

More Than a Dozen Florida Insurers Facing Ratings Downgrades

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By [Amy O'Connor](#) | January 9, 2020

The rating agency responsible for assigning financial stability ratings (FSR) to more than 40 Florida domestic insurers has warned that several carriers will receive downgrades due to deteriorating conditions in the state's property insurance market, and more than a dozen more could be downgraded in the next few months.

In a letter dated Dec. 20, 2019 that was forwarded to Insurance Journal, Demotech President Joe Petrelli warned Barry Gilway, head of state-backed Citizens Property Insurance Corp., that [Gilway's hoped-for shrinking of Citizens' policy count](#) might be "more difficult than expected as Demotech would be downgrading several carriers in January, February and March 2020."

Petrelli confirmed the authenticity of the letter in an e-mail to Insurance Journal this week and said the names of the insurers facing downgrades could not be disclosed, but that Demotech expects two to four downgrades by the end of January and then another four to six by the end of March.

Petrelli said current market forces as well as carrier specific financial metrics have created a hazardous financial environment for many insurers. Though he acknowledged [reforms passed in Florida to curb abuse of assignment of benefits](#) agreements could provide some relief, Petrelli said the impact of the legislation passed in the 2019 session would be "long-term."

The head of the actuarial firm that rates the Florida insurers described what he sees happening to place ratings in jeopardy.

"The economics of the marketplace over the past several years have made it impossible for Demotech to sustain each of the Florida focused carriers that we review each quarter at a [FSR] of A, Exceptional," he said.

Petrelli said that after Demotech reviewed the third quarter 2019 financials of carriers, it requested year-end projections of operating results for nearly half of the 40-plus carriers it reviews and rates.

"Having provided these carriers with ample time to implement revised business models, secure capital infusions, implement rate revisions, re-underwrite established books of business and utilize other enterprise risk management activities, it is apparent that few have returned to profitability," Petrelli wrote.

He noted that as many as 18 out of the 40 plus companies Demotech reviews “will not produce a level of pre-tax profitability consistent with sustaining an FSR at the A level nor position themselves to do so in the near term.”

Petrelli cited several factors that have affected the financial stability of carriers in the Florida market over recent years, including:

- Insurer investor capital appears to be exiting rather than entering Florida.
- A “burdensome” level of holding company debt and the interest of that debt that was infused to support growth, permit the strengthening of loss and loss adjustment expense reserves without a diminution of surplus, or otherwise support the implementation of business models, given the operating results, e.g. losses, of carriers that had to address the natural disasters of 2016 through 2019.
- The rising cost of reinsurance in in 2019.
- The cumulative impact of carrier acceptance of rate revisions at a percentage change that eliminates the time, effort and expense for a hearing and decision, i.e., less than 15%, has had a cumulative impact over the past several years. Rates are below where they should be because companies have taken smaller than needed rate increase, according to Demotech.
- Judicial decisions that Demotech says have revised the claim settlement landscape.
- The revised rules of engagement for claims settlement, as set by the judiciary, have had an undue impact because the natural disasters of 2016, 2017, 2018, and the hail and tornadoes of 2019, have increased the number of claims that could be subject to the new rules of engagement.

The letter was also forwarded to the Florida Office of Insurance Regulation, which confirmed its receipt. The regulator would not comment on the current state of the Florida insurance market but said “Florida is one of the most complex insurance markets in the world. OIR is closely and consistently monitoring the financial condition and operational results of the state’s domestic property insurers. As always, OIR engages in regulatory activities to protect consumers.”

Gilway, who also confirmed receipt of the Demotech letter to Insurance Journal, said Citizens is a state-run insurer and has no regulatory authority over private insurers, though it pays close attention to the market.

“We will continue to closely monitor market conditions and are ready to perform our residual duties if called upon to do so,” he said in a statement.

Jeff Grady, president and CEO of the Florida Association of Insurance Agents (FAIA), noted that Demotech [has issued similar warnings of ratings downgrades](#) before and not followed through, but added “There is no doubt the financial results of Florida’s domestic property market were abysmal in the third quarter.”

He said if these trends continue and a significant number of carriers are downgraded by Demotech, other interest groups including realtors and bankers will also be significantly impacted and quickly become part of the larger group searching for a solution.

Florida Insurer Financial Troubles, Slow Creep of Market Losses

Conditions in the Florida insurance market have been well-publicized over the last year as [rising losses from AOB claims](#) led to higher insurance rates and a tightening of coverage in several regions of the state, particularly in south Florida.

Despite the reforms passed last year, many of these claims could take years to resolve and will still have an impact on insurer losses in the short-term, thus leading to a continued increase in policyholder rates.

Just last month, Florida's Edison Insurance Co. was subject to a rate hearing by the state for a 21.9% rate increase it requested for policies with a Feb. 1, 2020 and March 1, 2020 effective date. Representatives with the company told regulators they would have needed a 38% rate increase without the reforms.

In addition, observers say [several years of major hurricanes](#) and a "loss creep" from those claims have also challenged insurers in recent months and may be inhibiting domestic insurers' ability to properly pad their books.

A June 2019 report [from AM Best on the state of the Florida insurance market](#) said hurricane losses, AOB issues, and adverse loss reserve development have created a difficult market for insurers.

Hurricane Irma losses have increased steadily, Best said, due in part to the social inflation brought on by AOB issues as well as rising loss adjustment expenses such as claims investigation costs.

"This loss creep is taking the form of unfavorable adverse development, which is hurting insurers' performance," Best said.

According to the report, several carriers, including the top five publicly traded Florida insurers (United Insurance, FedNat, Heritage, Universal and Homeowners Choice) have reported adverse development related to Hurricane Irma, "considerably increasing ultimate loss estimates since impact," Best said.

The report also noted claims from Hurricane Michael appear to be taking a "similar, though less severe, trajectory," with several carriers increasing ultimate loss estimates as more time passes.

These losses appear to be dampening the appetite of reinsurers upon which Florida-focused companies have grown to rely, the report states.

"Rising reinsurance costs have the potential to pressure some of the more thinly capitalized Florida-specific companies in the market," Best said.

"The higher reinsurance costs may give way to greater use of insurance-linked securities and alternative risk transfer mechanisms such as catastrophe bonds," Best said. "Insurers will look to

expand their programs to include more cost-effective options to expand capacity and provide both company and policyholders with adequate protection.”

Insurers mostly blame litigation from first party lawsuits, particularly on water damage claims, for the increase in their losses.

In its rate hearing, Edison Insurance representatives said while new reforms are limiting claims with an AOB attached, they are not limiting first party lawsuits.

Ryan Purdy, Merlino & Associates principal and consulting actuary who was assigned to the Edison filing, told regulators that the frequency of the insurer’s water damage losses without an AOB increased 56% over a three-year period, and severity of those claims that were represented by an attorney increased by about “four-fold.” The company said it currently receives about a thousand first party lawsuits a year.

“While there’s great optimism about how House Bill 7065 will improve the claims environment of the state, it cannot be said with great certainty at this point in time what specific value these savings might be given these uncertainties,” Purdy said.

Citizens President & CEO Gilway [highlighted the Florida insurance market issues](#) during the insurer’s December board of governors meeting. He cited third quarter underwriting losses of \$378 million for Florida insurers, which represent 79% of the Florida market, and a negative net income of \$137 million. He said these losses could have an impact on any efforts to further reduce Citizens’ policyholder count, which the insurer plans to try to do this year.

“The market impact [of losses] is a continuation of increased rates – rates [increases] are being filed consistently on a monthly basis ranging from 3% to the 14.9% allowed for automatic approval by OIR,” he said. “These rates are absolutely necessary to overall stability to the marketplace.”

The result of these market changes will make Citizens a more competitive insurer in the overall Florida marketplace as Citizens cannot statutorily keep pace with the same level of rate increases as the private market, he noted. Citizens is required by state law to submit a slate of actuarially sound rates to OIR annually for approval while complying with a legislative glide path that caps rate increases at 10 percent, excluding coverage changes and surcharges. Last year Citizens [submitted an overall 8.2% rate increase](#) that it [later amended to 2.3% after the AOB reform law was passed](#).

“Citizens is operating in a difficult market environment today. Virtually all companies continue to be impacted by excessive litigation that is clearly resulting in major financial issues in the market and more recently by increased reinsurance pricing,” Gilway said at the meeting.

Where to Go From Here?

In the long-term, Demotech said several steps could be taken for carriers to improve their financial stability, including:

- Submission to OIR of a well-documented and thorough filing to “true up” their reinsurance costs.
- A marked and immediate decrease in the interest rate applicable to the accumulated debt in their holding company
- Securing actuarially sound rates at the earliest possible date
- Access to sufficient capital to move loss and loss adjustment expense reserves to an adequate level.

However, Petrelli said Demotech acknowledged that these options would take time to implement. In the meantime, Demotech downgrades of so many domestic carriers could have a catastrophic effect on thousands of Florida policyholders, as many mortgage lenders typically require an insurer hazard rating of ‘A’ on homeowners insurance policies.

Petrelli noted that its FSR rating of ‘S’ is acceptable by some in the insurance sector and said he has previously contacted Fannie Mae and Freddie Mac to revise their insurer hazard insurance rating requirement for Demotech from an FSR of ‘A’ to ‘S’, but to date the matter is still under consideration.

The Federal Association for Insurance Reform (FAIR) said in a press release it is “deeply concerned” about the operating results of Florida-based insurance companies, and said it has heard from many policyholders affected by the recent insolvencies of [Florida Specialty Insurance Co.](#) and [Windhaven Insurance](#).

“Under certain circumstances, policies issued by downgraded insurers may not comply with federally backed mortgage requirements. Policyholders, insurance agents, lenders and realtors will be scrambling to find insurers acceptable in the mortgage market. This may also result in policies being transferred to government-owned Citizens Property Insurance Corporation, which is not a great option for the state or policyholders,” FAIR stated.

The association noted it also expects fourth quarter 2019 financial data will result in additional operating losses beyond the dollar amounts already reported.

“Absent substantive legislative reforms to fully curb market distortions specific to Florida, significant double-digit rate increases will become commonplace, adversely impacting every aspect of Florida’s otherwise vibrant economy,” FAIR said.

Florida insurance advocates like FAIR are hoping the state legislature will provide some relief to the Florida insurance market when the session begins next week.

“Legislative action can favorably impact both the frequency and need for rate increases in Florida’s residential homeowners insurance market. FAIR is asking state regulators and legislators to develop and pass balanced and meaningful reforms to provide relief to Florida’s policyholders,” the statement said.

Florida State Senator Brandes, who is a member of the Florida Senate Banking & Insurance Committee, clearly has the Florida insurance market on his mind. In response to FAIR’s

statement, Brandes tweeted, “The most underreported issue going into session is the rapidly declining condition of Florida’s insurance market.”

Gilway said Citizens will evaluate all proposals aimed at addressing market issues as they become available during the 2020 legislative session.

OIR said to Insurance Journal it will continue to work with the governor, Florida Cabinet and Florida Legislature this upcoming session and beyond to “promote a stable and competitive insurance market for consumers.”

Update: This story has been corrected to reflect an earlier assertion that “dozens” of Florida insurers faced ratings downgrades.