

**DRAFT: 1/12/10 – Executive Summary Recommendation by Randy Dumm – This is a working draft and does not represent the views or position of the Florida Commission on Hurricane Loss Projection Methodology.**

**EXECUTIVE SUMMARY**

Legislative changes brought about by the passage of CS/CS/CS/HB 1495 added a new subsection to the law which creates and defines the role of the Florida Commission on Hurricane Loss Projection Methodology (Commission). The new requirement in s. 627.0628(4), F.S., directs the Commission to hold public meetings for the purpose of receiving testimony and data regarding the implementation of windstorm mitigation discounts. The Commission is further required to present a report by February 1, 2010, to the Governor, the Cabinet, the President of the Senate, and the Speaker of the House of Representatives to include recommendations for improving the process of assessing, determining, and applying windstorm mitigation discounts pursuant to s. 627.0629, F.S.

In fulfilling the new requirement in the law, the Commission held six public meetings in Tallahassee, Florida. The input and data received during the process as well as other information gathered by the Commission resulted in this report.

Mitigation refers to the efforts undertaken to reduce the frequency or severity of loss. While there are many different types of mitigation (e.g., air bags in cars, alarm systems), the focus of this report is specifically on windstorm mitigation. For homes, windstorm mitigation can be separate from the structure (e.g., hurricane shutters) or they can be an integral part of the building (e.g, hurricane straps, longer roofing nails, or roof shape). While mitigation is an important part of all insurance markets, it should be especially true for markets that have significant exposure to catastrophic loss. For Florida, the potential benefits of windstorm mitigation are well documented and beyond dispute.<sup>1</sup>

Given these benefits, windstorm mitigation has been widely touted as a critical component of the state's efforts to stabilize and strengthen the insurance market in Florida. By improving the performance of the housing stock against wind-related losses, windstorm mitigation was to result in greater market participation by insurers and reinsurers as the uncertainty surrounding the performance of the housing stock was reduced. Besides improving the safety for homeowners and their families, windstorm

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<sup>1</sup> Research on mitigation performance following the 2004 and 2005 hurricane seasons showed a clear benefit in the form of lower loss levels for mitigated structures versus unmitigated structures.

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mitigation also was expected to lead to price stability for the market in general and premium reductions for some consumers.

Against this backdrop, a logical conclusion was that windstorm mitigation efforts would result in a healthier property insurance market in Florida. Instead, the current state of the market indicates a perverse outcome where these efforts have resulted in a worsening of the residential property insurance market. This is particularly problematic given that the market has experienced no hurricane losses in the past four hurricane seasons.

The problems related to windstorm mitigation credits are complex and will not yield to a single solution as the process involves or is related to 1) the use of modeling to determine the impact of various mitigation features on expected loss cost, 2) the translation of mitigation relativities to mitigation credits, 3) the application of mitigation credits into the ratemaking process, 4) gathering information regarding the insured population and reflecting that in the ratings, 5) potential inspection fraud in determining windstorm mitigation credits.

In addition to the five items noted above, market distortions have been caused by 1) decisions on how those credits are to be applied to the ratemaking process, 2) timing issues related to insurer delays in requesting rate relief and the insurance regulator’s reluctance to allow offsets to windstorm mitigation credits, 3) the decision to require the use of one modeling firm’s mitigation relativities to develop mitigation credits, 4) the potential presence of fraud and its impact on premium sufficiency and the reliability of future loss data.

**Historical Background**

The Florida Building Code establishes construction practices and building requirements that are directly related to windstorm mitigation. ~~Mitigation has been a concern of the state of Florida stemming back to the 1940s and 1950s. Over the years, lessons have been learned and building codes have been improved. Following~~ Hurricane Andrew ~~in 1993~~ was the bell weather event in Florida that clearly indicated the need to strengthen and improve the existing building code. This was done through major changes in the building code in 1993 and 2002.

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The importance of windstorm mitigation practices from a public policy perspective is highlighted by actions taken by ~~serious efforts were made to strengthen and make building codes more effective at hardening homes. As a result,~~ the Legislature ~~in its desire to motivate windstorm mitigation measures,~~ began requiring to require recognition of the effects of hardened homes in residential property insurance rate filings. The enactment of s. 627.0629, F.S., in 1993 ~~lead~~ the way for progressively more and more sophistication in the requirements for windstorm mitigation discounts. The Office of Insurance Regulation (OIR) was tasked with determining windstorm mitigation discounts “...that meet the minimum requirements of the Florida Building Code, based upon actual experience or any other loss relativity studies available to the office.” The statute is augmented by further requirements in OIR’s rule 69O-170.017, F.A.C. Additionally, the law specifies a future requirement to be met by February 1, 2011, for the adoption of a uniform home grading scale and the development of a method whereby windstorm mitigation discounts are directly correlated to a numerical rating assigned to a structure per s. 627.0629(1)(b), F.S.

Residential property insurers use output from hurricane computer simulation models to develop their rates. Such models also incorporate various windstorm mitigation features associated with the residential structures, which are being modeled. The output of the models consists of loss costs that are then used by actuaries to develop rates. Insurers are required according to s. 627.0629, F.S., to include actuarially reasonable windstorm mitigation discounts in their rate filings. Insurers must use the discounts developed by OIR or may use an alternative study as long as all assumptions are available to OIR for review. Additionally, insurers can modify other rating factors in their filing to reflect the overall revenue impact if the insurer has actual information on policies receiving the discounts and information to support the modification. Otherwise, insurers are not allowed to offset a loss of revenue that might result by virtue of applying the windstorm mitigation discounts to residential property insurance policies.

Data that directly addresses the impact of windstorm mitigation credits on insurer performance are not currently readily available. As noted earlier, there are several indicators of continuing financial problems in the residential property insurance market in Florida. Where there are several possible explanations for this<sup>2</sup> the following provide some indirect support for the suggestion that the application of windstorm

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<sup>2</sup> A number of circumstances have been reported to contribute to residential property insurers having financial difficulties. These include 1) the inability to compete with Citizens Property Insurance Corporation (Citizens) since its rates were frozen in

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mitigation credits in the Florida property insurance market is having a negative impact on insurer performance and financial viability.

- While there were no hurricane losses over the past four years, ~~The end of the 2009 hurricane season was the fourth consecutive year that Florida did not have a landfalling hurricane. Yet,~~ 102 of 210 insurers writing residential property insurance in the state posted underwriting losses in the second quarter of 2009.
- Florida’s largest private residential property insurer, State Farm Florida, gave notice of its intent to withdraw from the state.
- The rating agency A.M. Best downgraded nine insurers in 2009, and Demotech, who rates some of the smaller Florida insurers, withdrew its rating from six insurers. Two such insurers were ordered into receivership.
- A majority of the homes qualifying for significant windstorm mitigation credits under the My Safe Florida Home program did so without having to undertake any additional windstorm mitigation activities.<sup>3</sup>
- Three insurers participating in the state’s Insurance Capital Build-Up Incentive Program paid back their surplus notes early due to problems maintaining writing ratios and minimum surplus requirements as a condition of the surplus note agreement.

~~A number of circumstances have been reported to contribute to residential property insurers having financial difficulties. These include the following:~~

- ~~1)The inability to compete with Citizens Property Insurance Corporation (Citizens) since its rates were frozen in 2007,~~
- ~~2)The problem of having to replace reinsurance coverage offered by the Florida Hurricane Catastrophe Fund (FHCF) with more costly private reinsurance,~~
- ~~3)The loss of revenue associated with providing excessive windstorm mitigation discounts and not being able to offset premiums,~~
- ~~4)The losses in asset values due to recent financial market conditions,~~
- ~~5)The continued losses from hurricane claims,~~
- ~~6)The rising cost of private reinsurance.~~

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2007, 2) the problem of having to replace reinsurance coverage offered by the Florida Hurricane Catastrophe Fund (FHCF) with more costly private reinsurance, 3) the loss of revenue associated with providing excessive windstorm mitigation discounts and not being able to offset premiums, 4) the losses in asset values due to recent financial market conditions, 5) the continued loss development from hurricane claims, and 6) the rising cost of private reinsurance.

<sup>3</sup> According to the 2008 My Safe Florida Home Annual Report, 55% of the homes under the My Safe Florida Home program were “eligible for insurance savings without making a single improvement.”

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During the public hearing process, as summarized below, the Commission received testimony identifying a number of problems and issues:

- Regarding the ratemaking process and the interaction between the insurance industry and the OIR:
  - Various factors are putting pressure on insurer costs at the same time that the public is demanding more and more rate relief in a difficult economy. The fairness and adequacy of rates is an important issue. Those policyholders with high risk exposures should pay for the cost of their exposure, but what they are charged should be fair and based on the best actuarial and scientific approaches rather than merely shifting cost from one set of policyholders to another.
  - The current ratemaking process is highly controversial and contentious.
  - The translation from windstorm mitigation relativity to windstorm mitigation credit is one of the root causes of the current problems. The decision by the OIR to use the weakest structure rather than the average structure for the mitigation credit base meant that the weakest structure received no credit while increasing the windstorm mitigation credit for the strongest structures (using the average structure would have resulted in credits for the stronger structures and surcharges for the weaker structures). This resulted in no additional charge for the weakest structure while the strongest structure qualified for credits in excess of 80 percent. Using the average structure would have resulted in a surcharge of 137 percent for the weakest structure and a credit of 58 percent for the strongest structure. The financial impact of using the weakest structure as the base became problematic as rate offsets (increases) were not available.
  - Market distortions were caused by the OIR’s decision in 2007 to not allow the Insurance Services Office (ISO) rate filing because ISO mitigation credits differed from those published by the OIR (Applied Research Associates (ARA) relativities). The OIR had approved the ISO rate filings based on modeling from AIR Worldwide the previous two years. The OIR indicated that it would accept a “detailed” study to support an alternative approach to determine windstorm mitigation relativities but there was no indication as to what level of detail would have been acceptable by the OIR.
- ~~The state is without a clear vision and a feedback structure, which would allow it to better accomplish and align the joint goals of hardening homes and ensuring that consumers are receiving fair and appropriate discounts for their windstorm mitigating efforts. The balancing of various regulatory and economic goals is not being accomplished in a planned and controlled fashion. Over time, a system has emerged whose results, implications, and effects are not being properly monitored and where underlying problems are not being clearly understood and addressed.~~

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- There is an indication of substantial fraudulent behavior in the ~~The~~-residential structure inspection system.
  - ~~lacks clear accountability.~~ While not a direct indication of inspection fraud, ~~The moral hazard is significant with~~ some home inspectors are advertising their services free of charge to policyholders if the inspector cannot obtain a windstorm mitigation discount.
  - Some ~~I~~inspectors are ~~also~~ providing other “package” deals for various non-related services as an enticement to attract business.
  - Some inspectors are alleged to merely “drive by” in order to conduct the inspection. Other inspectors are reported to perform an incomplete inspection due to their failure to inspect the attic space.
  - In some instances, home inspectors might not have entered the structure but merely filled out the inspection form while talking to the policyholder over the phone.
  - Abuse of the system is not limited to residential structure inspectors, but also includes agents, insurance companies, and homeowners.
  - The penalty for fraud and abuse of the system is apparently not as strong and/or as clear as it could be. In many cases, a misdemeanor would be the maximum penalty, which may not be enough to discourage perpetrators knowing that they can easily get away with certain unscrupulous activities and practices.
  
- There is an indication of inspection problems unrelated to fraud.
  - ~~But,~~ sSome errors result from honest mistakes arising from ambiguities and judgment.
  - ~~The system lacks checks and balances; there are no audit requirements; there is very little accountability; and the system invites abuse and inefficiencies.~~
  - ~~A problem with the~~ The current windstorm mitigation discount system ~~is that not all homes are required~~ does not require all homes to be inspected.;
  - ~~and f~~fFor many of the homes that have been inspected, numerous errors are being recognized upon re-inspection.
  - The quality of data is poor and impacts both hurricane computer modeling results and the validity of actual windstorm mitigation discounts being granted to consumers. The error rates that have come to light from re-inspection reports indicate that errors range as high as 55-80 percent depending on the region of the state.

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- The residential inspection system lacks checks and balances; there are no audit requirements; there is very little accountability; and the system invites abuse and inefficiencies.
- The work of the Commission associated with reviewing and making findings regarding hurricane computer simulation models is being relied on for producing windstorm mitigation discounts. There seems to be a presumption that the use of windstorm mitigation relativities is appropriate for developing windstorm mitigation discounts to apply to policyholder’s premiums; however, more work needs to be done to properly validate the modeling process deriving such discounts.
- ~~Various factors are putting pressure on insurer costs at the same time that the public is demanding more and more rate relief in a difficult economy. The fairness and adequacy of rates is an important issue. Those policyholders with high risk exposures should pay for the cost of their exposure, but what they are charged should be fair and based on the best actuarial and scientific approaches rather than merely shifting cost from one set of policyholders to another. The current ratemaking process is highly controversial and contentious.~~
- The state is without a clear vision and a feedback structure, which would allow it to better accomplish and align the joint goals of hardening homes and ensuring that consumers are receiving fair and appropriate discounts for their windstorm mitigating efforts. The balancing of various regulatory and economic goals is not being accomplished in a planned and controlled fashion. Over time, a system has emerged whose results, implications, and effects are not being properly monitored and where underlying problems are not being clearly understood and addressed.

As indicated above, theThe current system of assessing, determining, and applying windstorm mitigation discounts has a number of problems. In providing our recommendations, we group these problems into as indicated above. These problems are identified in five broad areas of concern which include 1) ~~a lack of a unified and consistent state vision,~~ a system that has resulted in a controversial and frequently contentious ratemaking process, 2) a flawed residential structure inspection process, 3) incomplete and poor data quality, 4) hurricane computer modeling limitations, and 5) ~~a system that has resulted in a controversial and frequently contentious ratemaking process.~~a lack of a unified and consistent state vision.

The Commission makes the following recommendations based on these five areas of concern:

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**Recommendations**

~~*A unified and consistent state vision*—The emphasis in the current system is on reducing consumer rates with secondary consideration given to hardening homes. Other important state objectives are apparently being given a lower priority. Since the residential property insurance market is complex, the state of Florida has a number of worthwhile objectives and goals that need to be considered and simultaneously achieved. These include the need for solvent and financially stable insurers; the need to depopulate the residual market (Citizens Property Insurance Corporation); the need for fair, actuarial, and scientifically sound windstorm mitigation discounts for policyholders; the need to reduce future wind losses and protect Florida families with hardened residential structures; the need to eliminate fraud, abuse, adverse selection, and moral hazard from the system; the need for complete, unbiased, quality data on all residential structures; and the need to have credible windstorm mitigation discounts based on reliable and scientifically based hurricane computer simulation models; and the need for transparency and disclosure of any inherent rate subsidies such that disincentives are recognized that may act to block policyholder motivations to strengthen their residential structures.~~

~~To accomplish a unified and consistent state vision, the Commission recommends the following:~~

- ~~a. The creation of a state vision that is focused broadly on multiple state goals and objectives associated with the complex Florida residential property insurance marketplace.~~
- ~~b. A standing body of qualified, unbiased, objective experts be designated by the Legislature to monitor and evaluate the state’s vision annually and report back to the Legislature (e.g., February 1 of each year) regarding its observations, problems/issues, and recommendations for accomplishing and balancing objectives.~~

1. *Rating and the Determination of Windstorm Mitigation Discounts* – The process of assessing, determining, and applying windstorm mitigation discounts has resulted in tensions between insurers and regulators. The fairness and adequacy of rates are important issues. Windstorm mitigation discounts should be fair and based on the best actuarial and scientific approaches rather than merely shifting cost from one set of policyholders to another.

The Commission recommends the following:

- a. The role of the Office of Insurance Regulation should be limited to the review of rate filings. Windstorm mitigation relativities and discounts should be incorporated in the hurricane computer modeling review process. The Florida Commission on Hurricane Loss Projection Methodology should determine the appropriate windstorm mitigation standards and review models according to those standards.
- b. The determination and application of windstorm mitigation discounts applied to a policyholder’s rates should be determined similar to the way any other rating factors are determined.

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- c. Unless immediate action is taken by the OIR to actively encourage offsets based on the previously discussed translation of mitigation relativities to mitigation credits, the base used for determining mitigation credits should be changed so that the credits are based on the average structure.
- d. Windstorm mitigation discounts should not apply to Coverage B or coverage for “other structures” (external structures) since they are heterogeneous and present unmanageable modeling problems. Hazard increases due to other structures should be noted in the inspection process and considered in the underwriting process.
- e. Windstorm mitigation discounts should not be applied to contents only type policies due to economic considerations.
- f. The Florida Hurricane Catastrophe Fund (FHCF) should fully recognize the impact of windstorm mitigation discounts in its rating structure rather than phasing-in the discounts over time.
- g. Larger deductibles should be applied to wind losses if windstorm mitigation features such as shutters are not used at the time of a loss.

2. ***The Residential Structure Inspection Process*** – In the process of re-inspecting residential structures, numerous ~~The residential structure inspection process is revealing numerous~~ errors have been found upon re-inspections. Some of these errors are related to inspection fraud while others are a byproduct of the process or the lack of expertise of the inspector.

To directly address inspector fraud, the Commission recommends that statutory penalties would be increased to the level of a felony for conviction of fraudulent activities.

More broadly, ~~T~~he Commission recommends that the current residential structure inspection process be replaced with ~~a single not for profit an~~ independent inspection organization that would ~~conduct~~ provide oversight and administer all aspects of the inspections process. Its sole purpose would be to ensure complete, unbiased, and the highest quality data on residential structures. The board of this independent inspection organization would consist of experts that understand windstorm mitigation of residential structures, data collection, hurricane modeling, insurance and reinsurance underwriting, and the inspection of residential structures. The organization would operate as follows:

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- a. A data base or data archive would be created and maintained so that various queries can be run regarding inspectors, mitigation features, and other relevant factors for the purpose of allowing the organization to monitor its operations to ensure consistency and data quality. ~~The sole purpose would be to ensure complete, unbiased, and the highest quality data on residential structures.~~
- b. Policyholders would be required to have their residential structure inspected ~~once~~ periodically (e.g., every five (5) years) in order to be entitled to windstorm mitigation discounts.
- ~~c. The board of the independent inspection organization would consist of experts that understand windstorm mitigation of residential structures, data collection, hurricane modeling, insurance and reinsurance underwriting, and the inspection of residential structures.~~
- ~~d. c.~~ The independent inspection organization would be financed by residential property insurers as well as certain co-payments paid by policyholders (~~i.e.g.~~ \$25 per inspection).
- d. An inspector pool would be created and each inspector would be certified by the independent inspection organization based on meeting various standards, background, training, and experience requirements.
- e. A phase-out and phase-in period would be needed until the independent inspection organization could be up and running. It is recommended that insurers continue their re-inspection programs and strive to correct errors.

~~f. Each inspector should have a unique identification number that should appear on all work products.~~

~~g. A data base or data archive would be created and maintained so that various queries can be run regarding inspectors, mitigation features, and other relevant factors for the purpose of allowing the organization to monitor its operations to ensure consistency and data quality.~~

~~h. Once a year, the independent inspection organization would be subject to an outside audit.~~

~~i. Statutory penalties would be increased to the level of a felony for anyone involved in conviction of fraudulent activities.~~

~~j. The independent inspection organization would maintain a website to provide education for consumers. Other advertising efforts would also be done, but individual inspectors or inspection firms would not be allowed to advertise or independently solicit business since this would undermine the purpose of the organization.~~

~~3. A phase out and phase in period would be needed until the independent inspection organization could be up and running. It is recommended that insurers continue their re-inspection programs and strive to correct errors. A total quality management (TQM) program would be implemented by the independent inspection organization to strive for constant quality improvement and complete and error free data. The results of the TQM program would be reported on a periodic basis to the board of the independent inspection organization.~~

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3. *Data Quality* – As noted above, concerns about data include the lack of current data on the direct impact of windstorm mitigation credits on insurers and the level of mitigation credit activity at the exposure level. Additionally, significant concerns exist about the impact that inspection related inaccuracies will have on future loss data. In general, little consideration has been given to the quality and completeness of data.

The Commission recommends that policies and procedures be put in place that ensures complete and high quality data. The data should be consistent with hurricane computer modeling needs and sufficient for the level of “granularity” required for modeling. These include the following:

- a. All residential structures in the state should be inspected and the results entered into a centralized database.
- b. On-line data collection systems need to be utilized that have built-in data and edit checks.
- c. Hurricane modeling organizations and insurers should have access to the database to have the most up-to-date data available. Privacy issues may need to be addressed such that the data cannot be used for any other purpose.
- d. Re-inspections of residential structures should be conducted on a random sample of the residential structures to establish an error rate as a base line for quality improvement measurement purposes.
- e. On-line training programs should be created to educate inspectors about errors and inconsistencies, etc.
- f. The Florida Commission on Hurricane Loss Projection Methodology should have a role in providing input to the independent inspection organization since it is positioned to understand data requirements of the modelers and to facilitate the coordination of data issues.
- g. A total quality management (TQM) program should be implemented by the independent inspection organization to strive for constant quality improvement and complete and error free data. The results of the TQM program should be reported on a periodic basis to the board of the independent inspection organization.
- h. A data call should be implemented immediately to collect the necessary ratemaking and financial data to document the impact of windstorm mitigation credits at the ZIP Code level.

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4. *Hurricane Computer Modeling* – There is a lack of understanding of the capabilities and limitations of hurricane computer simulation models. The current system is operating on the assumption that hurricane computer simulation models found acceptable by the Commission can accurately or reliably determine windstorm mitigation relativities. However, there are limitations as to the currently accepted models. Although the models have met standards regarding the projection of loss costs and probable maximum loss levels, they have not been reviewed for their ability to model windstorm mitigation relativities as applied to policies on individual residential structures. This would require a new and different approach for the Commission.

The Commission recommends the following:

- a. The current statute regarding the Commission, s. 627.0628, F.S., ~~needs~~ should be modified to
  - 1) ~~be expanded to~~ task the Commission with developing the appropriate mitigation standards,
  - 2) add a structural engineer to the Commission, and
  - 3) revert the Commission’s process of developing standards back to an annual basis rather than “every odd year.”<sup>4</sup> This would expedite the development of the appropriate mitigation standards and the implementation of the windstorm mitigation discounts based on the revamped system.

~~1. The Commission would need to consider various validation requirements and logical relationship requirements, etc. The “granularity” level or level of resolution would need to be considered by the modelers and reviewed by the Commission in creating mitigation classes. Geocoding of the data would likely be a necessary additional requirement since the Commission currently only requires modeling at the five (5) digit ZIP Code level of resolution, which is insufficient for determining appropriate mitigation discounts.~~

- m.b. Insurers should use the same hurricane computer simulation model for developing windstorm mitigation discounts as they do for developing loss costs. The hurricane computer simulation models would incorporate windstorm mitigation discounts as part of calculating loss costs; therefore, there would not be a need for offsets.

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<sup>4</sup> The 2009 Legislative Session changed s. 627.0628, F.S., to require standards be adopted every odd year rather than every year.

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~~Both discounts and surcharges would be part of the modeling process for windstorm mitigation factors such that there is greater motivation of both a positive and a negative nature to harden residential structures.~~

~~Insurers should be allowed to use offsets to maintain an adequate rate level. It is anticipated that this can be done within the hurricane computer modeling process. The hurricane computer simulation models would incorporate windstorm mitigation discounts as part of calculating loss costs; therefore, there would not be a need for offsets.~~

~~n.c.~~ The uniform home grading system needs to be repealed since it is not feasible and presumes a level of accuracy that does not exist, and, as such, could be misleading and dangerous to the public.

~~o. A structural engineer needs to be added as a member of the Commission.~~

~~p.S. 627.0628, F.S., needs to be changed back to requiring the Commission to develop standards annually rather than “every odd year.” This would expedite the development of the appropriate mitigation standards and the implementation of the windstorm mitigation discounts based on the revamped system.~~

~~q. Residential structures should be viewed as a system and modeled as such.~~

~~1) Consideration should be given to site factors that impact the risk or negate mitigation efforts to the residential structure.~~

~~2) Human safety factors should be considered and policyholders should not benefit from a windstorm mitigation discount if it creates a safety issue (e.g., inspection form includes requirement for inspector to check and ensure that the mitigation features do not pose a threat to human safety).~~

~~3) The location of the property, including the factors of terrain and wind vulnerabilities, should be considered in the modeling process.~~

~~r.d.~~ Various research results and efforts funded by the state of Florida should be integrated into the process of hurricane computer modeling to the maximum extent practical.

~~**2. Rating and the Determination of Windstorm Mitigation Discounts**—The process of assessing, determining, and applying windstorm mitigation discounts has resulted in tensions between insurers and regulators. The fairness and adequacy of rates are important issues. Windstorm mitigation discounts should be fair and based on the best actuarial and scientific approaches rather than merely shifting cost from one set of policyholders to another.~~

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- ~~b. The determination and application of windstorm mitigation discounts applied to a policyholder's rates should be determined similar to the way any other rating factors are determined.~~
- ~~c. Windstorm mitigation discounts should not apply to Coverage B or coverage for "other structures" (external structures) since they are heterogeneous and present unmanageable modeling problems. Hazard increases due to other structures should be noted in the inspection process and considered in the underwriting process.~~
- ~~d. Windstorm mitigation discounts should not be applied to contents only type policies due to economic considerations.~~
- ~~e. All rate subsidies should be disclosed to the policyholder to avoid disincentives for policyholders to implement mitigation features.~~
- ~~f. The Florida Hurricane Catastrophe Fund (FHCF) should fully recognize the impact of windstorm mitigation discounts in its rating structure rather than phasing in the discounts over time.~~
- ~~g. Both discounts and surcharges need to be part of the rating system for windstorm mitigation factors such that there is greater motivation of both a positive and a negative nature to harden residential structures. But, these may be incorporated within the hurricane computer modeling results.~~
- ~~h. Insurers should be allowed to use offsets to maintain an adequate rate level. It is anticipated that this can be done within the hurricane computer modeling process.~~
- ~~i. Larger deductibles should be applied to wind losses if windstorm mitigation features such as shutters are not used at the time of a loss.~~
- ~~j. The active or passive nature of windstorm mitigation features should be considered in determining the amount of a windstorm mitigation discount. If the windstorm mitigation feature requires an action such as taking shutters out of a garage to install, the discount should be less than for a shutter system that is pre-installed and can be activated easily and quickly.~~

5. A unified and consistent state vision – The emphasis in the current system is on reducing consumer rates with secondary consideration given to hardening homes. Other important state objectives are apparently being given a lower priority. Since the residential property insurance market is complex, the state of Florida has a number of worthwhile objectives and goals that need to be considered and simultaneously achieved. These include the need for solvent and financially stable insurers; the need to depopulate the residual market (Citizens Property Insurance Corporation); the need for fair, actuarial, and scientifically sound windstorm mitigation discounts for policyholders; the need to reduce future wind losses and protect Florida families with hardened residential structures; the need to eliminate fraud, abuse, adverse selection, and moral hazard from the system; the need for complete, unbiased, quality data on all residential structures; and the need to have credible windstorm mitigation discounts based on reliable and scientifically based hurricane computer simulation models.

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To accomplish a unified and consistent state vision, the Commission recommends the following:

- a. The creation of a state vision that is focused broadly on multiple state goals and objectives associated with the complex Florida residential property insurance marketplace.
- b. A standing body of qualified, unbiased, objective experts be designated by the Legislature to monitor and evaluate the state’s vision annually and report back to the Legislature (e.g., February 1 of each year) regarding its observations, problems/issues, and recommendations for accomplishing and balancing objectives.

**Summary**

After hearing testimony, reviewing reports, and considering other available data and information, the Commission concludes that the current system for assessing, determining, and applying windstorm mitigation discounts has failed to operate as intended and has significantly contributed to problems in the residential property insurance marketplace. It is important to recognize that this report highlights the systemic problems associated with windstorm mitigation credits and not the long-term benefits that windstorm mitigation efforts should provide. From a public policy perspective, mitigation efforts to reduce catastrophic exposure to wind continue to be important. However, other methods for financing or incentivizing property owners needs to be considered as it is clear that relying on the insurance system as the primary funding source for mitigation via credits is not sustainable.

As noted above, the current problems are complex and systemic in nature. While some of the solutions described above can be implemented in the near term, most of the ~~There are no quick fix solutions. The system needs to be changed in a major way. The~~ above recommendations focus on addressing systemic types of problems and these will take additional time if they are to be implemented properly. Any interim measures taken should be designed to help prevent the current system from deteriorating further.

The Commission’s recommendations are meant to improve the process and are designed to correct numerous problems with the current system. As noted above, continued mitigation efforts to harden the housing stock is an important part of Florida’s long-term strategy to stabilize the residential property insurance market and increase the safety of its citizens. More specifically, we believe that ~~Implementing the Commission’s~~ these recommendations, in the long-run, ~~should assist the state of Florida in obtaining the following results~~ will help lead to:

**DRAFT: 1/12/10 – Executive Summary Recommendation by Randy Dumm – This is a working draft and does not represent the views or position of the Florida Commission on Hurricane Loss Projection Methodology.**

- ~~1) Better monitoring of the state's various goals and objectives related to the residential property insurance market,~~
- ~~2) Hardened residential structures to better withstand future windstorm losses,~~
- ~~3) Lower rates for Florida residential property insurance policyholders,~~
- ~~4) 1) Less fraud, less moral hazard, and less abuse in the system,~~
- ~~5) 2) A higher quality of data that includes complete and accurate information on every residential structure in Florida ~~thus enhancing fairness for policyholders and insurers,~~~~
- ~~6) 3) More efficient and refined hurricane computer simulation models,~~
- ~~7) 4) An improved and fairer rating system for all parties with less subsidies,~~
- ~~5) Financially stronger ~~A more financially sound private insurance market that includes~~ insurers who are better able to pay claims and result in less ~~Less~~ future assessments on Florida policyholders,~~
- ~~8) 6) Less stress on Florida's residual insurance market, a ~~A~~ reduction in the number of policies in Citizens with more policies placed in the private market, and~~
- ~~9) 7) Less need for debt financing for the FHCF, Citizens, and the Florida Insurance Guarantee Association (FIGA),~~
- ~~10) A more competitive and innovative residential property insurance market,~~
- ~~11) More insurers seeking to do business in Florida,~~
- ~~12) Less insurer's exiting the Florida insurance market,~~
- ~~13) Complete and accurate information on every residential structure in Florida, and~~
- ~~14) Safer homes in Florida that can be relied on to protect Florida families.~~

~~It is important that the state of Florida develop a long term vision regarding what it wants to accomplish and monitor results on an annual basis. The state needs a long term plan. And, there needs to be discipline to follow the plan regardless of the vicissitudes in the residential property insurance market. Underwriting cycles are a common fact of the insurance and reinsurance industries, and there needs to be some tolerance for market forces. Not that underwriting cycles should be ignored, but rather they should be understood for what they are.~~

Additionally, the Commission believes that better monitoring of the state's various goals and objectives related to the residential property insurance market is an important part of this process. ~~To recover from the residential property insurance crisis, the state of Florida needs to map out a course and then steer to it by monitoring results and taking corrective measures to reach the intended destination.~~ With this in mind, the Commission's recommendations for addressing windstorm mitigation discounts can be summarized by three key core components:

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- 1) the creation of a standing, objective body of experts to annually report to the Legislature regarding observations, problems/issues, and recommendations for accomplishing and balancing state goals and objectives related to the residential property insurance marketplace,
- 2) the creation of a not-for-profit independent inspection organization to ensure quality data and eliminate the potential for fraud and abuse, and
- 3) adding a requirement in the law for windstorm mitigation discounts to be based on hurricane computer simulation models found acceptable by the Commission. Windstorm mitigation relativities are an output of the hurricane computer modeling process and the recommended approach would be to eliminate the current requirements of OIR determining windstorm mitigation discounts or alternatively requiring insurers to do their own studies.

~~The problem is complex with major ramifications dictating a stronger scientific approach that is embodied in the hurricane computer modeling process. The Commission is positioned to expand its current scope to develop standards and review hurricane computer simulation models to ensure accuracy or reliability in the development of windstorm mitigation discounts as applied to individual policyholder policies. This approach will remove much of the “credibility issues” inherent in the current system, will result in greater fairness, will reduce long term costs, and will lessen the risk of assessments to all Floridians.~~

Various problems and issues as well as the recommendations are discussed in greater detail in Section V of this report. The recommendations are listed in summary form in the last part of that section.