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# Homeowners insurance in Florida is a precarious mess that was years in the making

Lawrence Mower, Alex Harris, Miami Herald - 6m ago

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Florida's crumbling homeowners insurance market is exposing one of the state's long-running flaws: its reliance on a single company to certify the majority of the state's insurers.

For the last few weeks, state regulators and Gov. Ron DeSantis' administration have been scrambling to contain the fallout after the state's primary ratings agency, Ohio-based Demotech Inc., warned of downgrades to roughly two dozen insurance companies, according to the state.



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The downgrades would have triggered a meltdown of the state's housing market, a pillar of Florida's \$1.2 trillion economy. Without the ratings, a million Floridians could be left scrambling to seek new insurance policies, possibly triggering a housing crisis in the middle of hurricane season and months before the November election.

State regulators believe they've staved off a disaster, at least temporarily, but the episode has observers questioning how it was handled and how the state could have handled it better. Introducing Support company few have ever heard of.

Feedback

“If this was a movie title, it would be ‘The Sum of all Fears,’ ” said Sen. Jeff Brandes, R-St. Petersburg, who has been warning for years that the state’s property insurance market was heading toward collapse.

The DeSantis administration [cobbled together a short-term fix](#) to allow insurers to stay afloat by using state-run agencies to back them up. And it went after the ratings agency, Demotech, and its president and co-founder, Joe Petrelli, calling it a “rogue ratings agency” and urging federal officials to disregard the company’s actions.

## Ghosts of Hurricane Andrew

The drama is just the latest problem as the state experiences its biggest insurance crisis since 1992’s Hurricane Andrew.

In the last two years, insurance policies for more than 400,000 Floridians have been dropped or not renewed. Fourteen companies have stopped writing new policies in Florida. Five have gone belly-up in 2022 alone. The record, set after Hurricane Andrew’s devastation, is eight in one year.

The latest was Coral Gables-based Weston Property & Casualty, which leaves 22,000 policyholders — about 9,400 in South Florida — scrambling to find new insurance companies.

Costs have also skyrocketed. In 2019, when DeSantis was sworn in, Floridians paid [an average premium](#) of \$1,988. This year, it’s \$4,231, triple the national average, according to [an Insurance Information Institute analysis](#).

In several ways, today’s problems have their roots in the decisions lawmakers and regulators made after Andrew, experts say.

The storm reshaped Florida’s insurance landscape, forcing several companies out of business and others to flee the state. With homeowners struggling to find coverage, the Legislature created the state-backed Residential Joint Underwriting Association — essentially a precursor to today’s Citizens Property Insurance — to insure homes that couldn’t be covered by private carriers.

The program quickly became one of the largest insurers in the state. It was taking on too much risk. State officials provided incentives for companies to take over its policies, and a number of new, smaller insurers got in line.



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The new insurers faced a problem, however: They were unable to get a financial stability rating from a qualified ratings agency. Homeowners with federally backed mortgages, such as Fannie Mae and Freddie Mac, are required to have highly rated property insurance companies protecting them.

State insurance and banking regulators, plus Fannie and Freddie, looked to various ratings agencies for help. Only Demotech was willing to rate the new insurers. The company, based in Columbus, Ohio, was founded in 1985 by Petrelli and his wife, Sharon Romano Petrelli. Its “A” rating was approved by both Fannie and Freddie.

Since then, Demotech has been the primary ratings agency for Florida-based insurers, which dominate Florida’s market and which pay Demotech to rate their financial strength. Although other ratings agencies, such as New Jersey-based AM Best, provide ratings for some insurers, no one has stepped in to compete with Demotech.

Without Demotech, Florida would not have an insurance market, said Kevin McCarty, the state’s insurance commissioner from 2003 to 2016.

“Regardless of whether you agree with them, they serve an invaluable service to the state of Florida and across the wider economy,” McCarty said.

## ‘We never got a phone call’

Florida’s reliance on smaller insurers has caused homeowners to ride out a series of booms and busts ever since.

Smaller insurers are mostly able to survive Florida’s hurricanes because of reinsurance — essentially, insurance for insurance companies. When a storm hits, an insurer might be on the hook for a few million dollars, while the reinsurer pays the rest.

But the smaller companies in particular are vulnerable to increases in the cost of reinsurance. A series of storms in 2004 and 2005 wiped out a number of insurers and drove up the cost of reinsurance, putting firms in a pinch. Several have also gone out of business because of mismanagement or incompetence.

In the last few years, insurers and state regulators have blamed excessive lawsuits for their woes, and Petrelli has been an outspoken critic of the Legislature’s inaction to curb litigation.



He has cited statistics from [Florida's insurance commissioner](#) that from 2016 to 2019, Florida accounted for between 7.75% and 16% of the nation's homeowners' claims but between 64% and 76% of the nation's litigated homeowners' claims. Critics say insurers' problems are more complicated.

[DeSantis](#) called a [special session](#) of the Legislature in May to pass insurance reforms focused on stabilizing the market and reducing lawsuits, but Petrelli said it wasn't enough.

On July 18 and 19, Demotech sent private notices to at least 17 Florida insurers, according to state officials – almost half of the companies it rates in Florida – warning that the insurance environment was worsening and that without corrective action, the companies faced a ratings downgrade. (Demotech has not said how many companies received the warnings.)

A ratings downgrade of that magnitude would create shock waves. Fannie and Freddie back about 62% of all residential mortgages, according to the Florida Association of Insurance Agents.

Demotech's "A" rating and above, which indicates a 97% certainty a company could afford all the claims from a 1-in-130 year hurricane, is approved by Fannie and Freddie, while its "S" rating, the next step down, is not.



A reduction from an “A” rating would force homeowners to find a new insurance company — and fast. Otherwise, the bank holding the mortgage could “force place” a homeowner with whatever insurance company they can find, which is usually far more expensive and offers less protection. That could include placing a homeowner with what’s known as a “surplus lines” insurer, which doesn’t need state approval for their rates. They can charge whatever they want.

“Getting force-placed insurance is terrible for a homeowner. You’re paying double the premium and getting half the coverage,” said Paul Handerhan, president of the consumer-oriented Federal Association for Insurance Reform, based in Fort Lauderdale.

Many homeowners would likely end up with Citizens, placing more risk with the state-run insurer that already covers nearly 1 million policies. (Its peak was 1.4 million, in 2011.)

Demotech, in large part, blamed [the Legislature’s inaction](#) for the changes.

“In Florida, the unwillingness or inability of the Legislature to address longstanding disparate, disproportionate levels of litigation, and increasing claims frequency has resulted in a level of dysfunction that renders our previous accommodation inapplicable,” several of the letters state.

DeSantis’ office coordinated a swift and public attack on Demotech.

In letters to federal housing authorities on July 21, Chief Financial Officer Jimmy Patronis called Demotech a “rogue ratings agency.” Florida Insurance Commissioner David Altmaier wrote that it was an example of “inconsistent, monopolistic power of a select rating agency and is trying to exert coercive influence over Floridians and policymakers in an effort to thwart public policy according to its own opinions.”

Even U.S. Sen. Marco Rubio waded into the fray, asking the Federal Housing Finance Agency to reexamine its dependence on Demotech.

Petrelli said he had no warning and no conversations with state officials before the letters were sent to federal officials and the news media. He said the correspondence with the companies was the normal course of business, part of regular, ongoing conversations with companies about their financial status that they’ve been doing every quarter since 1996.

The level of rancor was “unprecedented,” Petrelli said, but it did not change how it rates companies. In recent weeks ratings were downgraded for four companies and ratings were withdrawn from four more [including Weston](#)



Mark Friedlander, communications director for the industry-backed Insurance Information Institute, said the response was unlike anything he'd ever seen. Ratings agencies are supposed to be neutral third parties that rate companies without influence, he said.

"It was definitely, in our opinion, stepping over the line," Friedlander said of the state's response.

On the other hand, Petrelli "has pushed himself further into the limelight by publicly engaging in political theater," the Florida Association of Insurance Agents said in a memo distributed by the Office of Insurance Regulation.

The association's memo wondered whether the state's insurers should move on from Demotech. It also raised longtime criticisms that Demotech often downgrades a company just days before it goes insolvent.

"That often begs the question, 'Does a Demotech rating mean anything or provide the intended peace of mind to agents, consumers, and lenders?' " the memo stated.

Petrelli said companies keep their "A" rating as long as possible precisely because the "S" rating is not accepted by Fannie and Freddie, despite Demotech's numerous attempts to get them to accept it.

When a company gets an "S," he said, "unfortunately, they drop off the edge of the cliff."

## A 'very elegant' solution

Notably, the Office of Insurance Regulation's letter did not dispute that Florida insurers were failing. The office has its own [watch list of 27 companies](#) under "enhanced monitoring."

Patronis' letter also suggested insurance companies needed to find a new rating agency, but Friedlander said that likely wouldn't help. The New Jersey firm AM Best has stricter requirements than Demotech, he noted.

Six days later, the state announced a solution should the companies' ratings be downgraded.

Florida's plan is to let insurance companies that are financially stable but just missing that "A" rating from Demotech, to keep operating and covering people's policies.

If they go under, homeowners' claims would be covered by the long-running state program known as the Florida Insurance Guaranty Association, which covers the first chunk of claims for any failed insurance companies. Citizens would foot the bill for anything over the limit of \$500,000 for homes and \$300,000 for condo units.

Handerhan called it a "very creative, very elegant, very consumer-centric" solution.

But will it satisfy the federal mortgage holders?

Despite repeated emails and calls over the last week from the Herald/Times, representatives from Fannie Mae and Freddie Mac didn't offer an answer. The Florida Housing Finance Agency didn't respond to Rubio, either, according to his office.

An Office of Insurance Regulation spokesperson said they're "confident" the solution will be acceptable.

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AGRICULTURE

July 21, 2022

Joseph Petrelli  
President  
Demotech, Inc.  
2715 Tuller Parkway  
Dublin, Ohio 43017

VIA: E-MAIL

Mr. Petrelli:

The Florida Office of Insurance Regulation (OIR) has recently learned that Demotech, Inc. (Demotech) has notified approximately 17 Florida domestic property insurance companies that their Financial Stability Rating (FSR) will be downgraded from an "A" to an "S" or an "M." OIR has a strong belief that rating agencies and regulatory agencies in the insurance industry serve two important, but very different, roles. As such, we have endeavored to ensure that Demotech is able to derive its ratings based upon the consistent and objective application of its own standards. However, as OIR learns more about the notice letters sent to companies, and considering the impact these actions would have on millions of Floridians, countless jobs, and Florida businesses, this type of unilateral action warrants further scrutiny. OIR is compelled to take the extraordinary step of scrutinizing these unprecedented actions to protect the Floridians we serve, especially two months into hurricane season. This is an example of inconsistent, monopolistic power of a select rating agency and is trying to exert coercive influence over Floridians and policymakers in an effort to thwart public policy according to its own opinions.

OIR has taken note that Demotech has recently received the Nationally Recognized Statistical Rating Organization (NRSRO) designation through the federally run Securities and Exchange Commission (SEC) and are now required to publicly post their rating methodology. It appears that impacted carriers only received notification of this rating methodology in the last two days through the downgrade notice they received. OIR has reviewed recent letters received by impacted carriers, received feedback regarding conversations between Demotech and impacted carriers, reviewed your personal statements, and **have noted several discrepancies between these recent decisions and the rating methodology posted on Demotech's website.** To ensure actions are not made in a capricious manner and are fairly and consistently applied, the OIR has determined that we would benefit from an understanding of why these discrepancies exist, if Demotech plans to amend its methodology to account for these discrepancies, and if Demotech plans to allow companies to appeal its decision as allowed for in Demotech's posted methodology. Within that context, the OIR makes the following inquiries:

• • •

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1. OIR has been advised that many carriers that have been notified of a pending downgrade have reached out to Demotech in an effort to provide additional information. The majority of carriers that have done so have reported to OIR that Demotech has been unwilling to consider additional information. Specifically, Demotech has informed many carriers that additional capital won't prevent the pending downgrade. However, Exhibit 2 notes that Demotech "may afford the affected entity a reasonable time to respond to the notification of Demotech's intent to withdraw and Demotech may consider any new information provided by the entity, including...access to additional capital." Demotech also states that carriers "will be afforded an opportunity to...provide additional information for Demotech's consideration." It appears most of these letters were delivered on July 19, with a downgrade date of July 26 – nearly two months into hurricane season. Does Demotech believe that a reasonable time to respond is one week? If Demotech has chosen not to allow carriers to provide additional information, does Demotech intend to amend its methodology to state this? If Demotech has chosen not to consider access to additional capital, does Demotech intend to amend its methodology to state this? If not, does Demotech intend to communicate this to carriers in any other fashion?
2. In a document published on its website labeled "Exhibit 2 – Rating Procedures and Methodology" there are references in multiple places of an appeal process. However, other than as outlined above, there does not appear to be a formal appeal process in place. Does Demotech intend to allow carriers an opportunity to formally appeal ratings downgrades? Your notice letters to carriers did not outline this process. If so, does Demotech intend to more thoroughly describe the appeals process, including when Demotech will entertain new information and/or capital contributions, and when it won't?
3. Similarly, Exhibit 2 states that, "(w)hile Demotech acknowledges and recognizes the importance of the profitability of the entity assigned a rating, we believe that balance sheet strength and financial integrity are the ultimate determinates of the long-term financial stability required..." However, most carriers are reporting to us that Demotech has placed a strong emphasis on underwriting results. While profitability is important, the ability of companies to withstand unprofitable years from a surplus position is even more important. Does Demotech plan to clarify its new position in updated methodology? If not, does Demotech plan to communicate to carriers in another fashion the increased importance placed on profitability?
4. Rating methodologies typically consider legislative changes or actions which impact ratings; however, your recent comments seem to imply that Demotech's rating methodology contemplates the absence of policy as the mechanism to rate carriers. Demotech's opinion of what policy proposals should be passed, especially in a state it does not reside, is not a fair and consistent approach to rating. Did Demotech expect the positive benefits from recent Florida legislation to happen overnight? If not, does Demotech believe that seven weeks after passage of this legislation is a reasonable timeframe for years of litigation to cease? If not, what other factors did Demotech consider when making the assertion that the claims environment will continue to be unfavorable, given the positive progress the Florida legislature has made? Did Demotech expect carriers to immediately reflect underwriting results as of first quarter, despite the fact that first quarter results occurred before the effective date of SB 2D? Did Demotech consider allowing carriers to show quarters of underwriting results *after* the effective date of SB 2D before asserting that the claims environment would continue to be unfavorable? If Demotech's future legislative proposals are not passed, can carriers be expected to play as pawns in a political game?

OIR does not regulate private rating agencies, and it is very important that this request not be misconstrued in any way as a request that Demotech deviate from its rating methodologies or as advocacy by OIR for or on behalf of any one or several insurance companies with respect to their assigned FSR. OIR's primary concern is the protection of Floridians from harmful, unilateral action.

\* \* \*

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We've highlighted some significant discrepancies between Demotech's published standards and those it has recently applied. Given the potential impact of Demotech's financial ratings, OIR believes Demotech should perform a more comprehensive review, using consistent standards, of the proposed ratings prior to their effective date. Additionally, in the interest of stabilizing the private market and ensuring companies have all necessary information to take appropriate corrective action, we strongly encourage Demotech to clearly communicate its rating standards and methodology prior to these ratings becoming effective. As it stands, Demotech has not provided companies a meaningful path for review or appeal of these ratings and has been inconsistent in its application of its own posted methodology.

We are confident that as a credit rating agency, and a newly minted NRSRO, Demotech would agree that its rating standards should be applied objectively and consistently.

Please provide all applicable responses no later than Monday, July 25, 2022. We appreciate your transparency in this regard.

Sincerely,



David Altmaier  
Commissioner

• • •  
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