January 14, 2025

HAWAII INSURANCE MARKET STABILIZATION RECOMMENDATIONS

The purpose of this document is to identify options to address the challenges facing Hawaii's insurance market. Given the complexity of these issues, a wide variety of solutions have been explored by the task force, recognizing that no single approach will be sufficient to cure the issue and that each option carries inherent trade-offs.

I. INTRODUCTION

Currently the insurance market is in what's termed a "hard market." A hard market is the upswing in the insurance market cycle, when premiums increase, coverage terms are restricted, and capacity for most types of insurance decreases. See IRMI (International Risk Management Institute). There have been many contributing factors to this hard market; increases in replacement and repair costs lead to increased costs to cover risks, contributing to higher premiums and affecting availability. Increases in catastrophic events around the world such as wildfires and hurricanes contribute to increases in reinsurance costs, which in turn contribute to higher premiums and impacts on availability.

Due to the hard market, there are fewer insurance options for condominium and townhome associations. There are relatively few insurers offering master polices in Hawaii, often covering only part of a condominium's entire risk. The associations are then forced to use surplus lines insurers to cover the rest of the building's hurricane exposure, generally at higher rates, with higher premiums and deductibles.

Industry professionals have observed an increase in insurance premiums averaged at 300%-500% for wood frame condos and 50%-200% for concrete high rises. Some insurance companies have decided to not write polices for certain types of dwellings or reduce their risk exposure by not renewing expiring policies.

Given the complexity of these issues, it would be beneficial to explore additional solutions, recognizing that no single approach will be perfect and that each option carries inherent trade-offs and timing considerations.

Possible mitigation options are discussed below. *This discussion does not constitute legal advice, interpretations of law, and should not be construed as such.*

II. POSSIBLE MITIGATION OPTIONS

1. Reactivate the Hawaii Hurricane Relief Fund (HHRF)

Starting in the beginning of 2023 and continuing into 2024, many condominium associations were informed by their insurance carrier that their condominium master policy premiums would increase exponentially. The primary reason appears to be sub-limits placed on the hurricane exposure coverage within the condominium master policy. Reactivating the HHRF may assist the high-rise condominium associations to obtain

master policies for the exterior of buildings and common areas by providing an extra layer of coverage that may help achieve the overall necessary level of coverage. Coverage for individual units or homes may not be addressed by this option as there is still availability of the coverage in the admitted market, however, any statutory caps on coverage should be removed in the event coverage is needed.

The HHRF is generally governed by Hawaii Revised Statutes chapter 431P. However, the HHRF must immediately explore pricing for vertical (high-rise) hurricane coverage up to limits for which they deem appropriate.

The benefits of the HHRF option are that this could address the hurricane exposure insurance gap and may help condominiums address Fannie Mae and Freddie Mac mortgage requirements for 100% replacement cost coverage for all perils. However, this option may initially be limited, given that the HHRF's capacity to issue coverage cannot exceed its capitalization and the HHRF must maintain its solvency. Facultative reinsurance should be considered so that an individual buildings' risk is not pooled, but priced individually. Furthermore, premiums are expected to still be very high (relative to admitted market premiums) due to the small book size and high reinsurance costs. Should the assessments within HHRF be reinstituted, additional costs will be incurred.

There may be concern from non-condominium property owners, that, in the event of an assessment on insurers, their premiums would increase to cover the costs of the assessment.

Impacts from restarting the HHRF and its impact on premiums will vary from condominium to condominium.

If there is a perception among insurers that this program is unfairly competitive with their business, it may affect their willingness to enter, expand, or remain in the admitted market.

The timeline for implementation would be contingent on the HHRF Board's ability to build a coverage model with appropriate rates, obtain rate approval, and hire staff or a contract administrator to run the program.

While the HHRF was dormant for many years, board members were appointed in 2024 and started meeting. The board of the HHRF is in the process of hiring a consultant to conduct a study to determine the root causes and the extent of the condominium market's exposure and risks. Identifying the gap between market need and availability, supported by robust data, will provide a solid foundation to validate the need and to support future mid- and longer-time solutions.

It should be noted that the funds in the HHRF have a balance of approximately $171M. The task force has learned that this balance can be used to fund HHRF's start-

up operations. The task force is also proposing other sources of funding to sustain future operations if needed.

2. Hawaii Property Insurance Association (HPIA) Plan of Operation

A. Amending the HPIA Plan of Operation to Cover Condominium Master Policies

Currently HPIA provides coverage to two territories, lava zones one and two and other territories. The need for insurance in both categories is about equal. Expanding the HPIA's plan of operation to include commercial products for AOAO buildings and structures operated as residential would provide insurance (not including hurricane).

The HPIA Board of Directors would need to conduct a feasibility study. The Commissioner would need to approve any proposal of the Board of Directors and a rate review would be required.

Additionally, HRS § 431:21-105(b)(1) provides in part that HPIA may "[a]dd additional insurance coverages with the approval of the commissioner, including coverage for commercial risks up to the limits of coverage for residential risks as set forth in the plan of operation[.]"

The HPIA has a Board of Directors in place as well as existing statutory language to provide a mechanism to cover extraordinary losses incurred by the association. The existing statutory framework also has mandated provisions to address solvency so that the total premium income from all association policies is priced to annually fund the administration of the association. Furthermore, additional, and significant policyholder surplus contribution may be needed if facultative reinsurance is not placed on AOAO structures.

There may be overall cost savings too, compared to other approaches, as HPIA is already operating and may be expanded instead of incurring costs of starting and operating a new entity.

However, this avenue may not address the affordability issue, as the premiums are expected to be very high relative to the admitted market premiums, due to small book size, high reinsurance cost, and anticipated need to purchase facultative reinsurance for specific risk. Furthermore, capacity issues may persist. There could be supplemental capacity with facultative re-insurance which has its limits and may be unaffordable to policyholders.

The HPIA would not be able to resolve issues with buildings that are in disrepair with no plans to remediate.

Moreover, if HPIA premiums are perceived as subsidized or inadequate for the risk, this may negatively affect the willingness of insurers to expand or join the admitted market.

Additional funding to capitalize expanded coverage may be necessary.

Based on the authority provided to the HPIA by HRS 431:21-105, the HPIA can be expanded to offer hurricane insurance for limited structures if necessary. If the HHRF is reactivated, this could be duplicative but differ in how losses are handled. Having both funds offer hurricane insurance is not recommended.

The Board of Directors would need to conduct a study or hire a party to conduct a feasibility study regarding this approach. Timing estimates would need to come from the Board of Directors and would depend on how fast pricing is developed and approved. The Insurance Division would then need to review and approve a plan and rate filing. However, we note that based on the HPIA's system upgrade which will not go live until August 1, 2025, any policies would renew and or start sixty (60) days from the August 1st start date.

B. Expanding HPIA's HO-6 condo program

The expansion of the HO-6 condo program would address non-hurricane coverage for residential condominium and townhome owners state-wide. The HPIA Board of Directors would need to increase coverage limits and update forms. The increase in coverage to HO-6 would require the Commissioner to approve the HPIA's proposed plan and a rate review would be required. However, this would provide options for condo or townhome owners who have found that they are not going to be renewed or now have coverage requirements not offered by any insurer.

This option would not require general funds and it is unlikely it would increase premiums to other policy holders. Furthermore, it would not require a waiver through an emergency proclamation from the Governor. This option would increase the availability of coverage but not the affordability. The timeline for this would depend on the HPIA Board of Directors as it would require pricing to be developed and approval by the HPIA. The Insurance Division would need to review and approve any plan and rate filing.

3. Mutual Models

There are two apparent possible approaches utilizing a mutual insurer model. The first, would involve residential associations forming a mutual insurance company. The second would involve a statutorily created mutual insurer, in a manner that may be somewhat similar to the Hawaii Employers' Mutual Insurance Company (HEMIC), created under HRS chapter 431, article 21.

A. Mutual Insurance Company

Residential associations currently insured under a master policy could create a mutual insurance company based on the member owned model. The risk in this would include reinforced concrete buildings, connected townhomes, and single-family structures. This would address the availability of non-hurricane property insurance and would not address the lack of availability or excessive cost for condo associations to secure hurricane coverage for 100% of replacement cost.

A consultant would need to conduct a study to see if the cost of creating this would be beneficial to an interested party. Those interested would need to run the mutual company. This model may address availability, assuming the entity is professionally managed. However, the premiums may be high due to the small book size, high risks, high reinsurance cost, and the anticipated need to purchase reinsurance for specific risk. There may be capacity issues. Supplementing capacity with facultative re-insurance may be unaffordable to policyholders. Furthermore, this would not address the affordability and it may duplicate efforts if the HPIA expands to offer commercial AOAO condo master insurance.

There would be no general funds required as the entity would be created by private parties to benefit the policyholders/owners. The Governor would not need to provide a waiver. The availability of coverage would depend on if there are enough qualified mutual insurance company applicants and if the entity becomes operational. The timeline is unknown and would depend on the actions of those who may pursue establishing such an entity.

This may not meet Fannie Mae/Freddie Mac insurance requirements which specify an acceptable rating from one of four rating agencies (AM Best, Demotech, S&P Global, or Kroll Bond Rating Agency), unless the mutual insurance company meets the definition of a "state insurance pool created by statutory authority to provide insurance for geographic areas or insurance lines which suffer from lack of voluntary market availability (such pool may be designated as a property insurance plan, a Fair Access to Insurance Requirements (FAIR) plan, an underwriting association, a joint underwriting association or an insurance authority)" Hence, the mutual insurance model may solve for availability and affordability of insurance for participants in the mutual company but may not assist with supporting full availability to all types of mortgages secured by individual units in these condo projects.

B. HEMIC Model

HEMIC was created to address the lack of workers' compensation insurance in Hawaii. It is seen as a take-all-comers program and an insurer of last resort. To translate this into the property market, an entity could be created to address residential associations currently insured under a condominium master policy. The risk would include reinforced concrete buildings, connected townhomes, and single-family

structures. This could target the non-hurricane property insurance and may be expanded to include hurricane coverage for limited structures in the future.

There is no existing statute and legislation would need to be enacted. HRS chapter 431, article 14A may serve as a rough model. A feasibility study should be conducted by a consultant and interested parties would need to step forward to run the entity.

A "take-all-comers" approach, similar to HEMIC, may force this entity to take on relatively expensive risk from poorly maintained buildings and other high-risk buildings.

If the entity receives a funding appropriation or relief from regulatory requirements, there is a risk that it will be perceived has having an unfair advantage over admitted insurers. This may negatively impact the willingness of insurers to expand or enter the admitted market. If subject to the Guaranty Fund, the wrap-around liability to other insurers may cause them to shrink their market share in all affected lines.

The Commissioner would need to review the application and determine if solvency requirements are met. This may address availability issues if it is run by a professional manager. However, premiums are expected to be very high (relative to admitted market premiums) due to a small book size, adverse risks, high reinsurance costs, and anticipated need to purchase reinsurance for specific risk, and it is unlikely to address affordability. This may also duplicate the effort of an expanded HPIA.

The funding source is unclear. General funds may be necessary to start. The Governor would not need to issue a waiver. Once operational, the availability would potentially be high, but affordability is unclear at this point. The timeline is unclear as well, but it appears this may take the longest to enact and start up.

This structure may satisfy Fannie Mae/Freddie Mac insurance requirements as long as it meets the definition of a "state insurance pool created by statutory authority to provide insurance for geographic areas or insurance lines which suffer from lack of voluntary market availability (such pool may be designated as a property insurance plan, a Fair Access to Insurance Requirements (FAIR) plan, an underwriting association, a joint underwriting association or an insurance authority)"

Capital required for this concept is available in HPIA and HHRF, so in that respect this is duplicative. It creates a third entity requiring management, systems and other expenses that already are available in HPIA and HHRF; therefore, this is not the recommended solution.

4. Formation of an Insurance Captive in Hawaii by AOAOs

A large AOAO or a defined group of AOAOs unable to obtain property insurance in the admitted market may form a captive insurance company under HRS sections 431:19-102 and 102.2. However, a consultant should conduct a study to determine feasibility. The Commissioner would need to approve the application and review for solvency. The program may address availability and have flexible coverage limits. It would require a professional captive manager. However, this may be unaffordable due to the initial capital required.

There would be no general funds required as the entity would rely on its policyholders to obtain sufficient capital. The scope of the program would also be limited to the entity providing the program and its policy holders. Therefore, not all condominiums would be eligible to participate. The Governor does not need to provide a waiver. The initial funding required to capitalize this entity may be significant and difficult to obtain. The timeline would depend on how long it would take to develop a captive program that would meet approval requirements, prepare an application, and have the application approved.

The captive would have no guarantee fund protection under Chapter 431, article 16, HRS. It is also unclear how readily a captive may obtain a credit rating.

This may not meet Fannie Mae/Freddie Mac insurance requirements which specify an acceptable rating from one of four rating agencies (AM Best, Demotech, S&P Global, or Kroll Bond Rating Agency), unless the captive insurance company meets the definition of a "state insurance pool created by statutory authority to provide insurance for geographic areas or insurance lines which suffer from lack of voluntary market availability (such pool may be designated as a property insurance plan, a Fair Access to Insurance Requirements (FAIR) plan, an underwriting association, a joint underwriting association or an insurance authority)" Hence, the captive insurance model may solve for availability and affordability of insurance for participants in the captive company but would not assist with supporting full availability to all types of mortgages secured by individual units in these condo projects. Therefore, this is not the recommended solution.

5. Restructure Current Large AOAO Condominium Master Insurance Program

In certain situated communities where there are single-family dwellings (detached homes) present under a current "condo" master, they may be able to consider amending their governing documents so that each homeowner/policyholder may seek individual options. The individual homeowner/policyholder may obtain DP-3 or HO-3 plus Hurricane policy (whether that is standalone or included on DP3/HO3) that is less expensive for the same amount of coverage than what the AOAO per-unit cost

would be. This would address the availability of non-hurricane and hurricane insurance for these policyholders. HRS section 514B-143(c) addresses the scenario.

The Governor would not need to provide a waiver. Each AOAO should conduct a study and speak with insurance agents to do an analysis of cost-benefits-savings. The potential savings will vary. This approach is dependent on what is still available in the market.

6. Other Government Based Solutions

In looking to solutions that have been utilized in other jurisdictions, the following might be additional ideas to consider:

1. Catastrophic Bonds: The exploration of catastrophic bonds as a tool to support future disaster response may provide additional financial resilience and attract investment to the state's disaster preparedness efforts.

2. Disaster Savings Accounts: Introducing disaster savings accounts, similar to health savings accounts, could incentivize consumers to build reserves for emergencies, thereby reducing the financial burden on state resources.

7. Condominium Laws – Chapter 514B

A. Enforcement of Coverage and Maintenance

The State could look at strengthening the enforcement of condominiums to clarify the 100% hurricane insurance coverage requirement, particularly in alignment with HRS condo provisions. Currently the law allows condominiums to adopt less than 100% insurance in their bylaws.

> **§514B-143 Insurance.** (a) The association shall purchase and at all times maintain the following:
>
> (1) Property insurance, including hurricane insurance:
>
> (A) On the common elements;
>
> (B) Providing coverage for special form causes of loss; and
>
> (C) In a total amount of not less than the full insurable replacement cost of the insured property, less deductibles, but including coverage for the increased costs of construction due to

building code requirements, at the time the insurance is purchased and at each renewal date.

B. Deferred Maintenance Management

AOAO governance has been an ongoing concern. However, there has not been agreement on how to address this issue.

8. Related Initiatives

Condominium Property Regime Task Force

Cross reference/coordinate efforts with Condominium Property Regime Task Force (enacted by Act 189, Session Laws of Hawaii 2023 and Act 043, Session Laws of Hawaii 2024). Act 043 enables a study regarding regulation and enforcement. Study due June 30, 2026.

Climate Advisory Team (CAT)

On January 7, 2025, the Hawaii Climate Advisory Team released it policy paper with recommendations on climate disaster resiliency, recovery and funding. See www.hawaiiclimateadvisoryteam.org

Hawaii Hurricane Relief Fund Board

The board has been reconstituted and meetings have commenced. See https://cca.hawaii.gov/ins/consumers/public-meetings/hawaii-hurricane-relief-fund/.

Public Awareness and Outreach

The task force recommends that public education around the issue be disseminated via various stakeholders including legislators, governmental entities, and the private sector in the form of newsletters, future townhalls and through media outlets.

One initiative to consider is a three-part consumer education flyer to be distributed by various stakeholders including the Importance of Adequate Condo Insurance, Rising Insurance Costs Causes and Impacts, and Mitigating Risk and Preparing for the Future.

Resource Links:

International Risk Management Institute

HRS 514B

Governor Proclamation Relating to Condominium Insurance
August 7, 2024
October 4, 2024

Catastrophe Bonds: Investing in Disaster Insurance

Catastrophe Savings Accounts

Mississippi Catastrophe Savings Account

Frequently Used Insurance Terms[1]

AOAO: Association of apartment owners

Admitted Insurance Company: If an insurance company is admitted, it means they've met the regulations set by regulators where they issue policies.

Property Insurance: insurance against loss of or damage to real or personal property of every kind and any interest therein, from any or all hazard or cause and against loss consequential upon such loss of or damage.

Reinsurance: Reinsurance is a type of insurance that is purchased by insurance companies to reduce risk. Essentially, reinsurance may restrict the cost of damages that the insurer can theoretically experience. In other words, it saves insurance providers from financial distress, thus shielding their clients from undisclosed risks. See also Facultative Reinsurance.

Surplus lines insurance: Surplus lines insurance protects against a financial risk that is too great or too uncommon for an admitted insurance company to take on. Surplus lines insurance can be purchased by individuals or companies. Generally, surplus lines insurance is more expensive than insurance from an admitted insurer because the risks are higher. Surplus lines insurance is provided by non-admitted carriers.

Policyholders Surplus:

Policyholders Surplus is essentially the amount of money remaining after an insurer's liabilities are subtracted from its assets. Policyholders Surplus is a financial cushion that protects a company's policyholders in the event of unexpected or catastrophic losses. In other industries it is known as "net worth" or "owners' equity." It is a measure of underwriting capacity because it reflects the financial resources (capital) that stand behind every policy written by the insurer. A weakened surplus can lead to ratings downgrades and ultimately, if the situation is serious enough, to insolvency.

Mutual Insurance: Hawaii Revised Statutes § 431:3-106 as "an incorporated insurer without capital stock, the governing body of which is elected by its policyholders. The policyholders, who are the insurer's owners, are known as members."

Named Peril: A named peril insurance policy is a home (or business insurance policy that only provides coverage on losses incurred to your property from hazards or events named in the policy.

HO-3: Policies may cover open perils for dwellings and other structures, as well as named perils for contents. However, while it covers many perils, it does not cover those specifically excluded in your policy like earthquakes and floods.

HO-6: The HO 6 form covers the real property interest and the personal property of insureds who own a unit in a condominium or share an ownership interest in a cooperative building.

Facultative reinsurance: coverage purchased by a primary insurer to cover a single risk—or a block of risks—held in the primary insurer's book of business. Facultative

[1] Some information courtesy of Investopedia, III and IRMI.

reinsurance is one of two types of reinsurance (the other type of reinsurance is called treaty reinsurance). Facultative reinsurance is more of a one-time transaction, while treaty reinsurance is typically part of a long-term arrangement of coverage between two parties.