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Florida's Big Insurance Problem

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By Nanette Byrnes

When Hurricane Ike took a left on Sept. 8, heading away from Florida, locals breathed a sigh of relief. Not only are their homes on the line with each burst of violent weather but their pocketbooks are increasingly at risk, too. Over the past four years, Florida taxpayers' vulnerability to a major weather catastrophe has grown.

The quasi-governmental company that was conceived as an insurer of last resort, Citizens Property Insurance, has become Florida's top underwriter of homeowners' insurance. Citizens now has more than \$433 billion of property exposure on its books, and Florida has exacerbated that risk by getting into the reinsurance business as well. "It's a disaster," says Brian P. Sullivan, editor of Property Insurance Report. "This is not something the public should be dabbling with."

Florida's concentration of risk in the hands of taxpayers is an example of the potential risks of having states supplement private-sector insurance. While Florida is particularly exposed to hurricanes, states including Texas and Louisiana also have increasingly popular state-sponsored insurance funds. And there's talk in Washington of adding wind coverage to the federal flood insurance program. The appeal for homeowners: reasonably priced policies that offer relief from rising rates. But critics say that, in Florida at least, the state-sponsored player has inadequate reserves to cover future losses if a big storm hits, and that private companies find it tough to compete. "If the market behaved more rationally, prices would likely go up," says Ross Buchmueller, chief executive of PURE Risk Management, which writes only high-end homeowners' insurance in Florida.

On the surface, Citizens looks like an attractive option. The insurer is projecting a \$4 billion surplus at the end of this year, says spokesman John Kuczwanski. But risk modelers project a rise in hurricanes, which could lead to heavy losses. According to the pro-industry Florida Insurance Council, if a category 4 or 5 storm hit Miami, it could cost \$50 billion in repairs. Hurricane Katrina cost insurers \$44.9 billion nationwide, according to insurance credit-rating agency A.M. Best.

Insurers typically try to spread the risk of such major calamities by buying reinsurance. Florida has instead taken on \$28 billion worth of reinsurance risk itself, and its reinsurance pool would have to issue bonds for anything over \$7.8 billion in losses. (The state's entire 2007-08 budget is \$70 billion.) Given the credit market's volatility, taxpayers could face a huge bill. In July the state agreed to pay \$224 million to Berkshire Hathaway (NYSE:[BRK-A](#) - [News](#)) just for the right to borrow \$4 billion if insurance fund losses exceed \$16 billion before May 15, 2009.

Citizens was never meant to grow to this size. It now has 1 million policies in force and accounts for 28% of all written premiums for homeowners' insurance -- more than double its nearest rival, State Farm Insurance. Formed as a backstop in 2002, the company took off after three major hurricanes in 2004 and 2005.

Faced with state-imposed limits on raising rates to cover their risks, insurers began to pull out of Florida. Allstate Insurance (NYSE:[ALL](#) - [News](#)) has reduced its presence by two-thirds since 2004, writing 500,000 fewer homeowners' policies. State Farm, meanwhile, is appealing for a 47% rate increase and stopped writing new policies in Florida in February. Earlier this year it also canceled coverage on all homes within a mile of the coastline. "We are very concerned about the financial condition of State Farm Florida," says spokesman Chris Neal. "Even in nonhurricane years, we have continued to lose money."

As Citizens grows, how much liability could taxpayers face? With foreclosures rising and reconstruction costs high, it seems that Florida's next big hurricane could leave a wake of financial destruction.