Florida's Insurance System: a man-made disaster

for the environment, taxpayers and the insured

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The R Street Institute

- Washington, DC-based think tank
- Mainly focused on promoting free-market solutions to social and economic problems at the state and federal levels
- Offices in Florida, Ohio, Texas, California, and Washington, DC
- Other projects include energy, product regulation, education, and the environment.
- In Florida, our focus is mainly on property insurance reform.

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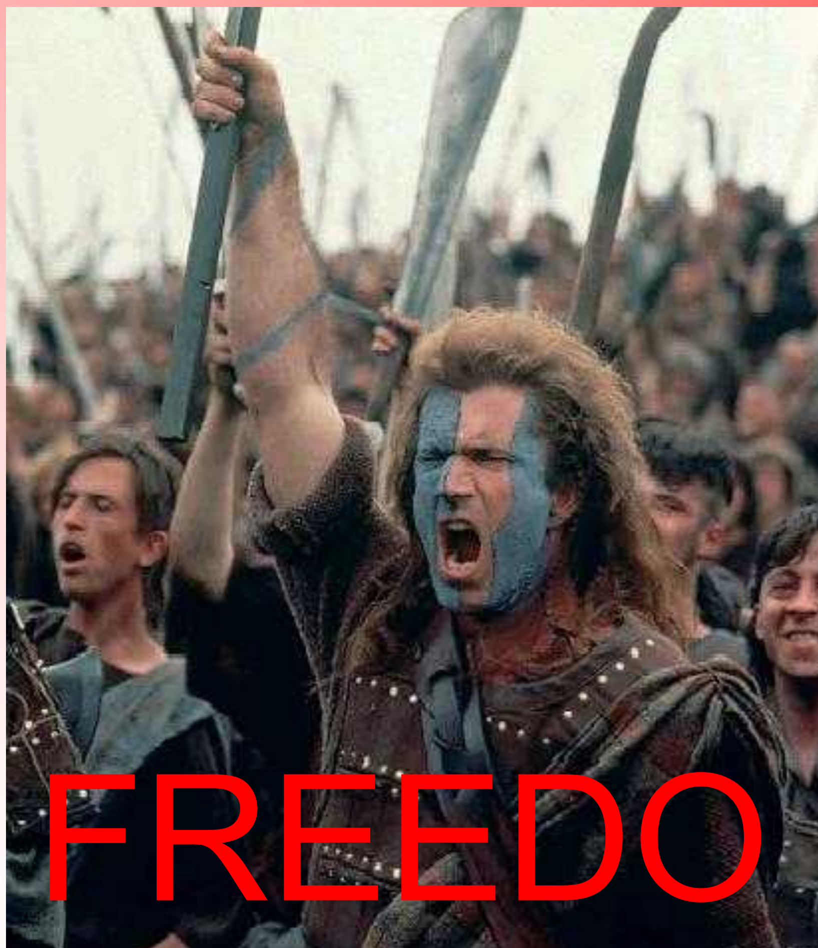
Our Mission



FREEDO
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Our Products

- Research and Public Education:
  - Reports: Mostly published in conjunction with the James Madison Institute in Florida;
  - Op-eds: About 15 published per year in Florida.
- Conferences.
- Legislative Outreach & Education.

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Our Beliefs

- Markets work.
- Central planning doesn't.
- Limited government: good.
- Florida's insurance environment: bad.

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Why Florida's Insurance Market is Bad:

- **Philosophically:** Concentrates risk and undermines competition.
- **Financially:** Places Florida, its taxpayers, residents, and businesses one bad hurricane season away from a major economic crisis.
- **Environmentally**: Subsidies encourage development in risky, environmentally-sensitive areas.

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The Problem…

- Florida has more property at risk than all the other “hurricane alley” states combined and carries 70% of world’s hurricane risk.
- $2.46 Trillion in total coastal exposure.
- 7 of 10 costliest storms have struck Florida.
- Site of most intense hurricane on record (Florida Keys, 1935) and second deadliest hurricane on record (Lake Okeechobee, 1935).

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Dealing with Hurricanes

- 8-year "drought" is longest in recorded history
- Hurricanes WILL strike—only a matter of WHEN
- Only way to make Florida less vulnerable is to:
    - Fortify the state's built environment (mitigation);
    - Discourage development in risky coastal areas;
    - Preserve natural buffers to wind & surge; and
    - Properly insure risk so Florida can quickly recover both economically and physically.

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How a broken insurance system makes Florida more vulnerable:

- Suppressed rates encourage risky development, which increases loss of life and property.
- Gov't-run, post-event funding mechanisms to artificially suppress rates pose huge financial risks;
- These financial risks can adversely impact economic and physical recovery after a storm.

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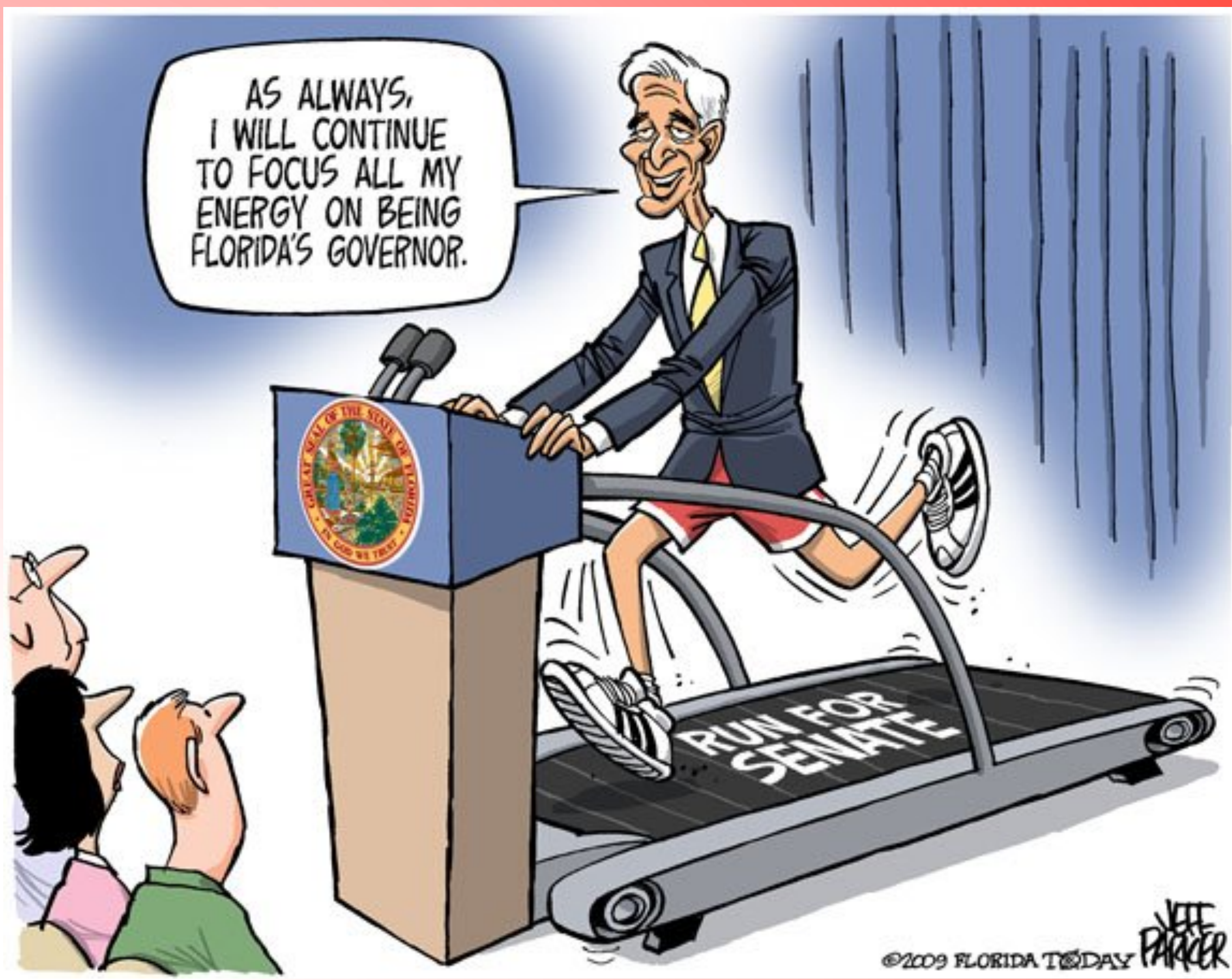
How did we get here?



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Background

- Due to the hurricanes of 2004 and 2005, and the resultant shock to the insurance and reinsurance markets, insurance prices spiked.
- Charlie Crist ran on a platform of “reducing insurance rates” without much explanation of how he would accomplish this.
- The result: 2007’s House Bill 1-A which dramatically expanded Cat Fund and Citizens.

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Florida Hurricane Catastrophe Fund (AKA, Cat Fund)

- State-run reinsurer for insurance companies created in 1993.
- Originally designed as a buffer to volatile private reinsurance rates as way of stabilizing the Florida insurance market.
- The largest provider of reinsurance in the state and one of the largest in the world.

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Cat Fund vs. Private Reinsurance

- The Cat Fund differs from private reinsurance in four major ways:
  1. Participation is mandatory.
  2. Sells an identical product to all insurers forced to participate in it.
  3. Can collect money necessary to pay claims after the event through its ability to buy bonds and tax to pay off those bonds.
  4. Covers risk only in Florida, so it does not spread its risk globally as every other reinsurer does.

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CAT Fund Today

- Has a statutorily-mandated capacity of $17B
- Most of its capacity covers Citizens.
- About $10 billion in cash reserves.
- Would have to borrow about $7B.
- Would have faced a shortfall 5 out of the past 7 years if tapped to capacity after sufficiently bad hurricane season.

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Citizens Property Insurance Corp.

- Created in 2002.
- State-run "insurer of last resort."
- Governor, President of the Senate, Speaker of the House, and CFO appoint governing board.
- Stats:
  - 939,342 policies (down from 1.5 million)
  - Amounts to roughly 20% of policies in Florida
  - Total liabilities exceed almost $300 billion
  - A 1-in-100 year storm could cost about $18 billion

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Citizens Property Insurance Corp.

- Relies on premiums, reinsurance coverage (mostly CAT Fund), and post-event funding.
  - Has unilateral authority to impose assessments (taxes) on every insurance policy issued everywhere in Florida (homeowners, renters, business, boaters, auto) if it faces a deficit after a storm.

***Private companies lack post-event funding option and must have ability to cover claims up front; otherwise they can't sell insurance in Florida.**

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Citizens Before/After Crist's "Reforms"

- Before: Insurer of last resort
  - To be eligible for Citizens, an applicant had to prove that he was unable to find coverage in the private market
- After: unfair competitor in the market
  - Citizens allowed to write a policy for any Floridian who gets an insurance quote more than 15% above Citizens Artificially suppressed rates (this serves as a de facto price control)

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Citizens Before/After Crist's "Reforms"

- Before: Risk-based rates
  - Citizens was required--as is every insurer selling policies in the state--to charge actuarially sound rates based on risk and basic math to have enough money to pay claims.
- After: Artificially-suppressed rates
  - House Bill 1-A arbitrarily lowered Citizens' rates and froze them; legislature subsequently passed a "glidepath" allowing for small increases.

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FLASHBACK

Why Florida's Insurance Market is Bad and makes the state more vulnerable to hurricanes:

- **Philosophically**
- **Financially**
- **Environmentally**

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Why Florida's Insurance Market is Bad and makes the state more vulnerable to hurricanes:

- **Philosophically:** Undermines competition.
  - Less consumer choice and innovative coverage options; and
  - Concentrates Florida's enormous hurricane risk onto the state's taxpayers rather than spreading it abroad across several private companies.

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Why Florida's Insurance Market is Bad and makes the state more vulnerable to hurricanes:

- **Financially:** Places Florida, its taxpayers, residents, and businesses one bad hurricane season away from a major economic crisis.
  - Citizens and Cat Fund Assessments for Several Years;
  - Assessments compound for multiple events;
  - Risk of Cat Fund shortfall → mass insolvencies;
  - Potential to bring Florida's economic recovery to a halt.

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Why Florida's Insurance Market is Bad and makes the state more vulnerable to hurricanes:

- **Environmentally**: Subsidies distort cost of actual risk, which:
  - Incentivizes destroying coastal wildlife habitats;
  - Encourages building on wetlands, sand dunes and barrier islands, which are natural wind & surge buffers;
  - Discourages building to withstand those risks (and Increases loss of life and property) and;
  - Conflicts with existing federal law (CBRA).

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Sand dune destruction in Florida CBRS Unit

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Risk-Based, Market Rates
Protect Floridians and the Environment:

- **MITIGATION & SAFETY on the front end:**
  - Organically encourages people to build stronger and safer in terms of resilience and location, which:
    1. Allows people to more safely shelter-in-place, freeing up evacuation routes and resources; and
    2. Decreases damage, loss of life, and repair & insurance costs.
  - Discourages building in risky, flood-prone and oftentimes environmentally-sensitive coastal areas that provide natural protection to inland development.

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Risk-Based, Market Rates Protect Floridians and the Environment:

- **FASTER RECOVERY on the back end:**
  - Stronger & smarter building practices = less damage & faster recovery (and cheaper insurance);
  - Flood of outside capital from private insurance and reinsurance companies ignites the economy and speeds-up physical recovery;
  - Current “pay-now-AND-pay-later” system of post-event financing would burden state with debt for many years, impede economic growth, and slow recovery efforts.

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In Conclusion…

- Florida cannot solve its problems by simply having Citizens raise rates across-the-board.
- Steps must be gradual and smart.
- Can start with:
  - Excluding or limiting Citizens coverage for new construction in highest risk areas, mansions and secondary/vacation homes;
  - Tightening Citizens eligibility requirements; and
  - Helping low-income residents fortify their homes.

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Questions?

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