

## **With Less Reinsurance for Reinsurers, Prices Set to Rise Again for Florida Carriers**

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It has been three weeks since Hurricane Ian struck Florida on Sept. 28, 2022. The storm took at least [119](#) lives and caused estimated insured losses [ranging](#) from \$31 billion to \$74 billion, with most estimates in the \$60 billion neighborhood. These damages exceed those caused by any other U.S. natural catastrophe, with the exception of Hurricane Katrina.

Above and beyond the tragic ongoing personal and economic hardship wrought, Ian will leave a troubling legacy in Florida's insurance and real estate markets. Prior to Ian, homeowners insurance premium for Floridians was already [three](#) times the national average. The state's property insurance market was [already faltering](#) and under extreme stress, with half a dozen insurance carriers in the state declaring insolvency in 2022 alone.

And this is just the beginning. The storm's aftermath will cause insurance rates to increase, rendering insurance coverage so out of reach that Florida home values will drop for want of buyers.

At the core of these rising insurance rates is the shrinking availability and affordability of reinsurance.

### **Reinsurance is insurance bought by insurance companies**

Reinsurance acts as a shock absorber in the insurance industry by assuming risk above and beyond what insurance companies are willing to bear.

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Insurance companies buy one type of reinsurance—excess of loss reinsurance—to set a cap on the most they are willing to pay out in claims from a major loss event. When losses burn through this maximum, insurers pay losses up to its maximum limit (the retention), and the rest is ceded to reinsurers. Without reinsurance, insurers' face existential threats from catastrophes such as Ian, so they transfer a portion of their risk to the reinsurance industry to protect their capital base. Insurance, at its heart, is the

management and assessment of risk, and reinsurance allows insurers to measure and account for more of it.

In locations where there is a significant risk of natural catastrophe loss, such as in Florida, insurers buy more reinsurance protection. The Florida insurance market is unique in that many of its insurers are small-to-medium-sized insurers based in the state that plug the gap left by national insurers who limit their Florida business because of the state's outsized risk. These Florida-only or Florida-mainly insurers are called "[take-out companies](#)" because they were established to take business away from the state-run insurer, Citizens Property Insurance Corporation (Citizens), which is the insurer of last resort. This means that if an individual cannot get insurance from any other Florida insurers, Citizens is their final option.

The average Florida take-out insurer cedes close to [two-thirds](#) of its premium and risk to reinsurers. This means that Florida insurers are very heavily dependent on availability of reinsurance. If the supply of reinsurance shrinks, or prices increase, insurers have to account for that market change, often meaning that homeowners must pay more for property insurance.

Additionally, reinsurers are careful not to bear too much Florida risk. Individual reinsurers will only take on a small portion of an insurer's risk, requiring insurers to cede risk to multiple reinsurers. For example, the Florida [take-out](#) insurer American Integrity, which writes less than a half billion dollars of premium, cedes business to 41 reinsurers.

### **Reinsurers grow skittish**

In the aftermath of Hurricane Ian, [Swiss Re](#), one of the world's largest reinsurers, is [cutting](#) back on its Florida exposure, raising rates and paying less commission to its insurer partners. Because the reinsurance market is largely driven by supply and demand, a drop in the supply of reinsurance capacity at the same time that demand for reinsurance grows is a formula for inexorably higher rates, passed on to insurers—and passed on in turn to insurance buyers or homeowners seeing premium increases.

Another reinsurance development contributing to scarcer and more expensive insurance premiums is the damage Ian caused to the [Florida Hurricane Catastrophe](#)

Fund (FHCF). The FHCF was created in November 1993 during a special legislative session a year after Hurricane Andrew. Its purpose is to serve as an additional source of reinsurance capacity for Florida insurers. The FHCF is one of the largest reinsurance partners for Florida insurers. At year end 2021, the FHCF had a fund balance of approximately \$11.3 billion. If Ian's losses prove sufficient enough to wipe out the FHCF's limits—which they may be according to a recent insurance industry analyst's report—Florida insurers will be hard put next year to find the reinsurance capacity they so desperately need. This means that when the next catastrophe hits the state, further crisis in the insurance market will follow, increasing rates, collapsing insurers and worse.

### **When reinsurers buy reinsurance**

Even reinsurers need reinsurance protection to avoid too much risk accumulation at any one location. Reinsurance for reinsurance companies is called retrocessional reinsurance. One of the largest providers of retrocessional reinsurance is Berkshire Hathaway's National Indemnity Group. The Berkshire company is cutting back renewing its retrocessional business with its reinsurance clients. If reinsurers cannot replace this lost capacity elsewhere, the decline in retrocessional capacity supply from one of the largest providers will mean reinsurers may bear more risk, and raise their rates—with the increase reflected in higher homeowner insurance premiums.

### **Some good news**

The bleak landscape of the Florida insurance market, with rising costs for consumers, potential insolvencies at some take-out companies and evaporating reinsurance capacity, also features some bright spots. First, the industry is sufficiently capitalized to absorb a \$60 billion loss. What is more, two government insurance providers, state-run Citizens and the federal National Flood Insurance Program (NFIP), have prudently purchased sufficient reinsurance to protect their balance sheets. Citizens is expected to pay out approximately \$2.5 billion in Ian claims. It has over \$7 billion in capital, so its balance sheet can sustain the loss payments. After first dipping its toe in the reinsurance markets several years ago, the NFIP now secures significant reinsurance

capacity from the traditional reinsurance market as well as from the insurance linked security (cat bond) [market](#).

### **Litigation, not insurance, drives Florida's insurance woes**

There is one way to offset the inevitable rise in Florida homeowner's insurance rates caused by higher reinsurance costs. The answer is a head-on attack at the root cause of Florida's insurance woes – excessive litigation. Florida's insurance woes stem from a man-made crisis rooted in excessive, unjustified litigation. Florida's broken insurance market is caused by a liability crisis. Uniquely in the United States, Florida is home to excessive volumes of homeowner insurance litigation, so much so that although Florida has 9 percent of the nation's homeowner insurance claims, it has [79 percent](#) of the nation's homeowner insurance litigation. Insurance risk modeling firm Karen Clark & Company [estimates](#) that over a quarter or more of Ian losses will be litigation-related.

Florida must address this crisis once and for all to strip out the unnecessary load from unjustified litigation. To do this, it must enforce the reforms enacted in this spring's [special legislative session](#) and put an end to contractors and attorneys engaging in unscrupulous practices and unjustified litigation. With reinsurance market forces driving higher rates, the only way to restore affordable premiums is to end the state's out-of-control litigation. Reinsurance supply and demand factors will be a headwind for insurance rates. But if the liability epidemic is addressed once and for all, it can be a tailwind to counter the impact of costlier reinsurance.