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REVIEW & OUTLOOK

Florida's Folly

It isn't easy to put one of the more well governed states on the path to fiscal ruin in a mere three months, but it seems Florida Governor Charlie Crist is exceptional. His campaign to socialize Florida's insurance market has placed the Sunshine State one big hurricane away from financial disaster.

Not that you'd know this from Mr. Crist's approval ratings, which remain in the stratosphere thanks in part to his populist turn bashing insurance companies. The Republican campaigned last year on promises to do something about his state's property-insurance premiums, which have climbed in the wake of some recent nasty hurricanes. Economists know that these rising costs are necessary, and in time beneficial, because insurers must build reserves against the more frequent storms hitting ever-more-populated coastal areas.

But Mr. Crist is a man on a poll-driven mission and his line has been that greedy insurers are ripping off his constituents. In January he convinced the Republican legislature to pass a "reform" designed to lower the price of insurance by making the state a larger player in the market and undercutting private insurers. The new law allows state-run Citizen's Property Insurance -- intended to be an insurer of last resort -- to compete directly with private companies.

This exercise in Cuban economics is already gutting Florida's once-competitive insurance market. Private insurers know the law will artificially depress rates, forcing some to operate at a loss. Many have responded by cancelling policies, prompting Governor Crist to issue an "emergency" order freezing premiums and barring cancellations. Yet even this hasn't stopped the bleeding.

USAA last week became the latest to significantly restrict the number of new policies it issues in the state, and to drop 27,000 second-home policies. This follows pullbacks from AllState, State Farm, Nationwide and others. The storms and new regulation have also forced some insurers out of business, leaving thousands of policyholders with no coverage and fewer options for getting it.

Large numbers of homeowners are now turning to Citizen's, which itself is only able to offer lower premiums because of its implicit taxpayer guarantee, and because its actuarial assumptions reside in la-la land. Citizen's likes to say it will

have \$8 billion with which to pay claims, but it rarely notes that much of this is a line of credit. Between such credit and its bonding authority, what Citizen's really has is the potential to rack up huge liabilities that will have to be paid by someone when the next storm surge comes ashore.

Most likely, that someone will be all Florida homeowners, who, in the event of a Citizen's collapse, will be on the hook for large assessments. This tax is likely to be levied on every homeowner, including those who don't live in areas at high risk for storm damage. Another option would be for the state to provide a bailout, putting all taxpayers on the hook. The risk of a taxpayer bailout is also high for the state's hurricane fund: The new law doubled its risk-bearing capacity to \$32 billion in business, thus allowing insurers to purchase reinsurance at cheaper rates than on the open market. However, the fund has only \$1 billion in cash on hand, and thus no way to cover its new business if disaster strikes -- short of dunning taxpayers.

In sum, what Mr. Crist has done is concentrate the risk of future hurricane losses within his own state government, rather than spreading it around the world through the insurance industry. This is astonishing, given that the Sunshine State accounts for 27% of all hurricane-exposed property in the U.S., worth some \$2 trillion. After Katrina, private insurers paid more than \$40 billion to 1.7 million policyholders in Florida. But the state government and its taxpayers may end up paying for the next big one largely by themselves.

At least other states are learning from the Florida meltdown. Rather than create state competitors to the private market, Mississippi and South Carolina have taken steps to expand their markets of last resort. Louisiana's Governor and insurance regulator have talked openly of the need to rebuild the private insurance market, rather than transfer risk to taxpayers. Even the liberal Atlantic Coast states, usually the first to turn to new regulations, have largely rejected attempts to socialize their storm risk.

For now, many Floridians are thrilled that their rates are falling and so the Governor is popular. He recently asked for new legislation to give Citizen's even more power to compete with private underwriters. However, Mr. Crist and his fellow Republicans had better hope that predictions of more frequent hurricanes are wrong. Because when they hit, and taxpayers discover there's no such thing as free insurance, what could get blown away is their governing majority.