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No major storms have socked Florida for a few years now, but the residential property insurance market does not appear to be benefitting from that lack of catastrophes.

State Farm Florida is still negotiating with regulators on the best way for it to leave the property market altogether. Nationwide Insurance Company of Florida recently said it needs to drop another 60,000 policies to reduce exposure. Over the past six months, two domestic insurers -- American Keystone and First Commercial Insurance Co. -- have been ordered into liquidation and another, Hollywood, Fla.-based Coral Insurance Co., is being run by the state as part of a process to start liquidation.

Insurance Commissioner Kevin McCarty has said that of the 210 writers with a significant presence in the residential market, 102 posted underwriting losses based on second-quarter filings and 60 saw declines in policyholder surplus.

The industry said there are at least five major drivers behind difficulties in the marketplace:

#### Mitigation Discounts

State Farm Florida filed to end these mandated discounts given to homeowners who hurricane-proof their homes because of the drain they cause on the company's bottom line but it was denied (BestWire, Aug. 6, 2009). Insurers are "slowly bleeding" because of the way they are required to give the credits to homeowners, said James Graganella, chief executive of Capitol Preferred Insurance Co. and Southern Fidelity Insurance Co. Companies can lose up to 90% of the wind rate after discounts, he said.

"These credits were not created in a truly scientific way," said Roger Desjadon, chief executive officer of Florida Peninsula Insurance Co. "The intention was good but it really amounts to giving away premium."

Allstate spokesman Nick Halliwell said the company is experiencing the same pressures as others and that it is awaiting a study on the mitigation discounts by the Florida Commission on Hurricane Loss Projection Methodology.

#### Sinkholes

Chris Neal, State Farm spokesman, said sinkhole claims are a "monumental cost driver." Robert Ritchie, president and CEO of American Integrity Insurance Group, said the average legitimate sinkhole claim costs \$130,000. Even if a company does not pay a sinkhole claim, it still costs \$7,000 to \$12,000 for engineer and geological studies, Ritchie said. Comparably, Graganella said his company paid an average \$8,500 on claims from hurricane losses in 2004.

"If there is spider cracking in the cement of a foundation, you can get someone to call it a sinkhole and file a claim," said Desjadon. "You are obligated to investigate, so you're spending money even before you determine if there's a loss."

Neal said there is another wrinkle in the sinkhole saga. Home sellers are filing claims because they know insurers must investigate. In the end, they get a professional report to show potential buyers at the insurer's expense.

#### Reinsurance

"The problem here is you're at the knees of reinsurers worldwide and when something occurs in the financial market, they lose surplus and it affects us," said Graganella, who said his reinsurance rates increased 10%. New laws are meant to make it easier for insurers to recoup the costs with rate filings but insurers say a change is needed. Rates are not approved quickly enough and many insurers have suggested a file-and-use system to more adequately adjust rates.

"I haven't had either of my rate requests approved," said Graganella. "There has to be a better rate adjustment system to respond to the reinsurance market."

Liberty Mutual spokesman Glenn Greenberg said the company still has a filing before the commissioner. The company has looked to reduce cat exposure by nonrenewing 3.5% of Florida policies this year. "We need adequate rate and we need to responsibly manage our exposure," he said.

#### Fraud/Inflated Claims

Desjadon said his company has seen an "awful lot of claims that are suspicious in nature recently." Neal said activity at State Farm's investigative unit continues to increase but that is "not unusual in a recession." Fraud and/or inflated claims allegations by insurers exist with the mitigation discounts and sinkhole claims, especially with public adjusters, they say.

#### Replacement Cost

The problem here is simple: Insurers can no longer offer actual cash value for repairs to homes, but must tender full replacement cost value. The law was changed after the 2004-05 hurricane seasons. Neal said the factor changes insurers' pricing models. Ritchie said there has been some "gaming of the system," resulting in an escalation of frequency and severity.

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