



# RISKY

## BUSINESS

*State-backed Insurance of Last Resort  
on the Rise, but States Face Risks*

**Growing awareness of risks associated with storms—particularly hurricanes—has states grappling with property insurance availability and rising premium rates. Property insurance has become a political issue.**

By Mikel Chavers

“There was public outrage over the rate increases ...  
(and) people were being cancelled right and left.”

—Florida Sen. Bill Posey

Since 2004, more than 40,000 coastal property insurance policyholders in Massachusetts have been dropped by private insurance companies—called the voluntary market—according to the state’s division of insurance.

“We’re having a very difficult time getting folks coverage,” said Massachusetts Rep. Ron Mariano, who is co-chair of a special legislative commission that convened in August 2007 to study issues with the state’s homeowners’ insurance market.

And the problems in Massachusetts are not unique.

When insurance companies started dropping property insurance policies and denying coverage along the coast, spanning from southern states such as Florida and upward to Massachusetts and beyond, state legislators started to do something about it.

Commercial and residential development could come to a screeching halt if property insurance isn’t available or is just too expensive. When people can’t get property insurance anywhere else, they turn to another market—one that’s set up by state regulators.

This market, called the residual market, exists to ensure coverage is available when private insurance companies reject applicants because their property is too risky, according to the Insurance Information Institute, a New York City-based analysis and information organization.

In other words, it’s a market of last resort.

At least that’s how the residual market started.

Now the market of last resort is changing—sometimes becoming the market of choice. As state legislators are faced with issues of property insurance availability and increasing rates, some states are passing legislation that expands the residual market’s reach, while others are providing

incentives to bring back private insurers to their states.

### States Taking on Risk

Property insurance plans in the residual insurance markets have grown enormously in the last few years, the Insurance Information Institute reports. At the end of 2006, total exposure to loss for state-run property insurers eclipsed \$650 billion and the number of policyholders was more than 2 million, according to the Insurance Information Institute.

Some of these state-backed plans are known as FAIR plans, named after the Fair Access to Insurance Requirements Act established after the urban demonstrations and riots of the 1960s. Other state plans are known as Beach plans or wind pools that write insurance specifically for wind damage.

“They are like a safety valve in the industry,” said Ron Cassesso, president of the Property Insurance Plans Service Office, a Boston-based trade group for state insurance pools. He said among his organization’s 34 members that include state FAIR and Beach plans, most have not gotten larger, but have seen a decline in new business applications and new business premiums.

But there’s an exception to that. State-run plans in states such as Alabama, Florida, Louisiana, South Carolina, Texas and Massachusetts have been growing, Cassesso said.

In Florida, for example, the market of “last resort” is known as Citizens Property Insurance Corp., but it is the largest property insurer in the state with 1.4 million policies in 2007.

Of those policies, 930,000 are homeowners’ policies that include windstorm protection, while the other 420,000 are

residential and commercial wind-only policies providing insurance solely for hurricanes, according to Rocky Scott, a spokesman for Citizens.

Florida’s legislature voted to expand the state-backed insurer’s reach in May 2007. New laws allow homeowners to purchase policies from Citizens if the rates for a similar policy from a private insurer are more than 15 percent higher. Before that, rates had to be 25 percent higher for a person to apply for a policy with Citizens.

Since then, Citizens has been growing at a staggering pace. Now Citizens is adding 50,000 to 70,000 new policies a month and processing 20,000 to 25,000 policies a week, according to Scott. The insurer added a million policies by the end of 2007—up from 420,000 in December 2005 to the current 1.4 million today.

That extreme shift to Citizens was, as Florida Sen. Bill Posey puts it, “because the insurance companies would not sufficiently serve the citizens of the state.”

As evidence to that growth, revenues for the state-backed insurer have more than doubled from \$1.1 billion in 2005 to \$2.4 billion in 2006. Revenues are estimated at \$4 billion for 2007, Scott said.

The issue of property insurance has become one of interest in the southern states. The Council of State Governments’ Southern Legislative Conference hosted a session on the issue at its 61st annual meeting in July 2007. The Southern Governor’s Association has also expressed interest in the topic and released a resolution on insurance in 2007 aiming at issues of declining insurance coverage and increasing premiums.

Homeowners’ insurance even became a 2006 campaign issue in Florida.

“There was public outrage over the rate increases,” said Posey. Not only were peo-



ple saying the rates from private insurers were unaffordable, but “people were being cancelled right and left,” he said.

As every day passes, Posey said, private insurance companies drop more policies. “So we had to make accommodations,” he said. “We were forced into it.”

In order to make those accommodations, Citizens rates are kept deliberately low in comparison to what is available or could be available from private insurance companies. For example, a \$150,000 masonry home in Miami-Dade County would cost \$4,687 per year to insure with Citizens without the portion for wind damage, said Scott from Citizens. Compare that to more than \$10,000 from an insurance company like State Farm for that same theoretical home in the Miami area.

But, Scott said, that’s if companies like State Farm offer policies in Miami-Dade County where there’s a high risk of wind damage. In Florida, insurance companies must file rates for all Florida counties even if they don’t plan to sell insurance in all counties.

Most experts agree that Florida’s approach is unique and that Citizens is a property insurance plan different from all other state plans.

## Paying for Catastrophes

So what happens when the market of last resort changes?

“The problem is when it also becomes the market of first choice,” said Steven Weisbart, vice president and chief economist for the Insurance Information Institute.

The biggest consequence to the growing residual market is that risk is not distributed as it once was, Weisbart said. For example, in the damage caused by Hurricane Katrina, 45 percent of total losses were covered by re-insurance companies

all over the globe, Weisbart said. But in the case of Florida, Citizens, as the largest policyholder for property insurance in the state, also carries the greatest concentration of the risk.

“By concentrating the effects of the risk, they are basically gambling,” Weisbart said. “And if they lose the gamble, the citizens pay.”

When there’s a hurricane or other storm, state-backed insurance plans can call on the private insurance market for help in paying for the damages. Basically, the state-backed plans can assess insurance companies for the deficits, meaning if there’s a shortfall, then insurance companies in the state will pay a portion to address that shortfall. That money is typically paid up front and then the cost is passed directly to policyholders. Florida’s legislation allows this assessment.

Mississippi also allows this type of assessment to help its state-created insurance pool, the Mississippi Windstorm Underwriting Association. With new legislation passed in March 2007, policyholders statewide can now be charged a surcharge for the cost of selling bonds to raise money in an emergency and for pool deficits. Before that law was passed, insurers in the state were assessed for deficits, but they couldn’t pass the cost along to policyholders.

After the 2004-2005 storm season, for example, Citizens in Florida paid \$5.2 billion in claims and got help for \$2.2 billion through an assessment. Although most of the 300,000 claims were paid, nearly 2,000 are still outstanding, Scott said.

Posey, the Florida senator, said the reality is that although many are painting the downside of this situation, the loss from a storm still gets covered either way. “If the state takes that risk on, you only have to pay for it if you have a catastrophe,” Posey

said. “If the voluntary market takes it on, everybody pays it.”

## States Woo Free Market

But as lawmakers in Massachusetts witnessed the growth of the state’s FAIR plan, it seemed people from one side of the state were helping to pay for homeowners in the Cape Cod area.

“There’s an equity issue there,” said Mariano, the representative from Massachusetts. When there is an assessment, he explained, it’s an assessment all across the state, not simply in certain areas.

The special commission co-chaired by Mariano and Massachusetts Sen. Stephen Buoniconti met in August to study the state’s homeowners’ insurance market. The commission released its recommendations in November 2007.

The commission wants to introduce a series of credits that encourages the voluntary market to come back to the state and begin writing property insurance again, according to the commissions report.

Three years ago, private insurance companies began pulling off Cape Cod, Mariano said, cancelling policies. The state’s FAIR plan went from insuring 22 percent of the homes on the cape to 46 percent of the homes in the last year and a half, he said.

“So we’re trying to incentivize companies to re-invest their portfolios,” Mariano said. Right now the FAIR plan has the ability to give credits, but the commission believes they are too small.

Peerless Insurance, which is part of Liberty Mutual Agency Markets, a business unit of Boston-based Liberty Mutual Group, recently re-entered the Massachusetts market to offer automobile and property insurance, according to the state’s division of insurance.

Other states are presenting legislation intended to make them more attractive to

insurers. Louisiana passed legislation to allow its Louisiana Citizens Property Insurance Corporation to solicit bids from private insurance companies willing to take over some of its policies. The legislation also provides financial incentives for insurers who come back to the state's homeowner insurance market on the condition that 25 percent of the new business they take on are policies from the state plan.

The program, called the Insure Louisiana Incentive Program, provides \$100 million in incentives from the state.

"The program is an effort to attract more property and casualty providers to our state and to increase the private market capacity by 15 percent," Louisiana Commissioner of Insurance Jim Donelon said in a press release.

In November, Louisiana's insurance department announced that six companies applied for the grants, representing \$34 million in requested grant funds. Raleigh-based Occidental Fire & Casualty of North Carolina sought the most grant money, requesting \$10 million, according to the state insurance department.

## On the Horizon

State legislators aiming to combat decreasing insurance availability and increasing premiums still must overcome some hurdles. In Florida, Posey said companies are still putting the legislature in the position of assuming more risk everyday. The growth of state-run plans in coastal states could still be on the rise, experts say.

Weisbart, with the Insurance Information Institute, predicts more mergers of smaller insurance companies with larger ones, which will be beneficial, he said. "The more medium to large companies that we have, the more capable they will be of taking care of risk."

States should also consider reducing the chance that losses occur in the first place by revamping building codes or simply enforcing them, Weisbart said. When it comes to subsidizing, he said, states ought to subsidize only those residents who cannot afford insurance, not those who simply do not want to pay higher rates. States can also look at land use policies and prohibit building too close to the water, Weisbart said.

"Some people are sitting on a sand dune, and you can't stop the ocean."

—Mikel Chavers is associate editor of State News magazine.



## Value Of Insured Coastal Properties Vulnerable to Hurricanes by State, 2004<sup>1</sup>

(in billions of dollars)

State	Coastal	Total	Coastal as a Exposure (2) Percent of Total
Florida	\$1,937.4	\$2,443.5	79%
New York	1,901.6	3,123.6	61
Texas	740.0	2,895.3	26
Massachusetts	662.4	1,223.0	54
New Jersey	505.8	1,504.8	34
Connecticut	404.9	641.3	63
Louisiana	209.3	551.7	38
South Carolina	148.8	581.2	26
Virginia	129.7	1,140.2	11
Maine	117.2	202.4	58
North Carolina	105.3	1,189.3	9
Alabama	75.9	631.3	12
Georgia	73.0	1,235.7	6
Delaware	46.4	140.1	33
New Hampshire	45.6	196.0	23
Mississippi	44.7	331.4	13
Rhode Island	43.8	156.6	28
Maryland	12.1	853.6	1
Coastal states	\$6,863.0	\$19,041.1	36%

(1) Includes residential and commercial properties. Ranked by value of insured coastal property.

(2) Total exposure is an estimate of the actual total value of all property in the state that is insured or can be insured, including the full replacement value of structures and their contents and the time value of business interruption coverage.

Note: Latest data available.

Source: AIR Worldwide, a risk modeling and technology firm with U.S. offices in Boston and San Francisco.