The Florida Market: Bracing for the Next Big Event

The Florida marketplace has faced numerous challenges over the last several years, and insurers are now bracing for another hurricane season. In recent years, a number of pressures have stressed operating performance, capital strength, and overall business opportunities for companies focused on the Florida property market. Many consider hurricanes the largest threat for this market, but assignment of benefits (AOB) has also had a pervasive, negative impact for many carriers. Hurricane losses, AOB issues, and adverse loss reserve development have created a difficult market that now appears to be dampening the appetite of reinsurers on whom Florida-focused companies have grown to rely.

A CAT Called AOB

For several years, the Florida property insurance market has been plagued by underhanded behavior that has led to elevated loss and litigation costs (“social inflation”), higher insurance rates, and shifting coverage availability throughout the state. The strained insurance environment has been stoked by the influential and commonly misguided use of AOBs in Florida. Some contractors have solicited the transfer of rights from insureds and subsequently inflated repair costs (primarily water-related), all the while using the legal system to their advantage. Most notably, these contractors benefitted from the one-way attorney fee rule that requires insurers to bear the litigation costs of both parties, should judgement go against them even if by an insignificant amount. The practice led to insurers often contending with situations of insufficient information as work was completed before an inspection was conducted or with contractors calling for more repair than what insurers felt was necessary. The negative impact worsened steadily and attempts from legislators to pass meaningful regulation to mitigate the situation often stalled.

The strain led to an environment marked by significantly higher losses and loss adjustment expenses, depressed insurer operating performance, and adverse loss reserve development patterns, leading to the need for insurers to file considerable rate increases, which unfavorably affected insureds. Per the Florida Office of Insurance Regulation’s (OIR) most recent AOB Data Call issued in January 2018 (based on 2017 data), the combined impact of changes to frequency and severity since 2015 has resulted in an average 42.1% increase in water losses each year, with southeast Florida the worst affected.

Furthermore, according to the Insurance Information Institute, homeowner property filed AOB lawsuits increased to 19,253 in 2018 from 2,852 in 2013. Exhibit 1 illustrates the collective loss experience for carriers with at least $1 million of direct Florida property premium written representing at least 50% of their total direct book. The population is made up of 59 single entities, although some belong to larger groups. Florida property includes homeowners, commercial multi-peril (non-liability), and fire and allied lines. The incurred direct defense and cost containment (DCC) expense ratio has increased considerably, to 8.3% in 2018 from 1.6% in 2009, likely due, at least in part, to litigated AOB claims. The direct loss incurred ratio increased steadily from 2014 to 2016, during which AOB losses were becoming more apparent, and then jumped significantly in 2017 and 2018 owing to hurricane losses.

Analytical Contact:
Chris Draghi, Oldwick
+1 (908) 439-2200 Ext. 5043
Chris.Draghi@ambest.com

Contributors:
Michelle Baurkot, Oldwick
Sam Hanig, Oldwick

2019-100
Compounding the impact for insureds has been the changing availability of insurance in certain sections of the state, as insurers rebalanced their geographic distribution based on declining appetites for areas more prone to the AOB issue. As availability in these areas shrank, Citizens Property Insurance Corporation became a more prominent option, which led to some stagnation in the depopulation efforts of years past. As Exhibit 2 illustrates, the depopulation of Citizens has waned significantly in recent years, but the slight uptick in the entity’s policies in force in the last few years suggests some policies are reverting back.

Moreover, independent agents have also been affected, given that agent compensation is often tied to performance-based commissions. Poor policy performance from AOB-related claims has created an environment that has not only stressed agents’ income, but has made it more difficult to serve customers, as agents must adhere to more stringent underwriting restrictions.

In response to the growing pressures, and in advocating for consumers’ well-being, several members of the Florida Association of Insurance Agents marched on the state capitol in March, calling for change. A month later, the calls for reform were heard, with approval of House Bill 7065 and Senate Bill 122. Governor Ron DeSantis signed the house bill into law on May 23, with all provisions to take effect on July 1, except for the prevailing attorney fee provision. As part of House Bill 337, signed May 24, the attorney fee provision came into effect when the bill was signed. This provision was added to House Bill 337 in response to concerns about a potential rush of AOB claims prior to the July 1 effective date.

What Does the New Law Mean for the Insurance Market?
Several changes about the use of AOBs, as well as the treatment of related litigation fees, are intended to dissuade bad actors from unjustly benefitting from rules meant to improve market efficiency. The bill outlines the rights afforded to the assignor, the assignee, and the insurer about proper use, notification, and enforcement. Among other provisions, it requires that the assignor be allowed to rescind the assignment without penalty, and mandates a copy of the agreement be sent to the insurer in an appropriate timeframe, as well as an initial

Exhibit 1
Florida Direct Writers’ Loss Experience

![Exhibit 1: Florida Direct Writers’ Loss Experience](chart)

Notes: Insurers with at least $1 million of direct Florida property premium, for which direct Florida property premium constitutes at least 50% of the total direct book. Property defined as Homeowners, CMP Non-Liability, Fire and Allied Lines.
Source: AM Best data and research
itemized estimate for services to be performed, in addition to a written notification of terms of the assignment for the assignor to review. The bill also establishes the responsibility of the assignee to cooperate with insurers’ claims investigations, provide up-to-date estimates about the scope of work, submit to examinations under oath, and participate in appraisal or other alternative dispute resolutions, depending on the insurance policy.

Specifically targeting the inequitable use of the one-way attorney fee rule as it relates to these cases, the bill also establishes a payment scale that determines which party is responsible for what fees based on the deviation between the pre-suit settlement offer and judgement obtained. When the difference is less than 25% of the disputed amount, the insurer is entitled to an award of fees; when it is greater than 25% but less than 50%, no party is awarded fees; and when the difference is 50% or more, the assignee is entitled to fees. Furthermore, the bill requires that assignees notify the assignor and insurer of his or her intent to file suit and provides time for an insurer to respond with a pre-suit settlement offer, request alternative dispute resolution, and inspect the property.

Finally, the bill establishes the right of insurers to offer policies that restrict the use of AOBs in whole or in part but require the restricted policies to be offered at a lower cost. In accordance with these changes, the bill prohibits Citizens from implementing rate changes unless they reflect perceived savings from the new regulation. Citizens recently announced it would lower its proposed statewide capped rate hike to 2.3% from 8.4% for homeowner policyholders, and other insurers may follow.

**AOB Reform Should Benefit Operating Performance and Loss Reserve Development**

Overall, the bill addresses several issues regarding the AOB epidemic and could materially improve operating performance and loss reserve development as they relate to the issue. Much of the bill addresses the need for more open communication and enforcement of responsibilities for all parties involved. Requiring assignees to provide accurate estimates and be subject to examinations under oath aim to deter those with ill-advised intentions while at
the same time outline the correct course of action for legitimate cases. An emphasis on pre-suit settlements seeks to diminish the need for litigation and speed up cycle times. Finally, allowing insurers to offer a restricted policy will enable them to offer the same coverage at a reduced cost to policyholders that do not find assignments attractive or worth the extra premium, thus passing the potential savings to the market and creating more affordable insurance.

Although passage of the legislation is a step in the right direction, AM Best is cautiously optimistic about its impact on insurers over time. Whether there are any loopholes in the law that can be exploited remains to be seen. Also, given the market dynamic, insurers have come to expect approval of significant rate increases, but with the passage of these bills, such increases may no longer be as easily obtained, as regulators expect consumer relief. Just how much relief will be realized remains uncertain, and expectations of more moderate rate changes in the near term may be disproportionate. There is concern that, in the short term, insurers may over-estimate the benefit of the reform in their pricing.

Additionally, although the law takes effect on July 1 and the attorney fee schedule is already effective, many claims still remain in process. These claims may take considerable time to settle and rates may continue to reflect the associated adverse impact until all open claims roll off. Furthermore, the bill specifically addresses the treatment and use of AOB-related matters; it does not address non-AOB claims. As a result, the one-way attorney fee rule still applies to those suits that do not include an assignment and may still burden insurers. Regardless, the bill goes a long way in addressing the immediate needs of the market and is expected to benefit the operating performance of Florida-specific property writers and the market as a whole.

**Extensive Loss Creep from Hurricanes Irma and Michael**

Hurricanes have also negatively affected the Florida property market, most notably Irma and Michael. At the most recent data calls, the OIR estimated the insured loss impacts of Hurricane Irma at $11.1 billion (as of November 2018) and of Hurricane Michael at $6.6 billion (as of May 2019). These estimates are based on reported claims, which have been rising.

The ultimate loss for Hurricane Irma has increased steadily in what has become known in the market as “loss creep”: the unanticipated growth in hurricane losses due in part to the social inflation brought on by AOB issues as well as rising loss adjustment expenses (such as claims investigation costs) in Florida. This loss creep is taking the form of unfavorable adverse development, which is hurting insurers’ performance. 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. Hurricane Michael appears to be taking a similar, though less severe, trajectory with several carriers increasing ultimate loss estimates as more time passes.

Hurricane Michael was the fourth Category 5 hurricane to make landfall—the last being Hurricane Andrew in 1992—and ranks as one of the three most intense storms to ever hit Florida; both storms rank in the top 10 based on US damage. With regard to the upcoming hurricane season, the National Oceanic and Atmosphere Administration (NOAA) predicts a near-normal season, with a likely range of nine to 15 named storms, of which four to eight could be in the form of hurricanes, two to four being Category 3 or higher. Colorado State University also predicts an average Atlantic hurricane season with 14 named storms, including six hurricanes, two of which may reach Category 3 or higher.
Given the prolonged period of benign weather activity leading up to these recent hurricanes and a favorable reinsurance market, several Florida-specific property insurers were formed, capitalizing on ideal conditions. Several of these carriers participated in Citizens’ depopulation efforts, transforming the state’s insurance market from one weighted towards national carriers to domestic carriers, based on written premium. National carriers’ risk appetite for the hurricane-prone state declined following the 2004 hurricane season, and newly formed carriers enjoyed several years of advantageous weather patterns before being challenged by hurricane and AOB losses. Exhibit 3 shows the leading direct writers of Florida property based on market share (covering homeowners, commercial multi-peril (non-liability), and fire and allied lines).

The Florida property book for 17 of the 23 carriers that have a market share equal to or greater than 1% (based on property parameters) constitutes roughly 75% or more of each carrier’s total direct book. This group accounts for approximately 56% of the direct Florida property premium. These statistics emphasize that the top writers of direct Florida property business have considerable concentration risk in the state, which includes both natural catastrophe and social inflation risks. Legislation may provide some relief for AOB losses but the risk of...
a hurricane is part of Florida’s risk profile. Catastrophes have strained earnings, but many insurers were able to survive the hits, albeit through significant reinsurance protection, which eased some uncertainty that relatively new companies might not be able to withstand their first encounter with a hurricane.

Reinsurance Pricing Is Rising

Prior to these recent events, reinsurance pricing had been favorable and many carriers built comprehensive reinsurance programs to mitigate their catastrophe risk. However, just as quickly as insurers were able to exhale following the recent AOB reform bills, many are facing another hurdle—rising reinsurance prices. The soft pricing to which many had become accustomed is shifting to a firmer market, driven apparently by changing views of risk and altered appetites. The cost benefit of doing business in Florida has changed considerably due to the higher frequency of severe weather, as well as rising loss costs attributed to AOB and litigation issues in the state.

Exhibit 4
Florida Direct Market: Reinsurance Dependence, 2018

<table>
<thead>
<tr>
<th>AMB#</th>
<th>Company Name</th>
<th>AMB Group Name</th>
<th>Best’s ICR</th>
<th>Rating</th>
<th>Policy-holders’ Surplus</th>
<th>Florida Property DPW as a % of Total DPW</th>
<th>Unaffiliated CPW/GPW</th>
<th>Unaffiliated CPW/PHS</th>
</tr>
</thead>
<tbody>
<tr>
<td>010672</td>
<td>Florida Specialty Insurance Company</td>
<td>...</td>
<td>nr</td>
<td>...</td>
<td>16,610</td>
<td>100.00%</td>
<td>107%</td>
<td>608%</td>
</tr>
<tr>
<td>014386</td>
<td>Weston Insurance Company</td>
<td>...</td>
<td>bb</td>
<td>Stable</td>
<td>43,075</td>
<td>81.03%</td>
<td>94%</td>
<td>190%</td>
</tr>
<tr>
<td>013848</td>
<td>Olympus Insurance Company</td>
<td>...</td>
<td>nr</td>
<td>...</td>
<td>30,060</td>
<td>99.38%</td>
<td>91%</td>
<td>477%</td>
</tr>
<tr>
<td>012201</td>
<td>First Protective Insurance Company</td>
<td>...</td>
<td>nr</td>
<td>...</td>
<td>64,080</td>
<td>74.76%</td>
<td>86%</td>
<td>559%</td>
</tr>
<tr>
<td>012686</td>
<td>St. Johns Insurance Company, Inc.</td>
<td>...</td>
<td>nr</td>
<td>...</td>
<td>46,038</td>
<td>93.92%</td>
<td>85%</td>
<td>588%</td>
</tr>
<tr>
<td>013934</td>
<td>People’s Trust Insurance Company</td>
<td>...</td>
<td>nr</td>
<td>...</td>
<td>77,844</td>
<td>100.00%</td>
<td>75%</td>
<td>212%</td>
</tr>
<tr>
<td>013007</td>
<td>Florida Peninsula Insurance Company</td>
<td>Florida Peninsula Group</td>
<td>nr</td>
<td>...</td>
<td>97,948</td>
<td>99.98%</td>
<td>66%</td>
<td>154%</td>
</tr>
<tr>
<td>014120</td>
<td>Prepared Insurance Company</td>
<td>...</td>
<td>nr</td>
<td>...</td>
<td>21,088</td>
<td>99.74%</td>
<td>64%</td>
<td>189%</td>
</tr>
<tr>
<td>010124</td>
<td>Gulfstream Property and Casualty Ins Co</td>
<td>Gulfstream Insurance Group</td>
<td>nr</td>
<td>...</td>
<td>30,395</td>
<td>67.11%</td>
<td>63%</td>
<td>321%</td>
</tr>
<tr>
<td>011716</td>
<td>Frontline Insurance Unlimited Company</td>
<td>...</td>
<td>nr</td>
<td>...</td>
<td>26,003</td>
<td>76.65%</td>
<td>60%</td>
<td>63%</td>
</tr>
<tr>
<td>020229</td>
<td>Safepoint Insurance Company</td>
<td>...</td>
<td>bb</td>
<td>Stable</td>
<td>45,567</td>
<td>92.73%</td>
<td>59%</td>
<td>216%</td>
</tr>
<tr>
<td>020566</td>
<td>Independent Specialty Insurance Company</td>
<td>Market Corporation Group</td>
<td>a+</td>
<td>Stable</td>
<td>52,339</td>
<td>52.55%</td>
<td>59%</td>
<td>76%</td>
</tr>
<tr>
<td>013765</td>
<td>American Integrity Insurance Co of FL</td>
<td>...</td>
<td>nr</td>
<td>...</td>
<td>74,658</td>
<td>99.85%</td>
<td>58%</td>
<td>247%</td>
</tr>
<tr>
<td>002277</td>
<td>Omega Insurance Company</td>
<td>Tower Hill Group</td>
<td>nr</td>
<td>...</td>
<td>14,934</td>
<td>99.77%</td>
<td>57%</td>
<td>250%</td>
</tr>
<tr>
<td>013990</td>
<td>American Platinum P &amp; C Insurance Co</td>
<td>Universal Insurance Holdings Group</td>
<td>nr</td>
<td>...</td>
<td>15,973</td>
<td>100.00%</td>
<td>56%</td>
<td>22%</td>
</tr>
<tr>
<td>012203</td>
<td>Capitol Preferred Insurance Co, Inc.</td>
<td>...</td>
<td>nr</td>
<td>...</td>
<td>40,521</td>
<td>63.53%</td>
<td>56%</td>
<td>269%</td>
</tr>
<tr>
<td>022283</td>
<td>Anchor Property &amp; Casualty Insurance Co</td>
<td>Anchor Insurance Group</td>
<td>nr</td>
<td>...</td>
<td>25,045</td>
<td>99.99%</td>
<td>55%</td>
<td>149%</td>
</tr>
<tr>
<td>012359</td>
<td>Tower Hill Prime Insurance Company</td>
<td>Tower Hill Group</td>
<td>a-</td>
<td>Negative</td>
<td>118,799</td>
<td>85.60%</td>
<td>54%</td>
<td>151%</td>
</tr>
<tr>
<td>013077</td>
<td>Edison Insurance Company</td>
<td>Florida Peninsula Group</td>
<td>nr</td>
<td>...</td>
<td>21,050</td>
<td>100.00%</td>
<td>54%</td>
<td>240%</td>
</tr>
<tr>
<td>013312</td>
<td>Tower Hill Signature Ins Co</td>
<td>Tower Hill Group</td>
<td>nr</td>
<td>...</td>
<td>49,674</td>
<td>97.08%</td>
<td>53%</td>
<td>146%</td>
</tr>
<tr>
<td>012719</td>
<td>Tower Hill Select Insurance Company</td>
<td>Tower Hill Group</td>
<td>nr</td>
<td>...</td>
<td>19,995</td>
<td>99.68%</td>
<td>53%</td>
<td>231%</td>
</tr>
<tr>
<td>012713</td>
<td>Universal Insurance Co of North America</td>
<td>Universal Insurance Group of Puerto Rico</td>
<td>nr</td>
<td>...</td>
<td>34,560</td>
<td>72.49%</td>
<td>52%</td>
<td>204%</td>
</tr>
<tr>
<td>011468</td>
<td>Security First Insurance Company</td>
<td>...</td>
<td>nr</td>
<td>...</td>
<td>88,585</td>
<td>100.00%</td>
<td>52%</td>
<td>243%</td>
</tr>
<tr>
<td>010600</td>
<td>Tower Hill Preferred Insurance Company</td>
<td>Tower Hill Group</td>
<td>nr</td>
<td>...</td>
<td>42,079</td>
<td>99.74%</td>
<td>51%</td>
<td>122%</td>
</tr>
<tr>
<td>013307</td>
<td>American Capital Assurance Corp</td>
<td>...</td>
<td>a+</td>
<td>Stable</td>
<td>61,056</td>
<td>87.33%</td>
<td>50%</td>
<td>72%</td>
</tr>
</tbody>
</table>

Notes: ICR=Issuer Credit Rating; DPW=Direct Premium Written; CPW=Ceded Premium Written; GPW=Gross Premium Written. Insurers with $1 million or more of direct Florida property premium, for which direct Florida property premium constitutes 50% or more of total direct book and unaffiliated ceded premium written represents 50% or more of gross premium written. Property defined as Homeowners, CMP Non-Liability, Fire and Allied Lines. Source: AM Best data and research
As a result, reinsurers are holding their ground with higher reinsurance costs, which are intended to reflect the unfavorable trend in loss experience. Several sources have reported an average increase in reinsurance costs of 15% to 20%, with even higher increases for the more loss-affected insurers. The change in pricing is likely to be much more individualized than in years past, as reinsurers place greater emphasis on performance, loss development, program mix, and quality of risks. Recent AOB reform may very well help reverse some of the unfavorable trends, but, given the timing, it is unlikely to have a material impact on this year’s renewal period.

The higher reinsurance costs may give way to greater use of insurance-linked securities and alternative risk transfer mechanisms such as catastrophe bonds. 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. The Florida Hurricane Catastrophe Fund (FHCF) also influences how much privately placed reinsurance is needed. Several carriers have elected to increase their participation rate with the FHCF, with more opting for 90% participation, as the cost is more desirable than what is currently being offered by reinsurers.

The FHCF offers the market a limited amount of protection based on prorated premium. As more insurers opt for higher participation rates, the FHCF’s resources are spread more thinly, resulting in less available protection for some and increasing the support needed from private reinsurers to maintain appropriate levels of catastrophe protection. Still, recent regulation increased the loss-adjusting expenses reimbursed by the fund to 10% from 5%, in consideration of growing litigation costs. The increase affords some relief to the reinsurance layers surrounding the FHCF that would have otherwise been subject to losses.

Rising reinsurance costs have the potential to pressure some of the more thinly capitalized Florida-specific companies in the market. Because of inherent hurricane risk, Florida property writers spend a considerable amount on reinsurance, given the necessity to purchase prudent catastrophe reinsurance programs. Exhibit 4 lists the companies that have a direct Florida property book of at least $1 million, for which the Florida book...
constitutes at least 50% of the carrier’s total book, and unaffiliated ceded premium written
constitutes at least 50% of gross premium written. Of the 25 listed insurers, the unaffiliated
ceded premium written constitutes at least 50% of policyholder surplus for all but one, and 21
have a ratio over 100. Unaffiliated ceded premium is reflective of private market reinsurance
dependence.

Exhibits 5a and 5b show unaffiliated ceded premium written as percentages of gross
premium written and of policyholder surplus for all companies with $1 million of direct
Florida property premium that represents at least 50% of the total direct book. These charts
do not cap the cession percentage and therefore include a larger population consisting
of 59 insurers. The large numbers illustrate the considerable dependence Florida-centric
property writers have on reinsurance and highlights concerns about pricing sensitivity.
Rising reinsurance costs can diminish potential earnings and strain operating performance.
Companies with stronger risk-adjusted capital or flexible reinsurance programs (such as the
use of multi-year reinsurance contracts) will be better prepared to face any significant changes
in reinsurer pricing or appetite.

Insurers may feel the need to adjust built-in assumptions and underwriting guidelines, as they
did with AOB, to diminish their exposure or increase rates in order to mitigate reinsurance
costs. In either case, recent concerns about coverage availability and insured premium rates
may not subside, as elevated reinsurance costs for a number of carriers replace AOB pressure.

Not all insurers feel the same pressure, however, as in the case of one sizeable player that
recently announced a material rate cut for homeowners. Whether other well-positioned
carriers will be able to do the same remains to be seen, but the dynamic may create a more
competitive environment in the near term, which may allow some participants to capitalize on
the existing landscape.

Flood: An Emerging Opportunity and Emerging Risk
Despite recent adverse activity in the Florida market, insurers must continuously evolve
and look for new opportunities, whether to capitalize on underserved markets or expand
capabilities to create more efficient operations. Strategic initiatives will be necessary to benefit
future operations and foster a more effective competitive position.

One underserved market that has been gaining more attention is the private flood sector. The
private flood market has been growing in recent years, as insurers have started to develop a
better understanding of flood patterns, and modelers have developed more sophisticated tools
to measure risk. There is also a growing need for more competitive and widely available flood
products aside from the government-sponsored National Flood Insurance Program (NFIP), as
its permanence and funding remain in flux. Reform that would extend the NFIP for five years
recently passed the House Financial Services Committee and has moved to the full House for
review.

According to the OIR, 31 entities have been approved to write primary flood business, and
six have been approved to write excess of NFIP. Direct private flood premium in Florida has
increased 67.8% since 2016, to $79.7 million in 2018. These numbers are slightly distorted
as they count individual companies that are part of the same insurance group, but they
nonetheless show the magnitude of growth that has taken place in recent years. Private flood
expansion provides additional capacity and options to homes that are not required to purchase
flood protection but are still at risk, which remains a concern, and represents a viable market.
Technology Continues to Improve the Claims Process
As technology continues to advance, so does the opportunity for insurers to capitalize on improvements, and the Florida insurance market is no exception. The claims process has been improving with new technology that has enabled policyholders to report claims through mobile devices, quickly sending video and pictures of damage to speed up cycle times. Mobile devices have also strengthened insurers’ loss mitigation efforts with pre-event notifications as well as post-event communications, to help guide affected insureds through the claims process. Aerial imagery has helped companies identify risks that may have been impacted by severe events through pre- and post-event image comparison.

Overall, the claims process in Florida has been improving; one could speculate that AOB pressures prompted innovative efforts to quickly interact with insureds and avoid third-party manipulation. Whether that is the case or not, the end result is a smoother and more satisfying claims process for some insureds. Risk mapping software has also become more sophisticated, with the ability to incorporate per-risk reinsurance costs and other granular characteristics to estimate exposure and accumulations. Furthermore, machine learning has made predictive modeling and pricing more effective with improved loss cost assumptions based on advanced processes, with a better alignment of rate to risk.

Rating Implications
Although the subject of this report is Florida-focused entities rated by AM Best, the same issues affect the Florida market as a whole. Issues of late have been related primarily to operating performance, as most companies in this market struggled to turn an underwriting profit in the wake of hurricanes and elevated water-related losses. AOB reform has the potential to subdue some of the recent operating performance pressure, but insurers will need to remain cautious when developing pricing and setting reserves based on realistic assumptions of improvement.

At the same time, an increase in reinsurance costs has the potential to counter relief and to narrow profit margins, as insurers pay more to maintain appropriate levels of reinsurance protection. For entities that are more thinly capitalized, the increase in reinsurance costs could lead to changes in the reinsurance program that could unfavorably impact risk-adjusted capitalization.

The AM Best review process includes an examination of the impact of severe weather events across various return periods. Should changes in reinsurance costs drive some entities to purchase less reinsurance, probable maximum losses (especially in tail events) may increase and weaken risk-adjusted capitalization. Ratings will continue to reflect the management of hurricane exposure and concentration risk, as recent years have highlighted the considerable risk in the territory. Reinsurance has served to absorb the bulk of losses but changes to program retentions and layers can lead to balance sheet strength considerations, which differ from recent operating performance pressures. Insurers may look to alter risk appetites with the intent of minimizing pressure on their balance sheet strength and operating performance.

The rating process also includes an evaluation of enterprise risk management (ERM) for each company. AM Best holds regular, comprehensive conversations to assess how Florida-specific insurers manage risks, especially with regard to the probability of a hurricane. All rated entities should demonstrate their sound understanding of geographic distributions and risk accumulations. Sophisticated pre-event modeling is common in preparing for expected losses and books of business are regularly reviewed and adjusted to manage exposure.
Reinsurance programs have been developed to handle significant events and proved useful for the hurricanes of 2017 and 2018. Currently, all of the rated Florida property-specific entities are assessed as having appropriate ERM programs commensurate with their risk profiles. AM Best will continue to monitor their positions as risk management tools and processes continue to evolve to capture emerging risks. The assessment includes consideration for how well a company’s ERM aligns with its expected and actual performance.

The Florida insurance market has proved challenging, with a revolving door of issues stemming from an increase in the frequency of hurricanes, to sinkhole losses of years past, to more recent AOB activity. Although regulation can take considerable time to pass, the state legislature has proven responsive to pressures. Issues in Florida have forced carriers to remain nimble in strategy and proactively manage several forms of risk, with rising reinsurance costs potentially being the next event on the horizon. AM Best will continue to monitor the state of the Florida property market and the impact it has on rated entities.