ISSUE BRIEF

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FLORIDA'S PRIVATE RESIDENTIAL FLOOD INSURANCE MARKET

Brett Lingle and Carolyn Kousky[1]

This Issue Brief draws on our recent report, *The Emerging Private Residential Flood Insurance Market in the United States.*[2]

FLORIDA'S FLOOD RISK

With millions of properties located in high flood risk areas,[3] Florida homeowners are extremely vulnerable to flood damage. As sea levels rise and coastal development continues, that risk is escalating. The Union of Concerned Scientists estimates that in the next thirty years, 64,000 Florida homes, representing about $26 billion in property value, are expected to be at risk of chronic tidal flooding – that is, flooding at least 26 times per year on average.[4]

It is no surprise then that Florida is the largest flood insurance market in the country and home to roughly 35% of National Flood Insurance Program (NFIP) policies nationwide. Yet despite the 1.7 million Florida households with NFIP coverage, a large and persistent flood insurance gap remains: many households at risk of flooding do not have flood insurance. For example, FEMA estimates that as of February 2018, the residential flood insurance market penetration rate in Florida's 100-year floodplain is on average 46%. This is in the area where flood insurance is mandatory for residents with a federally-backed mortgage. Outside the 100-year floodplain – where flood coverage is not required but households may still be at risk – take-up is much lower.

KEY FINDINGS

- Florida has the largest private residential flood insurance market in the country, but the vast majority of flood policies are still written by the NFIP. Despite recent growth, the private sector accounts for just 3% of all policies in the state.
- Florida has actively encouraged growth of the private market by implementing rules and regulations that make it easier for insurers to offer private flood policies.
- Until 2025, insurers are allowed to file flood rates on an informational basis only, enabling them to adjust prices in response to new information. Insurers we spoke with said the freedom to set and change rates was influential in their decision to enter the admitted market.

[1] Lingle is Senior Research Coordinator and Kousky is Director for Policy Research and Engagement at the Wharton Risk Management and Decision Process Center at the University of Pennsylvania.
[2] Available online at https://riskcenter.wharton.upenn.edu/wp-content/uploads/2018/07/Emerging-Flood-Insurance-Market-Report.pdf.
[3] See https://www.insurancejournal.com/news/national/2017/12/06/473276.htm
[4] See https://www.ucsusa.org/press/2018/new-study-finds-1-million-florida-homes-worth-351-billion-will-be-risk-tidal-flooding#.W3q3AOhKiCh

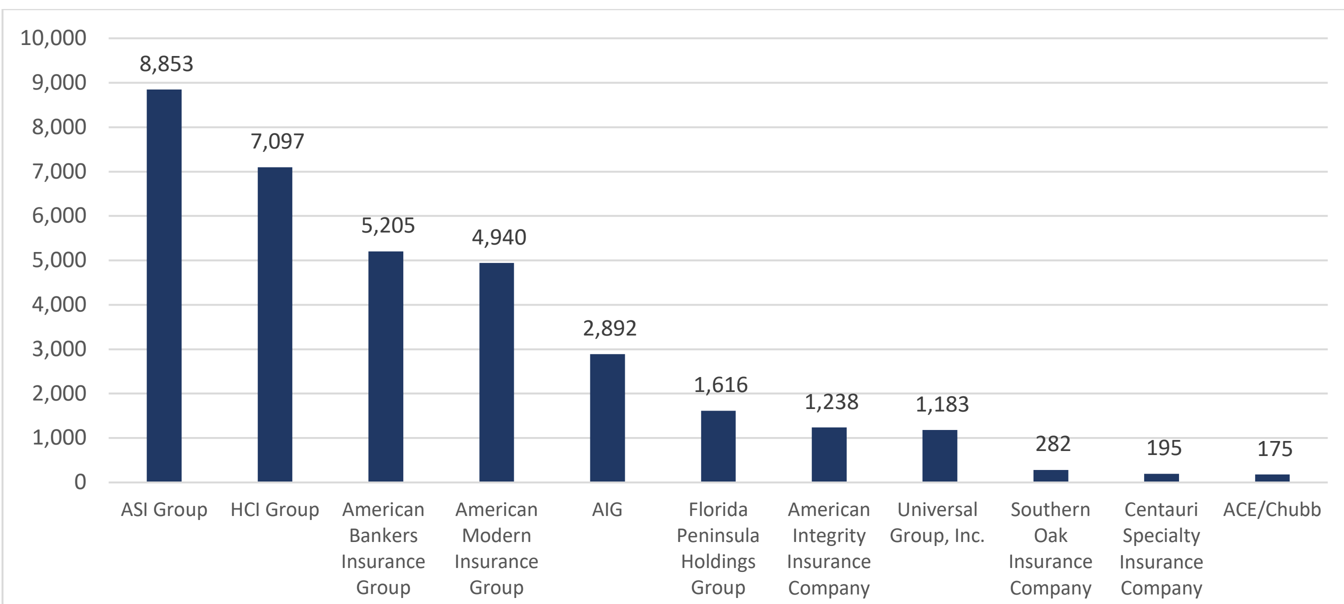
For the last fifty years, the NFIP has largely been homeowners' only option for flood insurance. In the last few years, however, a small private market has emerged and policymakers are increasingly interested in whether its expansion could increase the number of homeowners with flood insurance and whether it could offer more affordable coverage. Similar to its dominance in the NFIP market, Florida currently has the largest market for private residential flood insurance in the country. This issue brief describes the Florida market and the measures the state has taken to support its growth.

STATE OF THE MARKET

There are more private flood carriers active in Florida than in any other state. As of July 2018, there were 29 admitted insurers offering primary residential flood insurance in the state, up from 20 in December 2017 and 16 in December 2016. There are also many managing general agencies (MGAs) in Florida that offer flood coverage through the non-admitted market (also known as the surplus lines or excess and surplus (E&S) market).[5]

The Florida Office of Insurance Regulation provided admitted companies' unaudited, voluntarily reported flood insurance data from April 2018. The data show that the state's admitted insurers had 33,676 primary and 5,983 excess private residential flood insurance policies in force as of that date. Primary policies offer flood coverage independent of the NFIP, whereas as excess policies provide additional coverage above the NFIP residential cap of $250,000. These polices were written by eleven insurance groups and individual insurers throughout Florida.[6] Figure 1 provides a breakdown of the number of private primary policies in force by group/company.

FIGURE 1. POLICIES WITH ADMITTED PRIMARY RESIDENTIAL FLOOD INSURANCE WRITERS, APRIL 2018



Source: Company data voluntarily reported to the Florida Office of Insurance Regulation; the data have not been audited.

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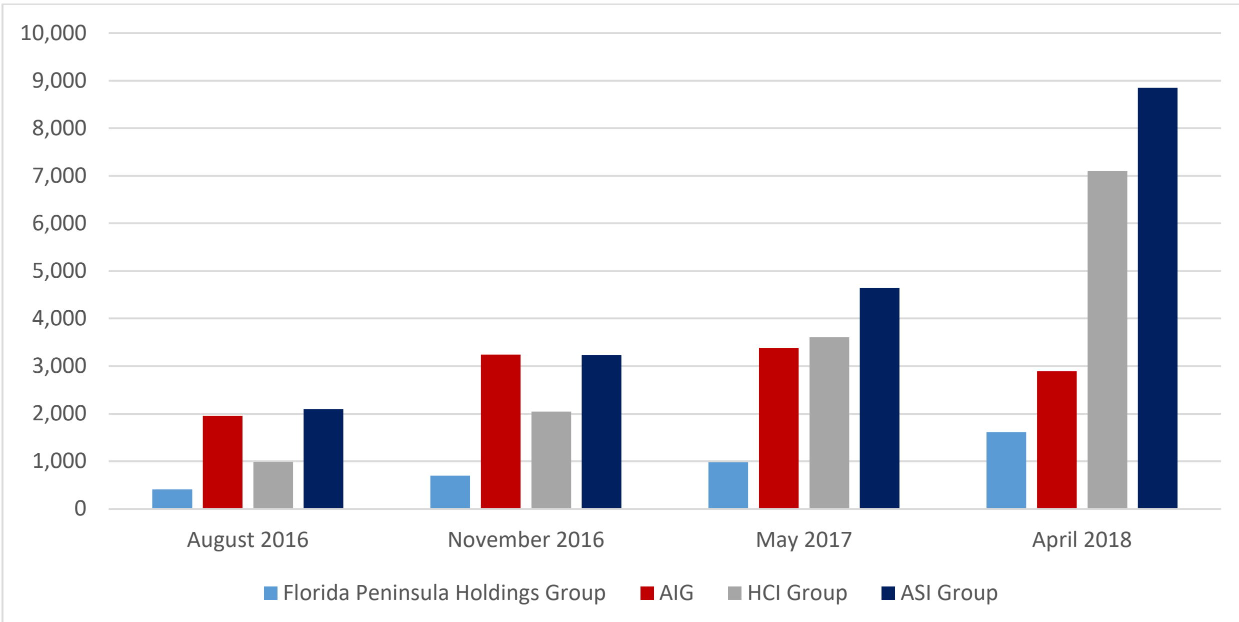
[5] Admitted insurers' rates and forms are regulated by the states. Non-admitted insurers have rate and form freedom but are still subject to solvency and market conduct requirements. For more details on the differences between admitted and non-admitted insurers, see our issue brief, Structure of the Residential Flood Insurance Market, available online at: https://riskcenter.wharton.upenn.edu/wp-content/uploads/2018/08/Market-Structure-IB-1.pdf

[6] Insurance groups such as AIG Group and ASI Group consist of subsidiary insurance companies, some of which may offer private flood insurance. For example, in ASI Group, American Strategic Insurance Corp., ASI Preferred Insurance Corp., and ASI Select Insurance Corp., all offer private flood. Individual insurers are single companies that offer private flood coverage; they are not part of a larger group of companies. For example, Southern Oak Insurance Company is an individual insurer.

While these numbers are modest in comparison with the state's 1.7 million NFIP policies, the private residential market has grown quite rapidly. This is shown for select companies for which data was available for several years in Figure 2. Most companies saw yearly growth in policy counts. Some firms saw major jumps in 2018; only AIG saw a slight dip, which may be attributable to additional firms entering the market. So far, these firms have paid claims on 366 flood policies at a 39% loss ratio.

FIGURE 2. FLORIDA'S ADMITTED PRIMARY POLICY COUNTS FOR SELECT COMPANIES



Source: Company data voluntarily reported to the Florida Office of Insurance Regulation; the data have not been audited.

Florida insurers offer both standalone flood policies – individual insurance products that provide coverage for a single peril – and endorsements to homeowners policies which allow an insured to add flood coverage to their homeowners insurance for an additional premium. Florida has collected data on whether admitted carriers offer endorsements or stand-alone policies. For admitted carriers, the majority offer endorsements, with one also offering stand-alone policies and just one only offering a stand-alone product. Table 1 lists the policy types for companies offering flood insurance as of May 2017. This table echoes the broader finding nationwide that admitted carriers are more likely to offer endorsements.

There is also a robust E&S flood market in Florida. Data from the Wholesale & Specialty Insurance Association (2017)[7] show that the number of primary residential E&S flood policies in Florida grew by 500 percent in a single year, from roughly 4,900 in 2016 to more than 24,400 in 2017. The E&S policies, however, are still less than 2 percent of all residential flood in Florida; the NFIP remains the overwhelmingly dominant provider. Of the 16 E&S products we identified, we found that Lloyd's of London backs 13 (more than 80 percent). One was backed by Hiscox, one by Lexington, and one was jointly backed by Lloyd's and Liberty.

[7] See https://www.wsia.org/docs/PDF/Legislative/Surplus%20Lines%20Market%20Data%20and%20Statistics%201-24-17%20w%20attachement.pdf.

TABLE 1. POLICY TYPES OFFERED BY FLORIDA ADMITTED WRITERS

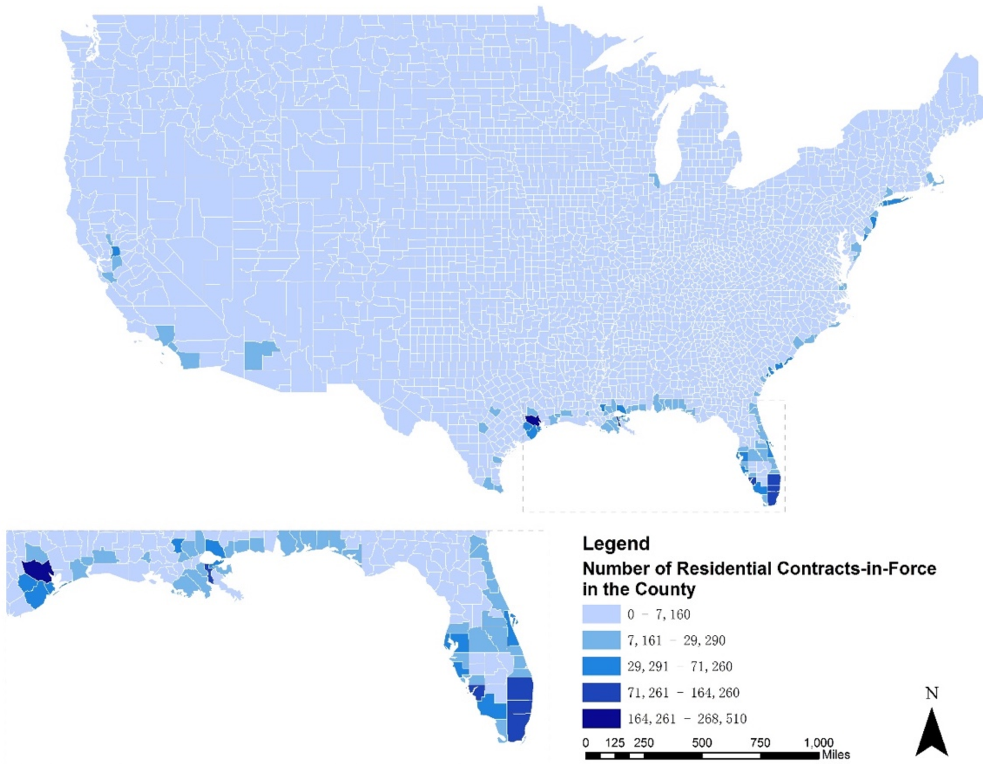
Group or insurer	Endorsement	Stand-alone
ACE/Chubb		✓
AIG	✓	
American Bankers Insurance Group	Mobile homes only	
American Integrity Insurance Company of Florida	✓	
American Modern Insurance Group	Mobile homes only	
ASI Group	✓	
Centauri Specialty Insurance Company	✓	
Florida Peninsula Holdings Group	✓	
HCI Group	✓	✓
Southern Oak Insurance Company	✓	
Universal Group, Inc.	✓	

Source: Florida Office of Insurance Regulation

Including both the E&S and admitted markets, there are more than 58,000 private primary residential flood policies across Florida. With that total, there are more private residential flood policies in Florida than there are NFIP policies in 35 different states including Alabama, Pennsylvania, Illinois, and Washington.

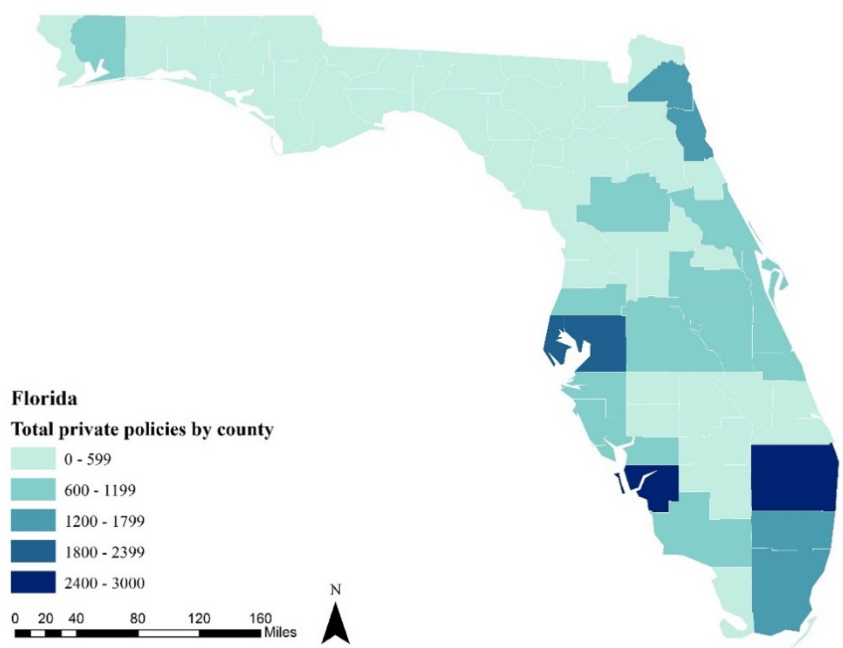
As with the NFIP, private policies are concentrated mostly in highly populated coastal counties, such as Palm Beach, Pinellas, and Miami-Dade. Figure 3 shows the number of NFIP residential contracts in force nationwide; the concentration of policies in Florida counties is evident. Figure 4 shows the number of private policies by county in Florida, and Figure 5 shows the percent of all flood policies that are private. The counties with the highest portion of private policies tend to be sparsely populated counties in the panhandle such as Liberty, Gadsden, and Hamilton counties, where there are very few flood policies at all. For example, 54% of Liberty County's 43 total policies are private. And of the 264 flood policies in Gadsden County, nearly 50% are with private carriers. In contrast, Palm Beach County is home to 2,859 private flood policies (the most of any county in the state), but these account for just 1.9% of the 150,120 policies countywide.

FIGURE 3: NFIP CONTRACTS IN FORCE NATIONWIDE, FEBRUARY 2018[8]



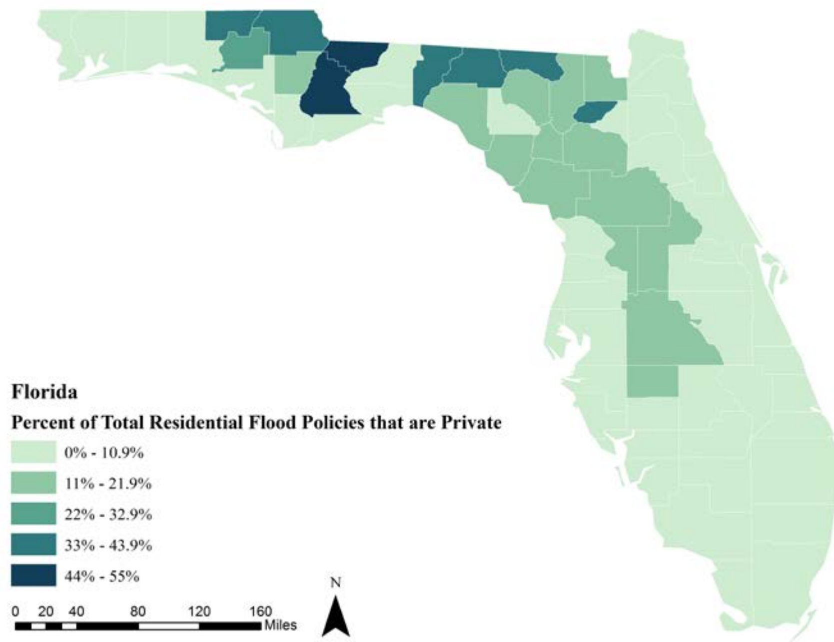
Source: Map produced with data from FEMA.

FIGURE 4: NUMBER OF PRIVATE FLOOD POLICIES BY COUNTY, APRIL 2018



[8] FEMA differentiates between contracts in force and policies in force for multi-unit structures. An insured structure counts as one contract in force, but if that structure has multiple units that are covered under one contract, each unit is counted as a policy. So, for example, a 50-unit condominium building is one contract but 50 policies.

FIGURE 5: PERCENTAGE OF PRIVATE FLOOD POLICIES BY COUNTY, APRIL 2018



Source: Maps produced with data from the Florida Office of Insurance Regulation.

ENCOURAGING MARKET GROWTH

Insurance is regulated at the state level. Each state has its own regulator, procedures, and requirements; this may be a hurdle for admitted companies trying to enter the private flood market. States regulate the rates and forms of admitted carriers, and we heard insurers voice concern that regulators privilege price stability, sometimes making it difficult to adjust prices and underwriting in response to new information such as new claims or damage data from a major flood event. This is problematic for a new line, such as flood, where there is low confidence in the models, little claims experience, and uncertainty about rating.

Another concern is how states treat catastrophe models. Many stakeholders point to the development and increasing availability of flood catastrophe models as a driver of the private flood market because they enable insurers to better evaluate and price flood risk. However, when admitted companies use models to price and underwrite insurance, those models are subject to the scrutiny of state regulators, who have authority to review and approve insurance rates. Multiple interviewees told us that state regulators are often uncomfortable with "black-box" catastrophe models, posing a challenge for rating catastrophic perils.

Florida has aimed to address these challenges and stimulate growth of the state's private residential flood market. In 2014 the state passed S.B. 542,[9] which enabled companies selling private flood policies to set and change rates on an informational basis only (i.e. without regulator approval). This makes it easier for a company to adjust pricing in response to new information. Our interviews with Florida insurers suggest that this policy has been effective. For example, Tower Hill, a prominent homeowners insurer in Florida, first entered the private flood insurance market by

[9] See https://www.flsenate.gov/Session/Bill/2014/0542/?Tab=BillText

offering a surplus lines product for which it could set and change rates without state approval. After gaining some experience with private flood and experimenting with rate setting, the company entered the admitted market in May 2018 by adding an optional flood endorsement to its homeowners policies. According to Tower Hill's president, the freedom to set and change rates was influential in the company's decision to enter the admitted market. In 2017, the Florida Legislature extended the use of informational rate filings to 2025.[10]

S.B. 542 also aims to provide greater clarity on the use of flood catastrophe models in rate-making. The bill directs the Florida Commission on Hurricane Loss Projection Methodology, an independent panel of experts that develops standards and evaluates hurricane models, to review and develop standards for flood models as well. Because flood insurance rates and the modeling methods used to develop them are not currently subject to state approval, admitted insurers can use flood models at their discretion. The Commission first issued standards in November 2017 and will begin reviewing flood models in December 2019.

The bill also made it easier for consumers to get flood insurance through the surplus lines market by removing the state's diligent search requirements. In most states, insurance laws and regulations require agents to make a "diligent" effort to place risks in the admitted market before turning to a surplus lines carrier. This generally means that a risk must be denied by three or more admitted insurers before it can be placed with a surplus lines carrier. S.B. 542 lifted this requirement, allowing Florida consumers to directly access the surplus lines market for residential flood coverage.

Finally, the bill aims to help consumers understand the consequences of switching to private flood by requiring agents to notify policyholders that they could lose NFIP rate subsidies if they later return to the NFIP. It also allows the insurance commissioner to provide certification that private policies meet or exceed NFIP coverage, making it easier for mortgage lenders to accept private policies.

LOOKING FORWARD

As an increasing number of homeowners face escalating flood risks, Florida's private flood insurance market is positioned to play an important role in closing the flood insurance gap. Its role to date has been unclear as there is no data to examine how many homeowners previously uninsured against flood are purchasing private policies versus how many are switching from the NFIP.[11] In many places, however, the private sector is making cheaper and broader coverages available and previously uninsured consumers may be more willing and able to pay for these products than they are for an NFIP policy. On the other hand, there is also concern that private firms shy away from some of the riskiest areas and may drop consumers after experiencing a loss.

Private firms are finding different niches in the emerging residential market. Some are targeting low-risk areas, for example, and others, high-risk areas. Some offer policies with high limits and expansive coverages, and others, limited products for homeowners in areas unlikely to see catastrophic flooding. If such product diversity continues, the private sector could be in a position to better match insurance to consumers' needs and preferences.

State regulations, most especially the ability to set and change rates in response to new information, will be an important determinant of how many households the private sector is willing to insure at a price that consumers are willing and able to pay. Residential flood insurance providers currently have rate and form freedom, but Florida's nascent private flood market has yet to be seriously tested. In response to a major flood event, insurers will be able to raise rates and not

[10] See https://www.flsenate.gov/Session/Bill/2017/00813/?Tab=BillText

[11] Insurers in the market believe their portfolios include both newly insureds and policyholders switching from the NFIP.

renew certain policies. Depending on insurers' response to such an event and the impacts on consumers, policymakers may change course and more strictly regulate insurers' rate setting and underwriting practices if they believe the consumer protection is needed. This would likely dampen insurers' eagerness to enter the market and expand their books of business. In that case, the private market may contract as consumers go without flood insurance or turn to the NFIP where coverage is guaranteed. Disasters are difficult for the private market to insure and floods are no exception. The growth in Florida may suggest a new division of public and private roles in flood risk management.

ABOUT THE WHARTON RISK CENTER

Established in 1985, the **Wharton Risk Management and Decision Processes Center** develops and promotes effective corporate and public policies for dealing with catastrophic events including natural disasters, technological hazards, terrorism, pandemics and other crises. The Risk Center research team – over 70 faculty, fellows and doctoral students – investigate how individuals and organizations make choices under conditions of risk and uncertainty under various regulatory and market conditions, and the effectiveness of strategies such as alternative risk financing, incentive systems, insurance, regulation, and public-private collaborations at a national and international scale. The Center actively engages multiple viewpoints, including top representatives from industry, government, international organizations, interest groups and academia.

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3819 Chesnut Street, Suite 130, Philadelphia, PA 19104 ~ https://riskcenter.wharton.upenn.edu/