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# FLORIDA MAKING WRONG WAVES OVER HOMEOWNER INSURANCE CRISIS

by

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Florida is facing a home insurance crisis, and Mother Nature is the culprit. In 2004 and 2005, eight hurricanes hit Florida, damaging homes and costing \$36 billion to rebuild. Weather forecasts are calling for increased hurricane activity, and the cost of insuring homes is going up even more. Last year, Florida Governor Charlie Crist tried to stabilize rates by supporting legislation for the state to take on some of the increased risk. But, like putting a Band-Aid on a gash wound, the reforms could not change the fundamental realities of Florida's insurance market. Now, Governor Crist is scapegoating the insurance companies. He has personally solicited mass tort lawyers to investigate and sue the industry. This tactic is dangerous and could harm Florida residents.

The heart of the controversy is over reinsurance rates charged by Florida's Catastrophe Fund ("CAT Fund"). Reinsurance is just what it sounds like: insurance for insurance companies. The ability of insurers to buy down risk of a catastrophic event through reinsurance is central to the way insurance works, particularly in high-risk states as Florida. In normal times, the CAT Fund helps stabilize reinsurance rates because it offers homeowner insurers a place to satisfy some of its reinsurance needs at less expensive rates. The CAT Fund can charge less because, unlike private insurers, which must base its pricing on affording anticipated risk, the state can make up shortfalls *after* a catastrophic event occurs.

According to the recent Governor's Property and Casualty Insurance Reform Committee's Report ("Governor's Report"), many private reinsurers have responded to the increased risk of hurricanes in Florida by pulling out of the Florida market entirely, and those willing to write policies for Florida increased their prices dramatically. In an effort to allay some of these costs, Governor Crist supported legislation that would expand the CAT Fund from \$16 billion to \$28 billion. This initiative

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exposed the State to significant financial risk, but Governor Crist hoped the extra availability of less expensive reinsurance would lower premiums for homeowners, as insurers passed the savings from the CAT Fund onto policyholders. He told *all* Florida homeowners that their premiums would go down. While some have, others have not.

Instead of looking for reasons why many insurers have not been able to lower premiums, Governor Crist has reached out to several of Florida's high-profile lawyers to investigate these insurers "on spec" to see if there are grounds for litigation against the insurers. These lawyers may be respected members of the bar, but asking almost any lawyer to see if he or she can file a lawsuit is a bit like inviting William Hung or Sanjaya Malkar back to sing on *American Idol*. There is little chance they will turn down the opportunity for the publicity and shot at financial reward.

There are several shortcomings with Governor Crist's latest tactics, however. From a substantive perspective, all insurers are not made out of the same cookie-cutter mold. Insurers have different books of business, different capacities for how much insurance they can write, and different exposures to risk. Therefore, they have different reinsurance needs. Some insurers, particularly smaller ones, have been able to pass on to consumers a direct benefit from the expansion of the CAT Fund, but many insurers have not.

The problem is that in the past few years, Florida's insurance market has fundamentally changed and become much more expensive. First, the potential costs of insuring people's homes have skyrocketed. As the Governor's Report explained, national weather services are predicting a cycle of increased severity and frequency of hurricanes in the Atlantic Ocean and Gulf of Mexico region, making Florida the "highest risk in the country for potential catastrophic losses." The cost of materials and labor for rebuilding homes also has risen considerably.

Second, the business model has changed. In the past, insurers could spread the risk of hurricanes among their many Florida policyholders and subsidize premiums through their passive investments. But, one out of six policyholders in Florida has reportedly filed a claim since 2004, which minimizes the ability to spread risk. Also, there is less passive income to offset premiums, as Wall Street rating agencies are requiring Florida insurers to invest less and keep greater cash reserves or buy more reinsurance.

The result is that Florida homeowners are now paying for much more of the cost of insuring their own homes. In fact, many homeowner's premiums still do not reflect the true costs of insurance, and their insurers have been phasing in the needed increases over time. For these insurers, lower reinsurance rates from the CAT Fund might help allay some costs, but they would not translate directly into reduced premiums.

With regard to procedural issues, seeking private lawyers to sue specific insurers improperly ignores the State's existing and powerful mechanisms for regulating the insurance industry. Homeowner insurance in Florida, as in others states, is highly regulated. The State's Insurance Commissioner licenses every insurer, approves all rates, and reviews each insurer's financial statements and accounting principles. The Florida Legislature, as shown by the many hearings it has held on this issue in the past few months, can provide significant oversight. The state Attorney General can bring a lawsuit on behalf of the state if a company engages in wrongful conduct. These taxpayer-funded watch

dogs are capable referees and already in place.

Using private litigation in place of this regulatory regime, as former United States Labor Secretary Robert Reich has said, is “faux legislation, which sacrifices democracy.” Its methods are Machiavellian: the threat of massive litigation is supposed to scare insurers to sell policies for dimes on the dollar, regardless of the actual cost of writing those policies. If the insurance industry risks its solvency to lower rates in Florida, there would be a huge risk that the insurers would not be able to withstand another 2004-2005 hurricane season.

In addition, there has been widespread concern in Florida and other states about the unholy alliances between state officials and contingency fee lawyers. In this instance, it is unclear whether Governor Crist intends for these lawyers to file lawsuits on behalf of the state or as a class action on behalf of residents collectively.

If litigation is brought on behalf of the state, the lawyers’ contingency fee will work against the residents. Lawsuits cloaked in the force and legitimacy of the State’s police power are supposed to bring credibility and a “moral authority” to a cause. The incentive for contingency fee lawyers, conversely, is to maximize their own profits. As the United States Supreme Court has stated, the government wins in litigation “when justice is done in its courts.” Its duty is not to prevail at all costs or to maximize recovery. This dichotomy between private gain and public good is the reason private lawyers do not prosecute citizens for alleged crimes and police officers are not given commissions for the traffic citations they write.

Equally troubling is a private class action on behalf of homeowners, not the state, where the lawsuit results from a Governor’s plea to private lawyers to sue. Lawsuits are to be filed on behalf of actual plaintiffs who seek redress from those who have wrongfully caused them harm. When lawsuits are created before plaintiffs walk into their lawyers’ offices, this principle is violated, whether done for private gain or political cover. A vivid example of the dangers of these lawsuits is the recent guilty plea by national class action lawyer William Lerach, who reportedly paid “clients” so that he could bring lawsuits in their names. Public officials should not contribute to this troubling practice of developing lawsuits first and finding clients later.

The danger for Florida residents is that the national insurers will respond to the litigation or threats of litigation by leaving the Florida market altogether. According to the Governor’s Report, the number of insurers writing residential coverage in Florida decreased from 225 in 1998 to 167 in 2006. Earlier this year, the *Daytona News-Journal* reported that of the 437 insurance companies licensed to issue homeowner policies in Florida, only 33 have done so. In addition, several companies that have stayed in Florida are scaling back or canceling some policies. If there was “big money” to be made, as suggested by some of the Governor’s remarks, companies would not be leaving the market, they would be entering it.

The better alternative is for Governor Crist to exercise the state’s existing power in working with the industry toward a resolution that keeps homeowner insurance affordable for both the homeowners and the insurers. The Insurance Commissioner and the state Attorney General already can review and subpoena documents to look for any improprieties. If there is no wrongdoing, they will not needlessly file lawsuits that will drain needed resources from the Florida insurance market and scare more insurers

away from the state. Governor Crist should grab this opportunity to lead his state out of this crisis and show that litigation is not an alternative to governing.

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