

insurance consumer advocate, is on pace to double every three years.⁷

Moreover, this aggregate increase masks even steeper increases in certain parts of the state. For example, Florida's Office of the Insurance Consumer Advocate finds that the average premium for a retired couple in Tampa (postal zip code 33610) has increased from \$249 in 2008 to \$627 last year while a family with teen drivers in the same zip code has seen its premium rise from \$1,267 to \$1,997.⁸ Other areas and other classes of drivers have seen similarly steep increases in insurance rates. If this could be attributed to some external factor — say a large increase in traffic crashes or a shift in demographics that resulted in a much larger number of younger or male drivers — then these steep rate increases could be characterized as a sensible response to increased risks. However, by most measures, the obvious external risk factors in Florida have actually declined. The number of vehicle crashes per 100 drivers has fallen from nearly 2 per 100 drivers in 1996 (the recent highpoint) to 1.52 per 100 last year, a decline of just about 25 percent. Demographic factors also have changed very little. Florida's population has, indeed, grown more slowly than during previous decades, and it has become only slightly younger since 2000. (Younger people, particularly males, are significantly worse drivers than older ones). So these trends cannot explain more than a tiny part of the increase in rates.

Instead, it appears that rampant increases in fraud and in the related overuse of medical services explain a large part of the increase in rates. Statistics compiled by the Insurance Information Institute show that, between 2009 and 2010 alone (final 2011 numbers aren't yet available), activities strongly correlated with fraud — excessive

“In some respects, the current PIP system serves the state well.”

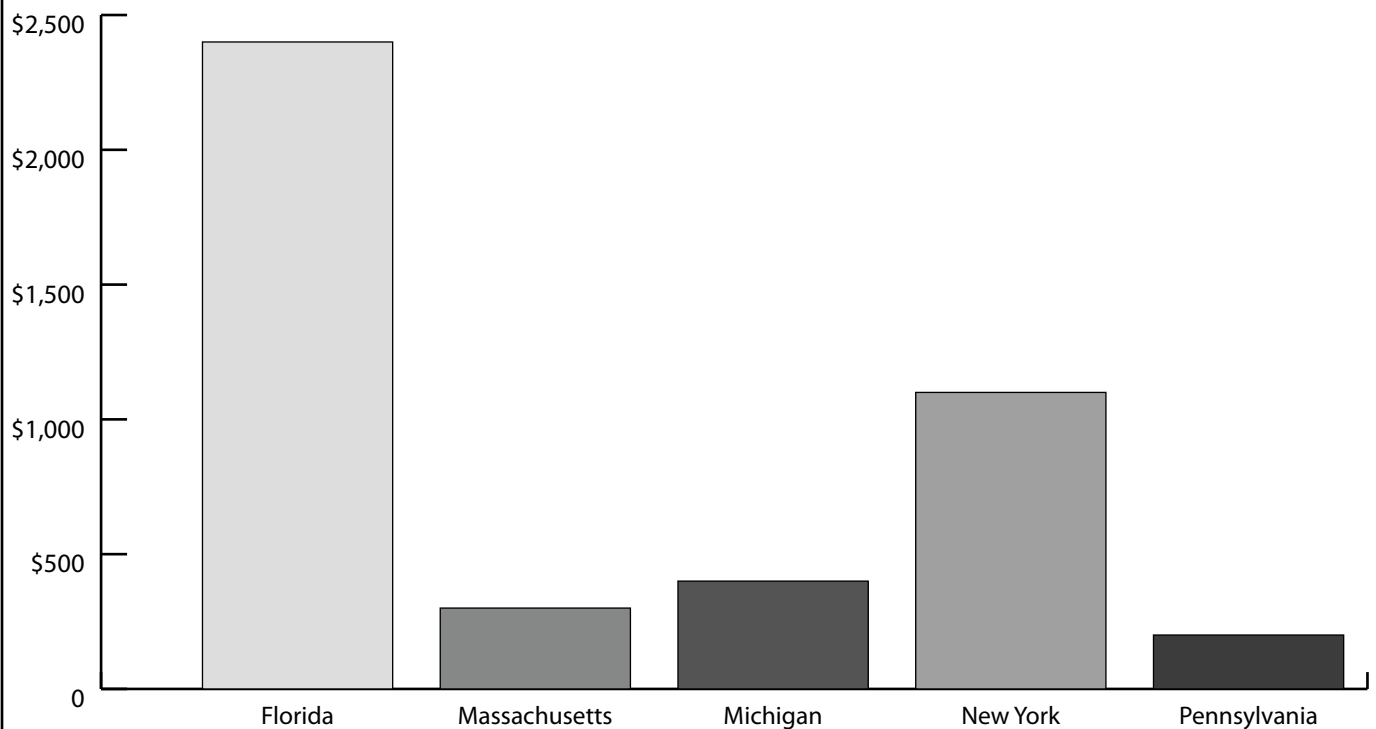
treatments by medical providers and faked injuries — all rose by more than 70 percent in a single year.⁹ Between 2008 and 2010, likewise, the number of staged crashes (the most complex and expensive source of fraudulent claims) increased from 1,268 to 2,779.¹⁰ In early 2011, likewise, the state’s insurance consumer advocate says that Miami-Dade County alone had more than 16 potentially staged vehicle crashes per week and 427 through the first two quarters of the year.¹¹ And medical providers may also be encouraging overuse of their services. Since 2007, the state’s consumer advocate reports that the number of medical procedures performed in the course of a typical no-fault claim has increased from about 60 to roughly 100, a change that has not been echoed anywhere else in the country.¹² This

increase in procedures provides indirect evidence that medical providers have made up for the imposition of a fee schedule in 2007 by doing more procedures, even when some underlying medical complaint is completely illegitimate. Most importantly, according to the State’s Consumer Advocate Florida, indeed, has the most potentially suspicious claims of any state with a PIP system (See table 3).¹³

The bottom line is that insurance has become very expensive in Florida: Among no-fault states, indeed, Florida now has the third highest PIP-related claims rate, even though it has one of the lowest mandatory benefits.¹⁴

To make matters worse, Florida also faces challenges with regard to the legal system that interacts with the insurance

Table 3: Suspicious Claims by State (2009) Larger States with Personal Injury Protection Laws



Source: National Insurance Crime Bureau via Florida Insurance Consumer Advocate

system. Despite the system’s ostensibly “no-fault” nature, the number of lawsuits filed as a result of vehicle crashes has risen sharply in recent years. Insurers attribute part of the rise to large fees that attorneys can earn from lawsuits related to vehicle insurance claims against them. In particular, Florida allows lawyers who take fees on a contingency basis to request “fee multipliers” of up to 250 percent of their ordinary fees.¹⁵ Whatever the factor, something is providing an incentive for more lawsuits – something the no fault system was meant to minimize. In 2011, the state’s insurance consumer advocate estimates that motorists will sue following nearly one out of 25 crashes, about four times more frequently than they sued as recently as 2006.¹⁶ There is no single “correct” number of lawsuits that should be filed, but a steep increase in the number of tort claims filed, absent any obvious external evidence, still shows the system is breaking down. A no-fault system is supposed to keep cases out of court, and, whatever it is doing, the current Florida system has not done so.

The result is that there’s a real risk that vehicle insurance companies could eventually start to leave the state. While vehicle insurance overall remained a profitable business in Florida during 2011, the PIP portion of the policies became a significant money loser for insurers. By the most accurate and broad measure of insurance company corporate performance, so-called “direct variable cost ratios,” vehicle insurers overall lost money in Florida during the most recent year for which data are available.

In particular, they spent \$1.15 on claims payouts, investigative, and sales costs for every dollar they collected in premiums.¹⁷ This is a problem because — to remain in the state — insurers as a whole need to

break even. They receive revenues only from policyholders and will not continue writing policies if they can’t make money. This means they will either hike premiums further or withdraw from the Florida market.

Table 4: Auto Insurers Are Losing Money on PIP in Florida

Dollars Spent on Payments and Costs Per Dollar Received in Premiums
(Direct Variable Cost Ratio presented in dollars, rounded)

2001:	\$1.18
2002:	\$0.99
2003:	\$0.89
2004:	\$0.86
2005:	\$0.80
2006:	\$0.77
2007:	\$0.84
2008:	\$0.75
2009:	\$0.97
2010:	\$1.15

Source: NAIC Database-1 via Office of the Florida Insurance Consumer Advocate

Despite all of these problems, a statewide crisis has not yet erupted. Because insurers also receive investment income that isn’t included in the “Direct Variable Cost Ratio” and can do well on parts of the policy other than PIP, an insurer can still make money overall while losing money on PIP. Furthermore, variable loss ratios have not remained stable historically. Insurers did not leave the state in droves when they had a similar loss experience in 2001.¹⁸ However, continued losses will not allow vehicle insurers to stay. That said, certain areas where rates have risen very quickly — largely inner city areas where rates were already the highest — are

“The result is that there’s a real risk that vehicle insurance companies could eventually start to leave the state.”

“The Legislature should reject the abolition of no-fault insurance for the time being.”

seeing signs of a crisis. And this crisis may well spread. Large, nationally recognized homeowners insurers have fled the state because they simply have not been able to make money. Vehicle insurers could add to the exodus if significant changes to the state’s PIP system do not take place in the near future.

Vehicle Insurance

Recommendations:

Reforms should attempt to retain the fundamental no-fault nature of the system, minimize disruption, and increase consumer choice for all Floridians. At the same time, the fundamental nature of the system and its reliance on settling cases out of court should be strengthened. Therefore, the Florida Legislature should pursue three goals to restore, retain, and revive the Florida Insurance vehicle insurance market:

- **Goal 1: Retain and enhance the no-fault nature of Florida’s vehicle insurance system.**
- **Goal 2: Make commonsense reforms to limit legal and medical costs.**
- **Goal 3: Crack down on fraud in all contexts.**

Recommendation 1:

Retain and enhance the no-fault nature of Florida’s vehicle insurance system.

No-fault vehicle insurance is a fundamentally just and effective way to deal with less serious vehicle-related claims. By settling claims with a minimum of paperwork and without the need for complex legal proceedings (or even determination of fault), it is certainly a pro-consumer system. Although it’s far from perfect and may make vehicle insurance slightly more expensive

at the bottom end, it’s still better than any alternative. Florida’s brief experience with eliminating the no-fault system for a few months in 2007 proved unpopular with the drivers impacted. Colorado, the one state to have had a no-fault system and done away with it, likewise, has seen vehicle insurance premiums rise more quickly than those in the nation as a whole in the wake of the system’s elimination.¹⁹ Even so, Florida’s insurance commissioner and many in the industry have flirted with the idea that no-fault should be abolished.²⁰

Recommendation 1A:

Reject outright abolition of no-fault.

The Legislature should reject the abolition of no-fault insurance for the time being. Although the current system has serious problems, getting rid of it — and the benefits it brings to consumers — is akin to throwing the baby out with the bathwater. The underwriting losses that vehicle insurers as a whole have sustained during the last two years are not greater than those that they sustained in the early part of the decade. Reforms then stabilized the system, restored profitability, and kept rates essentially stable for most of a decade. Legislatures exist, in part, to tweak laws in accordance with changing realities. Even if the system might need to be reformed again sometime in the early 2020s, that would not make current changes unnecessary or futile.

Recommendation 1B:

Consider expanding no-fault benefits.

In fact, the Legislature may want to consider working to enhance the system by increasing the minimum no-fault benefit provided, if it also makes efforts to crack down on fraud at the same time. Because the current no-fault limit went took effect

in 1979, inflation alone has eroded nearly two-thirds of its value.²¹ Given that medical costs have increased faster than inflation, Florida’s largest health insurer estimates that returning the no-fault benefit to its full 1978 purchasing power would require increasing it to over \$61,637.²² A higher PIP limit, however, is not a cure all. The one state with uncapped PIP (Michigan) also has the highest overall insurance rates.²³ Nonetheless, the obvious way to keep cases out of court is to allow fewer cases to go to court by raising the PIP limit. However, absent a crackdown on medical fraud — and shady practices short of fraud — an increase in the limit might well just increase fraud. A “naked” increase in benefit limits is a bad idea, but, in the context of other reforms that provided rate relief to vehicle insurance consumers, an increase in benefits could essentially be “free” in that the extra money it cost could be offset by declines in cost for the rest of the vehicle insurance benefits. Constructed in a manner that truly kept almost all claims within the no-fault limit out of court, such a practice could end up reducing overall costs.

Recommendation 2:

Make commonsense reforms to limit legal and medical costs.

The laws governing Florida’s insurance system — no fault and a medical fee schedule — should, in theory, limit legal and medical costs. The no-fault system means that motorists cannot typically sue each other directly or through insurance companies following non-serious crashes. A medical fee schedule, likewise, caps the amount that medical providers can charge for procedures handled under the PIP coverage. It doesn’t work this way in practice as both legal and medical costs have increased

significantly in recent years. To save the vehicle insurance market from collapse, Florida should reform the rules that both medical and legal providers follow in order to contain costs and provide rate relief to consumers.

Recommendation 2A:

End contingency fee multipliers for legal cases.

Whatever purpose they may once have served, the large contingency fee multipliers available to Florida lawyers who take cases against vehicle insurers have clearly outlived their usefulness. Today, numerous lawyers throughout Florida are eager to take on cases against insurers, even on a contingency fee basis; in fact, they advertise frequently on television, and a search for such lawyers in the state on Google reveals at least 172,000 web pages devoted to them, about the same number as exist in vastly larger Texas.²⁴ This indicates that payment rates to lawyers are at least sufficient. Likewise, insurers allege that lawyers often encourage people — including uninjured bystanders — to claim injuries.²⁵ That said, people who sustain particularly serious injuries or have evidence that their insurers have violated the terms of insurance contracts must have a right to sue under a system that ensures lawyers can get adequate compensation. Rather than the strict caps that some insurers want, attorneys’ fees should be limited to those customary for the type of work that attorneys do. An attorney who writes a demand letter to an insurer should be able to bill at a rate similar to that typically charged for simple transactional work; one who files and prevails in a complex lawsuit should be paid at a higher rate appropriate for complex civil litigation. But they shouldn’t

“To save the vehicle insurance market from collapse, Florida should reform the rules that both medical and legal providers follow in order to contain costs and provide rate relief to consumers.”

“The fee schedule itself is justifiable, even from a free market perspective.”

be subject to large multipliers. Likewise, as a simple matter of fairness, attorneys should never be able to collect fees greater than the aggregate amount they win for the individual or group they represent. In other cases, simply clarifying standards might work best. Insurers claim, largely based on anecdote, that lawyers send demand letters that go undelivered in order to allow them to sue insurers for more money for failing to respond in a timely fashion. (An insurer that doesn’t answer a letter can be forced to pay treble damages if a case goes to trial but, quite often, will simply settle.) So long as the standards are fair, there’s little harm in enforcing them to end this practice.

Recommendation 2B:

Revisit and rationalize the current medical fee schedule.

Since 2007, a relatively comprehensive medical fee schedule has set the rates at which providers may bill insurers for patients being treated under PIP. (A few diagnostic tests were previously covered under a much more limited fee schedule).²⁶ The fee schedule itself is justifiable, even from a free market perspective. That said, it appears to be broken and, if the executive branch cannot revise it of its own volition, the Legislature should consider ordering such a revision.

As a preliminary matter, it’s important to note that a fee schedule — a form of government price control for medical services — is not an ideal way to solve the problem of high medical costs associated with vehicle crashes. However, absent broader health reform that moves in the opposite direction from the current thrust of federal policy, it’s probably a least-bad solution. Right now, besides vehicle insurance, nearly all medical care in the United States, saving that paid

for out-of-pocket, gets provided based on some sort of fee schedule negotiated by someone (either a health insurer or the government) with significant monopoly power with regard to the doctor or hospital selling care. Private insurers’ fee schedules, to a greater or lesser extent, are almost always connected to those paid to the Medicare and Medicaid programs. Vehicle insurers, who pay a small percentage of all medical bills, have reasonably little negotiating power with regard to medical providers. As such, in the context of the existing medical system, they often end up being vastly overcharged in many cases.²⁷ This makes vehicle insurance more expensive and results in its subsidizing hospitals and health insurance. And because vehicle insurance is mandated (like Workers Compensation Insurance), the state government has some responsibility to control its costs just as it controls costs for workers’ comp insurance.

Because the number of medical procedures has increased markedly even as the fee schedule has tried to bring them under control, the current system clearly is not working. Unless treatment has recently become much more complex, some aspect of the current fee schedule clearly is out of whack and is causing providers to perform many more procedures than they did previously. This needs investigation. It’s possible that raising some per procedure costs on the fee schedule, for example, might reduce overall costs by reducing incentives to perform procedures of dubious value. Whatever the case, the fee schedule needs a serious revision that, at minimum, lets it accomplish the cost containment goals for which it was created.

Recommendation 3:

Crack down on fraud in all contexts.

Fraud is rife in Florida’s vehicle insurance industry. The overall number of suspicious claims in Florida alone — the most of any PIP state — means that something needs to be done. Our recommendations follow.

Recommendation 3A:

Equip investigators with all the tools needed to fight fraud.

At minimum, insurers and criminal investigators in Florida should have the same tools their counterparts in other states have to seek out fraud. Two recent court cases that sharply limited the ability of investigators to perform examinations under oath about medical treatments should be reversed through legislation that clearly restores the ability to use this investigative tool.²⁸ For much the same reason, Florida should extend the amount of time that insurers have to investigate possible fraud from the current 30 day mandatory payment period. These and other investigative tools make more sense than trying to pass new criminal laws: Florida already has most of the laws it needs to fight fraud. There’s little reason for even stronger laws against people who work to defraud insurers; the solution is better enforcement of the laws already on the statute books.

Recommendation 3B:

Investigate all types of medical facilities to eliminate fraud.

Medical and insurance industry sources blame unscrupulous storefront clinics, including “pain clinics,” for a large part of the increase in vehicle insurance rates in Florida. Certainly, the very rapid growth in these clinics, which correlates so directly with increases in fraud, rates, and billings, does suggest (although not prove) a causal relationship. While it may be worth engag-

ing in administrative reviews of some of these clinics, many of the legitimate clinics do have lower operating costs than hospitals. It would be unfair to shut down all walk-in clinics simply because some of them do commit fraud. Certain improvements in licensing ought to be considered — such as making sure that all clinics are truly controlled by medical professionals rather than attorneys.

Although clinics per se should not be singled out as targets for investigators, some clinic-related activities do warrant further investigation. For example, the large increase in the number of clinics run by massage therapists and Florida’s unusually high number of clinics that largely deal with PIP alone should raise eyebrows. But, rather than focusing their crackdown on small clinics, the Legislature should increase the number of tools available to detect fraud everywhere that it happens. Finally, the Attorney General, Chief Financial Officer, and Florida Bar should look deeply into referral networks that allow lawyers to refer business to clinics in which they have a financial interest. Although dual ownership of businesses is not, in and of itself, something the state should outlaw, it should be carefully policed for conflicts of interest.

Conclusion: Vehicle Insurance

The Case for PIP Reform

The rapidly deteriorating financial condition of Florida’s vehicle insurers should be a topic of concern for the state. While the current system appears to be unsustainable unless changes are made, Florida should not abandon the no-fault nature of the current system. Instead, the Legislature should pursue a modest package of changes that can and will make the state’s vehicle insurance system sustainable in the long term.

“There’s little reason for even stronger laws against people who work to defraud insurers; the solution is better enforcement of the laws already on the statute books.”

“The state’s risk of hurricanes and other severe weather events is quite simply the most daunting in the nation.”

These changes should involve better efforts to control legal and medical costs, plus a firm and sweeping crackdown on fraudulent activities. Florida needs to act soon if it wants to retain no-fault auto insurance and the benefits its existence brings to the state.

Part II Property Insurance

The Problem:

Florida may be called the Sunshine State, but the state’s occasional less-than-sunny weather during the hurricane season stands at the core of the problems facing its property insurance market. The state’s risk of hurricanes and other severe weather events is quite simply the most daunting in the nation.

There is little that the state can do to alleviate Florida’s position as a peninsula uniquely prone to experience hurricanes and tropical storms. But the problems of its insurance regulatory system are strictly manmade. In particular, bedeviled by voters’ concerns about high property insurance rates, lawmakers have moved to enable the creation of a government-run property insurer (Citizens Property Insurance Corp.) and a government-run reinsurer (the Florida Hurricane Catastrophe Fund) that simply cannot handle the risks they face. Indeed, they are expressly designed not to.

The Situation:

By all accounts, Florida has the most hurricanes of any state. While Florida covers only about 1.5 percent of the lower 48 states’ land area (55,000 square miles out of 3 million square miles), it has been struck by seven of the ten costliest hurricanes in U.S. history.²⁹ Florida is also the site of the

single most intense hurricane on record (1935’s Keys hurricane) and the second deadliest hurricane (the Lake Okeechobee hurricane, also in 1935).³⁰

Many of Florida’s residents live in coastal areas where the risk is greatest, and the number has increased in recent years. Florida has \$2.46 trillion in total coastal exposure, the most of any state.³¹ By comparison, the combined coastal exposure of the other “hurricane alley” states (Virginia, North Carolina, South Carolina, Georgia, Alabama, Mississippi, Louisiana, and Texas) is only about \$1.83 trillion.³² Florida has also grown and spread out. Although its population shrank slightly during the recession, the state’s population has almost tripled since 1970, growing to more than 18 million from 6.7 million,³³ and new data just released show Florida about to overtake New York as the nation’s third-largest state. Even during the new century’s first decade, when many perceived a slump in Florida, the state still added more than three million residents (more than live in Chicago) and grew 17.6 percent. That’s more than twice the rate of population growth in the country as a whole.³⁴ Moreover, during this period of growth, Floridians tended to move into homes that were larger and more spread out. Indeed, the Miami and Tampa-St. Petersburg metropolitan areas both saw their stock of single-family homes grow faster than the population.³⁵

Finally, nearly all climate scientists agree that the North Atlantic is currently in the midst of one of its cyclical periods of heavier than average hurricane activity. The National Oceanic and Atmospheric Administration reports that such a period began in 1995 and is likely to continue into the 2020s.³⁶ Forecasters believe that two major factors — both of them entirely be-

yond human influence or control — largely determine the prevalence of storms: a tropical multi-decadal oscillation and the El Niño/La Niña southern oscillations. The tropical multi-decadal signal involves warmer than average waters and lower than average wind shear across the tropical Atlantic, a stronger monsoon season in West Africa, and a weaker monsoon season in the Amazon Basin region.³⁷ The El Niño/La Niña shift involves the warming and cooling of waters in the South Pacific. In general, hurricane intensity increases as the world’s waters warm. Other factors, including sunspot activity and climate shifts that some scientists attribute to human activity, may also impact the hurricane cycle in ways that are not yet fully understood.

Because the State of Florida fundamentally cannot decrease the likelihood, frequency, or intensity of the tropical cyclones its residents will face, it must cope with its vulnerability in other ways. These ways should include physically fortifying its buildings and infrastructure to better withstand windstorms and tidal surge, implementing policies that do not encourage development in high-risk areas, and improving the state’s property insurance system to ensure that risks are spread broadly to entities with the financial strength to respond to disaster. On that score, the state-run mechanisms that were created to underwrite hurricane risk are in severe trouble.

Citizens Property Insurance Corp. (Citizens) is the state’s largest writer of property insurance and the third largest underwriter of property insurance in the country.³⁸ Although it maintains the façade of a private sector insurer, including corporate structure with a chief executive officer at the helm, Citizens is actually an unusually powerful government agency, exempt from most state

purchasing and hiring rules:

Because it is essential for this government entity to have the maximum financial resources to pay claims following a catastrophic hurricane, it is the intent of the Legislature that Citizens Property Insurance Corporation continue to be an integral part of the state, that the income of the corporation be exempt from federal income taxation, and that interest on the debt obligations issued by the corporation be exempt from federal income taxation.³⁹

Not only is Citizens sponsored by Florida’s government, but it also has the authority to impose a form of taxation on nearly every insurance policy issued in the state, potentially impacting citizens, businesses, and civic organizations statewide. When Citizens runs a deficit of greater than 10 percent, it has the unilateral power to impose assessments sufficient that “the entire deficit shall be recovered through regular assessments of . . . insurers [and] insureds.”⁴⁰ Citizens must first impose surcharges on its own policyholders, but may subsequently impose assessments on every property and casualty insurance policy issued in the state except for medical malpractice and workers’ compensation policies.

Citizens was chartered as an “insurer of last resort,” open only to those property owners who were legitimately unable to find coverage in the private market. However, former Gov. Charlie Crist’s 2007 insurance reforms allowed Citizens to offer policies to any Floridian who gets even a single insurance quote more than 15 percent greater than Citizens’ rates.⁴¹ Additionally, the 2007 legislation required Citizens to roll back its premiums to 2006 levels and freeze them there.

These changes transformed Citizens from a residual market mechanism into an

“Citizens was chartered as an ‘insurer of last resort,’ open only to those property owners who were legitimately unable to find coverage in the private market.”

“The Florida Hurricane Catastrophe Fund (the Cat Fund) is a state-run reinsurance corporation that is the largest provider of reinsurance in Florida and one of the largest in the world.”

active competitor in the property insurance marketplace. It is a state-owned behemoth with a number of unfair advantages. In fact, a commission appointed to review Citizens found the agency charged rates that would be illegal for a private company to charge because they were not actuarially sound.⁴²

The result is that, as of mid-year 2011, Citizens controls 22.2 percent of Florida’s personal and commercial residential policies in-force, with 27.6 percent of annualized premiums written and 22.2 percent of the state’s total structure exposure.⁴³ Through mid-year, the agency was also adding new policies at a faster clip than any private insurer in the state.

With its imposing size and its power to impose assessments to cover its own shortfalls, Citizens ultimately places Floridians themselves on the hook for its hundreds of billions of potential losses. This serious threat to Florida taxpayers is heightened by the extent to which Citizens relies on another taxpayer-backed entity — the Florida Hurricane Catastrophe Fund — to provide most of its reinsurance support following a catastrophe.

The Florida Hurricane Catastrophe Fund (the Cat Fund) is a state-run reinsurance corporation that is the largest provider of reinsurance in Florida and one of the largest in the world. Like private reinsurers, the Cat Fund provides insurance to insurance companies. When insurers’ total losses exceed certain levels, the Cat Fund, like private reinsurers, promises to cover a portion of the risk. In return for these promises, the Cat Fund collects premiums from insurers.

Unlike private reinsurers, the Cat Fund does not actually keep on-hand the funds necessary to pay most of its claims. Instead, if it runs short on money, it has the authority to issue bonds, which it repays by imposing

assessments on policies. All Floridians currently pay taxes that add about 1 percent to their insurance policies to pay off the Cat Fund’s debts from the 2004 and 2005 hurricane seasons. Roughly a third of the Cat Fund’s total coverage goes to support Florida Citizens.

Furthermore, while virtually all private reinsurers of any size have an international scope, the Cat Fund writes business only in Florida. Where a private company would balance the risk of hurricanes in Florida by taking on, for example, medical malpractice or workers’ comp risks, or the risk of earthquakes in California or Japan, the Cat Fund cannot. In sum, the Cat Fund turns the principle of diversification on its head by concentrating Florida’s peak hurricane risk within the state, rather than spreading it around the world. This means that, even assuming the Cat Fund has management talent and investing opportunities equal to those in the private sector, it must charge higher rates than the private sector would if it hopes to break even in the long run. Instead, it charges substantially lower rates than the private sector for comparable coverage.⁴⁴

The result is that the Cat Fund, unless reformed, will ultimately cost the state of Florida a massive amount of money. As of the end of 2011, the Cat Fund estimated it would have about \$7.17 billion on hand to pay claims that could potentially top \$18.39 billion.⁴⁵ Moreover, the Cat Fund’s advisors estimate it would only be able to raise about \$8 billion in post-event bonds in the 12 months following a major storm, which would leave the fund \$3.22 billion short of its funding obligations. As a result, business and political interests throughout the state have begun to raise significant concerns about the “hurricane taxes” that could be imposed following a major storm.⁴⁶

To address those concerns, the 2009 Legislature approved laws that slowly reduced the size of the hurricane catastrophe fund (HB 1495). The following year, the 2010 Legislature passed another package of reforms with overwhelming bipartisan majorities and with the support of the state's Office of Insurance Regulation and Office of the Insurance Consumer Advocate. This legislation would have reduced the size of Citizens, improved the stability of Florida's struggling primary insurance market, and brought more private insurance capacity into the state.⁴⁷ However, Governor Crist vetoed the 2010 legislation. In 2011, legislation that would have reduced the size of the Cat Fund, shrunk Citizens, and introduced new "consumer choice" provisions failed to advance to Governor Scott's desk for his signature.

As the Florida Legislature was heading into its 2012 session, polling by the American Consumer Institute finds that 70 percent of Floridians surveyed said they feared potential assessments of hundreds or even thousands of dollars should the fund be unable to make good on its obligations in the wake of a major storm.⁴⁸ Moreover, 55 percent of the 805 consumers surveyed said they would be willing to pay \$15 more per month for coverage if it made the Cat Fund financially sound.

Legislation to gradually scale down the Cat Fund (H.B. 833) has been introduced in the Florida House of Representatives, based closely on recommendations from the Cat Fund's chief operating officer.⁴⁹ Meanwhile, the Citizens Property Insurance Board of Governors has voted to adopt a set of 2012 legislative goals that include supporting legislation to further depopulate Citizens, although the board simultaneously expressed opposition to the proposed Cat Fund reforms.⁵⁰

Property Insurance

Recommendations:

Although the following recommendations do draw on ideas that have been proposed before, none of them is identical to those proposed in recent years. The proposals consist of three major recommendations:

- **Goal 1: Retain the Cat Fund as a self-financing "last resort" buffer for Katrina-sized events, but shrink it to remove the dangers it poses to state taxpayers.**
- **Goal 2: Pursue a much more aggressive depopulation of Citizens by granting it greater freedom to raise rates and to deny or non-renew policyholders**
- **Goal 3: Make Florida the most hurricane-safe state in the nation through vigorous private and public mitigation efforts.**

An explanation of each of these goals follows, and a series of conclusions sums up the paper.

Goal 1: Retain the Cat Fund as a buffer for Katrina-style events, but shrink it to remove the dangers it poses to the state.

The Florida Hurricane Catastrophe Fund is Florida's largest reinsurer. All insurers selling residential property insurance in Florida are required to buy some coverage from the Cat Fund.⁵¹ Currently, the Cat Fund has roughly \$7.17 billion of cash on hand to pay claims that could potentially top \$18.39 billion. The Cat Fund consists of a "mandatory" coverage layer of \$17 billion, which attaches following a \$7 billion retention of loss by the industry and is mandatory for all insurers doing business in Florida, and a Temporary Increase in Coverage Limits

"Moreover, 55 percent of the 805 consumers surveyed said they would be willing to pay \$15 more per month for coverage if it made the Cat Fund financially sound."

“There’s no single magic formula for reducing the size of the Cat Fund, and no single number should be considered an ideal size.”

(TICL) layer that offers optional coverage to companies that want it for losses above this amount.

A massive payout from the Cat Fund could require the state to issue more bonds than any other state has ever issued all at one time. If this were necessary, Florida would likely have to either default on its obligations or seek a bailout from the federal government. Furthermore, significant doubts exist concerning the independence and accuracy of the estimates of the Cat Fund’s ability to pay claims. The Cat Fund’s authorizing statute does not require it to meet claim obligations in excess of its resources, and even the fund’s own financial advisors project that it could fall billions short of those obligations. In that case, the Cat Fund’s annual report’s attestations of the fund’s solvency would prove cold comfort to the primary insurers and underlying policyholders who are required to rely on its promises.

While some in the insurance and reinsurance industry might desire complete abolition of the fund, this would be unwise in the short term. Rather than acting hastily, the Legislature should retain the Cat Fund as a buffer against the worst events while simultaneously working to eliminate its risk to Florida taxpayers.

Recommendation 1A:

Eliminate the Temporary Increase in Coverage Limits (TICL) in 2012.

As explained above, the Cat Fund currently includes a Temporary Increase in Coverage Limits (TICL), an optional layer of coverage for losses above and beyond those covered by the mandatory layer of coverage. Only a tiny fraction of insurers eligible to purchase TICL coverage did so in 2011, and its costs have increasingly converged with coverage offered in the

private reinsurance sector. The Cat Fund’s projected funding shortfall suggests it would not pay TICL claims, and positioning itself to do so would require imposing massive new taxes on Florida residents. Most insurers do not want the TICL layer, and its continued existence does not appear to serve any public interest. Eliminating the TICL layer immediately would have little or no impact on private market reinsurance rates and, if anything, might actually lower them by increasing competition in the reinsurance market and encouraging market participants to allocate capital to Florida. Getting rid of TICL will give legislators an opportunity to save taxpayers from its potential liabilities and, unlike other changes, would not do anything to increase the price of insurance.

Recommendation 1B:

Gradually reduce the size of mandatory Cat Fund layers starting in 2012.

An all-out abolition of the Cat Fund, which many in the insurance and reinsurance industries desire, could cause short-term price shocks for many consumers. To insulate consumers from rapidly rising rates and give private markets time to develop new capital structures, while better protecting Florida’s taxpayers, the state should steer a middle course of gradual reduction that will leave the Cat Fund as a safety net against the worst hurricanes. There’s no single magic formula for reducing the size of the Cat Fund, and no single number should be considered an ideal size.

A reasonable plan to shrink the Cat Fund, however, should include a specific schedule to shrink the fund’s size, increase private insurers’ retention, and strengthen the fund’s claims-paying capacity so that it can meet its obligations, especially if the state experiences more than one storm in a

one- or two-year period – as it did in 2004-05. The ultimate goal should be a stronger, more resilient Cat Fund roughly equivalent in size to the Cat Fund’s current cash-on-hand of \$7.17 billion. This amount reflects the cash build up over the last six years, which were unusually storm-free and during which the Cat Fund also collected surplus premiums from the TICL coverage layer.

To secure the Cat Fund for the future, therefore, the Legislature should develop a plan that raises the statutory ceiling of its mandatory coverage layer. The proposal put forth in H.B. 833 would see the statutory ceiling gradually lowered from the current \$17 billion to \$12 billion in the contract year that would start in June 2015. While that would mark a significant improvement, it would still leave the fund heavily reliant on post-event bonding to fund potential claims. Since Florida’s lucky streak of six consecutive storm-free hurricane seasons is unlikely to continue indefinitely, there can be no assurance that the \$7.17 billion of cash-on-hand the fund currently enjoys will not be depleted in the interim

Ideally, reforms to the Cat Fund would shrink the statutory ceiling of the fund’s mandatory coverage layer to \$7 billion, \$170 million less than the fund’s current cash on-hand. This could be accomplished by lowering the ceiling by \$2.5 billion in each

of the next four contract years, beginning in June 2012. Table 5 compares this schedule with the one suggested in H.B. 833, which was based on a plan put forward by Jack Nicholson, chief operating officer of the Cat Fund:

By acting during the 2012 legislative session, the state would provide affected parties ample time to plan for the first leg of reforms, which would be expected to have the greatest impact. This plan would, over time, increase the size of the total catastrophe that Florida could sustain while simultaneously reducing the risk the fund poses to taxpayers.

**Recommendation 1C:
Gradually increase the insurance industry’s retention and copayments starting in 2012.**

As the Cat Fund is currently structured, payments only trigger following an event that causes at least \$7.639 billion in total insured property loss. This is known as the industry’s retention. Under H.B. 833, the industry retention would be raised to \$8 billion (where it would have been if the retention had not been reset following the storms seasons of 2004 and 2005) and would automatically adjust upward based on the growth of total insured property values.

Property insurers with reinsurance coverage from the Cat Fund also participate

“This plan would, over time, increase the size of the total catastrophe that Florida could sustain while simultaneously reducing the risk the fund poses to taxpayers.”

Table 5: Proposals for Cat Fund Reduction

	H.B. 833 Proposals	Heartland/JMI Proposed Reforms
2012	\$17 billion	\$14.5 billion
2013	\$15.5 billion	\$12 billion
2014	\$14 billion	\$ 9.5 billion
2015	\$12 billion	\$ 7 billion

“After Florida’s unexpected interlude of six storm-free years, the Cat Fund currently has a relatively large amount of cash on hand.”

in losses above that threshold through co-payments. The level of co-payment depends on the coverage level purchased by the insurer. For each of the coverage types offered by the Cat Fund (commercial, residential, mobile home, tenants, and condominium unit owners) there are three levels of coverage: 45 percent, 75 percent, and 90 percent.⁵² Altogether, participating insurer co-payments are estimated to be \$1.815 billion for the 2011-2012 contract year.

The plan put forward by Cat Fund chief Jack Nicholson would increase participating insurer copayments in the maximum coverage level from 10 percent to 25 percent over three years, after which point the 75 percent coverage level would become the new maximum coverage.⁵³ While this is, likewise, a good start, it does not go far enough or quickly enough, and it only addresses the maximum coverage level while leaving the other two coverage levels untouched.

Where the Nicholson and H.B. 833 plans would increase participating insurer copayments at the maximum coverage level by five percentage points each year from 2013 through 2015, a better approach would increase the copayments at each of the three coverage levels by ten percentage points annually over that three-year period. As a result, the cat fund’s coverage levels would be 90 percent, 75 percent and 45 percent in 2012; 80 percent, 65 percent and 35 percent in 2013; 70 percent, 55 percent and 25 percent in 2014; and, finally, 60 percent, 45 percent and 15 percent in 2015.

Thus, the industry retention should be increased more rapidly, to \$9 billion in 2012 and by \$1 billion annually from 2013 through 2015, when it will reach \$12 billion. Together, the gradual increases in private insurance industry retention and copayments should aid in the goal of reduc-

ing the size of the Cat Fund’s mandatory coverage layer by \$10 billion over the next four years.

Recommendation 1D:

Require the Cat Fund to have cash or risk-transfer instruments recognized in the private sector as sufficient to repay debt.

After Florida’s unexpected interlude of six storm-free years, the Cat Fund currently has a relatively large amount of cash on hand. However, even this amount falls well short of the Cat Fund’s potential obligations, and even one medium-sized storm could wipe this out entirely and leave the state with nothing to deal with a subsequent event, as it did in 2004 and 2005. The Cat Fund, like a private reinsurer, should be a self-sustaining entity that does not pose any risk to taxpayers and over time, might even be sold to a private insurer or reinsurer to reap a benefit for Florida taxpayers. The Cat Fund should be required by 2016 to have a combination of cash and true risk-transfer instruments such as reinsurance catastrophe bonds or swaps that protect against its payouts for, at minimum, a 50-year probable maximum loss (PML).⁵⁴

Goal 2: Pursue much more aggressive depopulation of Citizens by granting it greater freedom to raise rates and to deny or non-renew policyholders.

The size and scope of the Citizens Property Insurance Corp. poses a risk to taxpayers, decreases the market for private property insurance, and results in many Floridians paying more than necessary for property insurance. Because Citizens is the largest property insurer in Florida, if it were eliminated immediately, some property owners would find it difficult or impossible to acquire affordable coverage. It should be

expected to take some time before private insurers will be willing to write coverage everywhere that Citizens currently does. Rather than an abrupt end for Citizens, Florida should adopt efforts similar to those pursued in Louisiana — the only state to suffer even more hurricane damage than Florida thus far in the 21st Century — and should work to “depopulate” Citizens.⁵⁵

Louisiana Citizens Property Insurance Corp., which has a similar corporate structure to Florida’s Citizens, has shrunk by roughly 40 percent from its post-Hurricane Katrina high of 174,000 policies by allowing private insurers to take out groups of policies, sometimes with small government subsidies, and to charge market rates.⁵⁶ While Florida has had a superficially similar depopulation program in place over the past six years, it has not worked, with a large number of “depopulated” policies ending up back in Citizens. Louisiana law grants the state’s insurance commissioner much broader authority to direct depopulation efforts than would be possible in Florida, but the basic structure of Louisiana’s depopulation efforts can and should be replicated. That structure would equip regulators and Citizens management with a “toolbox” of options to achieve that goal.

Recommendation 2A:

Give regulators and Citizens management a “toolbox” of options to depopulate Citizens, without destabilizing Florida’s overall property insurance market.

Simply mandating a reduction in Citizens’ size will not, by itself, remedy the situation that led to its growth, and prior efforts to implement abrupt changes in the size and scope of Citizens and other residual market mechanisms have either

proven unsuccessful or have produced politically unpalatable price increases. The Legislature and Governor must exercise leadership and oversight over the process of depopulating Citizens but should not actually micromanage the specifics of the depopulation process.

Instead, the Legislature should equip Citizens’ management and the Office of Insurance Regulation with a “toolbox” that allows them to adjust policies to achieve the broad goals that the Legislature sets out. This “toolbox” would include granting Citizens’ management greater flexibility to shrink its own market position and relaxing state control of property insurance rates to entice more private insurers to compete for business in Florida.

Citizens’ Board of Governors already has put forward a set of 31 non-legislative proposals to reduce its book of 1.5 million policyholders and \$500 billion in exposure. Those include capping coverage at \$1 million, raising its sinkhole deductible to 10 percent, and lowering personal liability coverage by two-thirds to \$100,000.⁵⁷ But in order to move even more aggressively, legislation will be needed.

Current state law allows Citizens to serve as a de facto price control mechanism for the entire market by allowing Florida consumers to buy Citizens policies if they receive even one price quote that is more than 15 percent above Citizens’ rates. But Citizens’ management should be given greater authority to limit who can participate in Citizens. This could include requiring that insurance agents and brokers wanting to place policies in Citizens to obtain multiple quotes from other companies before doing business with Citizens, excluding policyholders who receive competitive quotes from surplus lines carriers, or non-renewing policyhold-

“Simply mandating a reduction in Citizens’ size will not, by itself, remedy the situation that led to its growth...”

“A “toolbox” approach, as opposed to legislative tinkering with the specifics of Citizens operations, would allow for more fine-tuning of depopulation strategy, opening the process to more public input through the existing rulemaking process.”

ers who receive competitive quotes after they already are enrolled in Citizens.

Current state law places most property insurance rates under a prior approval system that requires insurers to get specific approval from regulators before instituting a rate change. Without ditching this system altogether, which may still make sense for very large proposed increases or decreases, greater flexibility should be granted to allow insurance rates to be decided by market forces rather than government regulation. To prevent severe price shocks and focus Citizens on its depopulation goals, the Legislature should relax prior approval rules where rate increases would aid depopulation goals. This will allow for orderly, predictable changes to insurance rates that do not cause undue hardship for Floridians.

Citizens itself also should be granted greater flexibility to raise rates. Current law caps Citizens’ residential policy increases at 10 percent a year. The agency’s board has requested the cap be increased and also that it be able to enact even larger rate increases to reflect increased reinsurance costs. Both requests are very reasonable, and the latter will be absolutely essential as coverage from the Cat Fund shrinks and becomes more expensive. Currently, \$6.6 billion of Citizens’ \$16.7 billion in total claims-paying capacity is from reinsurance it holds with the Cat Fund.

A “toolbox” approach, as opposed to legislative tinkering with the specifics of Citizens operations, would allow for more fine-tuning of depopulation strategy, opening the process to more public input through the existing rulemaking process. Fine-tuning is important because it is difficult to know in advance the full consequences of any given regulatory change. Freeing itself from the minutiae of the program’s specific

administrative details also would give the Legislature and its committees more time to perform “big picture” oversight of the state’s insurance markets.

Recommendation 2B:
Apply stringent standards of ethics and transparency to Citizens and the Cat Fund.

Many of the private companies that might otherwise write insurance in Florida are concerned about the stability and claims-paying resources of Citizens and the Cat Fund. Further complicating matters, the Cat Fund currently does not have an obligation to pay out claims if it does not have the funds to do so, and the State of Florida is specifically insulated from lawsuits should the fund run out of money.

While an outside, non-governmental firm provides financial and other advice to the Cat Fund and Citizens, the firm that conducts them operates under conditions that could give rise to questions or conflicts of interest. For example, in addition to the Cat Fund, the firm represents Citizens, the Cat Fund’s largest client, in effect, offering advice to both sides of one of the state’s largest financial transactions. Moreover, it is not clear that this firm would be precluded from profiting from the mammoth bond issues that the Cat Fund and Citizens could make. While there is no evidence of misconduct — or even public accusations of it — the current situation, nonetheless, makes many private market firms nervous about trusting the Cat Fund’s estimates.

To eliminate the appearance of a conflict of interest, the State Board of Administration should require Citizens and the Cat Fund to have separate advisors and auditors. It should conduct a transparent selection process that includes public Requests for

Proposals (RFPs) and bidding processes. The advisors selected should be excluded from remuneration from any financing the entities might engage and should be subject to a “blackout” requirement precluding them from doing related business for at least three years after the completion of its current year assignment.

Goal 3: Harden Florida’s built environment against hurricanes; end subsidies for development in hurricane-prone areas.

Florida’s rapid growth and the fundamental factors of its geography have left the state exceedingly vulnerable to damage from major storms. To mitigate these risks, the state must do more to harden its built environment — houses, businesses, and public infrastructure — against such damage. No single policy or group of policies can ever make Florida entirely safe. Florida’s existing laws, including its building standards for new construction, already set very high standards, although their enforcement has been questioned. When and if the state is flush with cash at some point in the future, it may wish to consider significant efforts to retrofit public infrastructure and even the private property of low-income residents to be more resistant to storm damage. However, given the state government’s current fiscal situation, an ambitious and costly mitigation agenda is likely not practical in 2012 just as it was not practical in the past.

Even so, the state can and should take meaningful steps in the direction of making itself safer. Little or no additional revenues would be required to pursue such goals as withdrawing subsidies for future development in the most hurricane-prone areas of the state, restoring the state’s hurricane mitigation sales tax holiday, seeking greater

flexibility to use existing federal grants for mitigation, and exploring whether human activity is to blame for the recent upsurge in Florida’s sinkhole claims.

**Recommendation 3A:
Prohibit Citizens from covering
structures in coastal area.**

As long as they are not violating the rights of others, private landowners should not face any restrictions on the use of their own land. However, Florida’s government has no obligation to assist in the unwise development of new areas that are very likely to face severe hurricane damage.

As Florida is the most low-lying state in the country, most areas of the state face some risk of hurricane damage.⁵⁸ But in the most vulnerable wetlands areas, the state should restrict using public funds to develop or subsidize development. Such a policy would prohibit the state and localities from providing any real-estate related service to people who developed the area unless the service was provided to everyone else in the state. The state would bar itself from building roads over wetlands at below average elevations, building public buildings or leasing space in such vulnerable areas.

Those changes might seem extreme, but there is one simple change that could be made in the 2012 legislative session that would go a long way toward ending these harmful subsidies: Prohibit Citizens from covering any structures built after June 2012 in areas that lie seaward of the state-designated Coastal Construction Control Line, as well as those designated under the federal Coastal Barriers Resources Act.

The current practice of allowing Citizens to provide both builders’ risk and property insurance serves to encourage development in these environmentally-sensitive areas,

“Florida’s government has no obligation to assist in the unwise development of new areas that are very likely to face severe hurricane damage.”

“Between 2006 and 2008, Florida ran a state-supported mitigation program called My Safe Florida Home.”

which not only face great hurricane risk, but also serve to form natural buffers that mitigate the damage tropical storms do farther inland.

Language that would have barred Citizens from offering coverage in sensitive wetlands areas was attached by the bill’s sponsor, Sen. Alan Hays, to Citizens reform legislation (S.B. 1714) that cleared the state Senate Banking and Insurance in March 2011. The entire measure, however, died in the Senate Budget Committee without ever reaching a floor vote.

The 2012 session is an appropriate time to revive Hays’ proposal, which had significant support from taxpayer, insurance, and environmental groups. It could even be expanded to cover the Cat Fund as well, requiring private insurers to purchase entirely private reinsurance should they wish to write coverage in these areas.

Recommendation 3B:

Create a one-week hurricane mitigation sales tax holiday and use it as an opportunity to promote mitigation.

Most of Florida’s insufficiently secured structures are privately owned and, as such, their owners must take primary responsibility for securing them against hurricanes. Between 2005 and 2007, Florida had “mitigation sales-tax holidays” — periods during which the state briefly suspended its sales and use taxes on items ranging from flashlight batteries to roof tie downs. In 2008, however, the Legislature eliminated the practice, citing budget problems.⁵⁹

Since then, Virginia and Louisiana have adopted similar holidays, and the American Legislative Exchange Council has proposed a national model law setting up a hurricane mitigation preparedness week right before the June 1 official beginning of hurricane

season.⁶⁰ ALEC’s model legislation also suggests convening a mitigation advisory committee similar to Florida’s My Safe Florida Home Advisory Committee and, to the extent practical, scheduling public activities to promote hurricane mitigation during the same week the sales tax holiday takes place.

A mitigation sales tax holiday would have minimal cost, and some evidence from Virginia’s holiday, the basis for the ALEC model law, indicates that it may actually increase sales tax revenue, although Florida’s previous holiday was estimated to result in a \$3 million reduction in revenues. It would nonetheless encourage individuals to take more responsibility for their own property and, by creating a degree of public attention to the issue, would encourage retailers to offer additional specials and discounts.

Florida should adopt its own version of the ALEC sales tax holiday model legislation and encourage its residents to do more to secure their own homes, businesses, and communities against nature’s worst.

Recommendation 3C:

Seek additional flexibility in using federal funds to provide for mitigation.

Between 2006 and 2008, Florida ran a state-supported mitigation program called My Safe Florida Home. Despite overwhelming support from players in the insurance debate, Gov. Charlie Crist ended the program in 2008 by leaving it out of his budget. The program provided limited help to Floridians to retrofit their houses against serious hurricanes by installing roof tie-downs, storm shutters, and other devices that made their homes safer and more resilient. Over the long term, such mitigation is the key to allowing people to continue living in high-risk, storm-prone

areas, and to restoring a free market for insurance in Florida. The state could restart this process by asking for more flexibility to use federal funds it already receives and prioritizing their use for mitigation.

Florida's executive branch could begin by seeking permission to use the Community Development Block Grant (CDBG) Program — a “catch all” federal program that already is used to pay for property renovations in certain cases — to do mitigation retrofits. In smaller jurisdictions where the state administers CDBG funds, this permission alone could be used to establish some sort of mitigation program. In jurisdictions of greater than 100,000, which control their own CDBG money, the Legislature should similarly encourage them to start mitigation programs of their own and, where possible, work to consolidate expertise and purchasing to stretch dollars further.

Provided it actually receives a budget allocation in 2012 — and it may not — Florida should also seek permission to use funds from the Department of Energy's Weatherization Assistance Program, whose funding formulas have traditionally favored cold weather states, to pay for items such as roof tie-downs that save energy and also have the dual use of making a home more hurricane resistant. Because both hurricane resistance and energy efficiency measures have the consequence of “sealing the envelope” of a home against the elements, many mitigation measures will save energy, and vice versa.

Such tweaks of federal programs are hardly likely to make a significant dent in Florida's mitigation needs. But mitigation remains an urgent need for Florida, and as long as federal money flows toward Florida, the state should spend it in the ways that most benefit its citizens and communities.

Recommendation 3D:

Create a special commission to study the extent to which Florida's sinkhole problem results from human activity.

Sinkholes occur in Florida when an area in the Earth's surface subsides as a result of the dissolution of calcium carbonate rock — the “limestone” layer that underlies much of Florida. Sinkholes emerged as a major issue for many Floridians in 2010. During the 2011 legislative session, the problems were addressed in significant legislation that was signed by Gov. Rick Scott.⁶¹ What remains unclear is the extent to which the legislation will tamp down on sinkhole-related insurance claims, which have increased 1,200 percent in Florida since 1999.⁶²

The most significant questions center around anecdotal evidence suggesting certain land-use practices — particularly heavy withdrawals of well water to irrigate certain crops — may exacerbate sinkhole problems.⁶³ Thus far, little attention has been devoted to how, where, and/or if human activity actually impacts the prevalence of sinkholes in Florida. If research determines that there is a causal relationship between particular human activities and the occurrence of sinkholes, then people who undertake those activities should be liable for damages that result.

To weigh the scientific evidence with regard to this issue, the Legislature should convene a commission of geological and hydrological experts, with members selected by majority and minority parties as well as by the state's leading universities. The commission should be tasked with determining if, when, and/or how human activity might be a factor in the occurrence of sinkholes. If the commission determines that human activity is indeed a factor, it should also recommend what measures might be

“Because both hurricane resistance and energy efficiency measures have the consequence of ‘sealing the envelope’ of a home against the elements, many mitigation measures will save energy, and vice versa.”

“The 2012 legislative session offers Florida’s lawmakers an enormous opportunity.”

undertaken to minimize sinkholes and possibly to hold responsible those whose land-use practices are found to be a factor in causing sinkholes. This commission should be asked to report no later than the fall of 2012 in order to give the Legislature time to consider its recommendations and, if feasible, undertake steps to discourage human activity that results in the creation of sinkholes.

Conclusion: Property Insurance

The 2012 legislative session offers Florida’s lawmakers an enormous opportunity. While they cannot solve all of the insurance-related problems that face Florida, they can make a very real dent in some of them. Property insurance reforms should be near the top of the list of priorities. A sensible, evenhanded approach that recognizes a role for government but trusts the market to solve many problems would work best and bring the greatest benefits to Florida’s residents. In particular, the Legislature should act to shrink the Florida Citizens Property Insurance Corporation, reduce the size of the Hurricane Catastrophe Fund, and promote property mitigation throughout the state. Doing these things can save money and secure Florida against the risk that a natural catastrophe could also become a fiscal catastrophe for the state and its residents.

General Conclusion: Florida’s Insurance Marketplace

Florida’s markets for vehicle insurance and property insurance both face very significant challenges. If the Legislature does not reform vehicle insurance, it will run the risk of seeing vehicle insurers leave the state. If it does not reform property

insurance, it will run the risk of an all-out fiscal catastrophe.

Even with limited time and the need to approve a redistricting plan, Florida cannot afford a repeat of the 2011 legislative session, which saw failure of nearly all insurance reform bills. Nothing has improved in the past year; indeed, many aspects of the insurance environment have gotten worse. The time for new laws and new policies is now. Florida cannot afford to wait any longer. The risks to the state and its population are simply too great.

The Authors

Eli Lehrer is a Vice President of the Heartland Institute. He oversees Heartland’s Washington, D.C. office as well as field offices in Tallahassee, Florida, Austin, Texas, and Columbus, Ohio. In addition, he heads Heartland’s Center on Finance, Insurance, and Real Estate, which coordinates Heartland’s work addressing issues relating to insurance, risk, and credit markets.

R.J. Lehmann is Deputy Director of the Heartland Institute’s Center on Finance, Insurance and Real Estate. Prior to joining Heartland he worked as a journalist covering the insurance, banking, and securities industries. In this capacity, he served as Senior Industry Editor with SNL Financial, leading its coverage of the Dodd-Frank Act, the Patient Protection and Affordable Care Act, and legislative and regulatory activities at both the state and federal level.

Endnotes

- 1 National Association of Insurance Commissioners. “State Insurance Regulation: History, Purpose, and Structure,” NAIC, 2001, www.naic.org/documents/consumer_state_reg_brief.pdf. Life and Health insurance are also subject to state level regulation. In practice, federal laws

- increasingly preempt state laws related to health insurance and will do so to a greater extent as more provisions of the Patient Protection and Affordable Care Act take force. Life insurance per se is also regulated very largely at the state level, but the investment products that are very often sold as part of life insurance policies are subject to a number of federal regulations.
- 2 Florida Department of Highway Safety and Motor Vehicles. "Vehicle Insurance Questions and Answers," www.flhsmv.gov/ddl/frfaqgen.html.
 - 3 Robin Westcott. "Report on Motor Vehicle No Fault Insurance," Office of the [Florida] Chief Financial Officer, December 2011, www.myfloridacfo.com/ica/docs/PIP%20Working%20Group%20Report%2012.14.2011.pdf, 5.
 - 4 Chad Hemenway. "Another Battle for PIP Reform Brewing in Florida," National Underwriter, November 16, 2011, <http://www.propertycasualty360.com/2011/11/16/another-battle-for-pip-reform-developing-in-florida>.
 - 5 See e.g. Progressive Insurance. "Which States Offer Snapshot?" www.progressive.com/auto/snapshot-availability.aspx.
 - 6 Barbara Marquand. "The Most and Least Expensive Places to Buy Auto Insurance in 2011," www.insure.com/car-insurance/car-insurance-rates.html. For automobile insurance rates throughout, this paper uses data compiled by insure.com and the Office of the Insurance Consumer Advocate rather than more frequently used data from the National Association of Insurance Commissioners. These data sets are based on rate quotes extended to consumers rather than premiums collected. As such, they are more representative of the typical consumer experience in shopping for insurance.
 - 7 Wescott, 2011, 6.
 - 8 Wescott, 2011, 12.
 - 9 Lynne McChristian. "No Fault Auto Insurance in Florida: Trends, Challenges, and Costs," January, 2011, www.doh.state.fl.us/demo/BrainSC/AdvCouncil/NoFaultPaper0125111.pdf.
 - 10 Kevin McCarty, "Frequency of Auto Crashes Has Decreased," in "Cabinet Presentation: Personal Injury Protection," August 2011, 8.
 - 11 Wescott, 2011, 32
 - 12 Wescott, 2011, 16.
 - 13 Wescott, 2011, 29
 - 14 Kevin McCarty. "Cabinet Presentation-Personal Injury Protection," Florida Office of Insurance Regulation, August 2011, 11.
 - 15 See e.g. Ira Leesfield. "The Multipliers in Calculating Attorney's Fees," January 3, 2003, www.leesfield.com/CM/Speeches/Speeches61.asp.
 - 16 Wescott, 14.
 - 17 Ibid, 7.
 - 18 Wescott, 2011.
 - 19 Insure.com "Most and Least Expensive States for Automobile Insurance, 2011," www.insure.com/car-insurance/car-insurance-comparison.html.
 - 20 Diana Rosenberg. "McCarty: Florida Eyeing Ending PIP System Because of 'Vexing' Fraud and Abuse," BestWeek, September 6, 2011.
 - 21 Calculations by the authors using Bureau of Labor Statistics Inflation Calculator: www.bls.gov/data/inflation_calculator.htm, December 16, 2011.
 - 22 Christine Sexton. "PIP's Cap Set in 1979 Far Below 2011 Realities, Insurance Industry Says," Florida Tribune, September 26, 2011.
 - 23 Insure.com, 2011.
 - 24 Search conducted by the authors, December 17, 2011 at google.com. Texas generates 175,000 hits.
 - 25 Because insurers are generally unwilling to discuss specific cases, the prevalence and consequence of this behavior should be considered.
 - 26 [Florida Senate] Committee on Banking and Insurance. "Florida's Motor Vehicle No-Fault Law," Report Number 2006-102, September 2005, http://archive.flsenate.gov/data/publications/2006/senate/reports/interim_reports/pdf/2006-102bilong.pdf.
 - 27 For example, in the state of Michigan, which has no auto insurance fee schedule a single neck MRI that costs \$484 for Medicare and \$768 on the workers' comp fee schedule costs a typical insurer \$3,260. See: Eli Lehrer. "A Test Drive for Obamacare," The Weekly Standard, November 21, 2011.
 - 28 The cases are *Shaw v. State Farm Fire and Casualty Co.* (Fla. 5th DCA 2010) and *Custer Medical Center v. United Automobile Ins. Co.* (Fla. 2010).
 - 29 Eric Blake et al. "The Deadliest, Costliest, and Most Intense United States Tropical Cyclones from 1851 to 2010," National Oceanic and Atmospheric Administration Technical Memorandum. www.nhc.noaa.gov/pdf/nws-nhc-6.pdf.
 - 30 Ibid.
 - 31 AIR Worldwide "The Coastline at Risk: 2008 Update to the Estimated Insured Value of U.S. Coastal Properties" June 11, 2008. www.air-worldwide.com/_public/images/pdf/AIR2008_Coastline_at_Risk.pdf.
 - 32 Ibid. Totals are author's calculations.
 - 33 Office of Economic and Demographic Research of the Florida Legislature. "Florida Population by Age Group Actual and Projected, 1960 to 2030," <http://edr.state.fl.us/population.htm>.
 - 34 Bureau of the Census. "Census Data by State,

- 2010,” December 21, 2010. <http://2010.census.gov/2010census/data/>.
- 35 United States Bureau of the Census. “American Housing Survey for Miami-Ft. Lauderdale Metropolitan Area: 2007,” Issued February 2009, www.census.gov/prod/2009pubs/h170-07-28.pdf. United States Bureau of the Census. “American Housing Survey for the Tampa-St. Petersburg Metropolitan Area: 2007,” Issued February 2009. <http://www.census.gov/prod/2009pubs/h170-07-62.pdf>.
- 36 “NOAA Attributes Increase in Hurricane Activity to Naturally Occurring Multi-Decadal Climate Variability,” NOAA Magazine, <http://www.magazine.noaa.gov/stories/mag184.htm>.
- 37 Ibid.
- 38 Laura Layden. “Growing Problem: Citizens Property Insurance CEO suggests privatization,” Naples News. July 13, 2011.
- 39 627 Florida Statutes .351(6)(1). For a more readable version of what the legislation does, see Citizens Property Insurance Corp. “Citizens 2007 Regular Session Legislation for Consumers,” www.citizensfla.com/utilitybar/policyholderfaqs.cfm?show=text&link=/shared/faqs/faq_2007_Regular_Session.html.
- 40 627 Florida Statutes.
- 41 627 Florida Statutes.
- 42 Citizens Mission Review Task Force. “Comprehensive Final Report,” www.citizensfla.com/about/mrtf.cfm?show=pdf&link=/shared/mrtf/ComprehensiveFinalReport.pdf.
- 43 Florida Office of Insurance Regulation. “Personal and Commercial Residential Policy Data,” 2nd Quarter 2011. www.flair.com/office/onlineapplications/pcrespolicydata.aspx.
- 44 State Board of Administration. “Florida Hurricane Catastrophe Fund,” June 30, 2011. www.sbafla.com/fhcf/LinkClick.aspx?fileticket=Q14S3A6geGo%3d&tabid=319&mid=1006
- 45 State Board of Administration. “Estimated FHCF Claims Paying Capacity,” October 18, 2011. www.sbafla.com/fhcf/LinkClick.aspx?fileticket=aLdcDLREt1Q%3d&tabid=318&mid=1005.
- 46 See e.g. Barney Bishop. “Property Insurance Reform Should be a Priority for the State,” Florida Times Union, December 23, 2010 and Eli Lehrer. “Crist’s Costly Populism,” Miami Herald, April 13, 2010.
- 47 John Frank and Jeff Harrington. “Gov. Charlie Crist Vetoes Property Insurance Bill,” Miami Herald, June 1, 2010.
- 48 “ACI Survey Finds Floridians Support Fixing the State’s Insurance CAT Fund,” American Consumer Institute, December 5, 2011. <http://www.marketwire.com/press-release/aci-survey-finds-floridians-support-fixing-the-states-insurance-cat-fund-1594802.htm>.
- 49 www.flsenate.gov/Session/Bill/2012/0833/BillText/Filed/PDF.
- 50 Board of Governors Meeting, December 14, 2011. Board of Governors Meeting https://www.citizensfla.com/about/mDetails_boardmtgs.cfm?event=377&when=Past.
- 51 For the Cat Fund’s organic statute, see: XIV Florida Statutes 215.555.
- 52 Paragon Benfield, Florida Hurricane Catastrophe Fund Rates and Retention Multiples. <http://fhcf.paragonbenfield.com/current/11rates.html>.
- 53 Proposed 2012 Legislation. State Board of Administration of the Florida Hurricane Catastrophe Fund. September 2011 www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CDgQFjAA&url=http%3A%2F%2Fjohnsonstrategiesllc.com%2Fwp-content%2Fplugins%2Fdownload-monitor%2Fdownload.php%3Fid%3D163&ei=pK3rTu6CLObd0QHq1YXGCQ&usg=AFQjCNHmWQIM3TgzIyj-ySvj165Z2tu-9w.
- 54 PML is a standard insurance industry measure of what’s likely to happen. To receive the top rating from private insurance rater A.M. Best, private insurers are typically required to have sufficient resources to pay for 2 “100 year PML events” in a single year. For more information on the PML concept see: Qfinance.com. “Understanding and Calculating Probable Maximum Loss,” www.qfinance.com/insurance-marketschecklists/understanding-and-calculatingprobable-maximum-loss-pml.
- 55 Louisiana Citizens Property Insurance Corporation. “Depopulation Data,” www.lacitizens.com/Depopulation.aspx.
- 56 “Donelon Announces Fifth Round of Citizens Depopulation a Success,” Louisiana Department of Insurance, November 16, 2011.
- 57 Michael Adams. “Florida’s Citizens Insurance Says Legislation Needed for Real Change,” Insurance Journal. December 6, 2011.
- 58 United States Geological Survey. “Elevations and Distances in the United States,” www.webcitation.org/5uNhHeGAs.
- 59 John Kennedy. “Florida Scraps Hurricane Season Sales Tax Holiday,” The Orlando Sentinel, April 18, 2008.
- 60 “FLASH® Applauds Passage of Model Legislation to Promote Hurricane Mitigation and Safety,” PRWeb. February 3, 2011.
- 61 Bressler, Amery & Ross. “Florida Governor Rick Scott Signs Senate Bill 408 Into Law,” Insurance Law Alert. June 2011.
- 62 ASI Corp. “Solving Florida’s Sinkhole Problem,” December 7, 2010.
- 63 Ibid.

RECENT PUBLIC POLICY ANALYSES BY THE JAMES MADISON INSTITUTE

*Alternative Solutions to Florida's
Medical Malpractice System*
Beth Ann Fiedler, Ph.D.
Backgrounder # 69, November 2011

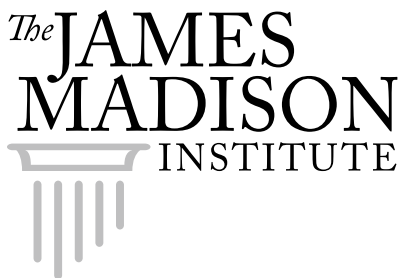
*Collateral Damage:
Floridians Coping with the Aftermath of War*
Dr. Susan A. MacManus, Dr. Susan C. Schuler
Backgrounder # 68, February 2011

*Solutions to Restore Florida's Property Insurance Marketplace
to Protect Taxpayers and the Insured*
Eli Lehrer
Backgrounder # 67, February 2011

Protecting Florida's Cities Through Pension Reform
Dr. Randall G. Holcombe
Backgrounder # 66, January 2011

Reforming Medicaid in Florida
Dr. Michael Bond
Backgrounder # 65, April 2010

*Property Insurance Solutions to Protect Homeowners, Taxpayers,
and Florida Government from Financial Devastation*
Eli Lehrer
Backgrounder # 64, March 2010



Enclosed is my fully tax-deductible gift to support The James Madison Institute and join at the following membership level.

- | | |
|--|---|
| <input type="checkbox"/> \$25: Student Member | <input type="checkbox"/> \$500-\$999: Constitutionalist |
| <input type="checkbox"/> \$50-\$99: Patriot | <input type="checkbox"/> \$1,000-\$4,999: Madison Fellow |
| <input type="checkbox"/> \$100-\$249: Federalist | <input type="checkbox"/> \$5,000-\$9,999: Montpelier Fellow |
| <input type="checkbox"/> \$250-\$499: Founder | <input type="checkbox"/> \$10,000 + : Chairman's Circle Society |

Name(s) _____

Mailing Address _____

City _____ State _____ ZIP _____

Home Phone _____

Office Phone _____

Office Fax _____

Email Address _____

- Yes! I would like to receive JMI updates via email.
 Yes! I'm interested in the JMI Planned Giving Program.

For those giving by credit card:

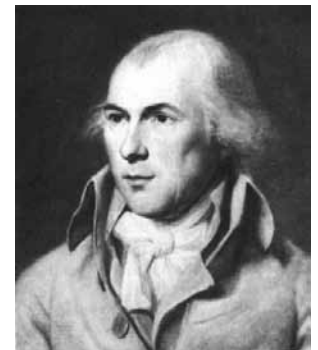
Name on Card _____

Master Card / Visa (circle one)

Acct # _____

Expiration Date _____

Signature _____



Please make checks payable to: The James Madison Institute

The JAMES
MADISON
INSTITUTE

2017 Delta Boulevard
Tallahassee, FL 32303

RETURN SERVICE REQUESTED

Trusted Solutions for a Better Florida

Non-Profit Org.
U.S. Postage
PAID
Tallahassee, FL
Permit No. 640