

Fiscal Hurricane Season

Florida's state-run insurers can't cover their liabilities, and all Americans may end up paying as a result.

Hurricane Irene is sparing Florida as it heads up the U.S. East Coast this weekend, but that doesn't mean the danger is over for the Sunshine State or taxpayers across the country. Florida still faces a fiscal hurricane that is going to hit the state's catastrophic insurance funds when the next big wind blows, and all Americans may end up paying.

That's the alarm raised last week from none other than Jack Nicholson, chief operating officer of Florida's state-run reinsurer, in an interview with Best's Insurance News. "We would like to be able to say to the legislature that we can pay 100% of our losses, regardless of what happens. Right now, we can't honestly say that we can," he said.

Mr. Nicholson manages the Florida Hurricane Catastrophe Fund, a tax-exempt trust created in 1993 to provide extra reinsurance to private insurers in the hurricane-prone state. The "Cat Fund," as it's known, is funded by premiums charged to insurance companies, by investment earnings, and by the ability to issue bonds after a storm and to tax insurers to pay for them. The fund was supposed to be a safety net, not a reinsurer of first resort.

It became the latter in 2007, when then-Governor Charlie Crist raised the reinsurer's coverage caps. The Cat Fund grew quickly thanks to its pricing advantage and a mandate that all property and casualty companies in Florida—including state-backed Citizens Property Insurance Corp.—purchase reinsurance from it. Citizens is an especially large client because its rates are also set by law below those of private competitors.

Oh, oh. What this means is that this hurricane season the Cat Fund estimates it has \$18.6 billion in liabilities but only \$7.3 billion in liquid assets, leaving an \$11.3 billion financing gap. The Cat Fund forecasts a 5.4% chance a hurricane could cause more than \$15 billion in claims. If you think a 5% chance is negligible, remember Category 5 Katrina in 2005, or Andrew in 1992.

A big storm, or a series of small ones, would wipe out the Cat Fund's cash and force it to issue bonds to cover the shortfall. The fund would then tax casualty and property insurers to pay the interest and principal on the bonds, and those companies would pass on the costs to Florida taxpayers through higher rates. That's assuming the fund can raise billions of dollars in today's volatile bond markets



Or the fund could simply refuse to pay its claims. The Sarasota Herald-Tribune recently analyzed nine insurance companies that cover two million Floridians and found that only one company could withstand a once-in-20-year storm if the Cat Fund only covers 90% of its claims, potentially leaving some 1.8 million without coverage.

Which means that Florida's pols are really betting the state would get a federal bailout. This is no mere conjecture. Mr. Crist lobbied Congress to pass such a federal disaster fund when he was Governor.

Mr. Nicholson has drafted a bill that would go a long way to avoiding this disaster. He'd reduce the size of the fund,

increase what insurers have to pay for coverage, require insurers to pay more before Cat Fund reinsurance kicks in, terminate optional Cat Fund reinsurance coverage that few companies use, and mandate that the fund hold more cash, among other things. These reforms would shrink the Cat Fund and open up Florida's reinsurance market to competition.

Citizens has to be reformed too, as CFO Sharon Binnun acknowledges. She points to a bill introduced by Senator D. Alan Hays this year that would raise Citizens's rates and reinvigorate private competition. That bill died after opposition from Republican Mike Fasano and a populist scare campaign. If Citizens doesn't get paid by the Cat Fund, it would "assess" insurers—code for tax—to "fill that gap," Ms. Binnun notes. So in the event of a big storm, taxpayers could take a double hit—first to shore up the Cat Fund, and then to shore up Citizens.

Governor Rick Scott has so far tinkered around the edges of insurance reform, and it's no fun telling Floridians that more private insurers and higher rates are needed to make the insurance market work. Then again, waiting for a big storm and dealing with a fiscal hurricane won't be popular either.