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Paige St. John of *Sarasota Herald-Tribune*

For her examination of weaknesses in the murky property-insurance system vital to Florida homeowners, providing handy data to assess insurer reliability and stirring regulatory action.

SARASOTA
Herald-Tribune

Lee C. Bollinger, President of Columbia University, presents the 2011 Investigative Reporting prize to Paige St. John of the Sarasota Herald-Tribune.

WINNING WORK

February 28, 2010

Weak insurers put millions of Floridians at risk ()

By Paige St. John

Millions of Floridians now bet their homes on property insurers that teeter on the edge of financial failure, a Herald-Tribune investigation has found.

These companies look nothing like the Allstates and State Farms that insure the rest of America -- legacy carriers that command bankrolls the size of small nations.

Instead, because State Farm and Allstate are fleeing Florida, a growing number of homeowners get their insurance from tiny, untested companies that have a few million dollars in the bank but insure billions worth of property they could never hope to rebuild on their own.

No one knows what will happen when the next big storm strikes Florida shores. But the signs are not promising.

Over the past year, without having to weather a single hurricane, Florida led the nation with a half-dozen property insurance failures. For the first time, state regulators openly warn that more failures will come, even if a storm does not.

The Herald-Tribune spent more than a year examining Florida's property insurers, tracing the ownership of more than 70 companies through shell corporations and reviewing the financial filings of each. It found:

- One in three privately insured Florida homeowners relies on insurers that exhibit one or more signs of financial risk.
- More than 100,000 homeowners relied on companies barely capable of paying for house fires, let alone hurricanes. These insurers' reserves come so close to the state's $4 million minimum requirement that they operate with only a few hundred thousand dollars of their own to pay claims.
- During the 2009 hurricane season, at least 38,000 Florida homes were insured by companies state regulators knew would fail. Homeowners were not told until after hurricane season, when one company was shut down and the other had to sell.
- Lawmakers and regulators have ignored warnings and encouraged private companies to stretch their limited cash further. They have pushed companies to insure more and more homes without increasing the money set aside to pay claims, a practice that put state residents farther out on a limb.

Larger dangers loom. Despite rising property values, one in three Florida carriers has decreased the cash set aside for storms.

The Florida-only carriers that provide the majority of hurricane coverage in this state now stretch their limited cash nearly twice as far as they did before 2004. They do it by buying a form of backstop insurance, called reinsurance, that is supposed to kick in and prevent insurers from failing when major catastrophes strike.

But insurers still must have their own money to pay what amounts to a deductible. And after every storm they need cash to operate and pay claims until they can collect on their backstop policies.

Experts point out that even companies with the best reinsurance policies can fail if they experience cash-flow problems.

In simplest terms, the average Floridian with a $350,000 house is insured by a company with less than $750 in hand to pay for that home. By contrast, the average carrier had $1,300 in 2003.

That same year, Allstate and other well-funded insurers had nearly $4,000 banked for the same risk.

"It is the Florida Ponzi Scheme," said Miami agent Phil Lyons, secretary of the Independent Insurance Agents of South Florida.

Regulators, insurance executives and industry lobbyists argue that the system, perhaps flawed, is all that Florida has to fill the yawning hole left by the mass exodus of national insurers.

"What were the options?" asked Sam Miller, vice president of the Florida Insurance Council, the industry's largest trade group in the state. "I don't think any other plan would have worked."

Yet among insurance insiders there is unease and growing alarm.

"There should be bells and whistles going off everywhere," said Jeff Grady, president of the Florida Association of Insurance Agents, where chasing down rumors of failing insurers has become the trade group's recent obsession.

"On the surface it may appear things are OK, but below the surface, things are really troubling."

WHY UPSTART INSURERS DOMINATE IN FLORIDA

Beginning with Hurricane Andrew in 1992 and accelerating after Katrina in 2005, Florida's property insurance market changed dramatically.

State Farm and Allstate, combined protectors of one-third of Florida homeowners before 2004, led a wave of withdrawals, followed by Nationwide, USAA, Hartford and Travelers.

In their place arose what insurance expert Robert Klein, director of the Center for Risk Management and Insurance Research at Georgia State University, calls the "Florida-zation of cat risk."

These are the insurance companies that only do business in Florida, taking an all-or-nothing gamble on the state's weather.

In 1992, these concentrated risk-takers insured just 6 percent of Florida. Today, including the Florida-only subsidiaries of national insurers, they cover 71 percent.

Insurance, historically, has been an industry built on huge reserves. Firms amass a foundation of capital, then risk that money by promising to repay homeowners in the event of losses.

Profits, historically, came from the interest earned on the money that sits waiting to be paid out.

All that has changed. In Florida, insurers are now risk-brokers, players with relatively little money and a lot of leverage. In place of huge cash reserves, they have reinsurance -- essentially insurance policies for insurance companies -- that pays off in a major disaster. Those policies are so costly that most companies have little money left to build reserves.

Reinsurance enables fast growth. Instead of building up a company slowly by amassing enough surplus to write more policies, new insurers can pledge a portion of future premiums and instantly take on thousands more customers and billions more dollars in hurricane risk.

The formula has helped springboard start-up insurers into multibillion-dollar enterprises in months. But it has crashed others just as quickly, putting thousands of Florida homeowners at risk.

Even in 2000, before the explosion of single-state carriers in Florida, A.M. Best, the nation's oldest financial rating company, issued a report warning that the state was growing companies without the financial depth to survive a single hurricane, let alone the state's average of 2.5 a year.

It accused Florida, paying these new companies to assume policies from the state insurance pool, of handing the riskiest properties to "thinly capitalized, opportunistic insurers."

NOT ENOUGH MONEY TO PAY OFF HOUSE FIRES

Miami businessmen Alexander Anthony and Albert Fernandez sold their security guard business to launch Northern Capital Insurance Group.

They rocketed from $476,000 in revenue in 2006 to more than $95 million by 2008, adding a second carrier, Northern Capital Select, in the process.

Last September, Inc. Magazine heralded the company as "America's Fastest Growing Private Company."

The award came with publicity and a congratulatory letter from Gov. Charlie Crist, thanking the carrier for its phenomenal growth.

But the meteoric rise also came at great risk, mostly to customers.

State records show the group has the most concentrated roll of the dice in all of Florida.

Three of every four policies written by the companies were in a 143-mile stretch of the Atlantic coast -- Miami to Palm Beach -- that presents the single greatest hurricane threat in all of America. For as far back as the records go, a Category 1 storm has rolled ashore here at least every four years.

The exposure of these two insurers during the 2009 hurricane season was twice that even of Citizens Property Insurance, the state-run company that covers homes deemed too risky by other insurers. Six other Florida carriers are in the same boat, carrying greater concentrations of risk in Miami than Citizens does.

"It scares me. I fear when the next storm comes. I fear if it lands anywhere near here," said Dulce Suarez-Resnick, a Miami agent who is past president of the Latin American Association of Insurance Agencies.

While Northern Capital Select had the highest concentration of hurricane risk in Florida, it also had the least amount of money.

Northern Capital Select's financial statements and reinsurance contracts show that in 2009 it was operating with barely a $300,000 cushion above what it needed to meet state solvency requirements -- not even enough to cover a handful of house fires.

The larger Northern Capital had greater assets, but also more risk, leaving it at the start of 2009 just above what state laws required for its exposure.

The problems started when the company was formed. Under the old business model of property insurance, the Northern Capital companies would have needed more than $130 million set aside to meet state requirements for the value of homes they insured in Florida.

They did it with less than $20 million.

The companies bridged the gap by buying huge amounts of reinsurance from overseas investors willing to gamble against a storm. According to third-quarter financial statements, the carriers by September 2009 spent $64 million of the $94 million in premium they collected buying that protection.

Between what the insurers paid for reinsurance and what they paid in other overhead costs, contracts filed with regulators show, there was not enough money left to pay claims.

The constant losses destroyed reserves. By last September, Northern Capital Select barely met the state solvency requirement.

But regulators did not warn consumers about the risk.

Instead, the agency in August secretly prepared an order placing the company under administrative supervision.

While Northern Capital basked in the glow of its Inc. Magazine publicity and hit the financial markets hoping to raise $12 million, OIR sought to require the company to buy more reinsurance and stop writing new business in Miami-Dade, Broward and Palm Beach counties.

An unsigned copy of the confidential order was obtained by the Herald-Tribune. OIR officials refused to acknowledge its existence, and calls to Northern Capital's owners were not returned. President Wayne Fletcher and vice president Will Brauer did not respond to repeated calls.

By October, Northern Capital began retrenching, merging its two insurers into one. In February, the company lost its "A-exceptional" financial rating from Demotech, after the rating agency claimed deadlines to raise additional cash and come up with a new business plan passed unmet.

The company remains in business.

IN THE RED ZONE: 42 INSURERS AND RISK

The financial troubles of Florida insurers go far beyond Northern Capital.

Six companies have failed or been forced to sell in the past year. Florida regulators say more are on the verge of collapse, but will not name the companies or say how many are in trouble.

In the absence of public disclosure, the Herald-Tribune turned to measures commonly used by those in the industry, from agents who place your policy to regulators who police the business, to academics and consumer advocates.

A half-dozen experts consulted by the Herald-Tribune cautioned that no single measure told the strength of an insurer.

They agreed, however, that there are several important indicators of financial weakness and they provided benchmarks for each. They include: low levels of savings, comparatively high amounts of risk, an over-reliance on reinsurance and a heavy concentration of customers in one geographic area.

The Herald-Tribune found that about 30 companies out of more than 70 reviewed appear fiscally sound. Forty-two failed at least one of the benchmarks.

That means one in three privately insured homes in Florida -- some 2 million families -- relies upon an at-risk insurer for hurricane protection.

Fourteen of those insurers tripped two or more of the four warning flags. Of the three companies that failed at least three tests, two of them, Edison and Northern Capital Select, were being shut down or sold by January.

In December, Aon Benfield, one of the the world's largest insurance brokers, questioned if the Florida insurance market is, in its words, "at the tipping point."

In a report to its insurance company clients, the brokerage estimated that one in 10 Florida carriers has insufficient capital to weather a catastrophe. Not one of the 150 national property insurers reviewed by Aon had the same risk.

Bryon Ehrhart, CEO of Aon Analytics in Chicago, said, "Florida is operating at a much higher leverage rate than the rest of the nation."

WHAT HAPPENS IF YOUR INSURER FAILS

After eight hurricanes swept through Florida in 2004 and 2005, five insurance companies failed. Some 58,000 homeowners across the state were pushed into the state's bailout program, the Florida Insurance Guaranty Association.

Aside from the nearly $900 million bill presented to Florida consumers to cover those checks, "It is not a bad place to land," said FIGA Operations Manager Tom Streuckens.

That is not always the case.

More than five years after Hurricane Ivan struck the Panhandle, Pensacola lawyer Charles Beall is still trying to force the solvency fund to compensate victims who lost four homes in the storm.

Two of Beall's clients have received low offers, but he said the other two have yet to get even a claim estimate from the state fund. One is unable to rebuild. Her unlivable, damaged town house sits unrepaired and empty amid rows of rebuilt homes.

Beall's hands are largely tied. The fund cannot be sued for acting in bad faith. The lawyer cannot even collect his legal fees unless he can persuade the fund to at least give him and his clients a denial.

"It's the ultimate insult when the state company set up to protect you ignores you," Beall said. "They ought to be thrown in jail just for callous indifference."

Even if the program worked perfectly as a backstop, it would not have enough money to cover everyone if a large enough wave of insurance failures struck after a hurricane.

The 2004-05 hurricanes pushed the solvency fund to its financial limits in 2006.

Executives acknowledge that the program would have difficulty raising money fast enough to make timely payment of claims for much larger insolvencies. The result would be homeowners receiving only partial payment, then waiting months, if not years, for the rest.

Streuckens considers a disaster of that scale unlikely.

"It is pretty much a doomsday scenario," he said.

But a "doomsday scenario" may not be all that unlikely, according to Aon's estimate of the number of Florida insurers at risk.

According to the broker's report, 18 percent of Florida insurers have borderline amounts of capital -- placing $143 billion worth of homes at risk of being uncovered in a catastrophe.

That is one and a half times the size of the insurance companies that failed following the 2004-05 hurricanes.

BILLIONS IN POLICIES FROM KEY BISCAYNE HOME

When Magnolia Insurance was approved to start insuring Florida homes in 2008 it had no office, no outside agents, and a lot of debt.

The carrier, opened by a Key Biscayne insurance agent working with a $24 million loan, did not even have an active insurance license when Florida regulators agreed in April 2008 to allow it to take as many as 60,000 policies from Citizens Property Insurance.

By mid-2008, thousands of South Florida homeowners were getting letters announcing that unless they objected, Magnolia was their new carrier.

Miami insurance agents working on behalf of homeowners to check on the obscure newcomer had little more than a Texas Post Office box to guide them.

"They didn't even have an office. They didn't even have a Web site. They didn't have a phone." said Dulce Suarez-Resnick, the South Florida insurance agent.

"You couldn't even help your customer get a copy of their new policy."

When she did locate Magnolia, it was at an unlikely place -- the personal residence of its founder.

"They were working out of his home in Key Biscayne," Suarez-Resnick said. "We knew from Day One Magnolia was not going to make it."

Just 20 months later, the same Florida regulators who helped put Magnolia into business put it under administrative supervision and ordered its president to leave.

The December order capped what is possibly the shortest start-to-suspension of a Florida insurance company.

Florida agents wonder how the company got licensed in the first place.

State incorporation records for Magnolia list its Key Biscayne business address as the four-bedroom red-tile roof home of company president Henry James Irl.

Florida law allows state regulators to deny an insurance license to a company whose executives show poor financial credibility. Yet the Office of Insurance Regulation cleared Irl, despite the fact that Miami-Dade County Circuit Court files show he had a history of bad credit card debt.

Court filings from 2006 through 2008 show Irl was sued for $40,000 in unpaid debts and interest, resulting in two orders attempting to collect the money by garnishing his wages at the not-yet operational Magnolia.

The last of those cases was not dismissed until the end of 2008. By then, Irl was running an insurance company responsible for the financial security of 100,000 homeowners with property worth $24 billion.

"How did the state of Florida allow this person to get approved to run an insurance company in the state?" asked Suarez-Resnick.

Officials with Florida's Office of Insurance Information refused to answer questions about Magnolia, including whether Irl had disclosed his personal financial problems. Irl did not respond to messages left with his company or at his home.

Circumstances surrounding Magnolia's supervision remain sealed under Florida insurance laws that treat regulatory investigations as confidential, leaving more than 80,000 policyholders in the dark as they must decide whether to renew.

Though company executives and their consultants met with state regulators in November, Magnolia operated through the 2009 hurricane season with no outward sign of trouble.

The only specific information about why Magnolia's operations were seized comes through Demotech, the financial rating firm that suspended Magnolia's "A Exceptional" rating two weeks before regulators stepped in.

With the rating suspension, Demotech explained for the first time that it had been negotiating with Magnolia for months over serious problems with its financing, policy handling and management.

FLORIDA OFFICIALS ASK: WHAT CHOICE IS THERE?

The Office of Insurance Regulation readily acknowledges Florida is in the throes of dramatic change.

From Kevin McCarty, insurance commissioner, to the lowest-level regulators, OIR officials expressed optimism for the market as a whole despite trepidation over the stability of individual insurers.

"You're right. There will be failures," said Robin Westcott, solvency director for OIR's property division. However, she and other regulators said, they believe most of Florida's relatively new insurers will survive and a large portion of the market is strong.

These officials argue the failures are a natural byproduct of the state's need to find new insurers quickly as national carriers dumped hundreds of thousands of customers after 2005.

Florida had to convince investors, entrepreneurs and others to get into the insurance business and assume tens of thousands of policies almost overnight.

The state has, since 2006, attracted 29 new companies with $509 million in new investment.

"I think it's a success story that we're able to attract new companies that are writing

615,000 policies," McCarty told Florida Cabinet members in August.

But in the months following, McCarty and his staff have switched their message, warning that some of those new carriers are failing and others need rate increases to survive.

"It is a difficult marketplace. ... You're getting to a point where these companies are going to separate themselves as to who can do it successfully and then those that aren't going to," Westcott said in November, following the shutdown of American Keystone.

"All we hear from the Legislature is 'Free Market, Free Market, Free Market,'" Westcott said. "Well, this is a function of Free Market."

April 18, 2010
How regulators put Florida homeowners at risk ()

March 14, 2010
How insurers make millions on the side ()

November 14, 2010
Creating an $82 billion threat: The formula: a hotel room, four hours and a dubious hurricane computer model ()

October 24, 2010
Sending billions overseas ()

December 5, 2010
How State Farm cashed in on a crisis ()

October 25, 2010
How Bermuda rigs rates ()

April 19, 2010
Regulators take gamble on discount insurance ()

November 15, 2010
Hurricane models: garbage in, gospel out: In secret calculations, a stew of flawed data ()

BIOGRAPHY

Paige St. John joined the Sarasota-Herald Tribune in 2008 as an investigative reporter. She has been a working journalist for more than three decades, covering Florida politics, the environment and natural disasters. Her prior posts include statehouse bureau chief for Gannett News Service, environment reporter for The Detroit News, and Traverse City, Mich., correspondent for the Associated Press.

A product of what was once the nation's smallest accredited journalism program (Southern Illinois University at Edwardsville), St. John continues the school's tradition of multi-faceted journalism. She specializes in database-driven projects, graphics and web sites, narrative writing and investigative journalism. Past awardwinning projects have exposed Florida's failure to protect environmentally sensitive beaches from rampant development, failure of federal regulators and medical device manufacturers to protect human lives, and institutionalized fraud within university enrollment systems.

She lives in Florida with her daughter and husband. They enjoy travel, horseback riding and kayaking.

FINALISTS

Nominated as finalists in Investigative Reporting in 2011:

Walt Bogdanich of *The New York Times* (/finalists/walt-bogdanich)

Sam Roe and Jared S. Hopkins of *Chicago Tribune* (/finalists/sam-roe-and-jared-s-hopkins)

THE JURY

Jeffry Couch
Editor and vice president, *Belleville (IL) News-Democrat*

Mark Katches (chair)
Editorial director, California Watch and the Center for Investigative Reporting

Thomas Curran
Associate editor, *The Star Ledger*, Newark, NJ

Deborah Henley
Executive editor, *Newsday*

Elizabeth T. Spayd
Managing editor, *The Washington Post*

Irwin Thompson
Assistant director of photography, *The Dallas Morning News*

Maribel Perez Wadsworth
Digital news executive, Gannett

WINNERS IN INVESTIGATIVE REPORTING

2020 (/prize-winners-by-year/2020)

Brian M. Rosenthal of The New York Times (/winners/brian-m-rosenthal-new-york-times)

2019 (/prize-winners-by-year/2019)

Matt Hamilton, Harriet Ryan and Paul Pringle of the Los Angeles Times (/winners/matt-hamilton-harriet-ryan-and-paul-pringle-los-angeles-times)

2018 (/prize-winners-by-year/2018)

Staff of The Washington Post (/winners/staff-80)

2017 (/prize-winners-by-year/2017)

Eric Eyre of *Charleston Gazette-Mail*, Charleston, WV (/winners/eric-eyre)

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2011 PRIZE WINNERS

Music (/prize-winners-by-category/225)

***Madame White Snake*, by Zhou Long (Oxford University Press) (/winners/zhou-long)**

Feature Writing (/prize-winners-by-category/211)

Amy Ellis Nutt of *The Star-Ledger*, Newark, NJ (/winners/amy-ellis-nutt)

Editorial Writing (/prize-winners-by-category/214)

Joseph Rago of *The Wall Street Journal* (/winners/joseph-rago)

Explanatory Reporting (/prize-winners-by-category/207)

Mark Johnson, Kathleen Gallagher, Gary Porter, Lou Saldivar and Alison Sherwood of *Milwaukee Journal Sentinel* (/winners/mark-johnson-kathleen-gallagher-gary-porter-lou-saldivar-and-alison-sherwood)

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