The Unnatural Disaster: Who Will Pay For the Next Major Hurricane

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FLORIDA’s UNNATURAL DISASTER: WHO WILL PAY FOR THE NEXT MAJOR HURRICANE?

ABSTRACT:

Since Hurricane Katrina, most state’s hurricane insurance programs have become increasingly political in an effort to control rapidly rising insurance rates. These legislative efforts often create their desired short-term effects, but only at the expense of harming millions of insurance customers in the long-term. Florida provides a perfect laboratory for examining the current crisis with its heavy coastal population and high vulnerability to hurricanes. By using a case study of a state with a more conservative hurricane insurance system, this article attempts to bridge the gap between the current system and the self-sustaining system. Specifically, the article proposes a glide path of reforms where states can gradually regain their self-sustainability in the long run. However, in the event the reforms are not implemented in time, the article also explores the federal options that may exist in the wake of a disaster.

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I. Introduction, Exposure to the Exposure

The Smiths are a married couple who own a home in Florida. A few years ago, after working hard all their life, the Smiths decided to retire and purchase their dream home across the street from the beach. Like the Smiths, an estimated 11.2 million people, over sixty-five percent of the state’s population, has moved into Florida’s coastal regions in the last half century. Along with the population increase, property values along the coast have been skyrocketing. Generally these are both considered great facts for a state, but not so when considered in a different light. The increased amount of structures, and each with an increased value, have created new and unpredicted levels of hurricane exposure. Though the Smiths love their house and they are able to afford the insurance, the Smiths are truly scared now. They are scared because they are Florida homeowners and the unnatural disaster is brewing.

“State officials [in Florida] have conceded [that] they would be billions of dollars short in their own catastrophe coverage if a severe hurricane hits.” Florida officials have also determined that in a worst case scenario, a single hurricane could cause as much as $198.9 billion in total damage. Furthermore, there are many years where Florida is hit by multiple hurricanes. Florida has rolled the dice, and if Mother Nature calls her number in the next few years, then the only question that remains is who will pay for the damage.

The Smith Family is not scared of the storm’s damage itself because that is why they purchased insurance. They are only scared of not being able to collect on their hurricane insurance policy even though they have fulfilled all their obligations. After all, the purpose of hurricane insurance is to give customers some sense of assurance that they will be returned to whole in the event of any storm damage.

Part I of this article explains the Smith’s dilemma by focusing on the broad political and policy considerations. The political section examines the natural tendency of the government to artificially lower rates for short-run political gain using the 2004 and 2005 hurricane seasons as the prime example. The policy section considers how the state could treat its insurance problems by examining the big five decisions: (1) private market led v. government led insurance systems, (2) pre-event funding v. post-event funding, (3) actuarially sound rates v. artificially low rates, (4) isolated insurance assessments v. broad insurance assessments, (5) in-state controlled v. federally controlled hurricane insurance.

Part II explains the realistic fear of the Smiths and millions of other coastal property owners in Florida by breaking down the unnatural disaster from start to finish to show how these

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4 Florida Department of Financial Services, Economic Impact of a 1-in-a -100 Year Hurricane, at 2 (Mar. 13, 2009) [hereinafter DFS Report].
5 In practice “hurricane insurance” is a fiction, but for the purpose of this article, hurricane insurance refers to hurricane related insurance, which most commonly includes multiperil homeowners insurance, windstorm insurance, casualty insurance, and covers other minor forms of property insurance as well. Hurricane insurance as used in this paper does not encompass flood insurance.
problems began and how they spiraled out of control, putting Florida where it is today. This section examines each of the three main pillars of the problem: (1) the state-run Florida Hurricane Catastrophe Fund (the Cat Fund), (2) the state-run Citizens Property Insurance Corporation (Citizens), and (3) the heavily regulated private insurance market.

Currently, as of May 2009, the Cat Fund, Florida’s own government reinsurance program, only has $18 billion to cover $29 billion of its obligations, a gapping $11.4 billion dollar hole of liability.\(^7\) Citizens, the government insurer of “last resort,” has its own problems. After years of artificially low rates it has drifted from its original intent and taken on excessive risk by insuring almost a third of Florida’s residential insurance market.\(^8\) The last problem comes from the private insurance market, where after years of strong government price caps, State Farm Insurance, Florida’s largest private insurer, as well as other insurers have announced their plans to cancel all property insurance policies in Florida.\(^9\) The unnatural disaster is already set. The only ingredient needed now is the next major hurricane, a likely encounter for a state that historically receives forty-seven percent of all hurricanes.\(^10\) Moreover, looking at the 2009 Atlantic Hurricane Season, experts are estimating fourteen named storms and seven hurricanes this year, including three major hurricanes.\(^11\)

The last subpart fleshes out the magnitude and the combined effect of these problems by providing a stern look at what would happen to the state in a worst case scenario, what would happen if another category five Hurricane Andrew was to churn through one of Florida’s major population areas.

Part III offers a contrasting view to the current Florida model by spotlighting South Carolina’s conservative insurance model, which predominantly relies on the private market to handle its insurance problems. This section looks at four policies South Carolina uses to keep the private market system healthy: (1) preserve the state-run insurer as a true insurer of last resort, (2) offer tax exemptions for private insurers willing to cover the riskiest properties, (3) offer tax exemptions to individual citizens to encourage hurricane preparation, and (4) avoid a state-run reinsurance program.

Part IV proposes a glide path of reforms that would create a sustainable insurance system for Florida while minimizing the pains of implementation over a period of years. This model would balance Florida’s unique priorities by preserving low insurance rates and moderate control while offering sustainability. Specifically, the glide path consists of three core policy shifts. The first shift is to restrict the Cat Fund’s coverage obligations to $16 billion. The second shift

\(^{7}\) Paige St. John, *Fla.’s Hurricane Catastrophe Is Fund in Jeopardy*, Sarasota Herald-Tribune, Feb. 7, 2009, available at http://www.theledger.com/article/20090207/NEWS/902070346/1410?Title=Fla__s_Hurricane_Catastrophe_Is_Fund_in_Jeopardy. The Cat Fund currently has around $18 billion by combing $10.6 billion in pre-event assets to cover reinsurance payments, and $7 billion from private insurance company deductibles as required to pay for the first part of catastrophic losses. There is also some predictions that the Cat Fund would be able to raise $3 billion in post-event bonding as well, but this is not calculated into the equation do to its speculative nature.\(^{Id.}\)

\(^{8}\) *DFS Report, supra* note 4, at 16.

\(^{9}\) *Id.*

\(^{10}\) Interview with Mark Delegal, Legal Counsel for State Farm Insurance Company, Partner for Pennington, Moore, Wilkinson, Bell & Dunbar Law Firm (Mar. 27, 2009).

is to return Citizens to its original function as an insurer of last resort to prevent it from competing with the private market. The third shift is to reduce government regulation on the private market rates to encourage competition and allow the free market to regulate prices.

Part V explores the emergency options Florida may have in Washington D.C. in the event of a major catastrophe occurring in the next few years. Given the current political realities, the question of national assistance is more of a question of “how,” than “if.” Specifically there are three proposed national solutions that are presently being considered inside the Capitol Building:

The first solution is to provide ad hoc national assistance, where the president brings in small amounts of federal money to help cover catastrophic damages. In extreme catastrophes, such as Katrina, Congress can approve much more. Due to its political nature and lack of accountability this is the least desirable option. The second solution is a national catastrophe fund that would operate like a reinsurance pool similar to Florida’s Cat Fund. This plan has previously passed both the U.S. House and U.S. Senate in 2008, but failed overall due to a veto threat from President Bush. However, a new national catastrophe fund is currently being proposed in the House, and with a new president, there may be a new result. The third solution, the national bridge loan, is the most attractive option because it would provide a depoliticized federal backstop in the form of a low interest bridge loan that a user state would be required to pay back. To establish this line of credit, Florida is currently lobbying the U.S. Treasury, the Federal Reserve Bank, Congress, and President Obama.

This article finds that Florida’s hurricane insurance system is in its darkest hour going into the 2009 hurricane season. For now the problems are set and the risks are real, so if a major hurricane was to hit the state, it is still unclear whether the Smith Family would be able to collect any from their insurance claim. The thrust of this article is to highlight Florida’s current problems to demonstrate the need for immediate reform, particularly in a more conservative and sustainable direction. Though Florida’s recent trend has progressed in a more political and riskier direction, there may be enough time to reform. The solution is to implement a glide path of reforms that implement marginal changes each year to achieve long-term sustainability. This conservative reform will eventually happen. The real question is whether the pendulum will swing back before, or after, the next major hurricane. In other words will the unnatural disaster will be defused in time.

I. Background, The Politics and Policies Behind the Unnatural Disaster

A. The Politics

Hurricanes have been striking the state long before it was ever called Florida, but never before has Florida been in such a vulnerable position. Florida will be taking on the 2009 hurricane season without sufficient resources to uphold their financial obligations, and the state has lost much of its control over the problem, at least through this hurricane season. As the title states this is Florida’s unnatural disaster. The disaster was created on the simple premise that at times it is politically popular to lower hurricane insurance rates in the short-term. High insurance rates following a major hurricane are often the warning sign that the state capitol will soon be cooking up some reactionary policy to make rates temporarily go down.

The underlying problem that everyone can agree on is that hurricane insurance rates in Florida’s coastal regions are currently exorbitant, and many people cannot afford to live around the coast. The next question begins the divide in opinion; should Florida just tell those who cannot afford living on the coast to move, or should some assistance be given to those property owners? The attitude of some is that “if you cannot afford the cost… you should move.”

Sounds simple, if it is expensive to live in a risky area and you cannot afford the property, then do not buy it.

However, like most things it is truly more complicated, specifically there are three problems. First, people who already lived in their coastal residence do not want to move. Another problem is that if hurricane insurance is too expensive it may cause some people not pay for insurance, that is not pay for the risk connected with their property. If this was played out on a large scale Florida’s homeless population could increase by thousands maybe millions overnight after a single hurricane. The third and final problem is the economic result of a widespread lack of insurance causing another housing slump in Florida. In the words of retired Florida State Senator Skip Campbell:

> We are going to have a major crisis statewide with people that can[not] afford property insurance rates and that [is] going to create a crisis in multiple sectors of our economy. [P]eople will not be able to sell their houses because there won't be buyers because buyers can[not] afford to pay the taxes and insurance. So, the banks are going to hurt, the mortgage companies are going to hurt, [the] real estate agents are going to hurt, and [the] general economy is going to start hurting because we will not have people who can, in fact, live in our communities to perform the jobs that we need; such as teaching, such as police officers, this is going to go one level even further down because we are seeing some of the commercial property owners having the same problems as the residential community, which is they’re getting hit with increased property taxes and almost astronomical property insurance rates. So, what do they do? [They increase rent.] This is the beginning of the problem and it's more far-reaching than anybody can ever think about.

In summary, hurricane insurance helps coastal residents as well as the overall state economy, therefore everyone can agree on the most basic premise that coastal areas provide some benefit to all of Florida. Now it becomes clear why Florida has a strong interest to protect their valuable coastal property to some degree. On this premise the State of Florida has been increasing government control and policies to ensure coastal property stays protected. But how much assistance is still the big question.

There is probably no better example than all of these political interests being played out than in the aftermath of the 2004 & 2005 hurricane season, where in a rare occurrence eight named storms pounded the Florida Peninsula in two years. Many insurance companies went

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14 Graditor, supra note 6, at 537-538.
15 The answer to this question depends on how on your opinion of how important the coastal regions are to Florida, and this is a question that the state legislature has been arguing over for decades, and will probably continue for many more decades.
out of business, the remaining companies decided to stay alive by severely increasing rates.\textsuperscript{17} Soon after insurance customers responded with outrage.\textsuperscript{18}

About the same time the 2006 Gubernatorial and state legislative election campaigns were getting underway.\textsuperscript{19} The current Governor, Charlie Crist, and many other politicians realized that by promising to lower hurricane insurance rates in the short-term, then it would provide a big campaign boost among the heavily populated coastal regions.\textsuperscript{20}

No sooner than Governor Crist was sworn in did he call for a special legislative session for the primary purpose of reducing insurance premium rates.\textsuperscript{21} That special session marked a huge shift in the state’s insurance policy.\textsuperscript{22} Many would argue that 2007 was the year that the Florida Hurricane insurance system became too risky, setting the unnatural disaster in motion and causing our current problems.

\textbf{B. The Policy Considerations}

The politics encourage some government support to aid hurricane insurance, but this section determines the how, how the state will assist coastal property owners. The largest question comes down to how the state’s insurance system should be led, more by the private sector, or the government sector.

For those who choose the former, there is little to discuss because the trade practices of the private insurance market have clear-cut definite requirements. Admittedly, there is no Southeastern coastal state that has ceded over absolute control to the private market, but there is at least one state who comes close, South Carolina.

In contrast, for those like the State of Florida who believe government should take the lead role, defining the insurance system is much more of an open book. Specifically, there are four more decisions to be made.

First, pre-event funding v. post-event funding: Can the government gather the necessary financial assets after the hurricane instead of before? Not having sufficient assets on hand at the time of the storm is the riskier choice, but the government has the ability to raise funds post-event through bonding and emergency assessments, a pseudo-tax of sorts.\textsuperscript{23} The State of Florida allows itself to cover a large portion of its insurance requirements with the pay-it-later philosophy.\textsuperscript{24} In contrast, the private insurance market requires sufficient assets to be set aside pre-event.\textsuperscript{25}

Second, actuarially sound rates v. artificially low rates: Can the government charge rates below what the scientific actuarial risk models demand, instead of charging adequate rates in regard to the respective risk? When the government does not charge adequate rates for the risk, the government is still accepting the same amount of risk without investing appropriately. If the expected risk is converted into damage the government will then have to seek additional

\begin{flushleft}
\textsuperscript{17} Id.  \\
\textsuperscript{18} Id.  \\
\textsuperscript{19} Id.  \\
\textsuperscript{20} Id.  \\
\textsuperscript{21} Id.  \\
\textsuperscript{22} Id.  \\
\textsuperscript{23} See generally Id.  \\
\textsuperscript{24} See generally Id.  \\
\textsuperscript{25} Delegal Interview, supra note 10. The government actually requires private insurance companies to set aside a sufficient amount of assets. Id.
\end{flushleft}
financial capitol through the post-event funding to cover the difference. The State of Florida has kept insurance rates in the public and private sector artificially low for multiple years.\textsuperscript{26} In contrast, the central tenant of the private insurance market is to charge actuarially sound rates; otherwise companies would go out of business.

Third, isolated insurance assessments v. state-wide insurance assessments: Can the government charge only those who purchase hurricane insurance, or can the government charge other types of insurance customers, such as a person who only has auto insurance? The State of Florida chooses to subsidize the cost of government-run hurricane insurance by making other types of insurance customers pay.\textsuperscript{27} Obviously this contrast the private insurance market where customers only pay for the risk they choose to cover.

Forth, in-state controlled catastrophe insurance v. federally controlled catastrophe insurance: Once it is decided that the government should assist, how many levels of government should provide assistance? If the federal government stepped in then it would further spread risk and payments to all American taxpayers instead of Floridians alone. There is currently no official entrance of the federal government into the states’ insurance policies, but the State of Florida is currently lobbying to change this as the article later explores.\textsuperscript{28}

Having the state’s hurricane insurance system being led by the government opens the door to riskier options. Now the risks have grown to a literally uncontrollable level due to each riskier decision the State of Florida has made: government-led insurance system, post-event funding, artificially low rates, and state-wide hurricane assessments. It is those policy decisions that have defined the next section.

\section*{II. \textbf{Florida's Optimistic Model, The Mechanics of the Unnatural Disaster}}

This section is where political and policy decisions meet reality. In 2009, there are three pillars which the Florida hurricane insurance system stands on, and each of those pillars currently has a major problem. This section breaks down all three of those pillars in detail, covering the Cat Fund, Citizens, and the private insurance market. This section also fleshes out the combined effect of these problems in a hypothetical worst case scenario hurricane.

\subsection*{A. \textbf{Florida Hurricane Catastrophe Fund}}

The Cat Fund is Florida’s government-run reinsurance pool, which basically provides insurance for insurance companies.\textsuperscript{29} Hurricanes are not steady forms of risk, so to help Florida’s insurance companies cover the rougher than expected hurricane seasons, the Cat Fund provides aid in the form of reimbursement. The Cat Fund works by taking annual premiums from primary insurers in return for providing reimbursement to insurers for a portion of their catastrophic hurricane loses.\textsuperscript{30} The reimbursements are based on pre-determined formulas, and reimbursements are only issued once a certain amount of damage occurs.\textsuperscript{31} This keeps the price

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\textsuperscript{26} See generally Florida Insurance Council, \textit{supra} note 16. \\
\textsuperscript{27} See generally Florida Insurance Council, \textit{supra} note 16. \\
\textsuperscript{28} Florida Cabinet Meeting, State Bd. of Admin. Asset Update, (Apr. 28, 2009) (Statement of Ash Williams, Executive Dir. of the State Bd. of Admin.). \\
\textsuperscript{31} Florida Insurance Council, \textit{supra} note 16. 
\end{flushright}
of insurance rates lower by spreading some of the risk away from individual insurance companies.32

The Cat Fund was a product of Hurricane Andrew, which is still a feared name in Florida. Hurricane Andrew ripped through Florida in August 1992 with winds up to 180 miles-per-hour destroying more than 60,000 homes in a matter of hours, and leaving as many as a quarter of a million people homeless.33 By the time Hurricane Andrew had passed it left $40 billion in destruction and damage.34 Though property damage was not the only damage left behind, that single storm bankrupted ten of the state’s property insurers.35 Many of the insurers who did not leave, stopped signing new policies, and some reduced old policies.36 The storm was the costliest natural disaster in America’s history at that time.37

Still reeling from the damage, something had to be done, so the Florida Legislature was called in for an emergency special session to search for a solution. The result was the creation of the Cat Fund, which provided up to $16 billion to the state’s residential hurricane insurers following major storm damage.38 As of 2008, Florida is only one of the two states to have a government-run catastrophe fund, though seven other states are exploring similar programs.39

The Cat Fund receives funding from three sources: (1) participating insurers paying reimbursement premiums, (2) investment earnings from those premiums, (3) emergency assessments that charge insurance customers in order to cover revenue bonds issued by the Cat Fund.40

One of the main revenue sources is the insurance companies who pay into the Cat Fund. The state-backed Citizens and private insurers covering property damage are both mandated to purchase reinsurance from the Cat Fund.41 The second income source comes from collecting the interest off those assets before they are needed. The final revenue source is the politically unpopular assessments, also commonly called “hurricane taxes.” If the Cat Fund is short on resources, then assessments can be made on most insurance policies in the state, including home, business and auto insurance.42 These assessments cover the cost of the bonds that the Cat Fund issues to meet its financial obligations.43

32 FLA. STAT. § 215.555(1)(e). The Cat Fund was designed to be “a stable and ongoing source of reimbursement to insurers for a portion of their catastrophic hurricane losses [that] would create additional insurance capacity sufficient to ameliorate the current dangers to the state’s economy.” Id.
35 Butler, supra note 33, at 733.
36 Id. at 733-734.
37 Id. at 732.
38 See generally Florida Insurance Council, supra note 16.
40 Mason, supra note 30, at 406.
41 Id.
42 Id.
43 Florida Insurance Council, supra note 16.
The Cat Fund worked relatively well from 1993 until the unusually rough 2004-2005 hurricane seasons. Those two seasons caused the Cat Fund to plummet into debt and issue post-event assessments, which are still being paid off. Those two seasons also brought politically unpopular high insurance rates. So right when the Cat Fund was beginning to show signs that it might be taking on too much risk, Florida’s politicians decided to increase the risk of the Cat Fund, regardless, in order to reduce rates. The state promised to provide another $13 billion in reimbursements on top of the current $16 billion in the event of a major storm hitting Florida.

This new $29 billion dollar responsibility was the shift that made the Cat Fund too risky. The State of Florida now retains nearly two-thirds of the risk for reinsured property within its own borders, which goes against one of the central tenants of insurance, “spreading the risk.”

More problems with the Cat Fund begin to show when the sub-prime mortgage lending crisis began to unfold. By late fall 2007, financial advisors for the Cat Fund gave warnings about the Fund’s ability to meet its obligations. In 2008, it took repeated attempts before the Cat Fund was able to only secure $3.5 billion in bond sales after attempting to sell $7 billion. To patch the state’s exposure, the Cat Fund squeezed by after purchasing the last $4 billion of reinsurance needed from Berkshire Hathaway Investment Company at a cost of $224 million to all of Florida’s tax payers. In addition, the 2006, 2007, and 2008 hurricane seasons were relatively quiet and did not test the Cat Fund with any new reimbursements.

As the 2009 hurricane season is among us, the Cat Fund is in more trouble than ever, potentially $11.4 billion dollars of trouble. The trick to make the Cat Fund work was to issue pre-event and post-event bonds to meet the necessary capacity, but now in the midst of an economic recession the possibility of issuing a large amount of bonds is not realistic. The smoke and mirrors techniques are beginning to reveal themselves, the risk from all the short-term decisions have accumulated, and Florida’s own politicians are now beginning to admit that the Cat Fund cannot cover the risk it promised to cover.

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44 Id.
45 Id.
46 Id. This expansion provided more relief for property insureds, while knowingly placing the additional risk on the general taxpayers in the event that the fund does not meet its demand in the wake of another major storm. Id.
48 Florida Insurance Council, supra note 16.
49 Id.
52 Paige St. John, supra note 7.
53 Thornberry, supra note 51. So just when Floridians are suffering from a recession they also run the risk of not having their insurance coverage reinsured by the state. In the words of veteran Florida lobbyist Gene Adams, “Under current economic conditions hardly anyone is buying bonds. Bonding capacity is a real issue. Who would buy these bonds, and what effect would it have on the bond rating in the state? It could affect our ability to sell bonds for other things like building roads.” Id.
54 Beatrice Garcia, Florida Hurricane Catastrophe Fund Under Scrutiny, Miami Herald, Mar. 29, 2009, available at http://www.miamiherald.com/business/story/971735.html. In addition, with a potential Cat Fund failure on the horizon, insurance consumers are losing confidence they will be paid. Furthermore, credit rating companies see the
B. Citizens Property Insurance Corporation

The purpose of Citizens was originally designed to be an insurer of “last resort” for those property owners who lived in the riskiest areas and could not attain “affordable” coverage in the private market. For many reasons there are some properties that the private insurance market is not interested in, so the state offers insurance to these properties to provide some protection. The general concept of Citizens has been around Florida since 1970 in different forms. This is also a common program found in different forms in all Southeastern hurricane prone states spanning from Texas to North Carolina.

The operation of Citizens went mostly uneventful until it was tested with the 2004-2005 hurricane seasons, which effectively bankrupted Citizens in both years. To bail Citizens out of the hole, it required $716 million to be taken from the state’s taxpayer’s general revenue in addition to charging three separate state-wide assessments.

Having failed twice, legislators reported to Tallahassee in 2006 determined to fix Citizens once and for all. The legislators were successful for a brief period by requiring Citizens to charge actuarially adequate rates.

Though Citizens might have been fixed, the underlying problem was not. Consumer outrage and political support against having to pay fair-value property insurance was still as strong as ever. The new legislation would increase Citizens’ rates by seventy-five percent, and Citizen’s customers politically refused to accept those rates.

Since that outcry the legislature has altered three major policies effectively recreating Citizens for the worse. The first change expanded Citizen’s assessment targets, allowing Citizens to impose assessments on most forms of insurance, similar to the Cat Fund.

Another change returned Citizens to its state of artificial balance by subsidizing Citizens’ rates for its 1.3 million coastal customers, thus reversing the legislation made just months potential failure as well and are threatening to downgrade the credit scores for all of Florida’s insurance companies, which will cause insurance rates to go up. Id.

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56 Florida Insurance Council, supra note 16. Citizens itself was formed in 2002 by combining two previous state-run insurers into one. “The latter of those entities, the Florida Windstorm Underwriting Association was created in 1970 for the purpose of covering wind risk in the Florida Keys. In the years since, it was expanded to most of Florida's thirty-five coastal counties to provide Florida residents adequate wind coverage when it was unavailable in the insurance market place . . . . The Florida Residential Property and Casualty Joint Underwriting Association, commonly known as the JUA, was created in a special session of the Florida Legislature in December 1992, only months after Hurricane Andrew ripped through South Florida.” Id.
58 Florida Insurance Council, supra note 11.
59 Id.
60 Id.
61 Id. “Actuarially adequate rates” are determined by adhering to the same one-in-a hundred-year storm maximum loss standards that private insurance companies use. Id.
62 Id.
63 Id.
64 Id.
Due to political support, Citizens’ rates have been legally frozen since 2006, and those rates will continue to be locked in until at least Jan. 1, 2010. Against the advice of Citizens’ staff, the legislature decided to underfund Citizens’ risk, which leaves problems for another day. The last change allowed Citizens to aggressively compete with private insurers. This new law allowed coastal homeowners to choose Citizens over a private insurer when Citizens is cheaper. This rewrote Citizens from being an insurer of last resort to being another competitive insurer that happens to be run and backed by the state.

In conclusion, it is no wonder why Citizens is so popular among its customers with the combined effect of Citizens issuing artificially low rates, subsidizing the difference through non-Citizens insurance customers, and being granted the ability for customers to choose Citizens over a private insurer. Since the 2006 reforms, the private market has begun to secede away from the riskier coastal properties because there is no way to compete with Citizens. “In 2002, Citizens had a total property exposure of $148 billion. As of May 2008, Citizens is responsible for property exposure of more than $440 billion. Never before has one insurance company in Florida carried so much risk.” In 2009, Citizens is Florida’s largest property insurer, covering almost one third of the state’s coastal homeowners. Now Citizens’ problems have compounded because as the organization has tripled in size, its problems have exponentially increased the magnitude of each of the three previous problems.

C. Private Insurance Market

Political support to artificially lower insurance rates is as strong in the private market as it is for Citizens. For thirty years the state has forced insurance companies to offer low insurance rates through rate price caps. All rate changes must be approved by the Office of Insurance Regulation (OIR). The Director of the OIR, Kevin McCarty, was appointed by Governor Christ, and in the words of Representative Hays, “the director is nothing more than the Governor’s puppet.” As a result, the OIR currently follows the orders of a man who became Governor by promising Florida he would artificially lower property insurance rates.

65 Id.
67 Id.
68 Id.
69 Id. “The competition does not stop there. Homeowners currently with Citizens have the option to reject a “takeout” offer from private insurers if staying with Citizens would be cheaper for them. Applicants seeking coverage can qualify for Citizens even if they have an offer for private market coverage if the private insurer premium is fifteen percent or greater than the Citizens premium.” Id.
70 Florida Insurance Council, supra note 16.
71 Id. Though Florida has used government involvements as an alternative to the private market in the first two pillars of the Florida insurance system, the third pillar is arguably the most intrusive by directly controlling prices for private business. Id.
72 Id.
Specifically, OIR reviews all private insurers in the state to ensure that rates are not “excessive, inadequate, or unfairly discriminatory” defined by fourteen factors. Many of Florida’s residents have argued that the decision to pay insurance rates should be their choice, not the state’s. Private insurance companies concur, and many insurers have already left the state due to the restrictive rate caps.

The state’s current battle of rate regulation is most notably being played out with State Farm. “A hurricane didn't prompt State Farm to pull out of Florida’s frail property insurance market, but the ramifications are hitting like a Category 5.” On Jan. 27, 2009, State Farm, the insurance giant, announced it will be cancelling on its 1.2 million homeowner policies in Florida, citing the state’s “punishing price controls.” The action played out after State Farm’s proposal for a forty-seven percent rate increase was rejected by an OIR decision, along with an administrative law judge later upholding that decision.

In response, because of its declining surplus and no ability to raise rates, State Farm said it had no other options. State Farm specifically cites the over-restrictive rate caps as the reason for its failure, admitting that is was continuously losing $20 million dollars each month and on pace to go insolvent with its Florida operations by 2011.

The biggest danger in all this, is that State Farm is more of the rule than the exception. The state fixed price caps have also resulted in Prudential, Allstate, Nationwide, USAA, and others reducing or discontinuing their current homeowner policies. This reverses the nature of the traditional private market. Instead of having insurers compete to offer the lowest rates, now the insurance companies are retreating from Florida, and only covering the less risker properties, if they are willing to cover any at all.

This creates a secondary problem if State Farm and the other major insurance companies continue to cede away from their Florida customers, then Citizens will continue to rapidly accumulate more customers. This further concentrates more risk into the state’s largest insurer.

In conclusion, all three pillars of Florida’s hurricane insurance system are now in some form of trouble after taking on too much risk without adequate funding. The benefits of artificially low rates are only short-term, and these major problems have caught up with the Cat Fund, Citizens, and the restricted private insurance market. Now Florida’s insurance problems are set for this hurricane season, and the only ingredient needed to launch the unnatural disaster is the next hurricane.

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76 FLA. STAT. § 627.062(2)(b). The flagship factor for hurricane-related insurance is based on the results from the Florida Commission on Hurricane Loss Projection Methodology, who heavily rely on expert evaluations of computer models to determine appropriate rates. Fla. Stat. § 627.0628(1).


80 Id.

81 Unnatural Disaster Editorial, supra note 78.

82 Id.
D. Florida’s Worst Case Scenario, How the Disaster Could Unfold

Imagine it is Hurricane Andrew all over again, but this time with a twist, in 2009 the hurricane churns directly through Miami or Tampa Bay. This would be the equivalent of a one-in-a-hundred year storm, another category five hurricane causing complete roof failure on many residences and industrial buildings, some complete building failures, all shrubs, trees, and signs blown down, complete destruction of mobile homes, and major damage to structures located less than fifteen feet above sea level.\(^\text{83}\)

This time the damage would cost Floridians between $183.22 billion and $198.99 billion in total damages according to the Florida’s Department of Financial Services.\(^\text{84}\) This would far surpass the damage of Hurricane Katrina, the costliest single hurricane damage in the United States to date.\(^\text{85}\) Out of that damage, $90 billion would come from insured property damage, split into $60.9 billion residential property loses, and the rest in commercial property loses.\(^\text{86}\)

Now that we know how the storm could play out, the real question is how would the current Florida insurance system do in this scenario? Many experts believe that if a major hurricane or a series of minor hurricanes were to hit Florida during the 2009 hurricane season then Florida’s whole hurricane insurance system would fail, resulting in valid insurance claims going unpaid.\(^\text{87}\)

This section specifically dissects each of the three individual pillars holding up the insurance system: the Cat Fund, Citizens, and the private insurance market. This order was picked because this would likely be the order that the hurricane insurance system failure would occur in Florida with the Cat Fund deteriorating first, and then its dependents, Citizens and the private market, would soon deplete their resources as well.

The first to go is the Cat Fund with a projected deficit of $11.4 billion.\(^\text{88}\) The Cat Fund is required to cover $29 billion of the $60 billion dollars in damage, while the total funding capacity of the Cat Fund in 2009 is only $17.6 billion.\(^\text{89}\) There are two options to resolve this debt: (1) raise money through post-event bonding, or (2) default on the debt.

The main tool that was intended to make the Cat Fund function was post-event bonding. However in light of the current credit crisis, the Cat Fund Advisory Council reported that “post-event bonding may not be sufficient to fund the Cat Fund’s total deficit [in 2009].”\(^\text{90}\) This is an understatement at best because the largest post-event bonding issuance ever was shy of $10

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\(^\text{84}\) DFS Report, supra note 4, at 2.

\(^\text{85}\) Id. Damages would affect residential structures, personal property, commercial property, utilities, agriculture, and government structures and land. Approximately forty-one percent of the total loss would be borne by insurance companies. Id.

\(^\text{86}\) Id.

\(^\text{87}\) Florida Insurance Council, supra note 16; see also DFS Report, supra note 4, at 15. “If the Cat Fund cannot deliver, Florida policyholders… could see their claims go unpaid altogether.” Florida Insurance Council, supra note 16.

\(^\text{88}\) Paige St. John, supra note 7. However, some estimates, such as Florida’s Central Financial Officer put the financial shortage at a much larger amount, $20.7 billion. DFS Report, supra note 4, at 17.

\(^\text{89}\) Paige St. John, supra note 7.

\(^\text{90}\) Florida Cabinet Meeting, State Bd. of Admin. Asset Update (Apr. 14, 2009) (Statement of Ash Williams, Executive Dir. of the State Bd. of Admin.).
billion dollars when made during good economic times.\textsuperscript{91} With the current health of financial
markets the post-event bonding capacity is likely to be closer to $0 than $10 billion. This clearly
turns us to the last option, failure and default. This option would simply ignore the insurance
policies owed to many Citizens customers and private market customers who would be
depending on their insurance.

Next to have trouble would be Citizens, who will need to cover $23.55 billion in this
worse case scenario.\textsuperscript{92} Specifically, Citizens is also depending on the Cat Fund for a total of
$11.22 billion in payments.\textsuperscript{93} Without the Cat Fund being able to pay up, Citizens would have
almost no other option but to declare a bankruptcy of sorts.

Assuming arguendo the Cat Fund was able to pay in full and on time, Citizens on its own
would still be expected to cover 9.27 billion of the estimated $60.86 billion.\textsuperscript{94} However, with its
current budget limited to $6.75 billion funding capacity, Citizens would have a projected $2.52
billion deficient. That deficient would require Citizens to issue the largest assessments ever
made on the state’s insurance consumers.\textsuperscript{95}

The last concern is the private market because with a dried up Cat Fund “nearly every
insurance company operating in the state will come up short.”\textsuperscript{96} Making this more likely is the
fact that the Cat Fund’s $17.8 billion in coverage owed to private insurance companies is the last
priority for the Cat Fund since the Cat Fund is statutorily not responsible if it defaults on the
private insurers.\textsuperscript{97} This means that the private insurance market that was statutorily required to
pay into the Cat Fund would then be left empty-handed in the aftermath.\textsuperscript{98}

So if the “big one” hits Florida in 2009, the first to go is the Cat Fund. Then without the
Cat Fund being able to cover its required policies, its dependents Citizens and the private
insurance market would then soon deplete their resources. In conclusion, “Florida’s gambit to
reduce insurance rates could bankrupt the state, paralyze its economy, and leave tens of
thousands homeless without money to rebuild.”\textsuperscript{99}

\section*{III. South Carolina’s Conservative Private Market Model}
Where Florida zigs, South Carolina zags, the two are on complete opposite ends of the
spectrum when dealing with hurricane insurance. The core difference is that South Carolina

\textsuperscript{91} Hays Interview, supra note 73.
\textsuperscript{92} DFS Report, supra note 4, at 17.
\textsuperscript{93} Id.
\textsuperscript{94} Id. The amount of $9.27 billion is figured by taking the $23.55 billion estimated gross total loss and subtracting
the $11.22 billion in Cat Fund Payments and the $3.06 billion in policyholder deductible payments. Id.
\textsuperscript{95} See generally Id. at 24-25. Citizens has three tiers to recover debt: (Tier 1) Citizens Policyholder Surcharge, (Tier
2) regular assessments, and (Tier 3) emergency assessments. Each tier is designed for different amounts of debt,
which allows Citizens to differ on who they charge, how long they charge, and how much they charge. Id. at 24-25.
http://www.gainesville.com/article/20081004/NEWS/810059993/1/SPORTS0102?Title=Is_Florida_in_danger_of_g
ing_bankrupt [hereinafter Florida Danger].
\textsuperscript{97} Interview with Patrick F. Maroney, Director of Florida Catastrophic Storm Risk Management Center and FSU’s
Kathryn Magee Kip Professor and Former Associate Dean for Graduate Programs within the College of Business
(Apr. 28, 2009).
\textsuperscript{98} DFS Report, supra note 4, at 25. For those who are forced to declare bankruptcy, the burden will be carried back
to all the remaining insurers. The remaining insurance debt after bankruptcy would be distributed though a
government program to all insurance agencies after bankruptcy. This will further increase rates for policyholders.
See generally Id.
\textsuperscript{99} Florida Danger, supra note 96.
believes that the private insurance market is better at repairing coastal insurance problems than the government.¹⁰⁰ South Carolina’s strong focus on letting the private industry run the majority of the state’s insurance system allows it to sidestep many of the policy decisions Florida faces in controlling a more government-led insurance system.

When most Southern coastal states were turning to more government-centered policies after witnessing the Katrina Disaster, South Carolina’s Governor, Mark Sanford, decided to stay the course and rely on his weapon of choice, to “unleash [private] market forces.”¹⁰¹ It was in the same time period when Gov. Sanford launched his successful and comprehensive legislative package, the 2007 Omnibus Coastal Property Insurance Reform.¹⁰² When asked why he did not go for a more government-based insurance system he replied, “I looked at it and I saw that fear was largely driving the agenda. I wanted to do something different.”¹⁰³

Now South Carolina relies on four main policies to keep its private insurance market healthy: (1) preserve the state-run insurer as a true insurer of last resort, (2) offer tax exemptions for private insurers willing to cover the riskiest properties, (3) offer tax exemptions to individual citizens to encourage hurricane preparation, and (4) not create a state-run reinsurance program.

The first and arguably most important policy is to keep the South Carolina Wind and Hail Underwriting Association (hereinafter SC Wind Pool) as an insurer of last resort. The SC Wind Pool is the rough equivalent of Florida’s Citizens. In South Carolina, the SC Wind Pool is truly a market of last resort with the average rates thirty-five percent higher than the private market.¹⁰⁴ The SC Wind Pool’s own policy documents make this clear by stating that their “rates will be higher than the standard market.”¹⁰⁵

As a result, the SC Wind Pool is adequately funded and generally returns a profit for the state.¹⁰⁶ This is a complete contrast to Florida’s Citizens, which has gone into deep deficits twice in the last five years, and is still attempting to recover by charging increased rates on all of Florida’s insurance customers.¹⁰⁷

The second policy South Carolina relies on is a tax exemption given to insurance companies for the purpose of attracting more companies to write coastal property insurance. This tax exemption is only offered to insurance companies who write full coverage policies to homeowners in the riskiest coastal areas.¹⁰⁸

After implementing South Carolina’s first and second policy, private insurers are returning back to coastal property areas. Allstate has announced that it will accept 2,300 policies it once declared “canceled,” and now State Farm and Farm Bureau are taking parallel action to increase business in the state.¹⁰⁹ The results in South Carolina once again stand in complete

¹⁰⁰ In turn this spreads the risk among many insurance companies, instead of a large portion of risk being organized under one state government program.
¹⁰¹ Rehrer, supra note 57, at 2.
¹⁰² See generally Id.
¹⁰³ Id. at 7.
¹⁰⁵ Rehrer, supra note 57, at 8 & 15. Still, some would go further, and say that the SC Wind Pool should never serve anyone capable of finding any private market coverage.
¹⁰⁶ Id. at 15.
¹⁰⁷ Florida Insurance Council, supra note 16.
¹⁰⁸ Rehrer, supra note 57, at 8
¹⁰⁹ Id. at 9.
contrast to the results in Florida, where its largest private insurer has announced plans for a complete withdrawal from the state.\textsuperscript{110}

The third policy is the creation of “Disaster Savings Accounts,” which offer income tax exemptions directly to coastal property owners who deposit their money in savings accounts for the purpose of hurricane preparedness.\textsuperscript{111} The policy was primarily created for the purpose of giving property owners an alternative to insurance by saving money themselves through the government’s implicit support.\textsuperscript{112} The Disaster Savings Accounts also provides up to an impressive eleven-percent return for the first year, after adding the seven-percent income tax waiver to a four-percent interest savings account.\textsuperscript{113} For some people a Disaster Savings Account will actually be a better option than formal insurance.\textsuperscript{114}

This policy truly polarizes the differences between Florida and South Carolina. When insurance rates get high, the trend in Florida is to transfer risk from the private market to the state’s insurance system, whereas South Carolina tries to empower the individual homeowner to transfer some of the risk to himself or herself in light of high insurance rates. However, due to Florida’s lack of an income tax, this exact policy would not be possible for the state.

The fourth policy is that South Carolina has affirmatively chosen not to host a government-run reinsurance program.\textsuperscript{115} Arguably, the backbone of Florida’s insurance system is the Cat Fund reinsurance program, which requires insurers to purchase a fixed proportional amount of reinsurance. The South Carolina plan allows insurers to seek reinsurance anywhere, including out of the state which allows the South Carolina insurance market to better spread the risk. In return this would likely dampen any financial shock from storm damage and would lower rates in the long run.\textsuperscript{116}

In conclusion, the theme of South Carolina’s policies is to reduce high insurance rates by promoting competition in the private market with no to minimal government involvement. Stated in simpler words by South Carolina’s former insurance commissioner: "Overregulation does not drive rates down, it has the reverse effect. It does the exact opposite of what the legislature wants to happen, which is to drive rates up.”\textsuperscript{117}

\textsuperscript{110} State Farm Press Release, supra note 79.
\textsuperscript{111} Rehrer, supra note 57, at 12.
\textsuperscript{112} This policy also rewards homeowners with insurance just the same, but for the purpose of helping insureds with hurricane deductibles which are often expensive. See generally Id.
\textsuperscript{113} Id.
\textsuperscript{114} Id. “Disaster savings accounts… may provide an additional incentive for people to purchase private insurance. To illustrate, consider the following scenario: An insurance policy with a high deductible, all other things being equal, will cost less than one with a lower deductible. An insurance company can always make a policy affordable by raising the deductible or requiring co-insurance. If the deductible or co-insurance gets too high, however, a policy may not provide a real benefit to somebody who purchases it, since a policy with a deductible larger than an individual’s liquid savings still leaves a homeowner unable to pay for damages without going into debt or selling assets intended for future use. At the margin, savings accounts designated for the disaster changes homeowners’ calculus, making it somewhat easier for them to accept higher deductible insurance policies.” Id.
\textsuperscript{115} This fact was created out of inference after reading a plethora of documents and conducting a Google search on South Carolina Hurricane Insurance without any references or successful results.
\textsuperscript{116} Id. at 15.
IV. Florida’s Future Model, the “Glide Path” to Sustainability

Florida has its own unique priorities different from every other state, so what works best for one state is not necessarily what works best for Florida. Specifically Florida’s differences stem from its heavier stake in coastal interest. Florida has nearly 1200 miles of coastline to protect, over six times more coastline compared to South Carolina’s 187 miles. Along with the abundant miles of coastline, Florida’s general economy and tourism are heavily attached to the coast. To protect those high priorities Florida’s insurance system needs moderate control along with the ability to promptly adapt to changes in the market.

Both of those two qualities are the drawbacks to a private market driven insurance system. Admittedly, South Carolina has less control and a sluggish implementation delay that characterize the state’s insurance system because of the decentralized nature of sharing control among many insurers.

Nevertheless, Florida’s current unfunded system is not working either. In the last three years the size of the Cat Fund’s exposure has greatly increased without proper funding, and Citizens’ rates as well as private market rates have been artificially decreased. Now all three pillars of Florida’s insurance system are inadequate. So the alternative is to create a glide path to a more conservative insurance system that stands somewhere in between the current South Carolina and Florida policies. “This crisis did not occur overnight and we cannot fix it overnight but the state needs to make the necessary changes to protect our state and citizens.”

The glide path proposals consist of the three core policy shifts that can be summed up as the three R’s of Florida’s hurricane insurance: (1) Restrict Cat Fund exposure, (2) Return Citizens to an insurer of last resort, and (3) Reduce regulation on the private market.

A. Restrict Cat Fund Exposure

The major policy goal is to restrict the Cat Fund’s exposure by making two reforms to the current Cat Fund. First, the Cat Fund’s coverage should be cut by $13 billion to its original coverage level of $16 billion. Second, the cost of reimbursement premiums for insurers should be raised to provide additional pre-event funding. By reducing its coverage and increasing its capitol this would return the Cat Fund to a much more stable and manageable risk.

The first reform deserves to be explored in detail. As part of the long term solution the Cat Fund should be reduced by $4 billion each year starting on June 1, 2010. The stair-step implementation will dampen the shock to the insurance market, and provide adequate time for insurers to seek reinsurance elsewhere. Roughly by 2013 the Cat Fund would reach its original and reasonable risk coverage of $16 billion.

The 2007 reform that extended the Cat Fund to $29 billion is the heart of the unnatural disaster; it has exponentially contributed to Florida’s problems. Though South Carolina has a

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120 Graditor, supra note 6, at 537-538.
121 Unlikely Homeowner, supra note 109. One example of this lack of control is the irony that the South Carolina’s Insurance Director has been dropped by his private insurer, and is likely to be left with no option but turn to the government-run wind pool. Id.
good hurricane insurance market without any form of government reinsurance, South Carolina also does not have a majority of its population lining the coast.\footnote{Zinn, supra note 1.} To treat these unique problems Florida’s Cat Fund has and will continue to offer the advantage of lower hurricane insurance rates through cheap reinsurance. Yet, there is a balance, only offer what the State of Florida can support and sustain, $16 billion.\footnote{Maroney, supra note 97.} The current situation in 2009 has made it abundantly clear that the Cat Fund cannot pay out what it has promised. Though there will be many years where the Cat Fund could cover much more than $16 billion, there will be years where it cannot, and consistency and consumer confidence are imperative factors in the insurance industry.

The second reform to the Cat Fund requires the OIR Commissioner to increase the amount of premium payments the Cat Fund brings in from private insurers. The new rate should be left for the commissioner to determine with guidelines of keeping Florida’s risk at a “reasonable level to adequately cover a 1-in-100 year hurricane.”

This would support more funding of the Cat Fund pre-event, while simultaneously requiring more from those who will benefit from the Cat Fund. In return, the Cat Fund will be more stable, and will be less dependent on outside funding from the bond market and policy assessments. Both of these policies will further sustain the Cat Fund making it more stable than it has been since its creation.

\textbf{B. Return Citizens to an Insurer of Last Resort.}\footnote{The reforms under this section largely came from my interviews with Rep. Hays and Proctor. Also many ideas stemmed from HB 1495, including the discussions and questions it raised before being passed by the Florida Legislature during the 2009 regular session.}

The next major policy goal is to reduce Citizens to its original purpose as Florida’s insurer of last resort. This can be done in three simple reforms. First, remove all of Citizens’ policyholders who are eligible to receive a “reasonable” offer from a private insurance company. Second, return Citizens’ rates to an actuarially sound level. Third, place a two-to-one ratio cap on assessing non-Citizens customers.

This first reform will shift Citizens back to its pre-2007 structure by informing all of Citizens’ policyholders who are eligible to receive a “reasonable” offer from the private market. “Reasonable” offer is to be defined as an offer within twenty percent of the current Citizens rate, and/or an offer equal to or below the true internal actuarial cost of the Citizens policy. This should be done immediately by soliciting private insurance offers on all of Citizens’ policies. Once the qualified policies have been determined, those policyholders shall receive a letter informing them of the available offer(s). The letter shall inform the individual that his or her policy will be discontinued within six months of receiving the notice, with the caveat that policies cannot be discontinued during two months prior to hurricane season.

By definition of being an insurer of last resort, Citizens should not cover those who are eligible for a reasonable quote from the private market. Citizens will continue to only protect those who are truly dependent on Citizens, thereby limiting Florida’s exposure.

The second reform should return Citizens’ rates to an actuarially sound level. This should be accomplished by raising Citizens’ rates no more than ten percent each year for each
coastal region, and no more than twenty percent for any individual policy. Rate increases shall continue until Citizens becomes actuarially sound again.\textsuperscript{126}

Citizens’ own executive, Christine Turner, called Citizens’ current rates woefully inadequate at forty to fifty-five percent below the actuarially sound standard.\textsuperscript{127} As State Representative Alan Hays said, “How can you with a clear conscience . . . have [policyholders] believe that the current rates should be continued? I consider the perpetuation of this rate freeze to be wrong. What good does it do them to buy something that is no good in the long run?”\textsuperscript{128}

The reason for selecting a ten percent price increase cap was due to historical outcries which likely suggest that any larger percentage would be politically rejected. Even with this proposal it may take many years for Citizens’ policies to reach an actuarially sound level considering the current inadequacy in addition to the naturally rising annual cost.

The third reform should limit the amount of assessments that can be placed on non-Citizens customers by a two to one ratio. This would mean that for any assessment issued, Citizens’ policyholders would have to foot at least twice as much of the assessment as noncitizens policyholders.

This would create more accountability by keeping assessments more isolated for those who benefit from living in a coastal region. However, this would still require inland residents to cover their fair share of the detriment when benefitting from the state’s economy. The result of these three proposals being implemented would return Citizens to a stable insurer of last resort, increase accountability, and all while better shielding non-Citizens customers.

\textbf{C. Reduce Rate Regulation on the Private Market}

The last major policy goal is to reduce rate restrictions on the private market through two simple reforms. First, OIR should not be allowed to regulate the rate price of private insurers. Second, Florida should adopt a tax exemption for those insurers who write full homeowner policies in Citizens-eligible areas.

The first reform would be to simply revoke all statutes pertaining to price regulation for homeowner’s multi peril insurance, and all other types of insurance related to hurricanes. Regulation would still exist for other rating factors subject to the unfair trade practices statute. Upon being signed into law any new policies written will be subject to this reform. However, to dampen the shock of some rate prices rapidly returning back to their natural equilibrium, existing policies would be subject to a twenty percent rate increase limit per year. After five years all policy rates should be completely set by market forces, not government regulation.

The regulation of rate prices would be determined by competitive forces in the free market instead of a politicized government entity. However, it is still a forbidden act in Florida to increase insurance rates, so the twenty percent rate increase limit would provide some restraint to likely create sufficient balance to facilitate legislative compromise. The largest benefit of this reform would be by retaining the state’s current insurers, as well as inviting new ones. State Farm


has publicly announced that with this reform, it would change course and keep its 1.2 million homeowner policies in Florida. Without having arbitrary price restrictions, then insurers would then be able and willing to provide insurance to riskier properties. Over time this practice should steal away more and more policyholders from Citizens.

The second reform would adopt a version of the South Carolina insurer tax exemptions for those who write full homeowner policies in areas eligible for Citizens coverage. The tax exemptions can only apply to state taxes, but would still offer a significant incentive. This reform will only encourage more competition by offering bonuses to insurers who are willing to cover some of Florida’s riskier properties. Both of these reforms would encourage current insurers to write more policies, as well as bring new insurers to the state.

The culmination of all seven glide path proposals would swing the pendulum towards a more conservative insurance system affecting all four categories mentioned in the previous “The Policy Considerations” section. Most importantly, the effects of these proposals limit government involvement in the market thus creating a more free market for private industry and competition. These proposals will undoubtedly improve Florida in the long run, but not in time for the 2009 hurricane season, so if the big one hit today there is only one last hope for Florida, the federal government.

IV. Proposed National Solutions

“When a risk is so large that the insurance market and individual states can't reasonably bear it, it's the role of the federal government to step in, as we've done to insure against acts of terrorism. Because when a catastrophe strikes, we all look out for one another,” said President Obama when speaking about hurricane insurance on the 2008 presidential campaign trail.

Like President Obama, some people see the risk and problems of hurricane insurance as too large for the single states, and have instead preferred some form of national assistance. The question of national assistance in 2009 is not whether to provide assistance or not, but the real question is framed as “how.” There has been a growing trend to increase federal disaster financial assistance following catastrophes, and the trend reached an apex in the aftermath of Katrina when the government handed out $114 billion in general aid. Much of the federal aid goes to replace damage that would otherwise be covered by hurricane insurance.

There is also further support with the federal government currently reaching unprecedented levels of spending and involvement in all contexts of government. Congress and the president signed an annual budget for 2009-2010 that is fifteen percent larger than every previous budget passed by Congress. That appropriations agreement is in addition to an


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automaker bailout this past December, and a $700 billion dollar financial sector bailout this past October.

With all this momentum favoring federal involvement, it seems almost certain that the federal government will extend financial aid in some form if a hurricane was to ravage Florida or another state this hurricane season. So the question of “how” to help in this context is split into three main categories: ad hoc national assistance, a national catastrophe fund, and a national bridge loan.

A. Ad Hoc National Assistance

Everybody knows about it, the “Air Force One Plan:” a big crisis happens, the U.S President declares a state of emergency, then the president flies in to save the day and passes out billions of dollars in aid. According to the L.A. Times, the national government has already created a steady supply of catastrophe assistance, “Since the 1970s, Washington has emerged as the insurer of last resort against floods, fires, earthquakes and… terrorist attacks.” Recently the government has come to save the day by giving $6.3 billion in response to the 1993 flood of the Northern Mississippi River, $7.24 billion in federal funds following the Northridge Earthquake in California, and $40 billion in aid following the September 11 terrorist attacks. In 2004, Congress also approved $13.6 billion to help cover the cost of four hurricanes. However, Katrina is the all-time leader by single-handily absorbing $114 billion of federal taxpayers’ money.

In the trend of growing federal disaster aid, Congress has passed a bill that gives the president a $2 billion per year allowance to spend on catastrophes with- out any further approval from Congress. For the president to exceed the $2 billion limit, congress must expressly approve the appropriations.

136 Delegal Interview, supra note 10; FEMA Website, available at http://www.fema.gov/government/grant/pa/stat1.shtm (last visited on Aug. 24, 2009). “Emergency” is loosely defined by FEMA as “any occasion or instance for which, in the determination of the president, federal assistance is needed to supplement state and local efforts and capabilities to save lives and to protect property and public health and safety, or to lessen or avert the threat of a catastrophe in any part of the United States.” Id.
138 Id.
140 Gosselin & Miller, supra note 137.
142 Bowden, supra note 131.
143 CRS Congressional Report, Elizabeth Bazan, Robert T. Stafford Disaster Relief and Emergency Assistance Act: Legal Requirements for Federal and State Roles in Declarations of an Emergency or a Major Disaster, Sept. 16, 2005, available at http://fpc.state.gov/documents/organization/53688.pdf. Once a state governor has requested the president to declare a state of emergency, the president is then authorized to offer financial aid for rebuilding. This

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Considering all the federal options in 2009, this is the least desirable option because it is ad hoc with no limits, no guidelines, no accountability, and no ability to prepare for the regular shocks that hurricanes require. For example, sending $10 billion or more to Florida every time a major hurricane hits is a poor solution for Florida and the rest of the American people. The reason is because people in less risk-prone areas, such as Iowa, should not have to subsidize the cost of living on the coast in Palm Beach. At the same time, the person in Palm Beach is encouraged to purchase risky property by being bailed out. Many people would agree that this option is not best for a strong majority of Americans, and if the federal government is going to get involved then it should discover a better way. Out of all the three federal options this has historically been the default option, but there are still two more options being currently debated in Congress.

**B. National Catastrophe Fund**

There is currently no National Catastrophe Fund (NCF), though it has been introduced and received preliminary success in Congress. If created, most expect a NCF to provide reinsurance similar to the Florida Cat Fund but on a national scale for all disasters such as: earthquakes, mudslides, tornadoes, blizzards, and of course hurricanes. With a government backed financial safety net, insurance companies would be allowed to lower their rates, especially in areas with the most uncertainty where rates have skyrocketed in recent years amid natural disasters.

The concept of a NCF has been gaining momentum in congress, and currently there is one active bill. The Multiple Peril Insurance Act of 2009 was offered on Mar. 3, 2009 to amend the National Flood Insurance Program (NFIP) to also provide coverage for damage resulting from winds in addition to floods. This basic concept has already been put into bill form and passed the House and Senate in 2007 and 2008, respectively. Nevertheless, the two chambers could not resolve their differences in conference, largely due to President Bush’s veto threat, which prevented the law from being officially ratified. However, the new Multiple Peril assistance would come in the form of FEMA funds, which would likely be extra sensitive to hurricane relief considering Obama’s selection to lead FEMA was hand-picked from Florida’s division of emergency management, the state’s equivalent of FEMA. Id.

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144 Id.
145 This is distinguished from the State of Florida justification example because the economic connection is exponentially more attenuated than it was as an internal state issue.
146 A regional cat fund would operate similarly. It would likely happen with Southeastern states pooling together to create something like a “Gulf States Compact.” The compact would include as many states as are willing to join, possible covering all nine Southeastern states from Texas to Virginia. One Florida Cabinet Member has already started a dialogue with insurance commissioners from other Gulf States. However, as of now a regional cat fund only exists in idea form. The Property Insurance Crisis: Have We Made progress . . . or Are We Worse Off Than Before?, Civic Concern, available at http://civicconcern.org/issues/insurance/ (last visited Aug. 29, 2009).
148 Gramlich, supra note 39.
150 H.R. 3121, supra note 12.
Insurance Act of 2009 is still alive and may have a different fate with a different president because President Obama has announced his approval of a national catastrophe fund.\footnote{Obama, supra note 131. “And because future hurricanes and other natural disasters will challenge us again, it’s time to come together as Americans and create a common-sense national catastrophe insurance system, so that no family, neighborhood, city or state is left to bear the full burden of these events alone.” Id.}

1. Federal Reinsurance Precedent: The NFIP

Along with the momentum there is also similar precedent to establish a NCF because the federal government has already created The National Flood Insurance Program (NFIP). In 1968 the NFIP was created as a result of the Mississippi River frequently flooding.\footnote{Flood Insurance, Insurance Information Institute, May 2009, available at http://www.iii.org/media/hottopics/insurance/flood/?table_sort_771043=8&printerfriendly=yes.} [The NFIP] is a national program enabling property owners in participating communities to purchase insurance as a protection against flood losses. This insurance program is designed to provide an insurance alternative to disaster assistance to reduce the escalating costs of repairing damage to buildings and their contents caused by floods.\footnote{Id.}


Before the NFIP many people could not attain flood coverage from insurance companies based on the degree of risk and related high cost.\footnote{NFIP Overview, available at http://www.mscoastalmapping.com/nfipOverview.htm (last visited Aug. 29, 2009).} The NFIP now mostly operates through private insurers using the “Write Your Own” Program where a pool of insurance companies issue specific pre-determined policies and handle claims on behalf of the NFIP.\footnote{Id.}

However, the federal government retains responsibility for underwriting losses, and as of 2007 the NFIP carried over 5.6 million policies.\footnote{Id.}

The NCF could be created very similar to the NFIP, because both would likely serve as a federal underwriter for policies written by private insurance companies. Both would be created to address the same two main problems. The first is that general federal disaster relief is already subsidizing some of the cost of hurricane insurance as it was for flood insurance back in the 1960s. The second similarity is the demand for the program due to the unwillingness of private insurers to write policies for the riskiest hurricane-prone coast properties in 2009, like insurer’s unwillingness to write policies for the riskiest flood-prone properties in the 1960s.

The NFIP and the NCF would also likely share similar criticisms, the main NFIP criticism stems from inadequate rates, which have resulted in a current $23.5 billion dollar debt owed to the U.S. Treasury.\footnote{David Conrad, The State of the NFIP and Flood Policies – A System of Risk Management - Is it Time for a Change?, ABA 34th Annual Spring Conference on the Environment Baltimore, MD, June 19, 2006, available at http://74.125.47.132/search?q=cache:DTK_NofxYRsJ:www.abanet.org/publicserv/environmental/conference/david_conrad_34thconf_presentation.ppt+20+billion+debt+NFIP&cd=2&hl=en&ct=clnk&gl=us.} A majority of this debt was recently caused by Hurricane Katrina,
Now interest payments on NFIP’s debt service cost over $1 billion annually, which consumes roughly half of all NFIP’s revenues. The same general criticisms are true for Florida’s Cat Fund, that the government cannot host an insurance fund without going into debt. The Cat Fund went into a deficit in 2006 and had to borrow almost two billion to keep the Cat Fund operating. The debt service from those bonds is currently being collected through emergency assessments across the state and will continue until 2015. With both the NFIP and Florida’s Cat Fund, the NCF’s closest predecessors, having declared some form of bankruptcy, what would lead anyone to believe a NCF would result any different?

2. **A Step in the Wrong Direction**

Naturally, some people are opposed to a NCF for various reasons. Many believe that the private insurance market is capable of handling hurricane risk without government intrusion. Still some also argue that because insurance has traditionally been a state issue it should remain so for the sake of precedent. In addition, some people, like the Sierra Club, believe a NCF would create a perverse incentive to continue to build in harm’s way.

Still the largest issue would be the question of whether a NCF could withstand the political pressure. In other words, could a NCF prevent itself from becoming more of a bailout for risk-prone states, could it continue to charge and protect each state equally? This view is further supported by only states of high risk lobbying for this legislation. Many people, including the American Insurance Association, fear that the same as Florida’s Cat Fund has subsidized the cost of living on the coast at the expense of inland taxpayers, it would cause similar problem on a national scale. The only difference would be that this problem would divide the states with little risk like Wyoming and Utah, with states that are more prone to catastrophes, like Florida with hurricanes, and California with earthquakes and wildfires. Even if the NCF begins fair, there will be eternal political pressure to artificially lower the rates, while still demanding the government to cover the same risk. In conclusion, Americans deserve a less politicized system that will not tempt politicians to artificially drop rates to win a close

160 *Id.*
161 *Id.*
162 *Id.*
163 *DFS Report, supra* note 4, at 24.
164 *Id.* at 26.
169 Maroney, *supra* note 97.
170 *Id.*
election in the short-run, while making Americans pay too much for a failed program in the long-run.\footnote{Delegal Interview, supra note 10.}

Though the greater weight of the current evidence seems to point against creating a NCF, it is still unresolved, and the NCF is likely be a major issue for Congress to debate over the next few years.

### C. National Bridge Loan

“Let’s hope we don’t have a storm,” said Alex Sink, the Florida’s Chief Financial Officer. Failing that, she said, “Hope for a multibillion-dollar… bailout. We have to recognize that if we have a big enough storm, just like the guys in Wall Street… we’ll be up there in Washington, hat in hand,” she said.\footnote{Florida Danger, supra note 96.}

Though Ms. Sink may not have known it, she was lobbying for the Homeowners Defense Act of 2009, S. 505, a proposed national bridge loan sponsored by Florida’s own Senator, Bill Nelson.\footnote{S. 505, supra note 147.} This is not the first Homeowners Defense Act, in 2007 H.R. 3355 passed the House with a strong 258 votes, but could not pass in the Senate.\footnote{H.R. 3355: Homeowners’ Defense Act of 2007, available at http://www.govtrack.us/congress/bill.xpd?bill=h110-3355 (last visited Aug. 29, 2009).} The new 2009 bill would create a “National Catastrophe Risk Consortium” (NCRC), a bridge loan program that would serve as financial backstop to provide low-interest loans to qualified reinsurance programs, such as Florida’s Cat Fund.\footnote{Sen. Nelson Seeks U.S. Help on Florida Hurricane Losses, Insurance Journal, Mar. 25, 2009, available at http://www.insurancejournal.com/news/southeast/2009/03/25/99029.htm [hereinafter Nelson Help]; see also S. 505, supra note 147.} The loans are being marketed by emphasizing that there is no actual permanent funding being requested, just a temporary line of credit, that would only be opened once eighty percent of a state’s claims-paying ability for covering a catastrophe were depleted.\footnote{Florida Cabinet Meeting, State Bd. of Admin. Asset Update, (Apr. 14, 2009) (Statement of Kevin McCarty, Commissioner of Office of Insurance Regulation).} So the only request is for loans, and only in very rare circumstances. The loans would be required to be paid back in full by a set time and would accrue interest at a rate three percent higher than marketable obligations of the U.S. Treasury.\footnote{S. 505, supra note 147.} This could soon become law as the new version of this bill, S. 505, is alive and ready for committee action.\footnote{Id.}

In the hopes of creating a bridge loan without getting Congressional approval, Florida is currently lobbying three other venues in Washington D.C., the U.S. Treasury, the Federal Reserve Bank, and the White House.\footnote{Florida Cabinet Meeting, State Bd. of Admin. Asset Update (Apr. 28, 2009) (Statement of Ash Williams, Executive Dir. of the State Bd. of Admin.).} Any one of these could provide Florida the line of credit Florida would need to make it out of this hurricane season intact.

The U.S. Treasury was Florida’s first target, but this April the department refused to issue a line of credit to back up Florida’s Cat Fund without Congressional approval.\footnote{William March, Cat Fund Denied Aid from U.S. Treasury, Tampa Tribune, Apr. 9, 2009, available at http://www2.tbo.com/content/2009/apr/09/na-cat-fund-denied-aid-from-us-treasury/news-metro/;} The Federal Reserve Bank has also been approached for the same basic request, and efforts remain...
ongoing. Yet Florida is not alone in this effort, as Louisiana, Texas, and California are lobbying for the same assistance as well.

The White House has also been approached, but President Obama has not made an official authorization as president. However, back in 2007, a then Senator Obama claimed the H.R. 3355 bridge loan bill was a “good start,” and it would certainly seem likely that he would continue to support a national bridge loan in his new executive role.

Turning from politics to policy, the bridge loan appears to be the best option considering the current political reality in 2009, that the federal government is almost certain to step in with financial aid following a major hurricane catastrophe. The federal government already subsidizes natural disasters in risk-adverse areas through the cost of ad hoc national assistance, so why not create a more organized way to distribute financial aid?

In contrast to the other two previous federal options, the national bridge loan would be a more “disciplined, structured plan” in the words of Senator Nelson. This program would give the government the least amount of financial and political involvement because a loan contains much fewer variables and policy decisions than an insurance policy. Out of the three traditional loan factors, principle, interest rate, and amortization period, only one factor would need to be determined for a national bridge loan because the other two would be pre-determined. Specifically, the principle is pre-determined by the amount of financial aid needed beyond eighty percent of a state’s claims paying ability, and the rate of interest is pre-determined at three percent above the treasury rate. Therefore the only factor that would need to be determined is the amortization period. This simplicity would likely depoliticize the whole process and create more accountability. There is also some evidence to support that this increased accountability would save federal taxpayer money by reducing the gross amount of emergency aid given to state and local governments after disasters.

In conclusion the ad hoc national assistance is likely to continue until the federal government chooses to go with a NCF or a bridge loan program. Both of the later two options seem to have momentum, but the bridge loan is the better choice due to its limited nature that would depoliticize the process, demand more accountability, and save taxpayer money.

Conclusion

The heart of the unnatural disaster is the eternal fight between short-term politics and long-term sustainability. Due to the nature of Florida’s hurricane insurance system being so government-oriented, it facilitates an extra temptation to over-expose and artificially lower rates for short-term results. The problems have now compounded over the years to make the state vulnerable, and now it is clear that Florida would not be able to weather all possible hurricane

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183 Id.
185 Nelson Help, supra note 176.
186 Id.
scenarios. This means that some insurance consumers may go empty-handed. As CFO Sink said it best at a recent Florida cabinet meeting, "we're almost running out of time."\(^{188}\)

Still Floridians are not quite out of luck, at least not yet. Admittedly sweeping changes will not come to Florida’s insurance system overnight, but the glide path offers a sustainable future for the state’s insurance system while minimizing fiscal and political pain in the short-term. Furthermore, even if the state cannot act soon enough, the federal government has many options to use in rescuing the states’ insurance systems. So the Smith Family still does not have any hard answers, but with the glide path they can have hope for Florida one day, and with the federal government, they will likely have some form of hope when they need it.