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Insurer's Exit Leaves Florida on the Brink

By Eli Lehrer

State Farm's decision to quit providing homeowners insurance in Florida shows that the state's insurance market simply can't survive in its current form. Moreover, the company's exit won't merely leave thousands of Florida homeowners scrambling for a reliable insurer, but it also will add to the financial risk that Florida would face if costly storm damage were to occur.

Indeed, unless Governor Crist and the Legislature swiftly make several painful but necessary changes to Florida's current insurance system, State Farm's retreat places the entire state in grave fiscal peril.

That's because inaction means that Florida's taxpayers will become practically the only major underwriter for coastal property owners, whose homes are among the priciest and most exposed to storms. That could literally mean bankruptcy for a state that's already dealing with a budget crisis.

Whatever State Farm's faults as a company, it at least could back its promises with actual assets -- about \$60 billion worth. Moreover, it charged less than many of its competitors while providing insurance for about one-fifth of all Florida homes.

Only the state itself, through Florida Citizens Property Insurance Corporation, sells more homeowners insurance in Florida. Partly because State Farm is a mutual company operating on a not-for-profit basis, it also wrote lots of coastal coverage that shareholder-owned companies tended to avoid.

Without State Farm, Florida easily could face a fiscal train wreck. No similarly-strong private company exists to take up the slack. In the wake of the ill-conceived property insurance "reforms" of January 2007, every sizeable out-of-state provider of homeowners insurance has either entirely withdrawn from the state or severely curtailed its business. The only companies writing significant numbers of new policies are Florida-only companies with fewer real assets.

Unlike State Farm, which purchased plenty of reinsurance (insurance for insurance companies), many of these in-state companies and Citizens rely almost entirely on the state government's own reinsurance entity, the Florida Hurricane Catastrophe Fund.

But the Cat Fund doesn't have sufficient real assets to back up its promises. Rather than making investments, as private reinsurance companies do, the Cat Fund plans to finance its payouts by selling enormous amounts of bonds after a major storm hit, with the debt to be repaid via surcharges on insurance premiums for homes and vehicles.

Under the current law, the state could assume liabilities totaling \$32 billion. However, because no state has ever sold more than \$11 billion worth of bonds all at one time, the Cat Fund simply cannot keep its promises -- especially in today's troubled credit market.

As a result, a costly storm or series of storms almost certainly would cause the

collapse of Citizens, the Cat Fund, and many nominally “private” companies. Yet because the State of Florida guarantees the solvency of all these entities, Floridians would end up footing the bill.

Moreover, because Florida has no personal income tax and has a statewide cap on property tax rates, the government has no practical way to collect the tax revenue needed to clean up the mess. If Congress doesn’t have the appetite to bail out Florida—and there’s a good chance that it won’t -- the state might well have to take a trip to bankruptcy court.

When the Legislature convenes in March, lawmakers need to consider some tough measures to pull Florida back from the brink. They should let the rates rise significantly for both Citizens and other insurers operating in the state – a step that will require real political courage. They should also act to reduce the size of the Cat Fund and encourage Floridians to do more to reinforce their homes against hurricanes.

Indeed, with whatever resources it can muster in tight times, the Legislature

should strive to increase funding for the “My Safe Florida Home” program, which helps Floridians make their residences less vulnerable to costly storm damage.

Meanwhile, State Farm’s exit from the Florida market makes it clear that Floridians – especially those who live near the coasts -- will have to pay higher insurance rates. The alternative, however, is much, much worse.

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