Political winds in a peak hurricane state

Why elections matter to Florida's property and flood insurers – in 2018 and beyond

John W. Rollins, FCAS, MAAA

Florida is known among the states for its unique level of hurricane exposure, with the majority of its residents making their homes in over 30 counties collectively containing more than 1,000 miles of coastline.

Less well-known are some quirky aspects of its political structure that directly influence not only property and flood insurance regulation, but also Florida's one-of-a-kind government presence within the market. After a decade-long and unprecedented lucky streak, the state has now been affected by three major hurricanes in three straight years. While Election Day 2018 is behind us and the new state leadership is coming into focus, several races remain too close to call and, as of this writing, are being recounted. Given the volatile political – not to mention atmospheric – winds, it is a good time for an overview of insurance governance and challenges in one of the world's riskiest catastrophe zones.

How Florida's Cabinet system can influence insurance regulation

The public servants who interact most frequently with U.S. insurers are state insurance commissioners, so let's start there. These chief regulators are usually either directly elected or appointed by the state's governor, but Florida has a "Cabinet" system of government. The four statewide elected officials – the governor, chief financial officer (CFO), attorney general, and agriculture commissioner – sit as the Financial Services Commission (FSC), which appoints or removes the commissioner of the Office of Insurance Regulation (OIR), as well as approves all administrative regulations or "rules." Each official has an equal vote, but in a further quirk of Florida law, the governor and CFO must be on the same side of a vote to appoint or remove the insurance commissioner.

Insurers operating in Florida are often advised to monitor the activities of the FSC as a whole and the viewpoints of each member. Why? Many of the rules that influence insurers' top-level business decisions are administrative (made by the OIR and approved by the FSC) rather than statutory (made by the legislature and signed by the governor),[1] and the administrative rules provide more detailed instruction or guidelines on how Florida statutes will be interpreted or applied in practice. For example, the voluminous and meticulous support requirements for Florida product filings are based mostly on rules. In addition, more specific decisions, such as rate filing approvals, are made by the commissioner - who ultimately answers to multiple elected bosses. Finally, the commissioner has wide authority to issue orders that can upend insurance business practices, especially in emergency conditions. Examples are the moratoria on rate increases and nonrenewals after Hurricanes Irma and Michael.

State-backed reinsurance and evaluation of catastrophe models

Florida also has a mandatory government-run property catastrophe reinsurance program, the Florida Hurricane Catastrophe Fund (FHCF or Cat Fund), and a body that regulates the use of catastrophe models in rate filings, the Florida Commission on Hurricane Loss Projection Methodology (FCHLPM). The Cat Fund makes rules surrounding a reinsurance contract, including its pricing plan and data reporting requirements, which are then approved by the State Board of Administration (SBA). The SBA's primary function is managing the state's pensions and investments, and its "trustees" include all Cabinet members except the agriculture commissioner. Thus, the governor, CFO, and attorney general together run the Cat Fund, appoint or remove its executive director, and adopt its administrative rules. The FCHLPM is a group of a dozen multidisciplinary technical experts appointed by the governor and CFO (with some ex-officio members), and the CFO chooses the chair and SBA employees administer its operations.

The SBA's role here matters because insurers typically pay 10% to 15% of their gross property insurance premium to the Cat Fund, based on a sophisticated rating plan outlined in

1 F.S. chapters 624-627 are the Insurance Code, and administrative rules chapter 69O-170 relates to property insurance regulation.

statute,[2] and driven by individual risk attributes (geography, construction, and occupancy) and the catastrophe models accepted by the FCHLPM.[3] For example, the insurer owes more premium to the Cat Fund for each older home in a coastal ZIP code than for each newer inland home on its books, based on that home's larger average annual losses among the accepted models. Insurers must also design their private reinsurance programs around the coverage provided by the Cat Fund's contract, which is not customized to each insurer's exposures. Thus, the two bodies influence product, underwriting, actuarial, and reinsurance strategy for private insurers in the state. Downstream, many of the statutes and rules governing OIR filings reference the Cat Fund and the FCHLPM.

How does private flood insurance fit into this system?

Looking ahead to the emerging Florida private flood insurance market, though the Cat Fund does not cover flood, the FCHLPM has developed standards for flood catastrophe models that will eventually influence the use of models in flood rate filings.[4] The OIR approves form filings for flood; a current law allows abbreviated informational filings for flood rates that do not require FCHLPM-accepted models, but only until 2025. The current commissioner has been a vocal supporter of an expanded private flood market and has issued filing guidance to insurers.

The state-supported property insurance market of last (?) resort

Yet another way Florida legislators influence the private property insurance market is through the presence of Citizens Property Insurance Corporation (Citizens), a state-run insurer that is positioned primarily as a provider of last resort, but competes directly with private insurers in some situations. Citizens sells a variety of personal and commercial property insurance products that often, but not always, offer more limited coverage than that of private insurers. Rates are set under the same statutes and rules as private insurers, except that Citizens cannot raise rates for new or renewal business more than 10% for any individual customer annually,[5] a statute known as the "glide path" in Florida. Finally, in most cases Citizens can turn away applicants that are offered comparable private insurance, but only if the premium is within 15% of the Citizens amount, and can only non-renew policyholders who find a rate lower than Citizens in the private market. Because of long-standing historical rate inadequacy for some policy types and regions, reflective of earlier public policy, and the glide path restrictions in periods of increasing loss costs, Citizens is effectively a competitor to private insurers in some parts of Florida, such as the "Tri-County" region that stretches from the Keys to Palm Beach.

Citizens is run by a nine-member Board of Governors appointed by Florida's governor (three seats), CFO (two seats and choice of Board Chair), and the leaders of the two legislative chambers – the House Speaker (two seats) and Senate President (two seats). The Board appoints or removes the chief executive of Citizens, with the Board Chair acting as his or her direct supervisor. The chief executive of Citizens must also be confirmed by the Florida Senate. Notwithstanding the influence of two Cabinet members, this gives the legislature some direct control over property insurance governance in Florida beyond its lawmaking responsibilities for the Florida Insurance Code.

The market influence of the judiciary

Let's turn to those insurance laws and their interpretation by the courts. Private insurers (and Citizens) must adhere to Florida statutes, which are modified by acts of the legislature signed by the governor. However, particularly in the area of claims, case law made by courts is voluminous. An overview of case law is beyond the scope of this article, but it's worth noting that ultimately, the Florida Supreme Court frequently decides key cases that greatly influence loss costs. The governor appoints these justices for life until a mandatory retirement age of 70 years old.[6] When justices reach retirement age during an election year, the election determines who selects their replacements.

What's at stake after the 2018 midterms

So where do we stand before and after Election Day 2018? The current Cabinet is all Republican, and all were subject to Florida's eight-year term limits, so each seat will change hands. While each race was very close, the Republican nominees won the CFO and attorney general offices. At press time, both the governor's and agriculture commissioner's races were being recounted due to close results, with the Republican candidate

2 F.S. 215.555.

3 F.S. 627.0628 and 627.0629.

4 F.S. 627.715, created by Senate Bill 542 in 2014, directed the FCHLPM to adopt these standards and gave insurers an exemption from using only FCHLPM-accepted models in flood rate filings, which expires in 2025.

5 F.S. 627.351(6) governs Citizens, and subsection (n) governs rates. A few other statutes are relevant to aspects of Citizens' operations.

6 This was just raised to 75 on Election Day 2018 by referendum amending the Florida Constitution (Amendment 6).

slightly ahead for governor but a near-tie in the agriculture commissioner's race. The current OIR commissioner has been a vocal proponent of both improvements in the claims litigation environment (centered around reforms to Florida's "assignment of benefits" laws) and the entry of private flood insurance. The OIR staff has also been generally supportive of actuarially sound rate filings that meet the state's standards. The new Cabinet will establish an approach to each of these issues. Likewise, the new SBA trustees will review the activities of the Cat Fund and SBA as well as the rules governing the reinsurance contract and its cost.

Though Republican majorities will be narrowed in each legislative chamber, the House and Senate will also remain under GOP control. However, public policy controversies relating to insurance are often as much regional as partisan. In 2018, the House passed a comprehensive claims litigation reform bill after several years of evolving approaches to the problem, but the Senate did not take it up. The new House Speaker and Senate President will establish their committee structures soon, and will determine whether to once again address reforms to these laws.

Finally, the seven-member Florida Supreme Court has issued a string of decisions over the past couple of years generally seen as promoting claims litigation and being unfriendly to insurers of all types. It happens that three of the four justices who made up the majority in most of those decisions must retire, and their replacements will be appointed by the new governor. The approach of the Court to insurance law will be influenced by these new justices, and the views of the governor will influence these appointments.

Floridians never seem to experience a dull hurricane season or dull election season. Insurers who are exposed to both Florida's windstorms and its politics should monitor the atmosphere - meteorological and political - in order to thrive and grow along with the third-largest state in the U.S.

CONTACT

John W. Rollins
john.rollins@milliman.com