Solving Florida's Homeowners Insurance Crisis: A Strategic Root Cause Analysis

Authors:

Donald D. Brown and Dennis A. Ross

Statement of Premise: Learning from Florida's Experience

We have always been told and are now convinced that one of the least painful ways to learn life's difficult lessons is to study and learn from the mistakes of others.

As former Florida Legislators, we hope to share our perspective about homeowners' insurance based upon what we like to call the "Florida Grand Experiment."

If you choose to learn from Florida's mistakes, it could just save you considerable pain.

But before we do that, we want to share these profound truths with you: They have guided much of our work as legislators:

1. "*It is a little recognized fact that in Western Cultures we tend to focus on symptoms rather than the root cause(s) of our problems. This tendency to focus on symptoms rather than the cause can also be seen in many other aspects of western culture, not the least of which is 'Public Policy.' In some high-profile cases, such as Band-Aids and Tylenol, this tendency has made some folks a lot of money."*

2. "*The golden rule of problem solving: Rule #1: Properly identify the problem, Rule #2: Properly identify the problem, and Rule #3: Refer to Rule #1 and Rule #2 before proceeding*."

3. "*Self-preservation and self-development are common aspirations among all people…However, there is also another tendency that is common among people. When they can, they wish to live and prosper at the expense of others...This fatal desire has its origin in the very nature of man—in that primitive, universal, and insuppressible instinct that impels him to satisfy his desires with the least possible pain*." - Frédéric Bastiat

If you find nothing more of value in this treatise, it is our sincere hope that these will be as meaningful to you as they have been to us. For a deeper exploration of these themes, please refer to the essay contrasting the views of Sun-Tzu and Frédéric Bastiat in Chapter 5 of the book: "The 9 Guideline Principles to Enact Change".

House Bill 1A was passed in the 2007 Special Session the Florida Legislature. It was well-intentioned and aimed at addressing high homeowners' insurance premiums. It, however, tackled the symptom rather than the root problem. High premiums are a symptom of deeper issues: 1) Our vulnerability to hurricanes, and 2) The insistence on building in high-risk areas while expecting others to bear the financial burden.

To truly reduce homeowners' insurance costs in Florida, we must address these core issues. Political attempts to lower insurance rates without tackling the underlying risks are unsustainable and expose taxpayers to massive liabilities in the event of a major hurricane.

Please Consider This: A Thought Experiment

"How much will it cost Floridians the next time a $50 billion hurricane strikes our coast?" The cost is $50 billion, but the critical question is, "Who will pay the bill?"

While the insurance industry might cover much of it, bankruptcies can shift the burden to the Florida Insurance Guaranty Association and ultimately to homeowners. If homeowners cannot pay, their net worth suffers, even dipping into negative territory. Once the damage is done and the wind ceases to blow, someone must pay the bill.

The real solution lies in reducing the risk through stringent building codes, effective mitigation, and a fundamental change in human behavior. Focusing solely on insurance premiums without addressing the root causes will perpetuate our reliance on Band-Aids and Tylenol, never solving the actual problem.

I. Executive Summary

Florida's homeowners' insurance market faces a crisis of affordability and stability. This paper argues that a fundamental misunderstanding of the root cause – persistent development in high-risk coastal areas – hinders the development of sustainable solutions.

It proposes nine guiding principles to address this crisis, emphasizing risk mitigation, responsible development, and insurance reform. The paper establishes

the need to evaluate future legislative proposals against these principles and elaborates on the limitations of "gimmick solutions" that focus solely on financial mechanisms.

While acknowledging the political and economic realities that necessitate incremental progress, the paper emphasizes the importance of prioritizing the guiding principles and utilizing public education to build support for long-term solutions.

Key Findings:

1. Florida's insurance crisis is multidimensional, encompassing political, insurance, hurricane, and human behavior components.
2. The current system relies heavily on public debt and government intervention, which is unsustainable in the long term.
3. Building codes, while among the strongest in the nation, still leave room for improvement in creating hurricane-resistant structures.
4. The global reinsurance market plays a crucial role in Florida's ability to manage catastrophic risk.
5. Lessons from international disasters, such as New Zealand's Canterbury earthquake, offer valuable insights for Florida's approach to disaster preparedness and recovery.
6. The concept of "Code Plus" standards, which exceed minimum building code requirements, shows promise in significantly reducing future hurricane losses and stabilizing insurance premiums.
7. Dr. Frank H. Knight's insights on risk versus uncertainty provide a valuable framework for understanding and addressing Florida's complex insurance challenges.

II. Introduction

A. Overview of Florida's Insurance Market Challenges

Effective problem-solving requires identifying the root cause. In the case of Florida's homeowners' insurance crisis, the root cause is the state's inherent vulnerability to hurricanes and the ongoing construction of homes and infrastructure in high-risk

coastal areas. This paper proposes a change in basic assumptions: moving beyond the "symptoms" of high premiums and company insolvency towards addressing the underlying issue of building in harm's way.

B. The Four Crises: Political, Insurance, Hurricane, and Human Behavior

Defining the Problem

So, to establish a framework within which we can begin to properly identify the root cause of our problems let us consider the following:

We have four related but different problems. They must all be addressed but the solution for one may not necessarily be the correct solution for the other three. The four problems are:

1. Political Crisis: The Political Crisis refers to the challenges and obstacles posed by the political environment and decision-making processes that impact the homeowner’s insurance market in Florida. This includes issues such as regulatory policies, legislative actions, and the influence of various stakeholders and interest groups on insurance-related decisions. The Political Crisis often involves competing priorities, short-term thinking, and the pressure to implement populist measures that may not address the underlying issues effectively. This can lead to unintended consequences, market distortions, and a lack of long-term, sustainable solutions to the insurance problem.

2. Insurance Crisis: The Insurance Crisis pertains to the financial and operational challenges faced by insurance companies operating in Florida's property insurance market. This encompasses issues such as the availability and affordability of insurance coverage, the financial stability of insurers, and the overall health and competitiveness of the insurance market. The Insurance Crisis is characterized by factors such as high premium rates, limited coverage options, the withdrawal of insurers from the market, and the potential for insurer insolvencies. These issues can make it difficult for homeowners to obtain adequate and affordable insurance protection, while also threatening the long-term viability of the insurance industry in the state.

3. Hurricane Crisis: The Hurricane Crisis refers to the physical impact and financial consequences of hurricanes and other severe weather events on Florida's homeowners and insurance market. This includes the devastating effects of high winds, flooding, and storm surge on residential properties, as well as the resulting damage claims and losses that insurers must manage. The Hurricane Crisis is exacerbated by Florida's geographic vulnerability to hurricanes, the increasing frequency and intensity of these events due to climate change, and the concentration of population and property values in high-risk coastal areas. The potential for catastrophic losses from hurricanes poses significant challenges for insurers, homeowners, and the overall resilience of the state's economy.

4. Human Behavior Crisis: The Human Behavior Crisis encompasses the individual and collective actions, decisions, and attitudes of homeowners, policymakers, and other stakeholders that contribute to the homeowner's insurance problem in Florida. This includes factors such as the tendency to underestimate risk, the desire for low insurance premiums despite high risks, and the resistance to adopting mitigation measures or risk-based pricing. The Human Behavior Crisis also involves the challenges of aligning incentives, promoting risk awareness, and encouraging responsible decision-making among all parties involved in the insurance market. Addressing this crisis requires understanding the psychological, social, and economic factors that influence human behavior and developing strategies to promote more sustainable and resilient practices.

These four interconnected crises contribute to the complex and multifaceted nature of the homeowner's insurance problem in Florida. Addressing these issues effectively requires a comprehensive, long-term approach that considers the political, financial, environmental, and behavioral dimensions of the problem. By understanding and tackling these different aspects of the crisis, policymakers and stakeholders can work towards developing more sustainable and equitable solutions for Florida's property insurance market.

To effectively address high homeowners' insurance premiums, it is imperative that we prioritize our guiding principles over short-term thinking and resist the pressure to implement populist measures that may not effectively address the underlying issues. Legislators must first acknowledge the true nature of the problem and commit to collaborative efforts towards appropriate solutions. Without this collective commitment, we will continue to struggle with escalating premiums and their associated challenges.

Having established the multifaceted nature of Florida's insurance crisis, we now turn to a set of guiding principles that will form the foundation of our proposed solutions. These principles, rooted in market-based approaches and individual responsibility, will serve as a framework for evaluating and developing effective policy recommendations.

III. Guiding Principles for Insurance Legislation

Principle 1: Pay for Hurricane Risk with Private Capital Rather Than Public Debt

- **Encouraging Private Sector Investment**: Both the book:[1] "The 9 Guideline Principles to Enact Change: A Legislator's Memoir – From Outhouse to State House" and the academic paper:[2] " Normalized Hurricane Damage in the United States: 1900-2005" advocate for leveraging private capital to cover hurricane risks. Government subsidies and artificial price controls often lead to market distortions and increased risk exposure. Market-based solutions and risk-based pricing are more effective for long-term stability. Examples include the use of catastrophe bonds, which transfer risk from insurers to investors, providing a buffer against large losses. Detailed analysis of the effectiveness of catastrophe bonds in other regions, such as the Caribbean Catastrophe Risk Insurance Facility, can provide valuable insights.

[1] The 9 Guideline Principles to Enact Change: A Legislator's Memoir – From Outhouse to State House, 2024 Brown, Donald

[2] Normalized Hurricane Damage in the United States: 1900-2005 Roger A. Pielke, Jr., Joel Gratz[2]; Christopher w. Landsea[2]; Douglas Collins[2]; Mark A. Saunders[2]; and Rade Musulin[2], February 2008 https://www.nhc.noaa.gov/pdf/NormalizedHurricane2008.pdf

Principle 2: Free-Market Competition Ensures Availability and Affordability

- **Benefits of a Competitive Insurance Market**: A competitive market fosters innovation and efficiency, leading to more affordable and sustainable insurance solutions. Pielke et al.[3] highlight how government interventions can distort market signals and discourage risk reduction investments. Case studies from states with deregulated insurance markets show increased availability and competitive pricing. For example, Texas's deregulated market has seen a proliferation of insurance products and a competitive environment that benefits consumers.

Principle 3: Limited, Cautious, and Temporary Government Intervention

- **Role of Government in Market Stability**: Government intervention should focus on temporary measures to stabilize the market during crises and encourage risk reduction. Long-term solutions should rely on market mechanisms to promote resilience and efficiency. Historical examples include the temporary reinsurance programs established after major disasters, which were phased out as private reinsurance markets stabilized. Detailed examination of the successes and challenges of these programs, such as the Federal Terrorism Risk Insurance Act, can offer valuable lessons.

Principle 4: Encourage Individual Responsibility

- **Promoting Self-Reliance**: Policies should encourage homeowners to take responsibility for their property and its resilience against hurricanes. This includes incentivizing investments in risk mitigation measures and ensuring that individuals bear the costs of their risk-related decisions. Programs like Florida's My Safe Florida Home offer free home inspections and grants for strengthening homes against hurricanes. Additionally, public education campaigns that inform homeowners about the benefits of mitigation measures can increase participation rates.

[3] Normalized Hurricane Damage in the United States: 1900-2005 Roger A. Pielke, Jr., Joel Gratz[3]; Christopher w. Landsea[3]; Douglas Collins[3]; Mark A. Saunders[3]; and Rade Musulin[3], February 2008 https://www.nhc.noaa.gov/pdf/NormalizedHurricane2008.pdf

Principle 5: Focus Government Aid on the Truly Needy

- **Targeted Subsidies**: Government subsidies should be limited to those who genuinely need them, such as low-income households. Broad subsidies often lead to overdevelopment in vulnerable areas, increasing overall risk and economic exposure. Examples of targeted subsidy programs include means-tested grants and sliding scale insurance premium assistance. Detailed analysis of subsidy programs in other contexts, such as the Low-Income Home Energy Assistance Program (LIHEAP), can provide useful models for implementation.

Principle 6: Use Science and Technology to Assess Risk Accurately

- **Data-Driven Risk Assessment**: Leveraging advancements in science and technology to accurately assess risk can lead to more effective and fair insurance pricing. This includes using predictive models and historical data to evaluate potential hurricane impacts. Technologies like LiDAR and geographic information systems (GIS) provide detailed risk assessments that help insurers price policies accurately. Additionally, incorporating real-time data from weather satellites and drones can enhance the accuracy of risk assessments.

Principle 7: Encourage Risk-Based Pricing

- **Aligning Premiums with Risk**: Insurance premiums should reflect the true risk of the insured property. Risk-based pricing incentivizes homeowners to invest in risk mitigation and discourages development in high-risk areas. Examples include higher premiums for homes in flood-prone areas unless they have flood defenses in place. Detailed case studies of risk-based pricing models in other regions, such as the National Flood Insurance Program's Risk Rating 2.0, can provide insights into best practices and potential pitfalls.

Principle 8: Support Research and Innovation in Risk Reduction

- **Investing in Innovation**: Encouraging research and development in risk reduction technologies and practices can lead to more effective strategies for minimizing hurricane damage and insurance losses. Grants and funding for university research into resilient building materials and construction techniques are examples of this principle in action. Additionally, partnerships

with tech companies to develop innovative risk assessment tools can enhance the insurance industry's ability to manage risk.

Principle 9: Foster Public-Private Partnerships

- **Collaborative Approaches**: Public-private partnerships can leverage the strengths of both sectors to develop and implement comprehensive risk management strategies. These collaborations can enhance resilience and sustainability in the insurance market. Examples include the partnership between FEMA and the insurance industry to promote flood insurance awareness and preparedness. Detailed case studies of successful public-private partnerships, such as the Community Rating System (CRS) under the National Flood Insurance Program, can provide valuable insights.

With these guiding principles in mind, it's crucial to establish a framework for evaluating future legislative proposals. The following criteria will help policymakers and stakeholders assess whether proposed laws align with our guiding principles and effectively address the complex challenges facing Florida's insurance market.

Warning

The "However..." Response and the Need for Practical Solutions

The proposed root-cause approach often elicits the "However..." response, a reaction that typically arises when readers grasp the deeper nature of the problem and the limitations of quick fixes. Acknowledging the limitations of immediate and complete redevelopment in high-risk zones, a pragmatic approach is necessary. Here, the nine guiding principles provide a framework for incremental change:

- **Incremental Building Code Improvements**: Start by enacting stricter building codes that prioritize hurricane-resistant construction practices. This can be phased in geographically or over time to minimize disruption while still increasing overall resilience.
- **Retrofitting Incentives**: Implement financial incentives for homeowners to retrofit existing structures in high-risk areas. These incentives could include tax breaks, subsidies, or low-interest loans to encourage proactive mitigation efforts.

- **Risk-Based Insurance Premiums**: Advocate for insurance reforms that reward risk mitigation. Homeowners who invest in making their homes more resilient would see lower insurance premiums, incentivizing proactive measures.
- **Development Zone Restrictions**: While outright bans on development in high-risk areas might be impractical, consider limitations on building density, requiring specific construction materials, or prioritizing development in less risky areas.
- **Public Education and Awareness Campaigns**: Launch educational campaigns to raise awareness about the risks associated with building in high-risk zones. This can empower citizens to make informed decisions about where they live and the importance of risk mitigation. This can build public support for long-term solutions.
- **Improved Catastrophe Modeling**: Invest in sophisticated catastrophe modeling to accurately assess hurricane risks and inform policy decisions related to building codes, insurance rates, and reinsurance strategies.
- **Land-Use Planning and Managed Retreat**: Explore strategic land acquisition programs or managed retreat strategies to gradually relocate existing development in the most vulnerable locations. This would require long-term planning and significant financial resources but could be a viable option for chronically damaged areas.

IV. Evaluating Future Legislation

Proponents of future legislation should answer questions that reveal how closely proposals align with the above principles:

1. Does this legislation address hurricanes and human behavior directly?
2. How will it impact the affordability and availability of insurance?
3. Does it encourage risk reduction through building codes or incentives?
4. How does it affect reliance on Citizens Property Insurance Company?
5. Will it mitigate fraud and litigation?
6. Is it climate-change-ready?

Criteria for Evaluating Proposed Legislation

- **Addressing Root Causes**: Legislation should focus on mitigating the root causes of high premiums—hurricanes and human behavior. This includes implementing risk-based pricing and encouraging investments in risk reduction measures. Detailed evaluation criteria, such as the effectiveness of proposed measures in reducing risk and their economic impact, will be discussed. For example, the impact of mandating hurricane shutters for new constructions in high-risk areas can be evaluated in terms of reduced insurance claims and increased safety.
- **Impact on Availability and Affordability**: Proposed policies should enhance the availability and affordability of insurance without distorting market dynamics. Case studies of legislative impacts, such as the National Flood Insurance Program's reforms, will be included. Analysis of how these reforms have improved access to affordable insurance while maintaining market stability will provide valuable insights.
- **Encouraging Risk Reduction**: Legislation should incentivize safer building practices and land-use planning to reduce economic exposure to hurricanes. Examples of successful legislative incentives, such as tax breaks for hurricane-proofing homes, will be provided. Additionally, analysis of the long-term benefits of such incentives, including reduced economic losses and improved community resilience, will be included.
- **Mitigating Fraud and Litigation**: Effective policies should address the litigious environment in Florida, which contributes to high insurance costs. Strategies to mitigate fraud, such as stronger regulatory oversight and harsher penalties for fraud, will be discussed. Detailed examples of successful anti-fraud measures in other states, such as New York's No-Fault Insurance Reform, will be analyzed.
- **Preparing for Climate Change**: Future legislation should be climate-change-ready, incorporating strategies to handle increasing risks from severe weather events. Detailed strategies for climate change preparedness, such as integrating climate models into risk assessments, will be included. Additionally, analysis of the potential economic impacts of climate change on Florida's insurance market and how legislation can mitigate these impacts will be provided.

V. Importance of Policy Recommendations

The need for informed decision-making and strategic planning is critical to address these challenges. The alignment between the arguments in the book: "The 9 Guideline Principles to Enact Change" and the findings of "Normalized Hurricane Damage in the United States: 1900-2005"[4] by Pielke et al. underscores the necessity for sound policies grounded in empirical research. Implementing effective policy recommendations can stabilize the market, reduce premiums, and enhance resilience against future hurricanes. These policies must address not only the immediate economic impacts but also long-term sustainability and resilience.

We are sure you appreciate the Herculean nature of the task we are about to undertake. The problems we face are complex and simplistic solutions have been tried and many have failed.

Having established both guiding principles and evaluation criteria, we can now turn our attention to specific policy recommendations. These proposed solutions are categorized into short-term, intermediate-term, and long-term initiatives, recognizing that addressing Florida's insurance crisis requires a multi-faceted approach with varying implementation timelines.

VI. Proposed Solutions (Recommendations) Timeline

Because there are several problems that must be addressed and because they require very different solutions, I believe our proposal should be structured into three broad categories: I. Short Term Solutions, II. Intermediate Term Solutions, and III. Long Term Solutions.

By categorizing the recommendations into Short Term, Intermediate Term, and Long-Term Solutions based on these criteria, the outline provides a roadmap for addressing Florida's homeowners' insurance crisis in a comprehensive and strategic manner. The Short-Term Solutions offer immediate relief and support, while the

[4] https://www.nhc.noaa.gov/pdf/NormalizedHurricane2008.pdf

Intermediate Term Solutions tackles systemic issues within the insurance market and regulatory environment. The Long-Term Solutions address the fundamental, long-standing factors that contribute to the state's vulnerability and require sustained, multi-stakeholder efforts to achieve lasting change.

Before we undertake a detailed discussion of policy recommendation let's further define our approach:

A. Short Term Solutions

Short Term Solutions Criteria:

- Can be implemented quickly, usually within 1-2 years
- Provide immediate relief or support to policyholders and the insurance market.
- Do not require extensive legislative changes or long-term structural reforms

B. Intermediate Term Solutions

Intermediate Term Solutions Criteria:

- Implementation Timeline of 2-5 years
- Involve more substantial policy, legislative, or regulatory changes
- Address systemic issues within the insurance market and regulatory environment

C. Long Term Solutions

Long Term Solutions Criteria:

- Implementation timeline of 5 years or more
- Address fundamental, long-standing issues related to risk exposure, vulnerability, and public awareness.
- Require sustained, multi-stakeholder efforts and significant resources

Recommendations

Of the policy recommendations that follow, some were drawn from the book titled: "The 9 Guideline Principles to Enact Change" and particularly the three key documents in its Appendix. They provide a comprehensive approach to addressing Florida's homeowners' insurance crisis. Implementing these recommendations in a coordinated and sustained manner could help to stabilize the insurance market, reduce hurricane vulnerability, and foster a more resilient Florida.

Many of the recommendations that follow were developed by a Special Property Insurance Committee appointed by Governor Jeb Bush. Other recommendations were the result of hearings held in March 2008 where the Florida House of Representatives Insurance Committee received two days of sworn testimony on the state of the Florida property insurance market. These hearings resulted in a 10-page report by Chairman Donald D. Brown and Representative Dennis A. Ross. A "introduction" to that report follows:

Introduction
Report of the Florida House Insurance Committee
To Speaker Marco Rubio

On January 22, 2007, the Florida Legislature passed House Bill 1A, a measure aimed at "reforming" the state's homeowners' insurance market. This bill significantly expanded the role of government in the market. However, in the wake of the 2008 national economic crisis, it became clear that Florida's decision to finance its catastrophe exposure with public debt rather than private capital was ill-timed. As the 2008 hurricane season approached, concerns arose about the potential for delayed claim payments and the imposition of post-storm assessments on policyholders, which could last up to 30 years.

In response to these concerns, the Speaker of the Florida House of Representatives requested that the House Insurance Committee convene a series of hearings to explore potential solutions. The Committee met on March 14 and March 24, 2008, to examine the issue of potential assessments and identify the root causes of Florida's

dilemma. The Committee sought to quantify the amount policyholders could be required to pay and engage in an honest dialogue about the ability of the state's insurance mechanism to pay claims after a major hurricane or multiple storms. Additionally, the Committee explored the relationship between an insurer's ability to use actuarial adequate rates under current regulatory rules and interpretations and the likelihood of taxpayers being assessed due to these rates.

This report summarizes the findings of the House Insurance Committee following these hearings. For a detailed analysis of the Committee's work, video recordings of the hearings are available at the following addresses:

• March 14, 2008: https://thefloridachannel.org/videos/31408-house-insurance-committee/

• March 24, 2008: https://thefloridachannel.org/videos/3-24-08-house-insurance-committee/

In the list of recommendations than follow, those that were the result of the Florida House Insurance Committee, based on sworn testimony, will be marked with the subscript "HCR"

VII. Short-Term Solutions

A. Consumer Protections

1. Implement a "deductible buy-down" provision, allowing policyholders to decrease their hurricane deductible by implementing mitigation measures.

2. Increase transparency through a "Truth in Premium Billing" statement, clearly delineating the components and prices of premium changes. Identify the amount of insurance premium tax by dollar amount.

3. Require insurers to offer installment payment plans for homeowner policies.

4. Extend cancellation or non-renewal notice to at least six months for long-term customers without claims.

5. Require insurers to offer a policy that excludes windstorm coverage from a residential property insurance policy if the policyholder signs a written rejection of such coverage on a form approved by OIR with appropriate disclosures. Insurers would still be required to offer a policy that includes windstorm coverage.

6. Require insurers to offer policies that provide no personal contents coverage.

7. Strengthening building codes to include impact-resistant materials and fortified roofing systems can significantly reduce hurricane damage. For example, after Hurricane Andrew in 1992, Florida implemented stricter building codes that resulted in less damage from subsequent hurricanes. **The University of Florida's Engineering Study** highlights the benefits of such measures, showing a reduction in insurance claims by up to 50% in areas with improved building codes (More on that later). These building codes should be regularly updated based on the latest research and technological advancements.

8. Eliminate maximum allowable deductibles. That is, allow insurers to offer deductibles of any amount in addition to the 2 percent 5 percent, and 10 percent deductibles that must be offered.

9. Maintain and expand the commitment to the Mitigation Program being administered by the Department of Financial Services. Earmark a portion of future mitigation funding to be used for Citizen’s policyholders.

10. Recommend an appropriation from the Legislature SOLELY for free inspections to encourage more homeowners to mitigate regardless of whether matching grants are available.

11. Strategies for retrofitting existing homes and buildings to withstand hurricane-force winds. This includes financial incentives for homeowners to make necessary upgrades, such as grants or low-interest loans. Retrofitting can include installing storm shutters, reinforcing garage doors, and improving roof-to-wall connections. Programs like the My Safe Florida Home program, which provides grants to homeowners for retrofitting their homes, have proven successful and could be expanded. Detailed analysis of the costs and benefits of various retrofitting measures will provide homeowners with the information needed to make informed decisions.

12. Embrace evidence from academic research and engineering studies such as Pielke et al. Findings[5]: This academic paper shows that while hurricane severity has not significantly increased, economic damage has escalated due to increased development in high-risk areas. This supports the need for better land-use planning and building practices to mitigate risk. Detailed data and case studies, such as the reduction of losses in Miami-Dade County due to improved building standards, illustrate these findings. Additionally, the paper highlights how effective land-use planning can prevent the clustering of high-value properties in vulnerable areas, thereby reducing potential economic losses.

13. Create a Sales Tax Rebate Program where consumers can apply to the Florida Department of Revenue for sales tax credits/rebates for approved mitigation materials and supplies. Require the filing of a mitigation verification inspection form as proof of purchase with the Department of Revenue.

14. Ensure insurance companies and agents are providing specific information to homeowners who want to know the premium discounts available for various mitigation options and the means for obtaining the discounts (e.g., continuing education requirements for agents).

[5] https://www.nhc.noaa.gov/pdf/NormalizedHurricane2008.pdf

15. Require wind mitigation inspectors to be licensed or certified by the state with exceptions for licensed contractors. Licensed contractors shall be exempt if a continuing education course in mitigation is completed.

16. Encourage local governments to participate in the state mitigation program.

17. Seek an IRS opinion allowing insurers to deduct catastrophe reserves if such reserves are deposited with and maintained by the state (such as the State Board of Administration). Seek an IRS opinion allowing insurers to deduct a "catastrophe premium equalization deduction" charged and held by the state in a segregated account for the benefit of insurers for use in the event of a catastrophe.

18. Seek federal funding of windstorm analysis/studies equivalent to federal funding for earthquake analysis/studies.

B. Mitigation

1. Promote and incentivize mitigation efforts to reduce future hurricane losses and increase public safety.

2. Require uniform mitigation verification inspection forms to be developed for all insurers. Specify the length of time an executed form is valid.

3. Authorize the creation of a not-for-profit corporation to raise funds from the private sector for additional mitigation grants.

C. Citizens Property Insurance Corporation

It is a well-documented fact that notwithstanding Section 627.0625 F.S., which requires that rates for all classes of insurance must not be excessive, inadequate, or unfairly discriminatory, rates for Florida Citizens Property Insurance Corporation (Citizens) have for many years been actuarially inadequate.

In March 2008 the Florida House of Representative Insurance Committee received sworn testimony from Citizens' outside actuary who testified it was his belief "…that their rates have been actuarially inadequate since January of 2007 when they were rolled back by this Legislature."[6] As recently as May 13, 2024, according to Caden DeLisa of "The Capitolist", "Citizens' rate cap, also known as the "glidepath," is not closing the gap between Citizens rates and private market rates," a legislative analysis state. "Instead, because of the rate cap and the increasing rates of private property insurance, the gap is growing and making Citizens more like a competitor to private insurers than an insurer of last resort. Because Citizens' rates are often well below those of private carriers, Citizens may be more competitive than otherwise intended."

Actuarially inadequate rate charged by Citizens creates cross-subsidies between Citizens rating territories and potential post loss assessment, not only for Citizen's policyholders but for "nearly every type of property and casualty policy"[7] in Florida.

1. Make Citizens rates less competitive with the admitted market by increasing the rate cap "glidepath" incrementally over 3 years.

2. Disallow the rejection of an approved take out offer by any insurer approved by Fannie Mae or Freddie Mac.

3. Create a self-supporting rating class for non-homestead properties that must pay an actuarially adequate rate. Post-loss assessments for this rating class, if any, should be applied to this class only. By segregating non-homestead policies can ensure that high-risk properties do not unduly impact the rates of primary residences.

   Example: High-value vacation homes and investment properties often represent a disproportionate share of potential losses. Creating a separate

[6] April 2, 2008, Letter from Florida House of Representatives Insurance Committee to Speake Marco Rubio
[7] https://www.citizensfla.com/documents/20702/29368837/Citizens%27+Assessments+Impact+All+Floridians+Brochure.pdf/b2c2a55c-e310-4236-6f22-a2d9994ff23c?version=3.0&t=1719972645644&d

account or rating class for these properties would prevent cross-subsidization and ensure more equitable rate structures.

4. Make "builders' risk" policies/coverage ineligible for Citizens unless the rates charged for this rating class are certified by Citizens' independent outside actuary to be adequate and in full compliance with Section 627.0625 F.S.

5. Allow authorized insurers to write non-homestead Citizens' policies on an individual risk rate basis.

6. Allow as an incentive for companies taking out substantial numbers of policies (10,000 or more) from Citizens to charge Citizens' rates for a period of three years after such take-out.

7. Return to the original rating standard adopted by Citizens as expressed in 627.351(6)(d)1.-5. F.S. 2003,[8] Subsection (d)1. says "It is the intent of the Legislature that the rates for coverage provided by the corporation be actuarially sound and not competitive with approved rates charged in the admitted voluntary market, so that the corporation functions as a residual market mechanism to provide insurance only when the insurance cannot be procured in the voluntary market. Rates shall include an appropriate catastrophe loading factor that reflects the actual catastrophic exposure of the corporation."

   Subsection (d)2. says in part: "For each county, the average rates of the corporation for each line of business for personal lines residential policies excluding rates for wind-only policies shall be no lower than the average rates charged by the insurer that had the highest average rate in that county among the 20 insurers with the greatest total direct written premium in the state for that line of business in the preceding year…"

[8] http://www.leg.state.fl.us/statutes/index.cfm?App_mode=Display_Statute&Search_String=&URL=Ch0627/SEC351.HTM&Title=-%3E2003-%3ECh0627-%3ESection%20351#0627.351

8. Rewrite the Citizens rate freeze to allow a modernized rating plan and actuarially sound rates to be filed as soon as possible while protecting consumers by phasing in any rate increases for existing individual policies from current levels at a reasonable pace.[9] This will signal consumers to make responsible insurance choices and put Citizens on the path to funding its obligations while easing the transition effects on consumer and business budgets. HCR

9. Revisit Citizens' charter as a true residual market entity. Property owners offered private insurance at approved rates should be ineligible for Citizens, especially for commercial policies such as coastal builders' risks. This will ensure Citizens is a safety net and not a subsidized alternative to willing, regulated providers. HCR

10. Specify that actuarially sound rates for Citizens include a provision for pre-funding of its obligations via reinsurance. Such funding should cover the same loss scenarios as required by OIR of all private market insurers: the "1-in-100 year" probable maximum loss.[10] Finally, with the provisions above any rate increase would be phased in over time.[11] HCR

D. The Florida Hurricane Catastrophe Fund (CAT Fund)

1. Authorize the CAT Fund or State Board of Administration to use catastrophe bonds, sidecars, and other capital market products to transfer the risk of CAT Fund coverage.

2. Amend the State Constitution to limit the use of CAT Fund assets to its statutory purposes and require a supermajority for any legislative appropriations from the fund.

[9] HB1A imposed the freeze by forcing Citizens to reinstate the rates from an old rate filing effective 03/01/2006 based on market rates charged during late 2005. It wiped out not only rate increased, but the significant rating plan modernizations made in Citizens' approved rate filings effective 01/01/2007.
[10] A form of this provision, requiring rates to be set assuming eventual pre-funding of severe events over time, was included in Senate Bill 1980 and repealed in HB1A.
[11] Christine Turner, Palm Beach Post editorial, March 31, 2008.

E. Reinsurance

1. Amend the reinsurance law to give insurers credit on their financial statements for other risk transfer or capital markets instruments, subject to the approval of OIR, provided there is a fully funded transfer of risk.

F. "Code Plus"

1. Develop a code plus standard that the insurance industry would recognize for maximizing premium discounts. ("Code Plus" will be defined later in this report.)

2. Encourage local governments to promote and advocate for code plus structures by providing incentives to builders like density bonuses, lower impact fees, and concurrency credits when new construction is built at higher levels than the current approved building code.

G. Rate Regulation Recommendations

1) Increase the transparency of regulatory activities by requiring OIR to maintain a public, web-accessible database of overall rate level requests filed, the amount recommended by OIR actuaries, and the amount approved by the Commissioner. Given that private actuaries must swear under penalty of perjury that their indications are fair, not misleading and reflect all legislative enactments[12], require a similar statement from OIR actuaries with respect to their published recommendations. In the public filing documentation, require OIR actuaries to disclose their major assumptions, and whether those deviate from the professional standards of the American Academy of Actuaries. Additionally, <u>when any proposed action on a rate filing is reviewed by OIR, require those meetings to be open to the affected parties (including the public) and in the sunshine.</u> HCR

[12] See form OIR-B1-1790, based on the language in HB1A.

2) Increase the efficiency of rate regulation by restoring a provision allowing expedited approval of rates and rating plan adjustments not exceeding a certain level[13], but with new consumer safeguards: a phase-in of individual policy premium increases exceeding an annual limit, and a requirement that annual filings be up to date before and after the expedited adjustment for a period of one year. This would speed competitive rates to market, free OIR to focus on significant pricing and coverage issues, and force insurers to continuously maintain fair rates. HCR

3) Allow the temporary prohibition on "use and file" rate filings, whereby rates are changed, and full filings made within 30 days to sunset. This will let insurers respond to changing market conditions – including offering competitive rate decreases – in the future, as well as lessening the regulatory burden on OIR. This would not prevent Citizens takeouts from being regulated to allow depopulation only at approved rates. HCR

4) If the temporary prohibition on property rate arbitrations is not allowed to sunset, then replace it with provisions installing an expedited judiciary process at the Division of Administrative Hearing (DOAH) so that insurers and OIR may have fast, final decisions on rate and rule disputes. HCR

5) Allow the unfettered use of information from hurricane risk models accepted by the Commission as actuarial support for rate filings. Rates are already regulated, and filing actuaries are already bound by law and standards regarding supporting information. However, OIR continues to stall the use of accepted models by insisting on the ability to disclose proprietary documentation already reviewed by the Commission under a process which assures public accountability while protecting trade secrets. HCR

6) Allow insurers direct access to the Public Hurricane Model and its detailed loss results prior to OIR's decisions based on those results. HCR

[13] SB1980 in 2006 regular session contained such a provision; it was repealed in HB1A.

7) Prohibit OIR from mandating territorial rate caps which force low risk homeowners to subsidize the insurance costs of high-risk homeowners. HCR

G. Other Public Policy Recommendations

1) Increase consumer awareness of the potential for "hurricane taxes" or assessments by requiring Citizens and the FHCF to annually calculate and publish an estimated percentage assessment, levied over a defined period, for a 1-in-100-year storm that strikes in the upcoming season. Require all insurance policy declarations pages to contain a notice specifying this estimated annual assessment in dollars and the period over which it would be levied. HCR

2) Continue to encourage responsible and affordable wind mitigation by funding the My Safe Florida Home program and requiring wind loss mitigation rating plans for insurers. Allow insurers to develop these plans using the results of any and all hurricane models accepted by the Commission but including discounts for all features enumerated in the current rule.[14] HCR

3) Develop a long-term growth management plan for the State of Florida that does not encourage inappropriate development by forcing Floridians to provide below market insurance coverage for coastal development. HCR

VIII. Intermediate-Term Solutions

A. The Florida Marketplace

1. Allow insurers to include reinsurance costs in their rates, with the burden of proof on the Office of Insurance Regulation (OIR) to justify excessive charges.

2. Permit insurers to renew policies with a specified hurricane deductible and provide a premium credit for higher deductibles.

[14] See rule 690-170-017, which mandates discounts from a particular hurricane model which is not commonly used by insurers and which produces generally higher losses than other models.

3. Grant insurers greater flexibility in rate setting, transitioning to market-based rates.

4. Request Congress to allow insurers to establish tax-deferred catastrophe reserves.

5. Continue to develop and nurture public/private partnerships to educate homeowners regarding the advantages of fortifying their homes.

6. Continue to develop, fund and update a uniform grading system for evaluating the hurricane strength of homes and commercial buildings.

B. Citizens Property Insurance Corporation

1. Authorize insurers to write non-homestead Citizens' policies at market rates.

2. Require minimum hurricane deductibles for non-homestead Citizens' policies based on insured value.

3. Require Citizens policyholders to upgrade their homes to meet the statewide building code over some period of time or risk higher hurricane deductibles applicable to their policies. An exception should be made for low-income policyholders. Or alternatively, permit Citizens to surcharge properties until they are retrofitted to meet building code requirements.

C. Regulatory Reform

1. Limit government intervention in rate-setting and allow market forces to determine appropriate rates

IX. Long-Term Solutions

A. Growth Management

1. Develop coastal areas more strategically, recognizing vulnerability to hurricanes.

2. Encourage local communities to consider the impact of development decisions on catastrophe exposure.

B. Improved Building Codes

1. Continuously update and enforce strong building codes to enhance the resilience of structures.

2. Continue to encourage local governments to promote and advocate for code plus structures by providing incentives to builders like density bonuses, lower impact fees, and concurrency credits when new construction is built at higher levels than the current approved building code.

C. Mitigation

1. Commit to long-term funding for the My Safe Florida Home program, providing free wind inspections and matching grants for mitigation. It should also be requested that the IRS confirm that such grants are not deemed taxable income to the recipient.

2. Aim to inspect and harden a significant portion of the existing housing stock built under older, less stringent building codes.

3. Continue to develop and nurture the creation of a not-for-profit corporation to raise funds from the private sector for additional mitigation grants.

D. Public Awareness of Risk

1. Promote educational efforts to increase public understanding of hurricane risk and the importance of mitigation.

2. Implement mandatory risk disclosure in real estate transactions.

3. Require signed acknowledgments of potential ineligibility for disaster aid if flood coverage is declined in high-risk areas.

While the proposed solutions address many aspects of Florida's insurance crisis, it's crucial to understand the pivotal role that reinsurance plays in the state's ability to manage catastrophic risk. The following section delves into the complexities of reinsurance and its impact on Florida's insurance landscape.

X. The Role of Reinsurance

Reinsurance, the insurance for insurance companies, plays a critical role in Florida's insurance landscape, particularly given the state's vulnerability to hurricanes.

In Florida, a state celebrated for its sunny days and sandy beaches, homeowners face a lurking menace: hurricanes. These natural disasters can cause catastrophic damage, leading to significant financial strain on insurance companies and, by extension, homeowners. Here, reinsurance (*insurance that an insurance company purchases to limit its risk by sharing some of its potential losses with other insurers)* plays a pivotal role, acting as a financial safety net for insurance companies, ensuring they can fulfill claims after disasters strike.

This discussion delves into the intricate role of reinsurance in safeguarding Florida's homeowners and stabilizing the insurance market.

A. Foundation of Reinsurance

Reinsurance plays a crucial role in the insurance world, providing a financial safety net for companies facing the devastating consequences of hurricanes. It's a system in which insurance companies purchase insurance to mitigate their risk exposure. For Florida, with its high propensity for hurricanes, this isn't just a safety measure; it's a necessity. Reinsurance provides a buffer that absorbs the shock of massive claims, ensuring that insurance companies don't buckle under the financial pressure of a natural disaster.

B. Why Reinsurance Matters to Florida Homeowners

Understanding reinsurance is crucial for homeowners. This mechanism ensures insurance companies remain solvent and capable of paying out claims in the aftermath of a hurricane.

Without reinsurance, insurers might hesitate to operate in such a high-risk area, limiting availability and driving up consumer costs. By spreading the risk globally, reinsurance makes it financially viable for insurers to offer coverage in hurricane-prone areas.

The global nature of reinsurance markets enables more effective risk distribution and cost management. Examples like the Caribbean Catastrophe Risk Insurance Facility (CCRIF) and the African Risk Capacity (ARC) demonstrate how spreading risk across multiple countries or regions can lead to more affordable coverage and faster payouts in the event of a disaster.

The debate over keeping reinsurance funds within Florida versus utilizing global reinsurance markets highlights the economic efficiencies gained from spreading risk internationally. While there might be an instinctive appeal to retaining funds within

the state, the global nature of reinsurance markets enables more effective risk distribution and cost management.

Reinsurance is not merely an accounting trick or a financial abstraction; it's a vital part of the insurance industry's infrastructure, particularly in risk-prone areas like Florida. By understanding the nuances of reinsurance, stakeholders can better navigate the complexities of the insurance market, ensuring stability and affordability for policyholders.

C. Alternatives to Reinsurance

Insurance companies have several avenues to access capital beyond their own balance sheets, which is crucial for expanding their ability to underwrite more policies, especially in high-risk areas like Florida. Beyond reinsurance, these methods include:

1. Letters of Credit: A letter of credit from a bank guarantee that the insurance company can access a specified amount of money when needed. This can be particularly useful for covering claims in the short term or as a form of collateral.

2. Sale of Company Stock: An insurance company can raise equity capital directly from investors by issuing new stock. This provides immediate funds and distributes ownership and risk among a broader base.

3. Bank Loans: Insurance companies can also take out loans directly from banks or other financial institutions. These loans provide immediate liquidity but must be repaid with interest, which can affect the company's financial health over time.

4. Catastrophe Bonds and Insurance-Linked Securities (ILS): These financial instruments transfer insurance risk to the capital markets. Catastrophe bonds, for instance, are designed to raise money in case of a specific disaster, with investors losing their principal if the disaster occurs. The ILS market has grown significantly in recent years, providing insurers with an alternative source of capacity for managing catastrophe risk. However, these instruments can be complex and expensive to issue, and their capacity may be limited compared to reinsurance.

5. Collateralized Reinsurance: This is a form of reinsurance where the reinsurer provides collateral to cover its potential obligations. The collateral, often in the form of trust funds or letters of credit, provides an additional layer of security for the ceding insurer. Collateralized reinsurance has become increasingly popular, particularly for covering catastrophe risks, as it allows reinsurers to isolate specific risks and attract investors who may not want exposure to an entire reinsurance portfolio.

6. Industry Loss Warranties (ILWs): These are a type of reinsurance contract that pays out based on the total loss experienced by the insurance industry from a specific event, rather than the losses of the individual insurer. ILWs can be a cost-effective way for insurers to protect against catastrophic events, as they are typically triggered only by very large industry losses. However, they provide less specific coverage than traditional reinsurance contracts.

7. Contingent Capital: These are arrangements where an insurer can access additional capital in the event of a significant loss event, often in the form of a pre-arranged debt facility or a put option on the insurer's stock. Contingent capital can provide insurers with an additional layer of financial protection, but it can be expensive and may come with restrictive covenants or trigger events.

8. Surplus Notes: Issued by insurers, these debt instruments are subordinated to all other claims, including policyholder claims. They provide a flexible form of capital that can be used under regulatory constraints. However, the issuance of surplus notes is subject to regulatory approval, and their use may be limited by factors such as the insurer's financial strength and the overall market conditions.

D. Why Reinsurance Remains Preferred

Despite these alternatives, reinsurance remains the preferred source of outside capital for several reasons:

- Risk Transfer Efficiency: Reinsurance is designed to transfer risk from the primary insurer. This allows insurance companies to manage their exposure to significant losses more effectively than through financial instruments that may still leave them bearing a significant portion of the risk.

- Capital Management Flexibility: Reinsurance agreements can be customized to cover specific risks, territories, or types of insurance, providing insurers with tailored solutions that other forms of capital cannot offer.

- Regulatory Favor: Regulatory frameworks often view reinsurance more favorably than other forms of capital. Reinsurance can be treated as a reduction in liability, directly lowering the amount of capital insurers need to hold against potential claims.

- Market Dynamics: The reinsurance market is global and highly competitive, allowing insurers to find cost-effective coverage for their risks. This competition helps keep reinsurance prices relatively attractive compared to capital costs through equity or debt markets.

- Operational Continuity: Reinsurance agreements often come with expertise and support from the reinsurer. This can help insurers manage claims and recover from large events more efficiently than if they had to rely on their resources or those provided through financial markets.

In practice, insurers often use a combination of reinsurance and other risk transfer mechanisms to manage their exposure. The optimal mix will depend on factors such as the insurer's size, risk profile, regulatory environment, and overall business strategy. For Florida property insurers, reinsurance will likely remain a key component of their risk management strategy, given the state's unique exposure to hurricane risk and the proven track record of reinsurance in absorbing losses from past storms.

While reinsurance provides a financial buffer against catastrophic losses, proactive measures to reduce potential damage are equally important. This brings us to the critical role of building codes and the innovative concept of "Code Plus" standards in mitigating hurricane-related losses.

XI. The Importance of Building Codes and "Code Plus" Standards

The most effective way to reduce Florida homeowners' insurance premiums is to reduce future losses.

While this statement oversimplifies the complex problem Florida faces, it does draw attention to the need for construction techniques that increase the likelihood that homes will be capable of withstanding high wind conditions.

For instance, many claim that Florida has one of the best Building Codes in the United States, but can improvements to the Code reduce future losses?

We believe the answer is an emphatic "Yes" based on a review of recently published research.

THIS IS IMPORTANT

A. Insights from the University of Florida's Engineering Study

In 2019, the University of Florida's Engineering School of Sustainable Infrastructure and Environment, within the Department of Civil and Coastal Engineering, unveiled a pivotal report titled "**Investigation of Optional Enhanced Construction Techniques for the Wind, Flood, and Storm Surge Provisions of the Florida Building Code.**"[15] This comprehensive study underscores the critical nature of hurricane mitigation efforts in Florida, charting the evolution and impact of building construction advancements since the Florida Building Code was implemented in 2002.

The report meticulously documents the tangible benefits these advancements have conferred upon the structural integrity of residential buildings in the face of hurricanes, with a notable decrease in wind damage post-Hurricanes Charley (2004); Irma (2017), Michael (2018).

[15] http://www.buildingasaferflorida.org/assets/Final%20Prevatt%20UF%20EnhancedBuildingOptions%20for%20FBC%20-%20FINAL27Dec2019%20(2)1.pdf

Despite the robustness of Florida's building codes, the study reveals that vulnerabilities in the building envelope systems continue to be a significant source of economic losses.

Drawing upon insights from FEMA and the Florida Department of Environmental Protection, the report presents an array of enhanced construction recommendations that surpass the standards set by the 6th and 7th Editions of the Florida Building Code.
These recommendations are geared towards bolstering wind resistance in new constructions and enhancing resilience against hurricanes.

B. Key Proposed Enhancements

Highlighted below are the key proposed enhancements, along with a brief commentary on their significance:

1. **Wind Resistance Improvement:**

    - **Design Wind Load Standard Update:** Incorporating ASCE 7-16 for wind load calculations ensures adherence to the latest research and provides more precise estimations.

    - **Roof Sheathing Attachment:** Utilizing roof sheathing ring shank nails (RSRS) for attachment offers a fortified, reliable solution capable of withstanding high wind velocities.

2. **Resistance to Wind-borne Debris:**

    - **Sheathing Requirements:** A minimum plywood thickness specification fortifies the building envelope against debris impacts.

    - **Glazing and Door Protections:** Requiring impact-resistant coverings for windows, doors, and garage doors critically mitigates the risk of breaches that lead to internal pressurization and subsequent water intrusion.

3. **Roof Coverings Wind Resistance:**

    - **Enhanced Performance Standards:** Implementing rigorous requirements for roofing materials, such as ASTM D7158 Class H for asphalt shingles, directly addresses one of the primary avenues for water intrusion.

4. **Wall Coverings Wind and Water Intrusion Resistance:**

    - **Strengthening Wall Coverings:** Improved performance criteria for various siding materials enhance their durability and resistance to wind and water forces.

5. **Roof Water Intrusion Resistance:**

    - **Sealed Roof Deck and Ridge Vents:** Emphasizing the creation of a secondary water barrier and tested ridge vents tackles critical vulnerabilities in roofs during hurricanes.

6. **Windows and Doors Wind and Water Intrusion Resistance:**

    - **Enhanced Performance Requirements:** Establishing rigorous standards for windows and doors ensures they can withstand hurricane-induced pressures.

7. **Soffit Resistance:**

    - **Soffit Performance Improvements:** Ventilated soffits tested for wind and wind-driven rain resistance and mandatory in-progress inspections aim to fortify a common failure point in buildings during storms.

8. **Other Best Practices:**

    - **Gutters and Staple Use:** Evaluating gutters for wind load resilience and advocating for eliminating staples in the Florida Building Code

underscores the importance of attention to detail for overall building envelope resilience.

These meticulously designed enhancements target the nuanced vulnerabilities identified through extensive hurricane damage assessments and research. By concentrating on augmenting both wind and water intrusion resistance, these measures promise to elevate the overall durability and resilience of buildings in hurricane-susceptible regions, potentially diminishing damage and loss during such disasters.

This approach embodies a comprehensive strategy for constructing a more hurricane-resistant building envelope, emphasizing the crucial role of fastener types, material standards, and installation techniques.

C. Challenges and Benefits of Implementing "Code Plus" Standards

However, implementing these enhanced building standards comes with potential challenges and obstacles. One significant hurdle is the increased cost of higher-quality materials and more stringent construction practices. Homeowners and developers may be reluctant to invest in these upgrades, particularly if they are not mandatory or if the perceived benefits do not outweigh the additional costs.

Another challenge is ensuring consistent enforcement of these enhanced standards across the state. Building code enforcement can vary from one jurisdiction to another. Ensuring that all new construction adheres to the "Code Plus" standards would require a concerted effort from local building departments and inspectors.

Additionally, some stakeholders in the construction industry who are accustomed to traditional building methods and materials may resist. Educating and training contractors, architects, and engineers on the importance and proper implementation of these enhanced standards will be crucial for their successful adoption.

Despite these challenges, the potential benefits of "Code Plus" in reducing losses and stabilizing the insurance market in Florida are significant. By investing in more resilient construction practices, the state can mitigate the impact of future hurricanes,

protect homeowners' investments, and create a more sustainable and affordable insurance environment.

In the swirling storm of Florida's hurricane season, homeowners' insurance premiums stand like a lighthouse, guiding through financial storms but at a cost that can sometimes feel as steep as the waves themselves.

The statement that the only way to effectively reduce these premiums is by minimizing future loss or claims is akin to saying the best way to avoid getting wet in a downpour is not to step outside. While fundamentally true, it oversimplifies the factors that soak Florida's insurance landscape.

Imagine, if you will, Florida as a vast archipelago of homes, each island bracing for the next hurricane. The traditional approach has been to build levees—insurance policies—to keep the floodwaters at bay. Yet, as any seasoned captain will tell you, the best way to survive a storm is by reinforcing the barriers and making the ship seaworthy.

In Florida's case, this means constructing homes that can wink at a hurricane and withstand its fury.

Enter the world of enhanced construction techniques, a realm where building codes don't just meet minimum standards but exceed them, where homes are not just shelters but fortresses against the elements.

It's the equivalent of outfitting your ship with the best sails, the sturdiest hull, and a skilled crew that even the Kraken thinks twice before attacking.

Yet, as we navigate these waters, we must maintain sight of the humor in our situation. We're armoring our castles against dragons that, instead of breathing fire, huff and puff and try to blow our houses down.

It's a modern-day fairy tale, where the big bad wolf is the hurricane, and the three little pigs are architects, builders, and homeowners working together to ensure their homes are the ones made of bricks.

As we consider improvements to Florida's building practices and insurance policies, it's valuable to look beyond our borders for insights. The experiences of other countries in managing catastrophic risks offer valuable lessons that can inform Florida's approach to insurance reform and disaster preparedness.

XII. Lessons from International Experiences

Florida can learn valuable lessons from the contrasting approaches to economic recovery and risk management taken by New Zealand in the aftermath of the Canterbury earthquakes and by Japan following its earthquake and tsunami.

A. New Zealand's Recovery Post Canterbury Earthquake

The Canterbury earthquake in New Zealand, notably the devastating February 2011 quake, presented significant challenges. However, the country's high insurance penetration, due to the partnership between the insurance industry and the Earthquake Commission (EQC), played a critical role in the recovery process.

New Zealand benefited from being covered by three of the world's top six reinsurance programs, which helped mitigate the economic impact of the disaster. The losses from the earthquake were approximately equivalent to 20% of New Zealand's GDP, showcasing the significant financial burden placed on the country.

The Earthquake Commission (EQC) was pivotal in managing and improving the claims process, especially after the 2016 Kaikoura earthquake, which generated another 40,000 claims. The EQC embraced digital technologies for efficient and unified claims processing, partnering with private insurers to manage the end-to-end claims journey.

This new operating model and technological implementation significantly enhanced disaster recovery, setting a precedent for a coherent and integrated approach.

Property insurance claims from the earthquakes amounted to about $38 billion, with 72%, the most significant portion, funded by existing reinsurance. This mix of

funding sources, including after-the-event reinsurance and additional capital, underscored the importance of robust funding mechanisms for future disasters.

Research has shown that the type and timing of insurance payouts significantly influenced the recovery of residential areas and businesses in Christchurch.

For every 1% increase in insurance payment for building damage, economic recovery increased by 0.36%. This empirical link between post-catastrophe insurance payments and local economic recovery highlights the critical role of timely and effective insurance responses in disaster recovery.

B. Japan's Post-Disaster Economic Recovery

In contrast to New Zealand, Japan's decision to retain risk following its earthquake and tsunami led to a more sluggish and painful economic recovery. The lack of substantial outside capital to finance rebuilding damaged infrastructure slowed the recovery process. This situation in Japan illustrates the potential drawbacks of a risk retention strategy, especially in large-scale natural disasters where the financial burden can be overwhelming.[16]

C. Applying International Lessons to Florida

Florida can draw critical insights from these contrasting approaches. New Zealand's experience underscores the value of risk transfer, mainly through insurance and reinsurance, in facilitating swift and effective post-disaster recovery. The integration of digital technology and collaboration with private insurers, as seen in New Zealand, can also enhance the efficiency and effectiveness of disaster recovery efforts.

In contrast, Japan's experience highlights the potential challenges associated with risk retention, particularly the difficulty in mobilizing sufficient resources for recovery without external financial support.

[16] Summary - Lessons Learned from the Fukushima Nuclear Accident for Improving Safety of U.S. Nuclear Plants https://www.ncbi.nlm.nih.gov/books/NBK253923/

Florida can benefit from a balanced approach to risk management that leverages the strengths of risk transfer and retention. This entails maintaining adequate insurance coverage and investing in technology and collaborative frameworks to optimize recovery processes. Such an approach can enhance the state's resilience to catastrophe events like hurricanes, ensuring a more robust and swift economic recovery.

While international examples provide valuable insights, there are additional key themes specific to Florida's situation that warrant further exploration. These themes, including the debate surrounding the Florida Hurricane Catastrophe Fund and the distinction between risk and uncertainty, provide crucial context for our policy recommendations.

XIII. Additional Key Themes

A. The Florida Hurricane Catastrophe Fund Debate

Now, let's address the debate surrounding the expansion of the Florida Hurricane Catastrophe Fund (FHCF). Some argue that expanding the FHCF will reduce homeowners' insurance premiums, but there are some important concerns to consider.

Cautionary Note: *A catastrophe fund violates one of the fundamental tenets of insurance – spreading the risk. It also supplants private-sector reinsurance, which is fully paid for in advance.*

Private reinsurance spreads the risk globally, and the cost of that reinsurance is paid upfront. A state catastrophe fund concentrates that risk in one jurisdiction and shifts the financial risk of catastrophic losses from private sector insurers to insurance buyers and taxpayers.

On the other hand, private reinsurance promotes the spreading of risk and loss. Results from the 2005 hurricanes indicate that the losses were borne as follows: 41% in the private insurer market, 24% among Bermuda reinsurers, 11% for U.S. reinsurers, 13% among European reinsurers, 9% in Lloyds, and 1% for other. Risk

spreading fosters a viable competitive market; risk concentration among a few insurers and state funds inhibits a competitive market.

So, let's break down the concerns:

1. Violating the fundamental tenet of risk spreading: As the cautionary note states, the FHCF concentrates risk within a single jurisdiction rather than spreading it globally. This approach violates a core principle of insurance and effective risk management. By expanding the FHCF, Florida would further concentrate risk, potentially increasing the state's and its taxpayers' financial vulnerability in the event of a major catastrophe.

2. Supplanting private reinsurance: The expansion of the FHCF would likely supplant private reinsurance, which is fully paid for in advance and spreads risk globally. Data from the 2005 hurricanes demonstrates the effectiveness of private reinsurance in distributing losses across a wide range of entities and geographies. By replacing private reinsurance with a state-run catastrophe fund, Florida would forego the benefits of global risk spreading and potentially expose itself to greater financial risk.

3. Shifting risk to insurance buyers and taxpayers: The cautionary note highlights that the FHCF shifts the financial risk of catastrophic losses from private insurers to insurance buyers and taxpayers. This means that the financial burden would fall on Floridians in the event of a major catastrophe, rather than being spread across a global network of reinsurers. This concentration of risk could lead to significant financial strain for the state and its residents.

4. Inhibiting a competitive market: As noted, risk spreading fosters a viable competitive market, while risk concentration among a few insurers and state funds inhibits competition. The expansion of the FHCF would likely reduce the role of private reinsurance and concentrate risk within the state, potentially leading to a less competitive and less innovative insurance market in Florida.

5. Potential for unintended consequences: Drawing from Bastiat's observations, the expansion of the FHCF could lead to unintended consequences, such as reduced market competition, decreased incentives for risk mitigation, and increased moral hazard (the risk that a party protected by insurance will take greater risks because the financial consequences are borne by the insurer). Policymakers should carefully consider these potential drawbacks before pursuing an expansion of the state-run catastrophe fund.

While the goal of reducing homeowner insurance premiums in Florida is understandable and important, the expansion of the FHCF may not be the most effective or sustainable solution. Instead, policymakers should focus on promoting a competitive and innovative private insurance market, encouraging risk mitigation efforts, and developing targeted assistance programs for vulnerable homeowners.

Florida can work towards a more resilient and equitable property insurance system without compromising the fundamental principles of effective risk management by strengthening the private reinsurance market, improving building codes and land-use planning, and providing targeted support to those in need. This approach, guided by the insights of Ellsberg, Knight, and Bastiat,[17] would prioritize the long-term stability and sustainability of the Florida property insurance market while also addressing the pressing need for affordable coverage.

B. Risk vs. Uncertainty: Insights from Dr. Frank H. Knight

Dr. Frank H. Knight, an influential American economist, laid the foundation for what would later become known as the Chicago School of Economics with his seminal work, "*Risk, Uncertainty, and Profit*," published in 1921. This book challenged existing economic theories and introduced a critical distinction between risk and uncertainty that has profoundly impacted economic thought and practice.

[17] See "The 9 Guideline Principles to Enact Change: A Legislator's Memoir – From Outhouse to State House" Chapters 1, 12, 17, 28, and 31. Also, see "Ris vs. Uncertainty: Insights from Dr. Frank H. Knight" on Page 26 of this report.

Beyond his contributions to economic theory, Knight was a formidable figure who resisted many of the prevailing economic shifts of his time, including Keynesianism and theories of monopolistic competition.

“Risk, Uncertainty, and Profit" remains a cornerstone of economic literature, celebrated for its innovative approach to understanding the dynamics of markets and the function of profit within them. Knight's rigorous analysis and the distinctions he drew between risk and uncertainty have enriched economic theory and provided valuable insights for entrepreneurs navigating the unpredictable terrains of the market.

A. Measurability

Knight argued that risk refers to situations where the probability of outcomes can be known or calculated, making them quantifiable and insurable. This measurability allows businesses to manage risk through insurance or hedging strategies. For example, the probability of a dice roll or the risk of a warehouse fire can be statistically assessed based on past data, allowing for the calculation of insurance premiums to cover such risks.

In contrast, uncertainty, or what Knight termed "true uncertainty" or "Knightian uncertainty," cannot be measured or quantified because it pertains to events with unknown probabilities. This unquantifiable nature of uncertainty makes it impossible to insure against or hedge similarly to calculable risks.

B. Predictability

Under Knight's framework, risk predictability is relatively high since it can be assessed and managed through statistical and mathematical models. Firms can allocate resources and adjust their strategies based on the known probabilities of different risks, integrating these factors into their business planning and capital allocation processes.

However, uncertainty presents a challenge to predictability because it involves rare, unique events or have no prior history to inform their likelihood. Decisions made

under conditions of uncertainty are based on judgment and intuition rather than calculable odds. This unpredictability necessitates a different approach to decision-making, where entrepreneurs must rely on their insights and expertise to navigate these uncharted waters.

C. Impact on Capital Adequacy

Knight's distinction between risk and uncertainty has significant implications for capital adequacy—the amount of capital a firm needs to sustain its operations and absorb unexpected losses. In the case of risks, firms can plan and set aside capital based on the expected loss probabilities and insurance costs, allowing for a more straightforward calculation of the necessary capital reserves to maintain financial stability.

On the other hand, uncertainty complicates capital adequacy assessment because it's challenging to predict the capital required to cover unknown and unmeasurable events. This unpredictability may lead firms to maintain higher capital levels as a buffer against unforeseen outcomes or invest in flexibility and adaptability as strategic assets in uncertain environments.

And that brings us back to the serious reality of Dr. Frank H. Knight's work. Understanding the difference between risk and uncertainty can help us prepare better for the unexpected challenges we can't anticipate. But it's not foolproof, and we need to stay vigilant to respond effectively.

XIV. Conclusion and Future Considerations

Florida's homeowners' insurance crisis is a complex, multifaceted challenge that requires a comprehensive and forward-thinking approach. This white paper has outlined a series of interconnected strategies aimed at stabilizing the insurance market, reducing risk, and protecting homeowners.

It's important to address a common question: 'Will implementing these recommendations reduce property insurance premiums?' The answer is more nuanced than a simple yes or no. Insurance premiums reflect the total cost of

potential damages, which will be paid one way or another - through premiums, assessments, or reduced property values. The key to potentially lowering costs lies in our willingness to change behaviors and adopt risk mitigation strategies. A $50 billion storm will inevitably cost $50 billion, but how that cost is distributed depends on our collective actions. The first step in addressing this crisis is acknowledging this reality. While Florida offers many benefits, living in a hurricane-prone area comes with inherent costs and responsibilities.

As we look to the future, several key considerations emerge:

1. Balancing Affordability and Sustainability: The proposed reforms aim to create a more stable insurance market while keeping coverage affordable for homeowners. Future policymakers must continue to strike this delicate balance, ensuring that risk-based pricing doesn't price out vulnerable populations while maintaining the financial viability of insurance providers.
2. Climate Change Adaptation: As the frequency and intensity of hurricanes are likely to increase due to climate change, Florida must remain at the forefront of climate adaptation strategies. This includes continually updating building codes, zoning laws, and insurance regulations to reflect the evolving risk landscape.
3. Technological Innovation: Embracing emerging technologies in risk assessment, building materials, and disaster response will be crucial. Future considerations should include the integration of AI and big data in risk modeling, the use of advanced materials in construction, and the deployment of drones and satellite imagery for rapid damage assessment.
4. Public Education and Behavioral Change: The success of many proposed reforms hinges on public understanding and cooperation. Ongoing efforts to educate Floridians about hurricane risks, the importance of mitigation, and the value of adequate insurance coverage will be essential.
5. Regulatory Flexibility: As the insurance market evolves, regulatory frameworks must be flexible enough to accommodate innovation while still protecting consumers. Future legislation should aim to create an environment that encourages new entrants and novel insurance products while maintaining robust consumer protections.

6. Global Reinsurance Market Dynamics: Florida's reliance on the global reinsurance market necessitates ongoing monitoring of international financial trends and catastrophe events worldwide. Future strategies should consider ways to diversify risk transfer mechanisms and potentially develop regional catastrophe risk pools.
7. Long-term Funding for Mitigation: Sustained investment in mitigation efforts, including the "My Safe Florida Home" program and initiatives to retrofit existing structures, will be crucial. Future budgetary considerations should prioritize these programs as a cost-effective way to reduce long-term losses.
8. Coastal Development Policies: As sea levels rise and storm surge risks increase, Florida must reevaluate its approach to coastal development. Future considerations should include managed retreat strategies, stricter building requirements in high-risk areas, and innovative financing mechanisms for climate-resilient infrastructure.
9. Cross-Sector Collaboration: Addressing the insurance crisis will require ongoing collaboration between government agencies, private insurers, reinsurers, builders, real estate developers, and community organizations. Future efforts should focus on strengthening these partnerships and creating new avenues for cooperation.
10. Continuous Evaluation and Adaptation: The effectiveness of implemented reforms should be continuously monitored and evaluated. Florida should establish a dedicated task force or commission to regularly assess the state of the insurance market and recommend adjustments to policies as needed.

In conclusion, while the challenges facing Florida's homeowners' insurance market are significant, they are not insurmountable. By implementing the multifaceted approach outlined in this paper and remaining vigilant to future trends and challenges, Florida can create a more resilient, stable, and equitable insurance landscape. This will not only protect homeowners and insurers but also contribute to the long-term economic stability and sustainability of the state in the face of ongoing hurricane risks.

The path forward requires political will, public engagement, and a commitment to evidence-based policymaking. By taking decisive action now and maintaining a

proactive stance, Florida can transform its current crisis into an opportunity to become a global leader in disaster resilience and innovative insurance solutions.

Sources

1. Brown, Donald. (2024). *The 9 Guideline Principles to Enact Change: A Legislator's Memoir – From Outhouse to State House*.
2. Pielke, Roger A. Jr., Gratz, Joel, Landsea, Christopher W., Collins, Douglas, Saunders, Mark A., & Musulin, Rade. (2008). *Normalized Hurricane Damage in the United States: 1900-2005*. Available at: https://www.nhc.noaa.gov/pdf/NormalizedHurricane2008.pdf
3. Florida House of Representatives Insurance Committee. (2008). *Letter to Speaker Marco Rubio*, April 2, 2008.
4. Citizens Property Insurance Corporation. *Citizens' Assessments Impact All Floridians Brochure*. Available at: https://www.citizensfla.com/documents/20702/29368837/Citizens%27+Assessments+Impact+All+Floridians+Brochure.pdf/b2c2a55c-e310-4236-6f22-a2d9994ff23c?version=3.0&t=1719972645644&d
5. Florida Statutes. (2003). *Title XXXVII Insurance: Section 627.351*. Available at: http://www.leg.state.fl.us/statutes/index.cfm?App_mode=Display_Statute&Search_String=&URL=Ch0627/SEC351.HTM&Title=-%3E2003-%3ECh0627-%3ESection%20351#0627.351
6. Citizens Property Insurance Corporation. (2006). *HB1A Rate Freeze Implementation*.
7. Florida Senate. (2006). *Senate Bill 1980*.
8. Turner, Christine. (2008). *Palm Beach Post Editorial*, March 31, 2008.
9. Florida Office of Insurance Regulation. *Form OIR-B1-1790*.
10. Florida Senate. (2006). *Senate Bill 1980*.
11. Florida Administrative Code. *Rule 690-170-017*.
12. National Center for Biotechnology Information. (2014). *Summary - Lessons Learned from the Fukushima Nuclear Accident for Improving Safety of U.S. Nuclear Plants*. Available at: https://www.ncbi.nlm.nih.gov/books/NBK253923/
13. Brown, Donald. (2024). *The 9 Guideline Principles to Enact Change: A Legislator's Memoir – From Outhouse to State House*, Chapters 1, 12, 17, 28, and 31.
14. Knight, Frank H. *Ris vs. Uncertainty: Insights from Dr. Frank H. Knight*. Page 26 of this report.
15. University of Florida's Engineering School of Sustainable Infrastructure and Environment. (2019). *Investigation of Optional Enhanced Construction Techniques for the Wind, Flood, and Storm Surge Provisions of the Florida Building Code*. Available at: https://www.buildingasaferflorida.org/assets/Final%20Prevatt%20UF%20EnhancedBuildingOptions%20for%20FBC%20-%20FINAL27Dec2019%20(2)2.pdf
16. NOAA's National Hurricane Center. (2010). *The Deadliest, Costliest, and Most Intense U.S. Tropical Cyclones From 1851-2010*. Available at: https://www.aoml.noaa.gov/hrd/Landsea/deadly/index.html
17. NASA Climate Change. (2018). *New Study Finds Sea Level Rise Accelerating*. Available at: https://climate.nasa.gov/news/2680/new-study-finds-sea-level-rise-accelerating/

18. Florida Association of Insurance Agents. (2003). *Insurance Reform Recognition*.
19. Florida Association of Insurance and Financial Advisors. (2002). *Significant Contributions to Insurance Reform*.
20. Building a Safer Florida, Inc. *Final Prevatt UF Enhanced Building Options for FBC*. Available at: https://www.buildingasaferflorida.org/assets/Final%20Prevatt%20UF%20EnhancedBuildingOptions%20for%20FBC%20-%20FINAL27Dec2019%20(2)2.pdf

About the Authors

Donald D. Brown

Don Brown is a retired insurance agent from DeFuniak Springs, Florida, with experience in the insurance industry. He has served on the Walton County Commission and as a State Representative in the Florida House of Representatives. Don is well known for his work on insurance issues and has been recognized by both the Florida Association of Insurance Agents and the Florida Association of Insurance and Financial Advisors for his significant contributions to insurance reform. His deep understanding of public policy and commitment to market-based solutions underscore his insights on the homeowner's insurance crisis in Florida.

Dennis A. Ross

Dennis A. Ross is a political science professor at Southeastern University in Florida and a retired U.S. Congressman. He also served as a Florida State Representative, where he was known for his extensive work on property insurance issues. Prior to his public service, and continuing to this day, Dennis is an attorney based in Lakeland, FL. His comprehensive background in law, education, and legislative service provides a robust foundation for his contributions to addressing the complexities of homeowners insurance in Florida.