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Citizens and the Florida Residential Property Market: How to Return to an Insurer of Last Resort

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Citizens and the Florida Residential Property Market: How to Return to an Insurer of Last Resort

Patty Born, Ph.D. | Cassandra Cole, Ph.D. | Charles Nyce, Ph.D

IMPORTANCE Formed in 2002, Citizens Property Insurance Corporation (Citizens) was created to be the residual property insurer for the State of Florida - the insurer of last resort. By 2011, Citizens' held 1.47 million policies or 23 percent of the Florida residential market for policies with wind coverage. Significant steps were taken to reduce Citizens exposure and by 2019, its market share was reduced to 4 percent. The policy count began to rise in 2020 and by the end of 2020, policy count had increased to more than 532,000, heightening concerns regarding market disruptions which could result in further increases in Citizens' exposure.

OBJECTIVES Citizens contracted with Florida State University to conduct an analysis of Citizens' exposure and identify: (1) opportunities to reduce its exposure; and (2) ways to increase the availability of private market residential property insurance. This paper summarizes the main findings of the study, including key recommendations for returning Citizens' to an insurer of last resort.

FINDINGS Our study finds that while Citizens has real opportunities to effectively reduce its exposure long-term, a combination of strategies will be necessary to ensure the adequacy of rates and solvency of the private insurers operating in the residential property market. Additionally, several actions must first be taken to improve the attractiveness of the Florida market and increase the capacity of the private market before changes to the structure of Citizens can be made. Finally, the FSU study notes that to achieve Citizens' goal of reducing its exposure, the issue of affordability of homeowners' insurance may need to be addressed outside of the insurance process.

CONCLUSION & RELEVANCE This paper takes a close look at the Florida market to better understand the environment in which Citizens operates. While prior research offers the context for understanding the potential role of a residual insurer and the effects on the private market, our assessment achieves three goals that, consequently, extend the existing work in this area. First, it provides an update on the structure of the residual market in Florida and the regulatory and market forces that continue to shape the structures of Citizens and the private market. Second, it offers a framework for classifying and organizing important policy issues related to the operation of a residual market that recognizes a range of stakeholder interests. Finally, it identifies potential hindrances to specific depopulation efforts and highlights the parties (e.g., state regulators) that must be involved. To this end, the paper provides a comprehensive assessment which, although aimed at issues specific to the Florida property market, may provide guidance for other states with residual markets.

Citizens and the Florida Residential Property Market: How to Return to an Insurer of Last Resort

Patricia Born*
Cassandra Cole**
Charles Nyce***

Abstract

Developments in 2020 have heightened concerns regarding market disruptions, which could result in increases in Citizens Property Insurance Corporation's (Citizens') exposure. As a result, Citizens contracted with Florida State University (FSU) to conduct an analysis of Citizens' exposure and identify: 1) opportunities to reduce its exposure; and 2) ways to increase the availability of private market residential property insurance. The FSU study finds that while Citizens has real opportunities to effectively reduce its exposure in the long term, a combination of strategies will be necessary to ensure the adequacy of rates and solvency of the private insurers operating in the residential property market. Additionally, several actions must first be taken to improve the attractiveness of the Florida market and increase the capacity of the private market before changes to the structure of Citizens can be made. Finally, the FSU study notes that to achieve Citizens' goal of reducing

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its exposure, the issue of affordability of homeowners insurance may need to be addressed outside of the insurance process.

Introduction[1]

Formed in 2002 by the merger of the Florida Windstorm Underwriting Association (FWUA) and the Florida Residential Property and Casualty Joint Underwriting Association (FRPCJUA), Citizens was created to be the residual property insurer for Florida; i.e., the insurer of last resort.[2] By 2011, Citizens held 1.47 million policies, or 23% of the Florida residential market for policies with wind coverage. Significant steps were taken to reduce Citizens' exposure, and by 2019, its market share was reduced to 4%. However, policy count began to rise in 2020, and by the end of 2020, policy count had increased to more than 532,000.

Developments in 2020 have heightened concerns regarding market disruptions, which could result in further increases in Citizens' exposure. As a result, Citizens contracted with FSU to conduct an exposure analysis study. The purpose of the study was to identify opportunities to reduce Citizens' exposure and increase the availability of private market residential property insurance. This paper summarizes the main findings of the study, including key recommendations for returning Citizens to an insurer of last resort.

Hartwig and Wilkinson (2014) note that Florida has historically had the highest share of the property market and remains at the top today, followed only by the Massachusetts Fair Access to Insurance Requirements (FAIR) Plan. There is also a large volume of data available and a variety of legislative and other activities to examine over a substantial period. As such, our findings for Citizens and the Florida market may yield valuable information for residual markets in other states that have experienced similar volatility in policy counts and varying degrees of success in depopulation efforts.

The paper is organized as follows. First, prior related studies are discussed, followed by summaries of past efforts by Citizens to reduce its exposure and the evolution of the Florida property market. The balance of the paper provides a discussion of current market hinderances and key recommendations, followed by concluding remarks.

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1. This study is drawn from the results of a grant project conducted by faculty at FSU for Citizens. The authors acknowledge the financial support of Citizens in the completion of this project. However, the recommendations expressed in the grant documents and summarized here are those of the authors based on the data collected and analysis conducted by the authors and a modeling company. At the time the grant project was completed, Jack Nicholson was a faculty member at FSU and the Director of the Florida Catastrophic Storm Risk Management Center and served as the primary investigator.

2. The definition of "insurer of last resort" used in this report is drawn from Citizens' mission statement, which states that its goal is to provide insurance coverage to "people who are in good faith entitled to obtain coverage through the private market but are unable to do so." Further information can be found on Citizens' website at *https://www.citizensfla.com/who-we-are#:~:text=Our%20Vision,are%20unable%20to%20do%20so*.

Review of the Academic Literature and Related Studies

Numerous academic studies have examined residential property insurance markets and the role of residual market mechanisms. Such studies cover a wide variety of topics that provide insights and a greater understanding and appreciation for the complexity of the insurance market. Cole et al. (2009) and Newman (2010) focus on the structure and development of the residual market in Florida and the regulatory and market factors that led to that structure, while Medders and Nicholson (2017) make recommendations for improvements of residual markets with an emphasis on financial solvency, market stability, and system-wide stress testing.

Klein (2008) compares and examines the residual market mechanisms of Alabama, Florida, Louisiana, Mississippi, South Carolina, and Texas. Klein concludes that the Southeastern states follow different strategies in dealing with coverage availability. However, he notes that Florida faces difficult problems and has taken the most radical approach to lower the cost for high-risk properties. Nutter (2002) evaluates the role of government involvement in the financing of catastrophic losses. He links the state management of rates (rate suppression) to the size of residual markets in Texas and Florida. Nutter asserts that states have effectively appropriated private capital to subsidize catastrophe risk, and he expresses skepticism over whether catastrophe programs that are priced below market will be properly funded and capable of being renewed after a major event.

Other academic papers have broadly studied residual markets across the country and the world. This literature considers flood coverage and other types of residual markets for automobile insurance, workers' compensation, health insurance, terrorism, and other perils. Kousky (2011) and McAneney et al. (2016), for example, consider a broad set of U.S. states and discuss market solutions, some of which may be relevant to the Florida market. A book sponsored by the World Bank and edited by Eugene Gurenko extends the discussion of residual markets and insuring catastrophic perils by reviewing programs in a variety of countries (Gurenko, 2004).

Public policy implications associated with providing a residual market for property coverage are addressed in the work of Weinkle (2015) and Grace and Klein (2009), which develop frameworks for analyzing the political interests that influence residual markets. The study by Grace et al. (2005) suggests that political implications can arise post-event that can cause insurers to reassess their risk following severe hurricane events and determine how to adjust their future strategic approach to the market. With the ability to increase rates, insurers may be willing to increase writing in high-risk areas, but without rate increases, they may pull back or exit the market. Much depends on the actions of state insurance regulators and political factors following the event. This study raises the issue of the need for federal catastrophe insurance, but the authors do not make any recommendations. Born and Klimaszewski-Blettner (2013) note that homeowners insurers have a difficult time providing stable coverage following major catastrophic events, and regulations may act to impede an insurer's willingness to provide coverage following such events.

Newman (2009) discusses the issue of ratemaking and the concept of subsidies as it relates to Citizens. Ratemaking and subsidization are sensitive political topics, particularly in Florida. Newman describes the role and process of deficit assessments for Citizens, the Florida Hurricane Catastrophe Fund (FHCF), and the Florida Insurance Guaranty Association (FIGA), as well as various key legislative changes that have affected the residential property insurance market in Florida, noting changes in years 1993–1999, 2004, 2007 (Special Session), and 2007 (Regular Session). Nyce and Maroney (2011) also consider ratemaking with suggestions for improving the process of territorial rating in the residential property insurance market. The authors conclude that in Florida, using the distance to the coast as a rating factor results in more granular pricing of property insurance than using the traditional territorial rating system.

The financing of catastrophic risk and the vulnerability of the insurance system is considered in the studies by Medders and Nicholson (2018) and Nicholson et al. (2018). The Medders et al. (2014) study points out that various market problems, externalities, and interventions associated with the Florida market have led to property insurer failures. The authors conclude that risk-based pricing and incentives for mitigation are needed to improve insurer financial results. A study by Marlett and Eastman (1998) addresses post-event assessments and their ability to fund obligations of insurers for addressing the catastrophe problem. The authors conclude that the use of post-event assessments increases market volatility and exacerbates affordability and availability problems.

Policyholder attitudes and behaviors are studied by several authors. Dumm et al. (2017, 2020) consider the behavioral aspects of the demand for homeowners insurance and conclude that near-term loss experience tends to affect the demand for insurance, whereas with the passage of time, the demand for insurance lessens in urgency and importance. Dumm et al. (2013) uses Citizens data to show that policyholders with a higher likelihood of loss tend to choose a lower deductible and, as a result, may adversely select against an insurer. This result has implications for rating as well as for a residual market insurer.

Factors that motivate a policyholder's decision to invest in mitigation is discussed by Carson et al. (2013). Born et al. (2011) discuss mitigation as one of "the 3 Ms of risk management," with money and residual markets representing the other two Ms. The study concludes that mitigation is the key factor because it influences the success of the other two Ms. Attempts to allocate money and create markets strategically to reduce existing market problems cannot prevail without proper incentives in place that recue the underlying risk (mitigation). Ways to incentivize mitigation measures and behaviors are discussed, covering various topics such as mitigation loans and the importance of retrofitting older homes.

Most of the studies discussed above focus on the creation or the role of residual markets or similar catastrophic programs for dealing with risk. There is also a wealth of academic literature on insurance markets in catastrophe prone areas in general.

For example, a study by Harrington and Niehaus (2001) discusses alternative approaches to government intervention for dealing with natural catastrophes. These approaches include state insurance mechanisms, federal catastrophe reinsurance, the establishment of tax-deferred reserves for catastrophes, and the alteration of regulations and tax policy to promote capital market instruments. The authors conclude that the best approach is to promote the establishment of tax-deferred catastrophe reserves. Boyer and Nyce (2013a, 2013b) examine theoretical models based on minimizing the total cost of providing catastrophic insurance coverage. Their models indicate specific roles for primary insurers and reinsurers, and they find that the optimal role for a government entity is as a backstop or reinsurer in the very tails of the loss distributions. Additionally, Kenneth Froot offers a series of research papers focused on catastrophes and the role of the reinsurance market (Froot, 2001a, 2001b, 2007, 2008) emphasizing the influence that reinsurance has on the cost of risk transfer in catastrophic insurance markets.

This paper takes a close look at the Florida market to better understand the environment in which Citizens operates. While prior research offers the context for understanding the potential role of a residual insurer and the effects on the private market, our assessment achieves three goals that extend the existing work in this area. First, it provides an update on the structure of the residual market in Florida and the regulatory and market forces that continue to shape the structures of Citizens and the private market. Second, it offers a framework for classifying and organizing important policy issues related to the operation of a residual market that recognizes a range of stakeholder interests. Finally, it identifies potential hindrances to specific depopulation efforts and highlights the parties (e.g., state insurance regulators) that must be involved. To this end, the paper provides a comprehensive assessment, which, although aimed at issues specific to the Florida property market, may provide guidance for other states with residual markets.

Citizens and its Exposure Reduction Efforts

Because Citizens was created by combining two existing associations, by year-end 2003, Citizens' policy count was over 820,000, with more than 433,000 of these being Coastal Account policies. Citizens' total policies across all three accounts, insured values, and in-force premiums have varied over time. In 2011, at its height, Citizens held 1.47 million policies, with a total insured value (TIV) of $511 billion. This represented 23% of the Florida residential market for policies with wind coverage. Since that time, Citizens and the Florida Legislature have taken several steps to reduce Citizens' exposure and market share, including creating the Property Insurance Clearinghouse and instituting time restrictions for legal action. Policy count dropped nearly 70% by 2019 to approximately 419,000 policies, representing a residential market share of 4%.

Over time, Citizens has had success with various exposure reduction programs. The four specific programs that warrant discussion are Citizens' Depopulation

Program, the Property Insurance Clearinghouse, the Florida Market Assistance Plan (FMAP), and Citizens' Risk Transfer Program.[3] Together these four programs represent the main efforts to reduce Citizens' exposure. For a discussion of other states' efforts in reducing residual market exposure, see the appendix.

Depopulation Program

Citizens' Depopulation Program helps Citizens reduce its exposure by removing existing exposures from Citizens' book of business. While it has changed over time, for all personal lines policies, participating insurers can currently select from Citizens' policies and submit offer letters to insureds. Insureds can select among the available offers via an online system or elect to remain with Citizens. However, if no decision is made by the due date, Citizens will select from among the available offers and inform the insured.[4] A similar process exists for commercial insureds, including the ability to opt-out. However, letters are sent directly to commercial insureds.[5]

The program is ongoing and has resulted in millions of policies being taken out of Citizens over time. Insurers participating in the program must be approved by the Florida Office of Insurance Regulation (OIR). Each year, as noted in Figure 1, the number of insurers that participate in Citizens take outs varies, ranging from a low of one company in 2003 to a high of 21 companies in 2014. Several years are notable for the percentage of policies removed from Citizens. For example, in 2015, 41.3% (272,785 of 661,161 Citizens policies) were removed, and in 2014, the number was 40.8% (416,623 of 1,021,694 Citizens policies). Though Citizens experienced an extremely high volume of depopulation activity between 2012 and 2016, depopulation activity has been low since that time, and Citizens' policy counts have varied only slightly for the last five years. Citizens reported a total overall policy count of 442,203 for year-end 2019 (*Citizens Property Insurance Corporation*, 2020a).[6]

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3. Information on the Property Insurance Clearinghouse, the Depopulation Program, and the FMAP is available at *https://citizensfla.com/web/public/programs*.

4. For more information about the current process for residential insureds see *https://www.citizensfla.com/depoppl*.

5. For more information about the depopulation process for commercial insureds, see *https://www.citizensfla.com/depopcl*.

6. While the depopulation program has been successful for Citizens, there is evidence that some policies return to Citizens after being taken out. For the period of 2008 through 2019, Citizens found that 55% (134,855 of 247,252) of the policies taken out by eight insurers that subsequently became insolvent returned to Citizens. Approximately 15% (222,510 of 1,480,952) of the depopulated policies that returned to Citizens were from insurers that remained solvent. Overall, for both solvent and insolvent insurers, 21% of risks returned to Citizens (357,365 of 1,728,204). The risks returning to Citizens are defined as those policies having the same address. When the definition of risks is changed to having both the same address and name on the policy, the above numbers drop from 55% to 44%, 15% to 10%, and 21% to 15%.

Figure 1

Year	Total Participating Companies	Total Policies Assumed	Citizens In-Force Policies	Assumed Policies as % of Prior Year's Total Policy Count	TIV Assumed	Citizens In-Force TIV	Assumed TIV as % of Prior Year's Total TIV
2003	1	28,219	820,223	3.3%	8,140,681,906	217,450,883,067	3.6%
2004	4	158,416	873,936	19.3%	30,663,076,480	230,402,084,769	14.1%
2005	10	293,684	809,949	33.6%	53,658,840,059	234,214,472,531	23.3%
2006	4	67,853	1,298,428	8.4%	15,637,589,369	407,948,066,525	6.7%
2007	7	247,923	1,304,949	19.1%	68,259,426,361	505,881,754,032	16.7%
2008	14	385,084	1,084,237	29.5%	106,870,490,165	419,883,779,112	21.1%
2009	11	149,645	1,029,214	13.8%	37,784,506,743	405,990,629,344	9%
2010	6	59,792	1,283,538	5.8%	13,888,913,857	460,703,299,504	3.4%
2011	3	53,577	1,472,391	4.2%	14,473,700,490	510,675,120,913	3.1%
2012	7	277,022	1,314,811	18.8%	75,927,165,347	429,424,399,130	14.9%
2013	18	365,767	1,021,694	27.8%	112,265,410,122	318,887,485,544	26.1%
2014	21	416,623	661,161	40.8%	117,530,082,371	201,957,396,325	36.9%
2015	14	272,785	503,865	41.3%	64,830,051,559	150,495,190,065	32.1%
2016	11	88,000	455,843	17.5%	23,362,914,453	124,063,055,743	15.5%
2017	7	34,008	440,406	7.5%	7,435,411,434	112,309,524,847	6%
2018	4	17,905	427,397	4.1%	4,307,930,768	108,896,296,069	3.8%
2019	3	10,084	420,467	2.4%	2,180,766,592	107,243,002,192	2%
2020	2	2,899	474,630	0.7%	9,649,973,376	121,755,324,207	0.9%

Note: Data for 2020 is as of end of the second quarter. Data is obtained from Citizens Corporate Analytics Business Overview reports available on its website at *https://www.citizensfla.com/reports*.

Property Insurance Clearinghouse

The Property Insurance Clearinghouse (see s. 627.3518, F.S.) was created in 2013 to help Citizens' agents find private market insurance coverage for consumers. The Clearinghouse is designed so that insurance agents that are trying to purchase a Citizens policy for their client can find private market insurers also willing to insure the property. The agent will enter the client information into the Clearinghouse, and if one (or more) private market insurers are willing to provide insurance, a comparison between the offers is completed to determine if any of the private market insurers quotes make the client ineligible for coverage with Citizens. Thus, the Clearinghouse helps Citizens reduce its exposure by reducing the number of policies it issues.

A recent report by Citizens indicates that the number of new policies diverted to the private market through the Clearinghouse has varied each year, but it has generally increased over the past few years (Citizens Property Insurance Corporation [Citizens], 2020b). In 2015, it was nearly 11,000 policies; by 2019, it was approximately 21,000. This represents $3.1 billion and $5.7 billion in Coverage A, respectively. The number of renewal policies moved to the private market due to coverage availability through the Clearinghouse being much less; i.e., 1,273 in 2019, or $221.5 million in Coverage A. There are currently 12 companies participating in the Clearinghouse.[7]

7. The list of participating companies can be found on Citizens' website at *https://www.citizensfla.com/clearinghouse*. The following companies are on the list as of February 2021: American Traditions, Avatar Property & Casualty, Capitol Preferred, Edison, FedNat,

Florida Market Assistance Program

The FMAP is another program designed to help Citizens control its policy count. Created in 1985 and still in existence today, the FMAP assists applicants for insurance who are unable to purchase coverage in the private market in finding coverage with an authorized insurer (see s. 627.3515, F.S.). Specifically, property owners register with the FMAP. Information about the property and current/previous insurance is provided. Insurance agents that are also registered with Citizens can review this information and then contact the property owner if they believe they can assist in finding appropriate coverage.[8]

This program is funded primarily by an assessment of property/casualty (P/C) insurers of $450. The expenses of the program are minimal, with the platform used to maintain the policyholder information being the major cost. Though 2020 projected expenses were $312,354, actual expenses have declined in recent years, falling from $297,977 in 2015 to $156,602 in 2018. Subsequently, the net year-end assets of the program have increased, growing from $104,313 in 2015 to over $505,000 in 2018. Expected year-end assets for 2020 were $557,765.[9] It is likely that the combination of the decline in the number of Citizens insureds along with the availability of the Clearinghouse, has reduced the volume of policyholders using the FMAP.

Risk Transfer Program

Citizens' Risk Transfer Program (Citizens Property Insurance Corporation [Citizens], 2020c) has varied over time depending on its policyholder count, TIV, and one in 100-year probable maximum loss (PML). For comparison purposes, in 2006, Citizens' TIV for all accounts was $407.95 billion, its PML was $20.87 billion, and its policyholder count was 1,155,448. That year, Citizens' total Risk Transfer Program coverage was $5.41 billion. In 2019, the TIV for all accounts was $111.25 billion, its PML was $4.59 billion, and its policyholder count was 442,203. In 2019, Citizens' Risk Transfer Program coverage was $3.36 billion.

The structure of Citizens' Risk Transfer Program has encompassed a mix of traditional reinsurance and catastrophe bonds, along with the FHCF's mandatory and optional coverages (the optional coverage increased FHCF coverage for 2007, 2008, and 2009). FHCF coverage for Citizens and all insurers that write residential property insurance is based on each insurer's exposure and can vary from year to year. Citizens' FHCF coverage for its combined accounts was $10.79 billion in 2007, which was its highest year of coverage, and $1.91 billion in 2019, which was

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Florida Peninsula, Heritage Property & Casualty, Monarch National, Safe Harbor, Southern Oak, United Property & Casualty (UPC), and Weston. Of these, Weston is the only company that is accepting wind-only policies.

8. For additional information on this program, see *https://www.fmap.org/*.

9. For revenue and expense information for this program over the past few years, see the FMAP Budget 2018 and 2020.

its lowest year of coverage. Citizens' Risk Transfer Program also includes catastrophe bonds, with its highest catastrophe bond coverage occurring in 2015 for $2.05 billion and its lowest coverage of $300 million in 2017. Citizens has been able to issue catastrophe bonds to provide multiple years of coverage. Citizens' Risk Transfer Program has included catastrophe bonds since 2012, with $750 million issued for the Coastal Account in that year. It is also noteworthy that Citizens' Commercial Lines Account (CLA) has never been covered by either traditional reinsurance or catastrophe bonds; however, the Personal Lines Account (PLA) in combination with the CLA has coverage provided by the FHCF. For FHCF coverage purposes, Citizens is treated as two separate insurers, with two FHCF reimbursement contracts; i.e., one for the PLA/CLA and the other for the Coastal Account.

Evolution of the Private Residential Property Insurance Market

The number of insurers operating in Florida has generally declined over the years, dropping from 290 in 1995 to 165 in 2019 (Florida Hurricane Catastrophe Fund [FHCF], 2020). During the last 25 years, the highest number of companies writing residential property insurance in Florida was 304 in 1999, and the lowest number was 157 insurers in 2016; i.e., a difference of 147 insurers. The number of insurers exceeded 170 in every year before 2012 and has remained below 170 for the last eight years.

Market Structure

The Florida residential property insurance market is dynamic and has been driven by a variety of factors. As of June 30, 2004, shortly after its creation, Citizens wrote 15% of the policyholders in Florida, Florida-based domestics wrote 22%, national writers wrote 28%, and the Florida domestic subsidiaries of national writers (referred to as Pups) wrote 35%. Classified another way, Citizens and the Florida-based domestics wrote a combined 37% of the market, and the national writers and their affiliates wrote a combined 63% of the market. In contrast, in 2019, Citizens wrote 4% of the policyholders in Florida, Florida-based domestics wrote 72%, national writers wrote 14%, and the Florida Pups wrote 10%. This means Citizens and the Florida-based domestics wrote a combined 76% of the market, and the national writers and their affiliates wrote a combined 24% of the market, indicating that Florida has seen a dramatic shift in market structure over the last 15 years.

Loss Ratios and Direct Premiums Written

Analyzing data going back to 1985 for coastal states exposed to hurricanes indicated that not only does Florida have the highest average loss ratio but a highly variable loss ratio as measured by its standard deviation and coefficient of variation. Figure 2 illustrates this with Florida compared to eight other coastal states.

Figure 2:
Variability of Loss Ratios of Coastal States, 1985–2017

	AL	FL	GA	LA	MS	NC	SC	TX	VA
Average Loss Ratio	0.729	**0.848**	0.7	0.805	0.828	0.676	0.699	0.696	0.622
Standard Deviation	28.25	**174.52**	8.09	143.68	107.22	34.92	89.37	25.97	23.04
Coeff. of Variation	0.388	**2.05**	0.258	1.78	1.296	0.517	1.28	0.373	0.37

Note: Data obtained from the NAIC Annual Statements.

The 84.8% loss ratio indicates that on average, Florida insurers needed 84.8% of the premiums earned simply to pay losses and loss adjustment expenses, leaving less than 16% of premiums available to cover all other business expenses.[10] The 174.52 standard deviation indicates an extremely high level of volatility within Florida's loss ratio over the time period examined. Effectively, the higher the standard deviation, the less confidence with which the industry can view the average loss ratio as a "typical" value. In other words, the loss ratio has proven less stable. Therefore, within Florida, insurers not only experienced the worst performance of any of these states, but they have a measurable reason to have less confidence in the Florida market to perform in a stable manner than any of the other states.[11]

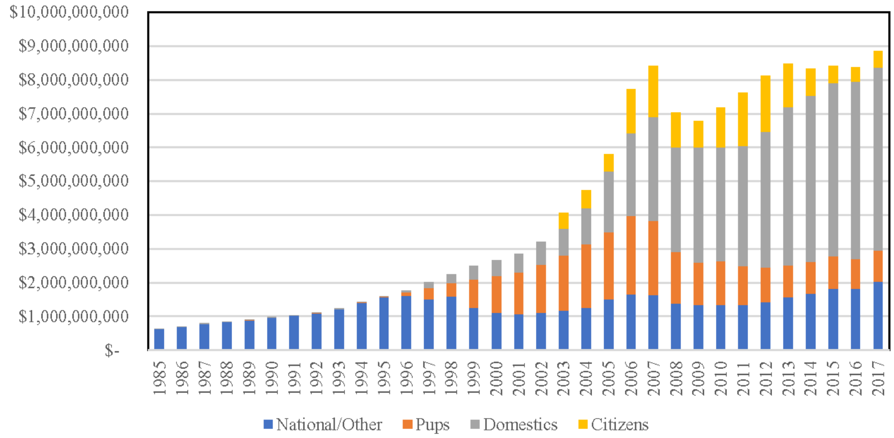
To gain a better understanding of the Florida residential marketplace, it is also important to consider changes in market share of the various insurers operating in Florida. Direct premiums written (DPW) are segmented into the following categories to reflect Florida's homeowners insurance marketplace more accurately: 1) National Insurers; 2) Pups; 3) Florida Domestics; and 4) Citizens. Figure 3

10. The 84.8% loss ratio is the average of the annual loss ratios from 1985 through 2017. In non-storm years in Florida, loss ratios vary significantly from this average. For example, the loss ratio in 2011 was approximately 30% and was similar in 2009 and 2010. However, it would be improper to "ignore" the storm years in the analysis.

11. Average loss ratios declined because of the lack of hurricane losses since 2005. Even with the 2016 and 2017 storms making landfall, Florida's loss ratio was below 1 (0.385 in 2016 and 0.901 in 2017).

displays the DPW in Florida for homeowners insurance policies, categorized by insurer type, for the years 1985–2017. This chart highlights the significant growth in the Florida Domestics, with reductions by National Insurers, Pups, and Citizens.

Figure 3:
Florida DPW in Homeowners Insurance by Insurer Type, 1985–2017



Note: Data obtained from the Florida OIR and Authors Calculations.

Nearly all Florida homeowners insurers experienced a premiums-to-surplus ratio of ≤ 1.0 in 1985 (well before Hurricane Andrew), indicating a claims-paying ability of at least $1 of policyholder surplus to every $1 of direct premiums written. By 1994 (two years post-Hurricane Andrew), most insurers still held their premium-to-surplus ratios at or below 1.0, with just a handful of companies potentially over-extending their capitalization. A turning point occurred from 1994 to 2003 in the capitalization of Florida homeowners insurers as 22 insurers saw their premiums-to-surplus ratios above 1.0, and three companies' ratios were in the highly leveraged range (6.0 to 7.0).

Such an abrupt change within a 10-year period may be attributable to two drivers: the formation of Florida Pups by National Insurers and the entrance of Domestic Insurers into the Florida homeowners market. Between 1996 and 2000, Travelers, Allstate, State Farm, and Nationwide all formed pup companies, limiting the capital they placed at risk to underwrite Florida homeowners. In addition, 23 domestic insurers started up during the 1996–2003 time frame; several of these insurers were arguably undercapitalized. Capitalization among Florida homeowners insurers was even worse by 2012. The financial picture was eroded by the combination of depleted policyholder surplus following the 2004–2005 storm seasons and regulatory and legislative interventions that increased pricing pressures on all insurers. By this time, 32 companies had premiums-to-surplus ratios greater than 1.0, with 19 of them above 3.0. In 2017, 29 companies were writing homeowners insurance with ratios more than 1.0, with eight of them above 3.0.

While there are still a significant number of companies with premiums-to-surplus ratios above the national average, there are fewer larger outliers than there were in 2012.

Capitalization

Recent data on private homeowners insurance availability in Florida describes a market with heavy dependence on small companies with limited capitalization. Although Florida attracts a high number of insurers relative to other coastal states, many of these insurers (more than in any other state) are independent, mostly small domestic Florida companies. These independents make up one-fourth of Florida's private homeowners premium volume, and domestics (based on OIR's Quarterly and Supplemental Reporting System (QUASR) data that includes both the independent and group-based domestics) represent more than half of the private insurance premium at 58%.

Despite the high number of insurers and the relatively high total premium amounts sold in Florida, the state's private homeowners insurance market has the worst level of capitalization (as measured by Policyholder Surplus [PHS]) of any catastrophe-prone state. As shown in Figure 4, between 1985 and 2017, total DPW in Florida increased more than 12-fold, while PHS only increased 1.6-fold. Given the large number of homeowners insurance companies concentrating most of their business in Florida and the large Florida homeowners insurance premium base attributable to domestics with relatively small stores of PHS, the existing level of capitalization may be insufficient should another major storm hit Florida.

Factors Affecting the Florida Property Market

As discussed in the prior section, the state of the Florida market has changed in recent years. These changes have been driven by several factors, including hurricane activity, third-party involvement in claims, and private market instability.

Hurricane Activity

A hurricane did not make landfall in Florida during the 10-year period from 2006 to 2015. During this time, the price of reinsurance became competitive, and insurers operating in Florida were able to purchase reinsurance at reasonable costs.[12]

12. The term "rate-on-line" refers to the reinsurance cost over the coverage, which is stated as a percentage. The reinsurance broker Guy Carpenter publishes an annual rate-on-line index, which dropped from 293.8 in 2006 to 191.34 in 2020, a reduction of about -35%. However, the trend has been slightly upward since 2017 (170.8 to 191.34, or about 12%). Note that the index is set at 100 in 1990. See Artemis (2020a) for more details.

Much of the price competition began in 2012 and persisted in later years due to the growth of insurance-linked securities (ILS) products (Christiana & Rosenbruch, 2016).[13] However, the hurricanes that affected Florida in 2016, 2017, and 2018 have resulted in a total of $19.84 billion in insured residential property losses over the last few years (FHCF, 2020). Early in 2020, the outlook for the 2020 reinsurance market renewals reflected a market that was hardening. Several news sources speculated about higher reinsurance rates and a difficult market for insurers in Florida for 2020 renewals (Dyson, 2020; Hudson, 2019; Howard, 2020; Haughey, 2020; Evans, 2020a, 2020b; *A.M. Best*, 2020; and Sheehan, 2020a, 2020b, 2020c, 2020d). Additionally, adverse loss development from Hurricane Irma has increased the ultimate loss estimates for Florida insurers (O'Connor, 2020a; Gallin, 2018; Evans, 2020c; and Draghi et al., 2019).[14]

Figure 4:
PHS and DPW Growth in Catastrophe-Prone States, 1985–2017

1985 – 2017	Total Decision Centers*	Groups	Individual Companies	Total PHS	Group PHS	Individual Companies PHS	Total DPW	Group DPW	Individual Companies DPW
Nat'l	-26.8%	-29.09%	-24%	555.67%	551.46%	755.53%	474.17%	460.61%	839.53%
AL	-18.99%	-23.29%	33.33%	383.78%	382.97%	889.62%	516.96%	516.53%	623.68%
FL	-40.16%	-45.19%	-17.39%	164.43%	163.41%	338.76%	1221.99%	985.92%	7499.83%
GA	-38.46%	-38.71%	-36.36%	456.05%	456%	479.18%	689.26%	711.48%	37.31%
LA	-31.33%	-45.33%	100%	269.25%	267.09%	1613.84%	464.25%	393.54%	2022.46%
MS	-30%	-35.38%	40%	267.71%	266.53%	1182.78%	513.14%	531.55%	149.6%
NC	-26.67%	-32.5%	20%	440.2%	441.6%	110.17%	670.72%	671.3%	647.86%
SC	-16.67%	-25.61%	75%	369.73%	368.79%	718.19%	698.63%	675.04%	1699.12%
TX	-32.17%	-38.78%	5.88%	246.38%	244.77%	1158.39%	614.97%	588.27%	2189.24%
VA	-33.66%	-34.78%	-22.22%	481.07%	481.55%	329.88%	621.75%	615.02%	4354.97%

* Total decision centers are the sum of the number of groups plus the number of individual companies.
Note: Data obtained from the NAIC Annual Statements.

The first hurricane of the 2020 hurricane season was Hurricane Hanna, which made landfall as a Category 1 with winds of 90 miles per hour at Padre Island, Texas (Uliano, 2020). As of the end of October 2020, there were 28 named storms representing the most active hurricane season on record. This included 10 hurricanes, with nine causing damage in the U.S. Louisiana suffered damage from

13. See Artemis (2020b) for catastrophe bond and ILS market statistics and data.

14. Adverse loss development, also known as "loss creep," refers to losses that insurers and/or reinsurers did not initially anticipate following a loss event. This term is used to describe the inadequacy of insurer loss reserves that have deteriorated over time.

five named storms, which included Tropical Storm Cristobal in June; Hurricane Laura in late August as a Category 4; Tropical Storm Marco weakened before making landfall in early August; Hurricane Delta in mid-October, which weakened into a tropical storm as it made landfall; and Hurricane Zeta on Oct. 28. Hurricane Zeta made landfall at Cocodrie, Louisiana as a Category 2 storm with winds of 110 miles per hour, and it was the eleventh tropical storm or hurricane to hit the U.S. in 2020. Given such an active year, Florida was fortunate not to experience a hurricane landfall through the end of October.

Third-Party Claims Activity

Florida has also experienced a significant growth in public adjuster and trial lawyer involvement in insurance claims (Office of Program Policy Analysis and Government Accountability [OPPAGA], 2010). This involvement has had significant effects on the frequency and severity of claims in Florida. 2008–2010 in Florida saw a significant increase in reopened claims from the 2004/2005 storm seasons. At that time, there was a five-year statute of limitations on reopening claims. As the window for reopening claims closed, Florida saw significant increases in sinkhole claims. The Florida Legislature addressed the sinkhole claims issues in SB408. By 2013, sinkhole claims had decreased drastically; however, assignment of benefit (AOB) claims began to grow. For several years, the Florida Legislature has struggled with the issue of AOB. Lawsuits for the top 25 insurers in Florida from 2013 to 2020 have totaled 273,920, and Citizens' share has been 69,061 or 25%. AOB cases accounted for 17,147, or 23%, of the total for Citizens (Citizens, 2020d). In 2019, the Florida Legislature passed House Bill 7065 to address the AOB problem. The provisions in the bill were designed to reduce AOB abuses, establish rights and obligations for assignees and assignors, and require notice to an insurer of the intent to initiate litigation. Outside of legislation, major steps to prevent fraud have not been common.[15]

Private Market Instability

Finally, there has been evidence of instability within the private market. For example, following Florida Specialty Insurance Company being placed into receivership[16] in November 2019, Citizens' policy count increased by approximately 24,000 policyholders (O'Connor, 2019b). This raised concerns about the possibility of other insurers failing (Saunders, 2020). By late fall of 2019,

15. On June 9, 2020, a significant action was taken by the Florida Bar against the Strems Law Firm to suspend the firm's license to practice law, accusing the firm of "mendacious, bad-faith conduct" involving lying to clients, judges, and opposing parties (Johnson, 2020a, 2020b; Lean, 2020). Additionally, Citizens filed a lawsuit against the Strems Law Firm and others on June 16, 2020, alleging damages due to fraudulent claims practices (Citizens, 2020e).

16. The liquidation order was filed on Oct. 2, 2019, and details can be found at: *https://www.myfloridacfo.com/division/receiver/companies/detail/553*.

Demotech had noted that 18 of 46 insurers appeared to be unable to sustain an adequate Financial Stability Rating (FSR) based on anticipated year-end results (J. Petrelli, personal communication, December 20, 2019). Suggested solutions included increasing the amount of reinsurance to proper levels, reducing interest rates on debt held by the insurer's holding company, immediately increasing rates to a level of actuarial soundness, and increasing capital to adequately cover loss and loss adjustment expense reserves. On April 2, 2020, when Demotech posted the results of its final review, only one company was downgraded to an "M" rating, while all others were able to work out various solutions involving mergers or acquisitions, changes to their business model, or other measures.[17]

In November 2019, Edison Insurance Company filed for a 21.9% increase due to poor loss experience connected to water damage claims (Office of Insurance Regulation [OIR], 2019). Two other public hearings followed in January 2020. Capitol Preferred Insurance Company initially sought a 47% increase (later reduced to 36.5%) for one of its programs involving 28,000 policyholders (OIR, 2020b). Reasons given by the company included the increased cost of reinsurance coverage, AOB, and first-party lawsuits. National Specialty Insurance Company requested a 38.1% increase in its public rate hearing for a program affecting 35,000 policyholders (OIR, 2020a). The company noted that 25% of the increase was due to an increase in reinsurance cost. Rate filings as of May 2019 have been compiled and discussed by Hurtibise (2019).[18] Recent observations indicate a trend towards double-digit rate increases. These were the first public rate filings involving a rate increase of 15% or more since 2013.

Additionally, the Florida reinsurance market tightened in 2020. Less ILS capital was available for capacity[19] (Draghi, 2020). Reinsurance brokerage firm Guy Carpenter expressed some concerns that Florida's reinsurance price increases were additionally affected by the COVID-19 pandemic (Evans, 2020d). For the first time since 2015, the FHCF decided to forego the purchase of reinsurance, stating that it had strong liquidity resources of $12.3 billion and would consider other alternatives since the reinsurance capacity in the market had become restrictive for Florida insurers. The FHCF issued $3.5 billion of pre-event notes on Sept. 16, 2020. Additionally, in late June 2020, Citizens decided not to place a $200 million catastrophe bond for its Coastal Account due to pricing concerns;[20] nevertheless,

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17. Demotech lists six insurer ratings of A", A', A, M, S, and L on its website. M is defined as insurers that have a "[m]oderate ability to maintain liquidity of invested assets, quality reinsurance, acceptable financial leverage and realistic pricing while simultaneously establishing loss and loss adjustment expense reserves at reasonable levels." An M rating is not acceptable for mortgage lenders. See *http://www.demotech.com/pdfs/papers/20050801_fsr_study.pdf* for more information on Demotech's ratings. *Demotech* (2020) reports additional details regarding combined loss ratios, operating profit/losses, reductions in surplus, and year-end actions taken by insurers in response to concerns raised by Demotech.

18. Milliman has documented filings for all residential property insurers from 2007 to 2019 for a complete historical context (Citizens, 2020f).

19. Given the loss creep problem, ILS capital has been viewed as trapped.

20. Citizens issued a catastrophe bond for $100 million for its PLA.

Citizens' overall Risk Transfer Program increased in cost by 20% over the last year (O'Connor, 2020b).

Hindrances to Citizens' Exposure Reduction

Before recommendations could be developed, some of the major hindrances to efforts to reduce Citizens' exposure and expand the private market were formally identified, some of which are discussed above. The greatest hindrance to a healthy, robust private insurance market in Florida is the unpredictability of catastrophic windstorm exposure, and the inability to adequately diversify this concentration of exposure around the globe results in Florida being a "peak risk" zone (Aon Benfield, 2018). Any solutions to address the Florida property insurance market need to reflect this exposure. The frequency and severity of windstorm activity adds significant uncertainty and volatility to property insurance in Florida.

Frequency and Severity of Windstorm Activity

Catastrophic exposure is expected to increase with population growth. Florida's significant increase in population, from approximately 13 million in 1990 to approximately 21.5 million in 2019 (U.S. Census) represents a 65% increase in population during those 30 years. Even with stronger building codes, the location choices of the population, along with significant coastal development, has greatly increased the value at risk in the state. This trend does not appear to be changing as the Florida Office of Economic and Demographic Research (EDR)[21] is projecting Florida's population to be 26 million by 2040, with most of that growth occurring in south and central Florida.

Additionally, while the catastrophe modeling industry has made tremendous strides in its ability to model windstorms, the industry continues to evolve in its understanding and ability to accurately model windstorm risk. Modeling of potential windstorm damages involves a variety of sciences (e.g., oceanography, atmospheric science, geography, and engineering) and builds layer upon layer of estimation and uncertainty into any model.[22] These models, while far from perfect, are the best estimates of what potential losses will be; however, they contain a significant amount of uncertainty, which is the inherent nature of low probability, high consequence events. These models then underlay the business model of every property insurer in Florida. The current insurance model requires each insurer to establish precise premiums on the revenue side; although, there is significant uncertainty on the loss and expense side. Compounding the problem is that the

21. See *http://edr.state.fl.us/Content/population-demographics/data/Pop_Census_Day.pdf*.

22. The authors appreciate the comments of one of the anonymous reviewers, which notes the importance of the scientific and technological advances as it relates to climate analytics. While highly relevant, an in-depth discussion of this issue is beyond the scope of this paper. For more information on this subject, see Guin (2017) and Gray (2021).

average property insurance consumer knows little to nothing about catastrophe modeling or how catastrophe exposure affects the insurance market. Insurance in and of itself is an opaque product. Catastrophe exposure adds to this lack of clarity for the end consumer.[23]

Risk-Return Tradeoff

The current risk-return tradeoff is another hindrance. Business ventures that have higher risk require a higher rate of return. For some insurance companies, the sound business decision may be to reduce or completely avoid Florida's catastrophic risk. They can reduce the risk by limiting their exposure in Florida and not selling property insurance in the state, or they can reduce the risk by limiting the amount of capital that is at risk. Incentivizing those with capital to invest in Florida requires adequate rates of return for those investors and/or a better understanding of the risk. Unfortunately, adequate rates of return are market determined, and those markets extend far beyond Florida and its catastrophe exposure. In capital markets, investors analyze the risk-return tradeoffs of hundreds if not thousands of investment opportunities. The proper rate of return to incentivize investment will vary with market conditions. Florida learned this in 2008 when the FHCF paid Berkshire Hathaway a $224 million premium for the right to borrow $4 billion in the event of a significant hurricane in 2008.[24] In difficult market conditions, capital can be very expensive. Yet, capital is exactly what Florida needs to support its catastrophic risk exposure.

Legislative, Regulatory, and/or Administrative Actions

Some past legislative, regulatory, and/or administrative actions can also pose a hindrance to Citizens achieving its objectives. While one could argue that legislative or regulatory intervention was necessary in 2007 to keep the insurance market operating, one could also argue that those interventions are still having an impact on markets today. Many of the legislative changes that were instituted regarding the property insurance market over the last few years have been enacted to improve the health of the private market. In addition, changes that occurred in the 2000s that expanded Citizens' risk exposure and policy counts have been followed by changes in the 2010s that have helped to reduce that exposure.

The One-Way Attorney Statute (FL Statute 627.428) is another significant hindrance to Citizens achieving its objectives. The statute allows insureds to recover attorney fees when they prevail in a case against an insurer, but the insurer cannot

23. The Florida Commission on Hurricane Loss Projection Methodology (FCHLPM) was created in 1995 (s. 627.0628, F.S.) as an independent commission to develop hurricane model standards and serves "to encourage the use of the most sophisticated actuarial methods to assure that consumers are charged lawful rates." See *https://www.sbafla.com/Methodology/* for further information.

24. See *https://www.insurancejournal.com/news/southeast/2008/07/31/92371.htm*.

recover fees if they prevail in the case. The structure of the one-way attorney fees and fee multipliers in Florida incentivizes attorney participation. As documented in the FSU study, the percentage of insurance claims that end in litigation has been increasing in Florida, especially the Tri-County area. This adds significant uncertainty and cost to insurers operating in Florida, and it serves as a significant hindrance to attracting capital and, consequently, ensuring a healthy private insurance market.

Third-Party Involvement

More generally, the involvement of third parties in the insurer-insured relationship has added significant costs for insurers operating in the Florida property insurance market. Public adjusters, lawyers, and contractors are examples of third parties that have a significant interaction in insurance claims in Florida. In 2019, Florida was one of five states to pass bills limiting who can represent an insured (besides a public adjuster) in a claim.[25]

This can be considered a response to Florida having among the highest homeowners insurance rates in the country, second only to Louisiana.[26] The homeowners insurers in Florida are collecting nearly $10 billion a year in premiums, making them a "target" for opportunistic fraud.[27] This has manifested itself in a variety of ways in the Florida market, such as reopened catastrophe claims in 2007–2009 following the 2004 and 2005 storms (reoccurring again with storm activity in 2017–2020); sinkhole claims in 2008–2011 leading up to SB 408; AOB claims in 2013–2018 leading up to HB 7065 in 2019;[28] and most recently, water claims in the Tri-County area. As one fraudulent opportunity window closes, it appears that another opens.[29]

Rating Agency Actions

The actions of rating agencies can affect insurance markets. For example, a rating agency might indicate that a company should restructure its book of business to reduce its catastrophic risk, which could increase Citizens' exposure. There are currently a limited number of insurers operating in the Florida residential property insurance market that are rated by the large rating agencies. From the public standpoint, the lack of ratings by agencies that use non-public data leads to less transparency and limited information for consumers and state insurance regulators.

25. See *https://www.claimsjournal.com/news/national/2019/10/09/293481.htm*.

26. See *https://www.iii.org/fact-statistic/facts-statistics-homeowners-and-renters-insurance.*

27. See Dumm et al. (2020).

28. HB 7065 is now Laws of Florida Chapter 2019-57. It amends s. 627.422 and creates sections 627.7152 and 627.7153, F.S.

29. See Dumm et al. (2020), which shows Citizens had more than 2000 sinkhole claims in Hernando County in 2011 and less than 200 in 2013 following SB 408, a more than 90% reduction in sinkhole claims.

Use of Glidepath and Mitigation Discounts

Another major hindrance to reducing the exposure of Citizens is its inability to reach actuarially sound rates due to the operation of the glidepath created in 2009 (CS/CS/CS/HB 1495 signed into law by the governor on May 27, 2009). This legislation restricted Citizens' rate increases, which could not exceed 10% per year, with certain exceptions. The purpose was to phase in rate increases over time, such that they would eventually reach actuarial soundness. However, in an analysis of its book of business, Citizens reports that its rates are below what private market insurers would charge based on their filed rating plans (Citizens, 2019). The glidepath may be limiting Citizens' ability to become a true insurer of last resort.

Similarly, insurers are required to either use the OIR's promulgated mitigation discount table or submit a study to justify a company-specific mitigation discount plan. As discussed in this report, the mitigation discount table utilized by the OIR is nearly 20 years old. If those discounts do not represent the true savings generated by the mitigation features, it could result in market distortions, as some property insurance would be under- or over-priced. These distortions can result in some properties not being absorbed by the private market through the Citizens Depopulation Program. Further, if the discounts are not accurate, the cost of conducting a study to submit company-specific discounts may be burdensome to small insurers.

Affordability of Coverage

Finally, one of the main drivers behind legislative, regulatory, and/or administrative actions is to ensure the solvency of insurers, but also to ensure that rates are fair, not excessive, and not unfairly discriminatory. Given the nature of the catastrophic risk in Florida, another issue of importance in the state is affordability of property coverage. It appears that one of the main drivers behind CS/HB 1A in 2007 was to address the affordability of property insurance. Addressing affordability in the ratemaking process introduces more opaqueness to the process and creates opportunities for cross-subsidization in rates.

Key Recommendations

For the purposes of classification and organization, and to allow for a better conceptual understanding of the various issues, the approaches presented in the FSU study were grouped into seven categories. Category 1 focused on efforts that would attract investors. By attracting insurance risk capital to Florida, Citizens' exposure can be reduced, and the private market can be expanded. To attract investors to the Florida residential property insurance market, it is important to understand why investors are not participating in the market and why many that are participating have chosen to limit their participation. Understanding the layers of the loss distribution and which layers need additional capital can help develop the ideas and approaches that may be more successful in attracting capital. Investors expect to earn a return that will compensate for the risk they are taking. The more investor capital that is attracted to the Florida market, the less likely it is that assessments will occur.[30]

The second category included recommendations related to loss control. Loss control is a broad term, which could involve avoiding risk, mitigating the potential for damage, or mitigating the severity of the loss once it occurs. Common approaches to loss control include prevention, reduction, separation, duplication, and diversification. Loss prevention refers to actions that are taken to prevent a loss from occurring—i.e., reducing the frequency of losses—and loss reduction is often used to refer to steps taken to lessen loss severity. Within this category, the study identifies ideas and approaches that would serve to mitigate the potential damage to an exposure by reducing the severity and/or frequency of loss. To the extent that most properties engage in some type of loss control, Citizens' exposure would be reduced. A greater level of participation in loss control efforts could make the market more attractive to private market insurers and/or incentivize more private market insurers to participate in Citizens' takeout efforts. Funding of loss control measures and how to achieve the maximum impact for the overall reduction of exposure in the insurance system are both important considerations necessary for their implementation.

Categories 3 and 4 considered efforts to create system efficiencies and improve data quality, analytics, and transparency, respectively. Over time, various laws, regulations, legal requirements, and court cases have negatively affected the insurance environment in Florida. In addition, claims settlement can be slow, especially following large storms, and susceptible to litigation arising from conflicts and tensions between policyholders and insurers. The involvement of trial lawyers, public adjusters, contractors, and other service/product providers in the process adds to the cost. Having quality data also allows for a better understanding of the state's exposure and its vulnerability to hurricane events, thus improving decision making at the public policy level. Additionally, it is important to have adequate and detailed loss and expense data to understand the drivers of insurance costs. Effective risk management requires having the right data, analyzing it correctly, and understanding the implications. Modern analytics can be utilized to provide better information about risks, and greater insurer transparency can be provided to Florida policyholders and taxpayers so that the public has a better understanding of how these factors affect the cost of insurance and the potential for assessments.

Efforts related to financial solvency are included in Category 5. Citizens' exposure and policy count could potentially become less volatile if private market insurers were more financially secure and fewer insolvencies occurred. As a result,

30. Florida policyholders are subject to various types of assessments in Florida by either Citizens, the FHCF, or the FIGA. Although the term "assessment" is used, assessments can be viewed as a tax. For the purposes of tax-exempt status, the Internal Revenue Service (IRS) considers assessments the same as a tax.

the entire market would benefit from improved insurer financial and premium stability. Financial solvency of Florida insurers is key to managing Citizens' exposure, financial strength, and capabilities; reducing bonding and policyholder assessments; and encouraging insurance investments in Florida. A better understanding of private market insurers' exposures would allow for improved risk management and fewer insolvencies.

Rating reform is the focus of approaches in Category 6. The differential between rates charged by Citizens and the rates charged by insurers in the private market is a major driver affecting Citizens' policy count. Rating methodologies can cause distortions in the insurance market and drive policies to Citizens unintentionally. Understanding and adjusting rating methodologies may be beneficial in reducing Citizens' exposure over the short- and long-term and expand the role of the private insurance market.

The final category consists of ideas and approaches that may not fit into the categories above. This could involve ideas that expand, reduce, or change Citizens' role or structure. As such, certain ideas could conflict with Citizens' stated boundaries and constraints, and feasible mitigating measures may need to be addressed for their inclusion in the study. Some ideas may be complex and/or lack a track record for evaluating results. Certain other ideas in this section may be able to stand on their own and provide a marginal but worthwhile benefit at a low cost.

Considering Citizens' objective, major hindrances, and other considerations, 18 recommendations were proposed in the FSU study:[31]

- **Recommendation 1**: Host workshops involving a variety of stakeholders to gain a better understanding of their perception of the Florida market and provide them with information about the Florida market that would be valuable to potential investors and private market insurers.
- **Recommendation 2**: Encourage new entrants to develop business models specifically for the Florida market, taking advantage of both traditional and alternative approaches to providing insurance coverage.
- **Recommendation 3**: Require Citizens' policyholders to engage in loss prevention and loss reduction efforts. Additionally, Citizens could require regular mandatory inspections of all insured properties every three to five years so that continuous and updated loss control recommendations can be provided on an ongoing basis.
- **Recommendation 4**: Expand and improve the Florida Building Code. This could include incorporating the idea of "Code Plus" standards and/or creating optional standards for wind and flood for older homes that cannot meet the 2001 building code.

31. The recommendations discussed in this section may relate to more than one of the categories identified earlier in this section. Also, the FSU study considered other ideas and approaches than those presented in the report. A summary of the other ideas and approaches can be found in Appendix M of the study.

- **Recommendation 5**: Work to expand and widely promote the use of managed repair programs involving certified contractors.
- **Recommendation 6**: Utilize different claims settlement processes, such as alternative dispute resolution and early offers to reduce the percentage of claims that are litigated or the dollar amount of claims.
- **Recommendation 7**: Create a statewide database that incorporates the loss control and mitigation features (including factors such as roof shape, mitigation features, age of roof, etc.) of every home in Florida, like the CARFAX™ database for automobiles.
- **Recommendation 8**: Change Citizens' takeout program from one of insurers selecting individual policies (a pull approach) to an approach where Citizens formulates various portfolios of policies (a push approach) using the concept of managing tail risk.
- **Recommendation 9**: In cooperation with the OIR and catastrophe modeling firms, consider deploying new, emerging methodologies to better evaluate the risk of financial insolvency for Citizens and private market insurers in Florida, considering, for example, an insurer's spread of risk and its contribution to an insurer's overall risk profile in ways that can be quantified for more accurately measuring catastrophic risk exposure.
- **Recommendation 10**: Regularly conduct aggregate stress testing to gain a greater understanding of the impact of large events on the vulnerability and the survivability of the overall insurance system.
- **Recommendation 11**: Modify, eliminate, or replace Citizens' glidepath to allow for greater percentage rate increases so that rates are closer to being actuarially sound and can better adjust to rate changes in the private market.
- **Recommendation 12**: Limit Citizens' policyholder eligibility to only situations where the private market insurer's premium is at least 15% higher than Citizens' premium for both new policies and renewals.
- **Recommendation 13**: Update or eliminate the mandatory mitigation credits for insurers or encourage private market insurers to establish what they believe to be proper discounts and charge a premium commensurate with the reduction of the risk/exposure.
- **Recommendation 14**: Create a marketing campaign that educates Floridians on the "true" cost of windstorm exposure.
- **Recommendation 15**: Establish stronger requirements that policies taken out of Citizens be held for three years.
- **Recommendation 16**: Work with the Division of Investigative and Forensic Services within the Department of Financial Services and other stakeholders to develop a comprehensive and centralized insurance fraud database.
- **Recommendation 17**: Establish a requirement that building permits on new residential construction should require proof of private market property insurance.

- **Recommendation 18**: Create a state-level program to address residential property insurance affordability.

The FSU study suggested that effectively reducing Citizens exposure in the long term will require the implementation of a combination of recommendations outlined above. An ideal starting point would be for Citizens, in cooperation with the OIR and others, to host workshops to gain a better understanding of the concerns of private market insurers and investors. At the same time, steps can be taken to begin to address some of the other issues identified in the study. For example, as noted in the discussion of hindrances, the exposure to catastrophic risk is a major consideration for private market insurers doing business or contemplating doing business in Florida. This risk can be mitigated through improved building codes and a requirement of proof of the ability to secure private market insurance before beginning construction in high-risk areas. It can also be mitigated by encouraging new entrants to the market and through efforts that would provide detailed information about properties and the strength of the Florida market. Collectively, these efforts could serve to effectively spread the risk across the state, as well as provide private market insurers with information needed to pursue broader geographic and product diversification strategies.

The major hindrances that act as deterrents to private market insurers doing business or expanding business in the Florida residential private market include third-party involvement in the claims settlement process, high litigation rates, and fraud. The passage of HB 7065 in 2019, which placed requirements and limitations on AOB is an example of recent legislative action that could reduce the impact of this hindrance. Efforts to reduce litigation and fraud could also lead to lower claims settlement costs. Another area of concern relates to mandatory mitigation credits. The current credits were developed using hurricane and building data from 20 or more years ago. The use of updated data could result in credits that are more credible and more accurately measure true exposure to correct market distortions in pricing.

Following the implementation of these recommendations, Citizens, in cooperation with the OIR and others, can host additional workshops to discuss these changes with private market insurers and investors to motivate greater investment in Florida and expand the private market. Simultaneously with the changes to improve the attractiveness of the private market, Citizens could work to expand and widely promote the use of managed repair programs, encourage loss prevention and loss reduction efforts of its remaining policyholders, and require regular mandatory inspections so that continuous and up-to-date loss control recommendations are provided on an ongoing basis.

Once the attractiveness of the environment in Florida has been improved and there is increased capacity within the private residential property insurance market, this should naturally lead to some policies moving out of Citizens. However, there is the need for more publicly available data to ensure transparency and allow for more sophisticated analytics. With this accomplished, Citizens could seek support from the legislature to implement changes to its structure to further reduce its exposure. First, it could change its takeout program to a push approach using the concept of managing tail risk. Next, Citizens could work to improve the quality of its remaining book of business and control its claims costs by addressing rate concerns. Specifically, Citizens could modify, eliminate, or replace the glidepath and limit eligibility for new and renewal business based on the cost of private market insurance as it was originally designed. Additionally, Citizens creates a marketing campaign to educate Floridians on the "true" cost of risk and how such efforts, if undertaken, can affect the cost of insurance.[32]

Conclusion

Citizens has made significant efforts to manage its risk and has successfully reduced its exposure to one of the lowest levels since its creation in 2002. It has a large surplus position and a strong Risk Transfer Program, but more can be done to reduce and manage its exposure and reduce its market share in the Florida residential property insurance market.

Efforts to reduce Citizens' exposure and expand the private market can be affected by a variety of factors, including the state regulatory and legal environments, the current ratemaking process, and the overall state of the private market. This report identifies key hindrances to ensuring a healthy, robust private insurance market. These hindrances stem directly from catastrophic risk exposure or arise from various external sources, such as legislative and/or regulatory actions that impose uncertainty in the property insurance market and constrain potential reactions by Citizens. Some of the recommended ideas and approaches described in this report would address these hindrances, but a long-term plan to address all the hindrances in the Florida market should be developed.

For purposes of classification and organization and to allow for a better conceptual understanding of the various issues, the approaches recommended are grouped into seven categories and were evaluated along four dimensions: 1) the impact on Citizens' access to capital markets and traditional reinsurance; 2) the implications to Citizens' ability to respond to significant market fluctuations; 3) the expected business outcome and expected benefits; and 4) identification of any conflicts with a boundary or constraint. While Citizens has real opportunities to effectively reduce its exposure in the long term, a combination of strategies will be necessary to ensure the adequacy of rates and solvency of the private insurers operating in the residential property market. Additionally, several actions must first be taken to improve the attractiveness of the Florida market and increase the capacity of the private market before changes to the structure of Citizens can be made. Specifically, efforts focused on improving system efficiencies; reducing claims costs; and improving the legislative, regulatory, and legal environments are

32. While educating Florida property owners may expand their understanding of insurance products and pricing, it is not necessarily going to make them willing to pay more for insurance. However, it could increase the use of mitigation and other actions that could positively affect the cost of coverage.

needed and will require cooperation among a variety of stakeholders. With the implementation of some of the recommendations discussed, it is possible that coverage may not be affordable to all residential homeowners. However, to achieve Citizens' goal of reducing its exposure, the issue of affordability may need to be addressed outside of the insurance process.

Appendix

Depopulation Efforts of Select States

Several states have undergone efforts to reduce the size of their residual markets. In 2007, Louisiana passed HB 678 and created the Insure Louisiana Incentive Program. The Program was designed to encourage insurers to write more coverage in the state by providing grants to qualifying insurers that commit to writing a minimum of $2 million of property insurance in the state. This matching program required insurers to have $2 in net premiums written for every dollar of new capital allocated and grant money received. In addition, at least once a year, policies within Louisiana Citizens are made available for takeout by insurers. Louisiana Citizens is currently on round 13 of this depopulation effort in which two companies participated.

Since beginning the takeout program, the size of Louisiana Citizens has decreased substantially. In 2008, the policy count exceeded 174,000 and it wrote nearly $280 million in premiums. In 2018, the policy count had dropped to less than 50,000 with approximately $67 million in premiums (The Property Insurance Plans Service Office, Inc., 2009; Hartwig and Wilkinson, 2014; The Property Insurance Plans Service Office, Inc., 2019). Due to concern with the dramatic drop in premiums, the following changes were made in 2017 and 2018[33]:

- Select policies are offered for takeout (not Louisiana Citizens' entire book of business)
- A more targeted approach to inspection of renewal policies was developed, instead of routine inspection every three years (Louisiana Citizens Property Insurance Corporation, 2020).

Similar takeout approaches have been undertaken by Texas and Massachusetts. In 2015, the Texas Legislature passed SB 900, creating the Voluntary Market Depopulation Program and the Assumption Reinsurance Depopulation Program. Both programs are aimed at reducing the size of the Texas Beach Plan. The Voluntary Market Depopulation Program allows participating insurers to review policyholder data and make offers to take out individual policies. All offers must be approved by the Texas Department of Insurance as well as the insured.[34]

The Assumption Reinsurance Depopulation Program is similar but allows insurers to make offers on a large number of policies at one time. Insurers must be approved to participate in the Assumption Reinsurance Depopulation Program. The approval process includes a review of the insurer's financial information and other documents, including verification of comparable coverage. As with the Voluntary

33. Although AOBs has been a major issue in Florida, this does not appear to be a major issue in other states, including Louisiana.

34. For additional details, see *https://www.twia.org/depopulation/voluntary-market/process/*.

Market Depopulation Program, policyholders can opt out and elect to maintain their coverage with the plan. Although these programs are still relatively new, the total policy count in the Texas Beach Plan declined from 286,860 in 2015 to 212,608 by 2018, premiums written have dropped by more than 20%, and exposure has declined by approximately 26%.

In July of 2018, Massachusetts announced the introduction of its clearinghouse. Participating companies are provided information about the policies currently in force, which they can review in relation to their underwriting criteria and make decisions for selecting policies to take out of the Massachusetts FAIR Plan. As with the Texas program, the policyholder does have the ability to opt out and remain with the residual market insurer.[35] Data are not yet available to determine whether this program has been effective in reducing the size of the plan.

35. For additional details, see *http://www.mpiua.com/wp-content/uploads/2018/08/Homeowners-Insurance-Clearinghouse.pdf*.

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