

Section

Example
of an Actual Real Estate Lease Review
for a High Profile Building and Tenant

REAL ESTATE LEASE REVIEW

Example of Actual Lease Review

Contract: Lease on High Profile Skyscraper, NY, NY – entire top four floors
Parties: High Profile Skyscraper, LLC (Landlord) and Big Shot Tenant, LLC (Tenant)
Reviewed by: Brent Winans, CPCU, ARM **Date Reviewed** 12/10/2006

The contents of this review are not intended as legal advice. All recommendations should be reviewed by qualified legal counsel.

Provisions	Comments (recommendations for changes in bold)
INDEMNIFICATION PROVISIONS	
[x] Each party indemnifies the other except “to the extent that any such claim results from the gross negligence or willful misconduct of” the Other or the Other Party.	The present lease terms appear to be in keeping with NY law. See legal disclaimer.
[x] Provision specifies types of risks to which it applies	To the maximum extent permitted by law
[x] Provision identifies any additional indemnities (eg., officers, directors, shareholders, etc.)	Yes, definitions of “Landlord Party” and “Tenant Party” are very inclusive.
[] Provision preserves equitable indemnity rights	No (does not have a specific statement that preserves any rights Landlord might have under equity that are not specified under contract). This is a minor point but could be added.
[] Provision specifies indemnification not limited by workers compensation benefits	No (does not have any provision which specifically asserts that the tenant’s indemnity is not restricted by any limitation on workers compensation benefits and the like). This provision should be added.
[x] State law restrictions/requirements checked	Yes, NY law bans provisions which seek to transfer the obligation for the contracting party’s own negligence. The provisions in this lease do not do that.
[x] Savings clause makes provision applicable "to the fullest extent permitted by law"	Yes

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INSURANCE REQUIREMENTS	
☒ Workers Compensation	Note: these WC limits are specified in the Work Letter insurance requirements, not in the main body of the lease, so they apply only during the period of construction. The lease should be modified to require these same limits during the course of the lease.
Employers liability limits:	
BI by accident \$	\$2,000,000
BI by disease/policy \$	\$2,000,000
BI by disease/employee	\$2,000,000
☒ Commercial General Liability	
\$ Combined single limit	\$5,000,000
☒ Additional insured status	For Landlord and Landlord Party
☒ Other requirements	Using “broadest form of such coverage from time to time generally available in New York City” Note: The liability requirements for the Tenant under the main lease are non-descript in several cases. The requirements for the contractor in D-Schedule 2-1 are more robust but lack specifics in some cases. Both provisions should be melded and specific contractor broadenings added to D-Schedule 2-1
☐ Automobile Liability	In the insurance provisions for the build-out, the Tenant’s contractors and architects are required to carry auto insurance. However, the lease does not require the Tenant itself to carry such coverage. If there is a need for the Tenant’s contractor and architect to carry such coverage, why would it not be required of the Tenant? A provision should be added requiring the Tenant to carry the same type of automobile liability coverage that is presently required of the Tenant’s contractor in the build-out (see page D-Schedule 2-2). Hired and Non-owned coverage is at minimum.
☐ Umbrella/Excess Liability (if necessary to meet liability limit requirements)	During the build-out, the Tenant and/or the Tenants General Contractor is required to carry an umbrella. (See D-Schedule 2-3) The limit to

	be carried is confusing and needs to be clarified as it relates to the build-out. Must the Tenant carry \$5,000,000 and the General Contractor carry \$20,000,000, or may they purchase a policy for \$20,000,000 that covers them both for this project? The provision is ambiguous and needs to be clarified. In addition, there is not provision requiring the Tenant to carry an umbrella policy beyond the build-out. It would seem reasonable to require at least a \$5,000,000 umbrella for the main Tenant, if not for all of the Licensees.
☐ Pollution Legal Liability	No requirement
☒ Commercial Property Insurance	
☒ Equal to 100% replacement cost	
☒ Tenant's improvements and betterments	
☒ Replacement cost valuation	
☒ "All risk" coverage	
☐ Flood coverage	No requirement
☐ Earthquake coverage	Earthquake is the type of low frequency, high severity loss for which coverage should be required. It presently is not.
☒ Other requirements	• Agreed amount endorsement • Terrorism coverage for 100% of replacement cost • Business Interruption for one year of fixed and additional rent with a 365 day extended period of indemnity endorsement Note: there is presently no requirement in Exhibit D, Schedule 2 requiring the Tenant to carry a builder's risk type policy during the build-out of their space. Such a requirement should be added.
☐ Boiler and Machinery Insurance	No coverage requirement. Even though the Landlord may have limited interest in whether the tenant carries this coverage, with the eight "dedicated systems" listed in Schedule E, the Tenant should consider it.

	A requirement should be added for tenant to carry comprehensive mechanical breakdown coverage for any machinery or equipment used by tenant.
[x] Evidence of Insurance	
[x] ACORD certificate of insurance with modifications	The lease presently requires that the certificates evidence waiver of subrogation for property and WC policies. To be consistent, once the blanket waiver of subrogation clause is added to the general liability policy, it should be noted in the liability certificate as well.
[x] Other requirements	Certificates to be provided 30 days prior to renewal
[x] Acceptability of Insurance	
[] Right to reject unacceptable insurers	No such provision presently. Such a provision should be added.
[x] Other requirements	Best rating of at least A- XIII
[] Insurance Deductibles	
[] Right to approve or disapprove deductible amounts in required policies	No provisions presently address Tenant's deductibles. Such a provision should be added specifying maximum deductibles that are acceptable to the Landlord.
[x] New York Disability Law Coverage	There is a provision requiring the statutory coverage to be carried. Such a provision should be added
WAIVERS OF SUBROGATION	
[] Commercial General/Umbrella Liability Insurance	There is presently no requirement that the Tenant's CGL policy contain a blanket waiver of subrogation clause. A provision should be added which states that if the policy does not contain the standard ISO waiver of subrogation provisions, a waiver of subrogation clause in favor of the landlord should be added.
[] Auto Liability Insurance	There is presently no requirement for the Tenant to carry auto liability coverage.
[x] Workers Compensation Insurance	
[x] Commercial Property Insurance	

Further Comments

1. **Section 4.3 should add condition to Landlord approval of “non-approved” contractors that they need to conform to minimum insurance requirements and execute appropriate exculpatory provisions in favor of Landlord Parties.**
2. Page 26 – Section 4.2(c) contains insurance provisions which must be met before the Tenant can make alterations to the building. These provisions conflict with the more detailed provisions contained in Exhibit D, Schedule 2. **This paragraph should be deleted and a reference made to Exhibit D, Schedule 2 in its place.**
3. Page 32ff – Section 6.1(b) holds the Tenant responsible for paying for “all damage or injury to the Building Systems, the Building or the Premises caused by or resulting from the negligence...of...Tenant...” There is no exception in this provision for damage which is covered by the Tenant’s insurance. This lack of an exception for insured damage causes this provision to conflict with Section 11.6(a) in which both parties agree to waive their rights against the other when damage is covered by the insurance policies they are both, respectively, required to carry. **An exception needs to be added to Section 6.1(b) to eliminate this conflict.**
4. Page 35ff – Section 7.1
 - a. **(f) B – broaden the language to include “any retentions or deductibles sustained under such policies of insurance.**
 - b. (f) B – what is the intention for passing along uninsured costs sustained?
5. Page 65 – Section 10.15 is in conflict with the Use & Occupancy restriction in 2.1(c) permitting re-heating but not cooking equipment. Need to discuss this further and if Tenant can install flue as noted we need to make sure the insurance requirements are satisfied.
 - a. The provision requires the tenant to “...indemnify, defend and save Landlord harmless, in accordance with the provisions of Article 29 of this Lease, from and against any loss, liability, damage or expense arising out of Tenant’s access to and/or installation or use of the Flue...” **Again, because the provision does not reference the waiver of subrogation paragraph which states that the parties will not seek recourse from each other for damages covered by their respective insurance policies, this section is in conflict with that waiver of subrogation provision.**
6. Article 11 – Insurance
 - a. 11.1 – (and 11.3a) I would like “A-“ changed to “A” for AM Best rating and question if \$5MM is enough. I don’t think \$10MM would be outlandish but at the very least would stipulate that “said limits are dedicated to the location”
7. Page 73 – Section 11.6(a) deals with the waiver of subrogation for property losses.
 - a. The provisions are inconsistent and confusing. In the first sentence it says that the parties are to waive their rights of subrogation against each other for loss or damage to the property covered by “any insurance policy carried by Landlord or Tenant.” In the next sentence it says they are to obtain a waiver of subrogation clause in “any fire or extended coverage insurance...” Later in that same very long sentence, it

- references a waiver applying to losses “from fire or other hazards covered by all risk property insurance...” And then in the next sentence it again references a waiver of rights for claims “resulting from fire or other hazards covered by such fire and extended coverage insurance.” **One phrase should be used consistently.** I suggest wording which waives subrogation for claims covered by the property insurance carried by the parties, or which would have been so insured had the other party carried the insurance required in the lease agreement.
- b. I think “...carried by *Landlord or Tenant*, or...” should be changed to “...carried by *the subject party*, or...” Subrogation rights attach when the insurer steps into the shoes of the party that **paid the loss** and has a cause of action against another party that **caused the loss**.
8. The Lease contains a provision regarding the Tenant’s roof equipment. It reads in part, “Roof Rights; 53rd Floor Mechanical Room. (a) Notwithstanding anything to the contrary contained herein, Tenant shall be entitled to use a portion of (1) the roof of the Building (not to exceed eight hundred (800) square feet in the aggregate) and (2) the 53rd floor mechanical room (not to exceed Tenant's Share of Taxes of space in the 53rd floor mechanical room which Landlord reasonably determines is allocable for the equipment of tenants in the Building) for the installation and operation of (i) exhaust equipment located at the top of the Flue and (ii) the Supplemental AC Units (collectively, “Tenant's Roof Equipment”).” **The Tenant should make sure that its property insurer is aware of this provision so that coverage extends to its property on the roof and in the 53rd floor mechanical room.**
 9. Article 12 – Destruction of the Premises
 - a. 12.1 discusses abatement of rent and potential scenario’s for cancellation. In 11.2 (c) the lease requires 12 months of rents coverage and a 365 day extended period of indemnity. As long as the tenant has a “continuing expense” the rents insurance will be triggered. Once tenant can obtain relief (under an abatement or cancellation scenario) then the “continuing expense” obligation will cease (and so will the payments from insurance). **I think the intent here needs to be clarified – do we want Tenant to pay the rent for a year even if the premises are untenable?** The end of 12.3 makes an attempt to deal with this but, in my opinion, falls short of the clarity that is needed.
 - b. Under this Lease the Landlord is making a substantial contribution to the cost of the Tenant’s build-out. It is clear from the lease that these alterations become the property of the Landlord but that the tenant is responsible for insuring them. In Section 12.2 it states that if there is a fire or other casualty and the lease is not cancelled, the tenant is responsible for repairing the alterations. However, **I cannot find any provision which states that in the event of a fire or casualty in which the lease is cancelled, the tenant is responsible for paying over the insurance proceeds on the build-out to the Landlord. This needs to be added.**
 10. Schedule 2 – Insurance Requirements (Tenant’s Contractor)
 - a. CGL –
 - i. Coverages should list “CG 0001” form number.

- ii. The enforcement of the “3-years following the acceptance of the work” will be tough to enforce unless there is some recourse provision [to Tenant] if Landlord requests certificate in 2 years and does not get it.
 - iii. In this case we need to stipulate the additional insured should be “CG 20 10 11 85 or equivalent”
- b. Auto – there is no such thing as additional insured on an Commercial Auto policy – Who is an Insured reads “anyone liable for the conduct of an insured described above only to the extent of that liability” so the vicarious liability is implicit in the form.
- c. WC – need to have a waiver of subrogation evidenced.
- d. Umbrella – agree with the \$20MM for Contractor but language is messy. Need to state that General Contractor has to carry \$20MM – don’t know what reference to tenant is here.
- e. Suggest increasing pollution cover above \$1MM – usually any policy such as this will have defense included within limit. I think \$2MM would be better - \$5MM ideal but given build-out work may be difficult to get. Any water intrusion that results in mold will be excluded from a CGL policy and should be anticipated on this cover.
 - i. Same comment on the 3 years following completion.
- f. There is no provision for Contractor to insure the property before installation is complete. **It needs to be clarified that property before installed is contractor’s responsibility – We may want to impose obligation to furnish builders risk policy so as to cover this exposure including material delivered to site prior to installation.**

Section

Other Materials:

- "Will Florida's Hurricane Insurance Plan Blow Us Away?"
- "12 Mistakes to Avoid When You Bid Your Business Insurance"
- Risk and Insurance Management Consulting Services

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Will Florida's Hurricane Insurance Plan Blow Us Away?

By Brent Winans, CPCU, ARM

After a major 1-in-100-year hurricane, Florida's present insurance structure could leave billions of dollars in policyholders' hurricane claims unpaid for months or even years. Projections are that \$18 billion dollars would have to be borrowed in the open market (if possible) to pay the claims. Then nearly all of Florida's policyholders would be assessed for decades to repay the debt. The average assessment for a homeowner insured by Citizens is projected to be \$9,400, with \$1,200 payable in the first year and the remainder charged over 30 years. The assessment on an average homeowner covered by another insurer is projected to be \$7,100, with \$230 payable in the first year and the remainder charged over 30 years. Businesses will be hit hard too. A business or condominium association paying \$150,000 to Citizens and \$50,000 in other premiums is likely to be assessed nearly \$600,000, with \$80,000 payable in the first year and the remainder charged over 30 years. A similar company that is not insured with Citizens is still likely to be assessed over \$500,000, with over \$25,000 payable in the first year and the remainder charged over 30 years.

With the federal government mired in a debt crisis and gridlock, Floridians must shoulder the responsibility to solve this problem ourselves. This article suggests seven steps that can be taken to provide hurricane insurance that consumers can trust to pay their claims and free them from crippling insurance assessments.

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Will Florida's Hurricane Insurance Plan Blow Us Away?

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After seven hurricanes hit Florida in 2004 and 2005, property insurance rates went through the roof, and thousands of homeowners and businesses received cancellation notices. Consumers put intense pressure on their elected leaders to fix the problem. In January 2007, the Florida State Legislature held hearings in Tallahassee on the insurance crisis. The experience of one state representative was typical. He was a Republican representing ocean-front property owners who traditionally have had a “keep the government out of my business” attitude. But they were up in arms. He related, “One of my faithful supporters shook his rolled up policy in my face and said, ‘My homeowners premium went up to \$10,000. You do something about this!’”

It is hard to blame the lawmakers for taking quick action to calm the public and keep rates down. To do so, they dramatically expanded the roles of the state-controlled Citizens Property Insurance Corporation (Citizens) and Florida Hurricane Catastrophe Fund (the CAT Fund) and froze Citizens’ rates.

Unfortunately, the measures lawmakers took in the crisis of the moment now threaten the collapse of both the Florida insurance market and economy. Citizens’ Chairman, Jim Malone, recently stated, “Our rates have been artificially and, I’m not afraid to say, irresponsibly held below market. I’m scared to death we’re going to have a big event or a series of medium events that become a real nightmare.”⁽¹⁾ The Chief Operating Officer of the CAT Fund, Dr. Jack Nicholson, said recently, “We would like to be able to say to the legislature that we can pay 100% of our losses, regardless of what happens. Right now, we can’t honestly say that we can.”⁽²⁾ In the most recent meeting of the Governor’s Cabinet on November 1, the President of Citizens, Scott Wallace, described that Citizens would have to levy large assessments against most Florida policyholders in the event of a 1-in-100 year storm. The Miami Herald reported, “Gov. Scott got Wallace to concede that many struggling homeowners could never afford to pay that, meaning they would default on their mortgages and lose their homes. ‘You would never organize your life like this,’ Scott said.”⁽³⁾

How has Florida put itself in such a risky position? By ignoring basic risk management principles and taking the following actions:

- Concentrating the risk rather than spreading it.
- Not allowing rates that are adequate to pay for the claims that are likely to occur.
- “Transferring” the responsibility for the claims deficit to those with a questionable ability and willingness to pay—the state’s own hurricane-traumatized policyholders.

And what will be the result in the event of a catastrophic storm? In a worst case scenario, billions of dollars in storm losses could go unpaid for months, perhaps years. Then, without further legislation or citizen input, Florida's taxpayers could be faced with unprecedented insurance assessments - "taxes" which could last decades.

Concentrating the Risk

One of the most fundamental principles of risk management is to spread the risk. "Don't put all your eggs in one basket." Insurers try to spread their risk over a wide geographical area to avoid the possibility of a single catastrophe affecting a large portion of their books of business. State governments often further accomplish this spread of risk by encouraging a healthy insurance market so that many different insurance companies will participate. In contrast, the state of Florida has concentrated the risk of multi-billion dollar hurricane losses in its own hands through Citizens and the CAT Fund.

Neither this nor anything else in this article should be taken as a criticism of the management or staff of either Citizens or the CAT Fund. They are insurance professionals who have done an amazing job of responding to ever expanding legislative mandates. Managers from both Citizens and the CAT Fund have testified before the House Insurance Committee on the dangers of the present strategy. But it is the lawmakers and regulators who are driving the bus.

Citizens

Citizens was created by the state legislature in 2002 as a homeowners insurance safety net. Since then, its mandate has been constantly expanded. Today, it is the largest property insurer in Florida, the third largest property insurer of any kind in the United States, and the largest property residual insurance market in the world, and it is growing. Jim Malone, Chairman of Citizens, recently reported that Citizens is growing at "a rate of 4,000 to 5,000 people a week."⁽⁴⁾ Citizens estimates that its total exposure to loss exceeds \$455 billion and its probable maximum loss from a single event (1-in-100 year storm) exceeds \$22 billion.⁽⁵⁾ This is concentration of risk at an unprecedented level. "No other state has the number of policies or the exposure to loss like Florida," Lynne McChristian, spokeswoman for the Insurance Information Institute recently commented. "They don't even come close."⁽⁶⁾

The CAT Fund

The state has further concentrated its hurricane risk by requiring subject insurance companies to purchase low cost reinsurance coverage from the state-controlled CAT Fund as a condition of doing business in Florida. According to senior CAT Fund officer Dr. Jack Nicholson, it has become "the largest catastrophe reinsurer in the world." Its exposure has grown from \$747 billion in 1995 to a projected \$2.23 trillion in 2010.⁽⁷⁾ But while Florida has created the CAT Fund, it has not matched that with the cash to pay for its claims. In the event of a 1-in-100 year hurricane, the CAT Fund would have to borrow most of the money to make good on its policies.

A further bazaar but little known fact about Florida's CAT fund is that, unlike other insurers and reinsurers, it has no legal obligation to pay its claims if it cannot raise the money to do so.⁽⁸⁾ So, in effect,

insurers have been told by Florida lawmakers, “We are setting up a hurricane reinsurance company to help keep our hurricane rates down. You are required to buy reinsurance from it even though it does not have cash in the bank to pay its claims. It will have to borrow money to pay you if there is a big hurricane. However, if it cannot borrow the money, then you just will not be paid, and the State of Florida will not pay you either.”

If the CAT Fund is not able to borrow the claim funds it needs, the impact will roll down hill. Citizens is counting on the CAT fund for over \$6.5 billion in a 1-in-100 year storm. Other Florida insurers are expecting even more. If the CAT Fund is unable to borrow the money it needs in a timely fashion, the impact to Florida insureds and to the Florida economy will be devastating.

In the event of a 1-in-100 year storm, Raymond James and Associates, the financial advisor to both Citizens and the CAT Fund, estimates that in order to pay their claims those two entities would have to issue bonds for a combined \$18.6 billion. That would be one of the largest public bond offerings in history, and Florida would be trying to do it in this distressed economy and following a devastating hurricane. Raymond James and Associates noted, “There is no certainty that... shortfalls can be financed at assumed interest rates, or at any interest rates.”(9)

The Private Market

Standard insurers have fled the Florida hurricane insurance marketplace. Of course, this is partially because they fear they have an over concentration of risk in hurricane prone areas. But they have also left because state lawmakers and regulators have made Florida a very difficult place to do business. State mandates are common and the process for rate approvals is challenging and unpredictable. In addition, the insurance industry has often been used as a political whipping boy. Predictably, these actions have resulted in less participation from large insurers with the most to lose, which has further concentrated the hurricane risk in the hands of the state.

Mandating Inadequate Rates

A second key risk management principle is to adequately fund for foreseeable losses. For the last several years, Florida lawmakers and the Florida Office of Insurance Regulation (OIR) have forced Citizens to charge inadequate rates. Of course, an inadequate property rate is one that will not provide the funds needed to pay anticipated administration and claim costs as projected by actuaries and other experts. Admittedly, hurricane insurance losses are inherently difficult to predict, but actuaries bring the very best tools available to this inexact science. Rates being charged by Citizens are essentially set by legislators and are far below the rates that are recommended by actuaries.

Citizens’ rates were rolled back to 2005 levels and frozen there through 2009. They are now on a “glide path” toward rate adequacy, with rate increases permitted of up to 10% a year. Because rates have been kept artificially low, private insurers have been unable to compete. In addition, consumers are largely unaware of the true risks they are bearing.

Transferring the Risk to Those Unwilling and Unable To Pay

The law now places the ultimate responsibility to pay for these deficits on the policyholders themselves. Good risk management practice requires that financial risk be transferred only to those who are both able and willing to pay. Assuming that a 1-in-100 year storm does hit Florida, after the storm, will Florida's policyholders fit that profile?

Policyholders are now responsible for paying assessments from three separate sources: Citizens, the CAT Fund, and the Florida Insurance Guaranty Association (the Guaranty Fund). Citizens can assess policyholders directly, while the CAT Fund and Guaranty Fund levy assessments on insurance companies who pass them on to policyholders. (See "Florida's Policyholder Assessments" on the final page of this Ideas in Action for a summary of the assessments each organization can levy.)

According to the report by Raymond James and Associates cited earlier, in the event of a 1-in-100 year storm, Florida insureds would be liable for assessments from Citizens of almost \$10 billion and assessments from the CAT fund of almost \$13 billion. In addition, there would almost certainly be several insurance company insolvencies, so policyholders would also be liable for assessments from the Guaranty Fund. The Raymond James report projected that the Guaranty Fund assessments could exceed \$3.5 billion.

These assessments would likely be stretched out over many years. Assessments would be substantially higher in the first year; then the remainder would probably be financed over the next 30 years. The Citizens and CAT Fund assessments would be applied to nearly all policies except workers compensation and medical malpractice.

What would this cost the typical policyholder? The same Raymond James report estimated that in the first year of assessments for a 1-in-100 year storm, the average Citizens residential policyholder would pay an extra \$1,200 and the non-Citizens policyholder would pay an additional \$360. (All figures are rounded.) Then annually for the next 30 years, the Citizens policyholder would pay an additional \$270 and the non-Citizens policyholder would pay an additional \$230. The total of payments would be \$9,400 for the "average" Citizens policyholder and \$7,100 for the "average" non-Citizens policyholder.

Using the same assumptions as the Raymond James report, what would be the impact on a business or condominium association? Let's assume that a hypothetical Citizens commercial policyholder pays \$150,000 to Citizens as well as \$50,000 in other subject insurance premiums. A similarly situated non-Citizens policyholder pays the same total premiums - \$200,000. In the first year of assessments for a 1-in-100 year storm, the Citizens policyholder would pay an additional \$80,200 and the non-Citizens policyholder would pay an additional \$26,700. Then annually for the next 30 years, both policyholders would pay an additional \$17,000. The total of payments would be \$590,200 for the hypothetical Citizens policyholder and \$536,700 for the non-Citizens policyholder.

It is important to note that these are not the maximum assessments which could be levied; they are just the projected assessments for a 1-in-100 year storm. A more severe storm or a series of storms in the

decades to come could push the assessments much higher. The maximum Citizens assessments under current law are not based on a percentage of the premium; they are based on a percentage of the deficit. In other words, Florida policyholders will be responsible for whatever it takes to pay the Citizens bill.

Will the policyholders of Florida stand for that after “the big one” hits? And if they do not pay their assessments, and Citizens and the CAT Fund cannot quickly float an unprecedented bond issue, how will the claims get paid? What will be the impact on the state’s economy?

When lawmakers put this system into place, they told policyholders that they were saving them from abusive insurance companies. In fact, they were saddling them with a huge IOU, and most Florida policyholders have no idea that they are already on the hook for a substantial hidden tax.

Recognizing that most Citizens policyholders are unaware of this obligation, a new law was recently passed which requires that effective January 1, 2012 all Citizens policyholders must sign the following statement at their next renewal. The law is a step in the right direction. Unfortunately, it does nothing to alert non-Citizens policyholders of the assessments they may face. It will be interesting to see how Citizens policyholders will react when they are forced to sign this form in order to renew their coverage.

Acknowledgement of Potential Surcharge and Assessment Liability:

1. As a policyholder of Citizens Property Insurance Corporation, I understand that if the Corporation sustains a deficit as a result of hurricane losses or for any other reason, my policy could be subject to surcharges, which will be due and payable upon renewal, cancellation, or termination of the policy, and that the surcharges could be as high as 45 percent of my premium, or a different amount as imposed by the Florida legislature.
2. I also understand that I may be subject to emergency assessments to the same extent as policyholders of other insurance companies, or a different amount as imposed by the Florida legislature.
3. I also understand that Citizens Property Insurance Corporation is not supported by the full faith and credit of the State of Florida.

A Federal Bailout?

Perhaps lawmakers are assuming that if the big one does hit, the feds will bail Florida out. Floridians may not be happy to learn that the state’s real hurricane insurance plan is to go hat-in-hand to the federal government and hope that they will quickly give us billions. Even if that is the plan, would Florida be given the aid, especially during this time of national debt crisis? We were all struck by the plight of the poor neighborhoods of New Orleans and the bayou after Hurricane Katrina, but will the country respond with the same sympathy to the owners of million dollar beach-front condos?

What Should We Do?

This article is primarily designed to educate about the problem, but here is a summary of seven steps I recommend that we take.

1. Educate Florida insureds and taxpayers. Florida's citizens need to understand our disturbing insurance situation or they will not be able to make informed decisions. We must learn that, at the root, we do not have an insurance problem; we have a hurricane problem.
2. Return Citizens to an insurer of last resort. Yes, we need a residual market to insure what private insurers refuse to, but Citizens must be the insurer of last resort, not the insurer of first choice. We must let the air out of the biggest residual market in the world before it explodes and harms us all.
3. Fund and/or shrink the CAT Fund. It is unconscionable to rely on a reinsurance company that must borrow money to pay its claims and that does not have to pay its claims if it cannot borrow the money. We must find a way to put cash behind the CAT Fund. One idea is to use a sunseting sales tax. Since an estimated 20% of Florida's sales taxes are paid by out of state tourists, Florida could use this approach to spread our risk. A CAT fund with real money in it would help to stabilize Florida's insurance market. But if we are unwilling to find a way to fund the CAT Fund, then we must reduce its size so that it has a better chance of meeting its obligations.
4. Make Florida a more insurer-friendly regulatory environment. That includes allowing rates to float to their natural, market driven level as quickly as is politically possible.
5. Require private insurers to be adequately capitalized. The legislature recently did increase the capital requirements for property insurers in the state. These need to be strengthened further to avoid a string of insolvencies (and Guaranty Fund assessments) after a big storm.
6. Strengthen building and zoning codes and enforce them. We must assume that there will be hurricanes and that we will have to pay for the damage. We must build accordingly.
7. National reinsurance backstop? There has been much discussion about a national backstop to help pay for our hurricane claims. The problem is that Florida has more catastrophe exposure than all of the other coastal states from Texas to Maine combined. If we can get the rest of the states to pick up our tab, I am all for it. But in this economy, that appears doubtful.

Closing Thoughts

Florida's political leaders have begun to take steps to put Florida's hurricane insurance on firmer footing, and they should be commended for that. They have allowed Citizens to begin to raise its rates. They have reduced the maximum liability of the CAT Fund from its highest levels. They are going to require the notice to policyholders printed above, which will begin to educate Citizens policyholders. But much more needs to be done to avoid a frightening hurricane insurance disaster.

None of these moves will be popular. Understandably, many will cry that they are “anti-consumer.” Florida’s property insurance rates are already painfully high and our economy is struggling. But it is not “pro-consumer” to maintain a course that may leave billions in hurricane claims unpaid, devastate our state’s economy and saddle insureds with assessments for decades to come. To remain on this course is not only “anti-consumer,” it is “anti-reality.”

In the meantime, Florida policyholders can only hope that former Florida Governor Charlie Crist’s strategy continues to work. Shortly after being elected, he visited Israel and the Western Wall. As is the custom, he wrote a prayer on a little slip of paper and tucked it into a crack in those ancient stones. The paper read, “Dear God, Thank you so much for all you have done for us. Please protect our Florida from storms and other difficulties. Amen.”

And all the state’s policyholders said, “Amen.”

Portions of this article originally appeared in [IRMI Insights](http://www.irmi.com/insights/default.aspx) in June, 2008. (note that “IRMI Insights” in the previous sentence is an embedded link to <http://www.irmi.com/insights/default.aspx>)

Footnotes

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- (2) Jeff Jeffrey, “Fla. Hurricane Cat Fund COO: Private Market Needs ‘More Skin in the Game.’”, BestWeek, August 15, 2011. Available at <http://www.insurancenewsnet.com/article.aspx?id=273058&type=propertycasualty>
- (3) Steve Bousquet, “Scott, Cabinet Get Lots of Bad Insurance News,” The Miami Herald Blog, November 1, 2011. Available at <http://miamiherald.typepad.com/nakedpolitics/2011/11/scott-cabinet-get-lots-of-bad-insurance-news.html>
- (4) Laura Layden, “Growing Problem: Citizens Property Insurance CEO Suggests Privatization,” Naplesnews.com, posted July 13, 2011.
- (5) Citizens Presentation to Florida House Insurance and Banking Subcommittee, January 2011. Available at http://www.myfloridahouse.gov/sections/Documents/loaddoc.aspx?PublicationType=Committees&CommitteeId=2607&Session=2011&DocumentType=Meeting%20Packets&FileName=IBS%2001_12_2011_online.pdf
- (6) Layden
- (7) Florida Hurricane Catastrophe Fund Update to Florida House Insurance and Banking Subcommittee, January 12, 2011. Available at http://www.myfloridahouse.gov/sections/Documents/loaddoc.aspx?PublicationType=Committees&CommitteeId=2607&Session=2011&DocumentType=General%20Publications&FileName=FactSheets_for_1-12-11_Mtg_Online.pdf
- (8) Raymond James & Associates, Inc., “Summary of Information on the Florida Property Insurance Market,” March 9, 2011. Available at <http://www.flor.com/siteDocuments/ForneyFLPropertyMarketPresentation03092011.pdf>
- (9) Raymond James and Associates, Inc.

ADDENDUM

Florida's Policyholder Assessments

In the event of major hurricane losses, Florida policyholders may be assessed from three different sources: Citizens, The CAT Fund and The Guaranty Fund. These assessments are independent of each other. Following is a brief description of the present assessment rules. This summary is intended for educational purposes only and is not provided as legal advice.

Citizens Surcharges and Assessments

1st – All Citizens policyholders may be surcharged up to 45% of their premium.

2nd - If the first surcharge on Citizens policyholders does not cover the deficit, then policyholders of non-Citizens policies may be assessed for one year for up to 18% of their premiums (or 18% of the deficit if greater). This applies to admitted and surplus lines property and casualty policies, including auto insurance but excluding workers compensation, medical malpractice, federal flood and crop insurance. On admitted policies, the assessment is levied against the insurance companies who may collect it from their policyholders. On surplus lines policies, agents must collect the assessment from their policyholders.

3rd – If the above one year assessments do not cover the deficit, an emergency assessment of up to 30% of the current premium (or 30% of the deficit if greater) may be levied against all policyholders (except workers compensation, etc.) for as many years as necessary.

So the total first year Citizens' surcharges and assessments will be up to 75% on Citizens policies and 48% on most other non-Citizens policies. (That is the case if the size of the deficits is not greater than the stated percentages of premiums. If the deficits exceed those percentages, the assessments could be much higher.) All of the surcharges will be collected when policies are cancelled, terminated, renewed or written new.

Florida Hurricane Catastrophe Fund (The CAT Fund) Assessments

The CAT Fund provides state sponsored reinsurance at below market prices to Citizens and private insurers. It also may levy assessments. Its assessments are levied against the state's insurance companies, who pass the assessments on to their new and renewing policyholders.

It may levy assessments of up to 6% annually, but cannot exceed a total of 10% in any given year. It may levy assessments for as many years as is necessary to collect the needed funds. Its assessments do not apply to workers compensation or medical malpractice policies.

The Florida Insurance Guaranty Association (The Guaranty Fund)

The Guaranty Fund handles the claims of insolvent property and casualty insurance companies. It is likely that some insolvencies will result from a severe hurricane. Its assessments are levied against the state's insurance companies, who pass the assessments on to their new and renewing policyholders. It may levy assessments of up to a 4% annual cap.



12 Mistakes to Avoid When You Bid Your Business Insurance

Brent Winans, CPCU, ARM
Vice President

- 1. Starting too late.** Allowing 60 days or less to bid your insurance is a sure way to get less than the best results. Start by requesting current loss runs, doing research on the condition of the insurance market and interviewing brokers six months before your renewal.
- 2. Not having three to five years of currently valued loss runs per line of coverage.** Part of insurance pricing depends on the condition of the insurance market. The other part depends on your company's own risk profile. Insurers place GREAT importance on seeing three to five years of currently valued loss runs on every line of coverage. If you do not have it, they will not quote or not provide as good a quote. (You may have to push to get these. Some self-serving brokers/companies delay providing these in order to thwart their insureds' efforts to obtain competitive quotes.) Be prepared to explain to prospective insurers what you are doing to prevent the kinds of losses you may have had in the past. Insurers want to see top management support for loss control. Convince them that loss control has that kind of support at your company, and you will get better quotes.
- 3. Not knowing what your loss ratio is per line of coverage.** Most insurers consider a loss ratio of 65% or less to be profitable. If you have a good loss ratio (5 years of losses ÷ 5 years of premium per line of coverage =< 65%), use it in your negotiations. If you do not, explain why the future will be different than the past. Many brokers do not routinely calculate loss ratios, so be prepared to do that yourself and include it in your specifications.
- 4. Bidding your insurance too often or bidding with too many brokers.** Unless you have no other choice, do not go out to bid every year. Insurers will stop quoting on your account. Every three to five years is a good rule of thumb for bidding your insurance with more than one broker. Do not involve more than two brokers besides your incumbent. You will get healthy competition with three brokers. If you use more, it is harder for any broker to put together an outstanding program, and it reduces everyone's enthusiasm for your account.
- 5. Not putting direct pressure on your insurers in the years in which you do not bid.** In the years in which you do not go out to bid, keep your insurer "honest" through direct negotiation. "I have a good loss ratio and the market is softening. If the carrier will agree to a 20% rate decrease 100 days before renewal, I won't go out to bid."
- 6. Allowing your existing broker to send submissions to insurers without your direction.** If your existing broker knows you are planning to go out to bid, it may try to block competitors by sending every insurer it represents a submission on your risk, even if it has little clout with many of those insurers. This is not considered unethical, but it usually will not work to your advantage. Tell your existing broker early that you are going out to bid and that you do not want it to submit applications to any insurers besides the incumbents without your expressed direction.

- 7. Allowing the competing brokers to fight over the insurers they are allowed to approach.** You want to assign the insurers that each broker will approach. This reduces confusion in the marketplace and promotes enthusiasm about your risk with potential insurers. Ask each broker for a list of the insurers it wants to approach by line of coverage, listed in order of preference. Unless you are unhappy with them, the incumbent broker should be given both the incumbent insurers and their first choice, since most insurers will work harder for the incumbent. Other insurers should be given to the broker that has ranked them highest. Ties are broken by your judgment call on who has the most clout with a market (never fun).
- 8. Allowing the competing brokers to use their own specifications.** You need to publish your own insurance specifications which contain all the underwriting information the brokers will need as well details on all of the coverage enhancements you want. If you do not do this, you will get apples-to-oranges quotes, be subject to more misunderstandings, be more susceptible to incompetent and unethical brokers and miss out on the opportunity to obtain desirable insurance provisions.
- 9. Assuming the brokers will understand and correctly explain the coverages they are quoting.** Unfortunately, some of the best sales people do not, so insist on receiving actual copies of all forms and endorsements quoted. Read them (also never fun). Ask questions. Insist on straight answers. *You will be rewarded.*
- 10. Not pushing to receive the quotes early enough to do a thorough review and analysis.** In your specifications insist that all quotations and supporting materials be provided to you at least one week before your expiration. State that you have the right to reject any quotations that miss the deadline. You need time to analyze and negotiate. Of course, if someone comes in with a dynamite quote at the 11th hour, you still have the freedom to do what is in your best interest. Confirm all terms in writing in your authorization to bind.
- 11. Not being aware of the financial condition and the admitted status of quoting insurers.** In Florida, the state managed Citizens Property Insurance Corporation and Florida Hurricane Catastrophe Fund (a reinsurance company) would be more than \$18 billion short in the event of a 1-in-100 year hurricane. Be aware of this when purchasing hurricane coverage. In the event of a catastrophic hurricane, be prepared to wait months or even years for full payment from Citizens and insurers backed by the CAT Fund. (See my article "Will Florida's Hurricane Insurance Plan Blow Us Away" at <http://www.floridatxwatch.org/resources/pdf/20111110IBrentWinans.pdf>.) Such a storm would likely bankrupt several Florida insurers. "Admitted" insurance companies (versus those termed "non-admitted" or "excess and surplus lines") are covered by the Florida Insurance Guaranty Association for up to \$300,000 per claim in most cases. Be especially careful of non-admitted carriers with a Best rating below A X.
- 12. Not checking all policies thoroughly once they are received.** A high percentage of insurance policies are not issued as quoted. Many of those errors are not caught by the insurance brokers, and those errors could cost you at claim time. So promptly check your own insurance policies once they are received. Immediately request any needed corrections in writing. The insurer may try to renegotiate the terms, saying they cannot deliver what was pledged. Keep following up, and do not take no for an answer until you have no other choice. It is only right that you receive what you were promised.



Consulting Services

Poorly handled insurance can have disastrous consequences. We help our clients plug coverage gaps and obtain the most competitive pricing on insurance. We also implement other risk management techniques when they will work better than insurance. **We provide our clients with the objective expertise they need to make informed decisions about insurance-related problems.**

Following are a few of our most frequently requested services.

The Service	The Benefit to Our Clients
Audit the client's risk exposures and insurance program	Exposes uncovered risks and uncompetitive premiums. Recommends ways to reduce claims so that the client can reduce costs. Determines when there are better solutions than purchasing insurance.
Prepare specifications for an insurance bidding	Ensures that the client is provided the most desirable coverages and that all insurers are providing quotations on the same basis so that the client can make informed decisions.
Manage the insurance bidding process	Referees the bidding so that the client can obtain the best quotation and the brokers work for the client's best interest.
Analyze proposals and recommend the best program	Frees the client of this time consuming, conflict ridden and maddeningly complex task.
Analyze self-insurance options	Determines if a captives, pool, high deductible or other self-insurance program is advantageous .
Review insurance programs for possible mergers and acquisitions	Determines if the insurance and risk management program of a possible merger/acquisition target exposes the client to hidden liabilities .

Clear Advantage Risk Management is a division of Plastridge Agency, Inc. However, if we are engaged as the consultant, Plastridge will not serve as the agent.

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