

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based only on the provisions contained in the legislation as of the latest date listed below.)

Date: March 31, 1998 Revised: \_\_\_\_\_

Subject: Property Insurance

	<u>Analyst</u>	<u>Staff Director</u>	<u>Reference</u>	<u>Action</u>
1.	<u>Emrich</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Favorable/CS</u>
2.	_____	_____	_____	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____

**I. Summary:**

More than 5 years ago, Hurricane Andrew caused over \$15 billion in property insurance losses in Florida, including \$10 billion in residential losses. That event severely impacted the Florida property insurance market. Today, while there are some encouraging signs of the insurance market stabilizing, there are still significant availability problems and overall Florida's private sector market for homeowners' insurance continues to remain unstable. As of February 28, 1998, the Florida Windstorm Underwriting Association (FWUA) had 436,446 policies in force with \$78.9 billion in exposure and the Residential Property and Casualty Joint Underwriting Association (RPCJUA) had 372,289 policies in force representing approximately \$50.6 billion in exposure.

Since 1993, Florida laws have restricted the ability of insurers to cancel or nonrenew personal lines residential policies (i.e., homeowners, mobile home owners, condominium unit owners, and similar policies) for the purpose of reducing the insurers potential hurricane losses. The current versions of the moratorium on hurricane-related cancellations and nonrenewals (i.e., one version covers personal lines residential policies, and the other covers condominium association policies) expire on June 1, 1999. This Committee Substitute for Senate Bill 2054 would extend those provisions until June 1, 2001.

This bill amends sections 627.7013 and 627.7014 of the Florida Statutes.

**II. Present Situation:**

More than 5 years after Hurricane Andrew caused over \$15 billion in insured losses, Florida's private sector market for homeowners' insurance and other forms of residential property insurance remains unstable. Florida's two state-created property insurers of last resort continued

to have a large number of policies in force representing a significant exposure. As of February 28, 1998, the Florida Windstorm Underwriting Association (FWUA) had 436,446 policies in force with \$78.9 billion in exposure while the Residential Property and Casualty Joint Underwriting Association (RPCJUA) had 372,289 policies in force representing approximately \$50.6 billion in exposure.

### **Moratorium on Hurricane-Related Cancellations and Nonrenewals of Residential Policies**

Soon after Hurricane Andrew, insurers began to reevaluate their Florida exposures, raising the possibility of a mass exodus from the Florida private sector residential property insurance market. Florida law, since May of 1993, has restricted the ability of insurers to use the possibility of hurricane losses as the basis for canceling or nonrenewing personal lines residential policies and has, since June 1996, applied similar restrictions on the cancellation or nonrenewal of condominium association policies.

Initially, in 1993, the Legislature imposed a 180-day moratorium on non-renewals, by prohibiting insurers from non-renewing any personal lines residential property insurance policies for the purpose of reducing hurricane exposure from May 19 until November 14, 1993.

In November 1993, the Legislature enacted a 3-year “moratorium phase-out” that followed the 180-day moratorium, that limited the number of residential property insurance policies that insurers were permitted to non-renew. The law prohibited insurers from non-renewing more than 5 percent of their policies in the state in any 12-month period, and also prohibited insurers from non-renewing more than 10 percent of their policies in any one county in any 12-month period. These percentage limitations applied separately to mobile home policies. Certain exceptions were provided for insurers that could demonstrate an unreasonable threat to their solvency. By its terms, the 3-year moratorium was scheduled to expire on November 14, 1996.

In 1996, the Legislature replaced the “moratorium phase-out” with the current 3-year “moratorium completion,” that runs from June 1, 1996, until June 1, 1999, (s. 627.7013, F.S.). The current moratorium applies to any policy that was in effect on June 1, 1996, and does not apply to policies written after that date. The law has the same percentage limitations as the moratorium it replaced, summarized in the above paragraph, but it allows insurers to transfer policies to another authorized insurer without it counting as a nonrenewal. It also allows an insurer that has an over-concentration of wind risks in areas eligible for the FWUA to apply to the department for approval of an “accelerated exposure reduction program” for nonrenewals only of the windstorm portion of the policy, if replaced by windstorm coverage from the FWUA. This allows an insurer to non-renew the windstorm coverage for up to 15 percent of its policies in the state within a 12-month period (accelerating the 3-year limit of 5 percent per year), without any limit on the percentage of nonrenewals in any particular county, subject to approval by the department under specified standards. The state’s two largest writers of residential property insurance have obtained approval for an accelerated exposure reduction program.

Also, the 1996 law enacted a moratorium to apply to condominium association policies, which were not covered by the previous moratorium laws, (s. 627.7014, F.S.). This law is substantially similar to the 1996 moratorium completion law, summarized above, that applies to personal lines residential policies. The moratorium under this section applies to all condominium association residential policies in force on June 1, 1996.

### **Constitutionality of the Moratorium**

The constitutionality of the current personal lines moratorium was upheld in October 1996, by the U.S. District Court for the Northern District of Florida in the case of *Vesta Fire Ins. Co. v. State of Florida, Department of Insurance*. The U.S. District Court's decision has been appealed to the U.S. Court of Appeals for the Eleventh Circuit. Oral arguments before the Eleventh Circuit Court were held last month.

The plaintiffs in *Vesta* argued that the moratorium was unconstitutional by requiring involuntary servitude in violation of the Thirteenth Amendment, depriving the plaintiffs of substantive due process in violation of the Fourteenth Amendment, impairing obligations of contract in violation of Article I, and taking property without just compensation in violation of the Fifth Amendment.

The District Court upheld the law against each of these charges, as follows:

1. *Involuntary servitude:*

The court relied on long-standing federal case law to hold that the prohibition of involuntary servitude applied only to slavery and similar forms of compulsory labor.

2. *Substantive due process:*

The court found that, under controlling decisions of the U.S. Supreme Court:

In the absence of any infringement upon fundamental rights, legislative acts affecting the benefits and burdens of economic life will survive substantive due process scrutiny if such acts are supported by a "legitimate legislative purpose furthered by a rational means." Indeed, economic legislation is *presumed* valid until the one complaining of a due process violation establishes that the legislation effects the deprivation of a constitutionally protected interest by means that are arbitrary, capricious, and without any rational basis.

The court held that "the Legislature acted, not in an arbitrary and capricious manner as Plaintiffs suggest, but in a rational way to ameliorate a significant danger to Florida's welfare."

3. *Impairment of obligations of contract:*

The plaintiffs claimed that the moratorium unconstitutionally impaired their pre-existing contractual right to cancel or nonrenew insurance policies. The District Court relied on a three-part test established by the U.S. Supreme Court in 1983: in order for a state law to be upheld in spite of the prohibition on impairment of contract, the law must in fact operate as a

substantial impairment, the legislation must serve a significant and legitimate public purpose, and the “adjustment of the contracting parties’ rights [must be] based upon reasonable conditions and [must be] of a character appropriate to the public purpose.”

As factors establishing a significant public purpose, the court cited the destruction caused by Hurricane Andrew, the number of insolvencies caused by Andrew, the threats from insurers to nonrenew substantial number of policies or withdraw from the state, and the consequences these actions would have for the state’s economy in general. As factors establishing that the conditions were reasonable and of an appropriate character, the court cited the moratorium’s limited nature (in that it did not prohibit non-hurricane-related cancellations), the ability of insurers to seek solvency-related waivers of the moratorium or approval of alternative plans, and the time limitation on the burdens imposed. The court noted that the duration of the moratorium had, at that point, been extended to 6 years, but did not comment on the question of what time limitations might be considered unreasonable conditions of a character inappropriate to the public purpose.

4. *Taking without just compensation:*

The plaintiffs argued that the moratorium was a taking because it forced insurers to commit capital to Florida and because, taken together with the Catastrophe Fund law, the moratorium required insurers to pay money to the Catastrophe Fund. The court found that the intrusion on the plaintiffs’ rights did not go so far as to be a taking, because the insurer still received the benefit of its insurance policies, could still cancel them for non-hurricane-related reasons, and could still withdraw completely from the state over time. The court found that the moratorium “constituted a valid exercise of the state’s police power -- that is, the power was intended to, did, and still does, address a legitimate state purpose by means rationally related to the desired end.” The court also found that the creation of the Catastrophe Fund was neither irrational nor arbitrary, and insurers receive something of value (the functional equivalent of reinsurance) in exchange for the premiums they pay to the Catastrophe Fund.

### III. Effect of Proposed Changes:

**Section 1.** Amends s. 627.7013, F.S., to extend until June 1, 2001, the current moratorium on hurricane-related cancellations or nonrenewals of personal lines residential policies. The extended moratorium would continue to apply only to those policies that were in effect on June 1, 1996, and would not apply to policies issued after that date.

The bill provides legislative intent language stating that as of March 1, 1998, the general instability of the market is reflected by the fact that the FWUA had more than 430,000 policies in force, approximately half of which were initially issued after January 1, 1997. Additionally, in spite of depopulation efforts, the RPCJUA still had approximately 370,000 policies in force as of March 1, 1998.

The bill would remove authority for insurers to petition the Department of Insurance for approval of “accelerated exposure reduction plans” in FWUA-eligible areas, which is discussed above under the Present Situation Section.

The bill would allow the moratorium to be terminated before June 1, 2001, if the market situation improves dramatically. The moratorium would cease to operate once the property exposures of the FWUA and RPCJUA, combined, remained below \$25 billion for 3 consecutive months.

**Section 2.** Amends s. 627.7014, F.S., to extend the moratorium on hurricane-related cancellations and nonrenewals of condominium association policies until June 1, 2001. The extended moratorium would continue to apply only to those policies that were in effect on June 1, 1996, and would not apply to policies issued after that date. Legislative findings state that as of March 1, 1998, the general instability of the market is reflected by the rapid growth of the FWUA, which had more than 9,700 commercial residential policies in force which represents a 58 percent increase over the number of such policies 1 year ago. The bill also deletes provisions relating to “accelerated exposure reduction plans” in FWUA-eligible areas, and states that the moratorium will cease to operate once the property exposures of the FWUA and RPCJUA, combined, remained below \$25 billion for 3 consecutive months.

**Section 3.** Provides that the bill will take effect upon becoming a law.

#### IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

See discussion of the *Vesta* case above under II. Present Situation. An additional factor that may be relevant to the constitutionality of this bill is the fact that the extended moratorium applies only to those policies that are currently subject to the moratorium, i.e., those policies that were in effect on June 1, 1996. Therefore, the bill does not apply any restriction on non-renewing policies that are not already covered by the moratorium.

**V. Economic Impact and Fiscal Note:**

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The bill continues for an additional 2 years the moratorium on hurricane-related cancellations and nonrenewals of property insurance policies, which imposes on insurers the burden of maintaining some insurance policies that they might otherwise not maintain.

The continuation of the moratorium delays until at least 2001 the possibility of massive insurer withdrawals from Florida that could result in significant growth of the FWUA and RPCJUA, and attendant growth in their potential assessments on insurers and policyholders.

C. Government Sector Impact:

None.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Amendments:**

None.