Florida TaxWatch

Ideas in Action

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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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 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, especial 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 sunsetting 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

(1) Brent Batten, "Brent Batten: Insurer Seeks Private Citizens," Naplesnews.com, July 15, 2011.

(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." Napelesnews.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.floir.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.