

SELF INSURANCE TRUST SCHEMES

WHO MOVED YOUR CHEESE OR WILL YOU HAVE ANY CHEESE TO EAT NEW AUTHORIZED NON-TRADITIONAL CONDOMINIUM INSURANCE

**An original article by Professional Public Adjuster Charles R. "Dick" Tutwiler, C.P.C.L.A., P.C.L.A.;
December, 2007**

As a result of the "insurance crisis"(depending on your perspective) in Florida following the big four hurricanes in 2004 and the three sea maidens/witches of 2005, Hurricanes Rita, Katrina and Wilma, no stone has been left unturned in the quest for some type of insurance protection at a reasonable price. Not only is price a factor but insurance at any cost is problematic in that coverage in many cases simply is not available. One only has to look at the lack of law and ordinance coverage particularly for condominiums to see the sea change in insurance markets/ coverage over the last five years.

This insurance crisis is particularly acute in the condominium communities across the state given this issue of pricing and market availability as well as what has been widely reported of the perception in the condominium communities that nothing will be paid by the insurance company because of high deductibles, restrictive coverage/policy language, and poor service from their insurance companies. Throw in the bankruptcy of one of Florida's largest condominium carriers, Southern Family, and you will understand the entrepreneur juices that are flowing to find a better way.. Thus, new protection schemes have been proposed to fill voids left by these perceived inequities and short falls.

2007 FLORIDA LEGISLATIVE CHANGES - SELF INSURANCE

As pointed out in an article authored by Ken S. Direktor, Esquire and Lance D. Clouse, Esquire of the law firm of Becker & Poliakoff, titled Is Self Insurance Right For Your Association, the Florida Statutes governing condominiums has historically provided that an association or group of associations may self insure against claims against the association, the association property, and the condominium of property required to be insured by an association upon compliance with its applicable provisions of (Sections) 624.460 - 624.488 Florida Statutes. The 2007 amendment specifically states that self insurance is adequate insurance under the statute for condominiums.

Self insurance proposals now seems to be in vogue and a 2007 legislative amendment has opened the door for these plans to fit the needs of communal living communities. As the legislature has amended the statute these plans are now before the Department of Financial Services for their review and approval.

Some of the selling points being offered for these self insurance trusts are:

1. "They are Florida authorized and are admitted insurance companies".
2. "The trust must comply with every rule and regulation of the Florida Office of Insurance Regulations."

3. These programs will save between 20% to 30% in costs as it cuts out the traditional insurance company overhead cost.
4. They say it will achieve significant cost savings by purchasing the truly catastrophic high cost reinsurance on a wholesale basis.
5. The services and employees needed to manage the trust are purchased on a contract basis as needed and thus the employee and service costs are not a fixed and incurred cost but in fact is a cost that is incurred on an as needed basis.
6. They are member owned not for profit insurance companies, all profits (if any) are income belonging to the trust member.

TRUST PRODUCTS (POLICY)

The trust proposals that have been offered to date stated that the trust will provide an identical property policy and coverage that will mirror Citizens wind and hail policy and forms.

Obviously the self insurance schemes are to date from this writer's experience untested and certainly have raised many questions regarding how they will work in a truly catastrophic event.

One obvious question is, how will the policyholders be paid for the damages given that there is no traditional insurance company with staffing and adjusters available to service the policyholder. The trust proposals to date have indicated that a third party administrator (TPA) will be appointed by the trust and are to be "under the authority and control of the trustees and members, and the TPAs will adjust the claims.

One only has to imagine the conflict and discourse that is likely to result in this scheme given that one or several groups of condominium buildings in a trust may object to the adjustment proposed by the trusts TPA adjuster in adjusting and presenting a settlement for which all members of the trust will have to pay the assessment for the loss to one building when the other trust members building damage did not exceed their deductible.

Other big factors involved in these schemes is that they do not have the Florida Insurance Guarantee Association (FIGA) backing should the trust fail.

From the point of view of the community associations members there could be significant issues with lenders in that given that there is no traditional insurance and the losses are to be paid through assessment, certainly the financial institutions holding mortgages or being asked to provide a mortgage could have second thoughts or perhaps at worse, call mortgages for violation of the loan agreement terms regarding insurance.

One trust states that "prior to beginning operations the trust will receive a credit rating that will be acceptable to all lending institutions in the United States and all foreign banks that accept U.S. ratings."

SELF INSURANCE - REINSURANCE

While the above plans to date propose the self insured trust to be funded by assessments for the loss between the hurricane deductible and the reinsurance limit, certainly one has to take into consideration the reinsurance policy limit as it relates to these trusts particularly for large catastrophic losses. If for example the total insured value of all the trust assets (multiple buildings and locations) and particularly if they are located in one geographical area, significantly exceeds the assessable amount of the gap between the deductible and the reinsurance, any loss above the reinsurance will have to borne in total by all of the individual unit owners in the collective trust. This could be a significant assessment given a catastrophic loss to geographically closely located properties.

Should some members fail to pay their part of the assessment then those that do will share in the deficiency on a proportionate basis. The trust would then take legal action to recover from those that did not pay.

While I am sure that the controversial hurricane models are being consulted for the probable maximum loss there nonetheless is no guarantee that the losses will not exceed the assessed self insured trust assessment amount, the reinsurance, as well as some possible contribution by the Florida Hurricane Catastrophe Fund which may impose a 10% co-payment requirement. These assessments will take place at a time of great financial strain as one can imagine the loss to unit owners property that from experience has shown as much as 50% of all unit owners have no insurance and/or are greatly under insured.

Another example of the reliance on these probable maximum loss proposals is a program recently introduced to the condominium community on the West Coast of Florida wherein a national broker using a 250 year windstorm probable maximum loss calculation concluded that within a certain geographical area the probable maximum loss would be \$155,000,000.00. This was the limit set in the policy that was being offered as a total pay out for this program, however, it was insuring \$1.5 billion dollars worth of property or in this case the coverage proposed by the broker was limited to approximately 15% of the total insured value .

This example put forth by a traditional insurance company and a broker is using questionable modeling data in my view to gain market share from in this case Citizens Insurance Company, by reduced pricing offset by a theoretical 250 year worst case scenario. If considering insurance trusts or other insurance schemes in this writer's view it is critical to understand who your partners are in these plans. Concentration of all the trust members, as in the case of the recent broker proposals, in one geographical area is a prescription for financial ruin. Not only is the geographical disbursement important, but also the condition and age of the buildings are critical considerations.

A FEW CLOSING THOUGHTS

1. Lloyds is now talking about the one billion dollar storm, as a real reality.
2. Advances for emergency service - re-roofing, etc. may prove to be very pragmatic in that the question will come up as to how self insured trusts are going to come up with financial funds on an emergency

basis given the lack of a traditional insurance company's financial clout to make advance that are so critical to preserve, protect and mitigate damages.

In conclusion, this paper is not meant to provide an in depth analysis of the pros and cons of the self insured program, however, I think it is beneficial for conference attendees to be aware of these insurance schemes that have now been authorized by the Florida legislature and the plan to see where your firms services and skills may be of benefit to policyholders in the event these plans that are now authorized become part of the insurance dynamic in Florida.