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Waiting for Hurricane Charlie (Crist)

All Americans will pay if Florida doesn't reform its insurance market.

Florida has been hit by some of the most damaging and costliest hurricanes in history, and we're not talking small numbers. Andrew, Wilma, Charley and Ivan inflicted tens of billions of dollars of damage on homes and businesses over the past few decades. Now the Sunshine State awaits the really big one: Hurricane Charlie (Crist).

When that storm hits, Floridians can thank the former Governor. In a mere four years, he crippled the private insurance market and socialized taxpayer risk into two public institutions: Citizens Property Insurance Corp., an insurer, and the Florida Hurricane Catastrophe Fund, a reinsurer. They are structured to fail under pressure. This is a Category Five fiscal problem that would ultimately mean demands for a Washington bailout, so the sooner Florida's policy makers fix it the better.

Start with Citizens, created in 2002 to consolidate various entities into a single insurer of last resort. Other states have these funds, but they set the prices high enough that consumers rely on the private market. Not in post-Crist Florida. In 2007, Mr. Crist championed legislation that froze Citizens's rates at 2006 rates, undercutting the private market. The law also gave Citizens the right to sell insurance to any Floridian who was quoted a rate more than 15% above Citizen's rates.

Private companies couldn't compete. State Farm, Allstate, USAA, Nationwide and others either left Florida entirely, slimmed down or stopped writing policies on the coast—where almost 80% of Florida's insured properties are located, according to AIR Worldwide, a risk modeling firm. Many Floridians had no choice but to turn to Citizens, which now controls 25% of the market, measured by revenue. It is the insurer of *first* resort

Citizens assured the state legislature last month that it is in "its best financial position ever," with "pre-event liquidity" of over $14.6 billion. That may sound hefty. But some of that money is borrowed, and the insurer itself estimates a once-in-a-100-year storm could cost upward of $22 billion. Its total liabilities are $451 billion. No storm would hit every insured house, but the possibility of a more than $22 billion event is there.

So how would Citizens pay its claims? It has three sources of primary income: premiums from policy holders, coverage from its reinsurer (more on that later) and the ability to levy "assessments," or taxes, on policy holders and every other Floridian. It's the latter ability that

Citizens counts on to top up its coffers, and that's what makes it different from a private insurer, which lives and dies by its actuarial estimates before the storm hits.

Floridians are already paying for this structure. In 2004 and 2005, eight storms hit the state. Only one private insurer went bust—and that was arguably due to poor management, not the storms. Citizens nonetheless found itself in a deficit that it is still trying to pay off. Meanwhile, Floridians now pay some of the highest insurance rates in the nation to get Citizens out of the red. And this is after five quiet storm seasons.

Then there's the state reinsurer, known as the Cat Fund. It was created in 1993 after Hurricane Andrew and was intended to be a stable source of liquidity for insurers. Private insurers and Citizens are required to buy reinsurance from the Cat Fund, and they have the option to buy more if they like, although many don't.

The Cat Fund collects premiums but these aren't nearly enough to cover its liabilities. Instead, the fund relies mostly on its ability to sell bonds to raise capital after a big event. This was always a risky strategy, but it wasn't clear how risky until the 2008 financial panic. The fund's executives slashed the estimated amount of capital they thought they could cover to $13 billion from $28 billion in 2007. A private insurer, Tower Hill, petitioned to get its premium lowered. The state denied the request.

Last October, the Cat Fund said there's still "significant uncertainty" about how much money it can raise after a hurricane. The fund has about $6 billion of cash on hand. Anything above that would have to be raised in the bond markets. Imagine if the Cat Fund had to go cap in hand for $20 billion or $30 billion, all at once. Citizens, by the way, counts on the Cat Fund for $6.4 billion worth of coverage.

Mr. Crist's unstated answer to all this was that when the big one does hit again, Washington will ride to the rescue. In other words, the real insurers of last resort for Florida beachfront property are taxpayers in Waterloo and Denver. Even today's House Republicans would find the pleas difficult to resist as TV cameras recorded the damage, especially given Florida's role as a swing state.

Add this up and it's clear that reforming Florida's insurance market is the single biggest challenge facing new Republican Governor Rick Scott. His instincts are good: On the campaign trail last year he pledged to "level the playing field so that solvent insurers are allowed to compete with each other for business, not with the subsidized and financially unsound government-run insurance company." He has started to sound out advisers about how to move ahead.

But the politics will not be easy to navigate because any reform will have to reinsert price signals into the market—meaning higher premiums for Floridians, at least in the short term, given that Florida is so often hit by hurricanes. Some Republicans may resist spending political capital to fix a problem they may not get credit for tackling if a hurricane doesn't hit on their watch. Many Democrats will oppose any changes.

Then again, Republicans will surely get blamed for premium and tax increases when a big hurricane hits. Florida voters did the country a favor when they refused to send Mr. Crist to the Senate. Now Republicans have an obligation to clean up the looming fiscal catastrophe his policies have left behind.