Market Bulletin
LLOYD'S

FROM:	Director, Worldwide Markets	EXTN:	6677
DATE:	20 June 2005	REF:	Y3573
SUBJECT:	**FLORIDA PROPERTY INSURANCE ISSUES**		
SUBJECT AREA(S):	New comprehensive Florida property insurance legislation; Florida residual market deficit; expected residual market assessments		
ATTACHMENTS:	Appendix 1 Details of Florida property insurance legislation Appendix 2 Residual market (CPIC) deficit and assessments		
ACTION POINTS:	**Managing agents to note new legislative provisions**		
DEADLINE(S):	**None**		

1. Purpose of bulletin

This bulletin describes:

- new Florida property insurance legislation, signed into law on June 1, 2005; and
- the status of the Florida residual market ("Citizens Property Insurance Corp." or "CPIC") deficit, and the potential levying and collection of assessments to eliminate the deficit.

2. 2005 Florida property insurance legislation (Chapter 2005-111, Laws of Florida)

The 2005 Florida legislature enacted property insurance legislation affecting a wide variety of areas, including the Florida Hurricane Catastrophe Fund, residual markets, ratemaking, coverage, and claims processing. The legislation (Committee Substitute for Senate Bill 1486, now referred to as Chapter 2005-111, Laws of Florida) also provided for further studies, reports, and audits, leading to the expectation of further legislative action in 2006. Governor Jeb Bush signed the act on June 1, 2005. Some provisions of the act took effect on that date, and others, as noted, will take effect later in the year.

The text of the act can be found online at http://election.dos.state.fl.us/laws/05laws/ch_2005-111.pdf .

Appendix 1 summarises the portions of the act that could have an impact on the surplus lines and reinsurance markets. Managing agents should note, for example, the possibility mentioned under "use of hurricane loss models; reports of loss and exposure data" that they be required to provide loss and exposure data.

3. Florida residual market deficit and assessments

Market bulletin Y3511, issued on 7 March 2005 and entitled *"Florida: potential deficit assessment for Citizens Property Insurance Corporation"* stated that the CPIC had a deficit as a result of the 2004 windstorm losses and that a deficit assessment could be levied on Florida property insurance premiums in consequence. The CPIC board of governors has recognised a deficit of $516 million, but has deferred any further action until later in the year, when a new board will be in place.

It is expected that at some point after August 1, 2005, the new board of governors will submit a deficit elimination plan to the Florida Office of Insurance Regulation, involving deficit assessments. Further details of this issue are set out in appendix 2.

4. Further information

This bulletin has been drafted in conjunction with Lloyd's America and Lloyd's local counsel in Florida.

Please contact Lloyd's Worldwide Market Services (contact details found below) for more information.

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This bulletin has been sent to active underwriters and the compliance officers of managing agents and to Lloyd's brokers.

Julian James
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Appendix 1

Details of Florida property insurance legislation

Residual market – Citizens Property Insurance Corporation ("CPIC")

CPIC is Florida's residual market entity for property insurance. As of May 31, 2005, it had 740,225 policies in force, with total exposure of $187.6 billion.

The legislation restructures the CPIC board of governors. Under current law, the board consists of seven members appointed by the state Chief Financial Officer. The new board will consist of two members appointed by the Governor, two members appointed by the Chief Financial Officer, two members appointed by the state Senate President, and two members appointed by the Speaker of the state House of Representatives. The new board must be appointed by August 1, 2005.

The apparent purpose for the change to the board makeup was to make CPIC more accountable to the public, but in practice it may mean that CPIC behaves less like an insurance company and more like a public agency, with negative consequences for the insurers and insureds who are subject to assessment to fund CPIC deficits.

The act revises the current mandate for CPIC to attempt to procure reinsurance. The new language requires CPIC to make its best efforts to procure reinsurance to cover its 100-year probable maximum loss, but, as with prior law, there is no absolute requirement for CPIC to obtain reinsurance. In recent years, CPIC has operated without any reinsurance other than the cover provided by the Florida Hurricane Catastrophe Fund.

More dramatic changes to CPIC were removed in the course of negotiations over the final version of the legislation. In its early stages, both the House version and the Senate version of the legislation would have removed the requirement that CPIC rates be non-competitive with, and higher than, voluntary market rates, at least in the areas where CPIC had a large market share. In the end, this proposal was replaced with language authorizing CPIC to charge competitive rates (provided they are "actuarially sound") only in the Florida Keys (Monroe County). Early versions of the legislation also included language that would have either made dwellings valued at more than $1 million ineligible for CPIC windstorm coverage or would have limited the amount of CPIC windstorm coverage for any dwelling to the first $1 million.

Florida Hurricane Catastrophe Fund ("Cat Fund")

The act lowers a participating insurer's Cat Fund retention for 2005 to its share of $4.5 billion, and provides that this retention applies only to the insurer's two largest hurricane events for the year. The retention applicable to all other hurricane events in the year would be one-third of this amount. As with prior law, retention would rise each year to track Cat Fund exposure increases. (Under prior law, the total retention for 2005 would have been $4.95 billion for each event, instead of $4.5 billion for each of the two largest events.)

Use of hurricane loss projection models; reports of loss and exposure data

The act limits the use of hurricane loss projection models in admitted insurers' rate filings. Under prior law, model-derived information could be used if the model had been determined to meet the standards of the Florida Commission on Hurricane Loss Projection Methodology. Under the new law, model-derived information may be used only if all of the proprietary information related to the model is disclosed to the insurance regulator. Under Florida's public records law, this proprietary information would then become available for public inspection in the absence of a specific law preserving its confidentiality. The legislature has separately enacted such an act (House Bill 1939), and the disclosure requirement is contingent on that act becoming a law. As of this writing, House Bill 1939 has not yet been presented to the Governor to be signed or vetoed.

Florida's Office of Insurance Regulation has contracted with Florida International University to develop a "public" hurricane loss projection model to be used by the regulator as a benchmark for measuring rate filings. In furtherance of that effort, the act requires all insurers to provide hurricane loss data and exposure data in response to a data call from either the office or the university. As with the modelling disclosure provision, this provision is contingent on House Bill 1939 becoming law.

By its terms the loss and exposure reporting requirement is not limited to admitted insurers, although it is placed in Chapter 627, Florida Statutes, which, by its terms, does not apply to surplus lines. However, in light of the experience with the various emergency rules and orders imposed during the 2004 hurricane season, it would not be unreasonable to expect the regulator or the developers of the public model to demand loss and exposure data from the surplus lines market.

Cancellations and nonrenewals

The act allows the Office of Insurance Regulation to enter an order prohibiting the cancellation or nonrenewal of a residential policy covering a hurricane-damaged property until 90 days after the property is repaired, subject to exceptions for non-payment or fraud by the insured or payment of policy limits by the insurer. As with the reporting requirement discussed above, limitations on cancellations and nonrenewals are in a chapter of the statutes that, by its terms, does not apply to surplus lines, but, in light of the 2004 experience, it should be expected that the Office of Insurance Regulation will attempt to apply any order implementing hurricane-related prohibitions on cancellations and nonrenewals to the surplus lines market as well as the admitted market.

Valued Policy Law

The act revises the Valued Policy Law (which, in essence requires a property insurer to pay policy limits in the event of a total loss) in response to a 2004 appellate decision that had construed the Valued Policy Law to require a windstorm insurer to pay policy limits in the case of a total loss caused in part by windstorm, a covered peril, and in part by flood, an excluded peril. The decision in *Mierzwa*, in broad terms, called into question the efficacy of any policy exclusion, at least in the case of a total loss, including a constructive total loss in which damage exceeding 50% of the property value triggered a local requirement that the structure be torn down rather than repaired.

The revisions specify that the insurer's liability for policy limits is limited to situations in which the total loss was caused by a covered peril, and cases in which the covered peril would, by itself, have been sufficient to create a constructive total loss. The new language provides legislative intent to the effect that the Valued Policy Law does not deprive the insurer of any defence under the policy, does not create additional coverage, and does not require the insurer to pay for a loss caused by an excluded peril. When a loss was caused in part by a covered peril and in part by an excluded peril, the insurer's liability is limited to the amount of the loss caused by the covered peril.

In no event is the insurer liable for more than the amount necessary to repair, rebuild, or replace the covered property, after considering all other insurance payments received by the insured.

The revisions are not retroactive and specifically apply only to claims filed after the effective date of the act (June 1, 2005). Because the effect of the change is not retroactive, Florida courts are continuing are continuing to apply the *Mierzwa* interpretation of the Valued Policy Law with regard to claims arising from the 2004 hurricane season. On 26 May, a Florida circuit court granted summary judgment for the policyholder plaintiff with regard to a 2004 hurricane claim based upon the holding in *Mierzwa*. The same Florida circuit judge recently certified a class that may eventually include as many as thousands of Florida policyholders claiming additional recoveries from the under the *Mierzwa* rule.

In spite of the legislature's efforts to clarify the statute and correct what it considered to be an erroneous judicial construction, the new language creates new issues for prospective claims that could again become the subject of litigation. In that event, it is possible that the efficacy of policy exclusions may remain in doubt until the litigation is concluded.

Studies, reports, and audits

The act requires various studies, audits, and reports, which may set the stage for additional major legislation in 2006. Issues to be studied include hurricane insurance capacity; the performance of the Cat Fund; the performance, structure, and impact of CPIC; possible mandatory law and ordinance coverage; and related matters.

Other matters

The act also addressed a variety of other matters, the impacts of which appear to be limited to the admitted market. The areas addressed included:

- Hurricane loss mitigation programs.
- Future adoption of uniform rating territories and uniform policy language.
- Public hearings on rate filings.
- Disapproval of policy provisions.
- Outline of coverage and coverage checklists.
- Mandatory offers of 5% and 10% hurricane deductibles and notice of dollar value of percentage deductibles.
- Mandatory offers of law and ordinance coverage.
- Prohibitions of hold-backs in connection with replacement cost coverage.
- Mediation.
- Sinkhole claims.
- Notice of mitigation discounts.
- Insurers' duties upon receipt of claims.

Appendix 2

Residual market (CPIC) deficit and assessments

At its June 8, 2005 meeting, the CPIC board of governors recognized a deficit of $516 million in the high-risk account, which is the subdivision of CPIC responsible for writing windstorm-only coverage. However, the board decided to defer any further action until later in the year, when the new board is in place. It is expected that at some point after August 1, 2005, the new board of governors will submit its deficit elimination plan to the Office of Insurance Regulation, and it is assumed that that plan will consist of deficit assessments. The current estimate is that a one-time-only assessment of 6.8% of subject premium will be required to eliminate the $516 million deficit.

Under the CPIC statute, the assessment will apply to all property insurance premium written by carriers in the admitted market or paid by insureds in the surplus lines market. The subject lines of business include all insurance covering real or personal property, including insurance for fire, industrial fire, allied lines, farmowners multiperil, homeowners multiperil, commercial multiperil, and mobile homes, and including liability coverage on all such insurance, but excluding inland marine and excluding vehicle insurance other than insurance on mobile homes used as permanent dwellings.

After the Office of Insurance Regulation verifies the aggregate amount of the assessment, CPIC will determine the percentage of direct written premium for subject lines of business in the admitted and surplus lines market necessary to fund the deficit. Then CPIC will levy assessments on admitted insurers and surplus lines insureds. The dollar amount of the assessment on an admitted insurer will be equal to the pre-determined percentage of the insurer’s 2004 direct written premium for subject lines of business. The dollar amount of the assessment on a surplus lines insured will be equal to the same pre-determined percentage of the new or renewal premium.

Admitted insurers are required to pay the assessments when they are levied. They are then able to recoup their paid assessments through a premium surcharge. The surcharge must be filed with the Office of Insurance Regulation, but the Office’s authority with respect to surcharge filings is limited to verification of the arithmetic calculations in the filing.

Assessments on surplus lines insureds are to be collected by the surplus lines agent at the same time as the agent collects the surplus lines tax. The agent then remits the collected assessments to the Florida Surplus Lines Service Office, which transfers them to CPIC.

Florida’s Surplus Lines Service Office (“FSLSO”) has been preparing to administer the assessment mechanism for surplus lines insureds for some time. However, the FSLSO will not move forward until the deficit and assessment needs have been certified by the Office of Insurance Regulation.