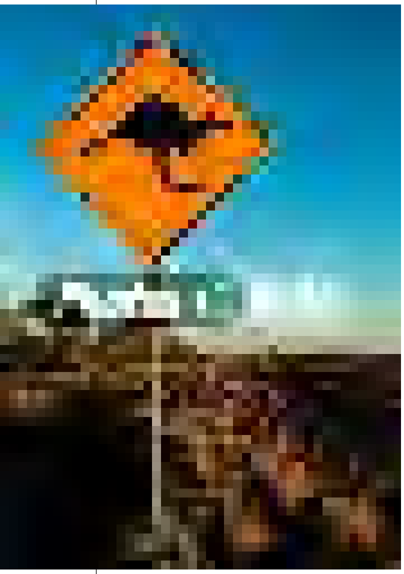
By Rade Musulin

Insurance Down Under

A veteran of Florida's insurance scene offers some perspective from his new vantage point in Australia.



I worked in Florida for more than 20 years, spending a good part of my time in Tallahassee grappling with various aspects of the state's insurance system. My last day of work in the United States was at the Florida Capitol, toiling away on the 2006 property insurance bill on the frantic final day — and night — of the Florida legislative session. Five days later I was in Sydney, Australia, beginning a job as an actuary.

While Australia is similar to the United States culturally, some things are different — like driving on the other side of the road, shivering through winter in July, seeing kangaroos in the bush and dressing my kids in uniforms for public school. The insurance system is quite different as well and may hold some interesting lessons for Florida as it goes about wrestling with insurance issues.

In Australia, regulation is at the federal level and focuses on solvency. There is no rate regulation on most types of insurance, so insurers can charge whatever they want and change rates as often as they want. If an insurer decides to change rates today, renewal notices can go out tomorrow reflecting the new prices.

Prices are low, competition is fierce and consumers are relatively satisfied. There are no large residual markets like the state-run Citizens Property Insurance and no evidence that insurers are taking advantage of their freedom to set prices by gouging consumers. Australia absorbed a significant hurricane in 2006, Cyclone Larry, which resulted in $350 million in claims, without significant market disruption.

A major Australian insurer recently decided to change its policy contracts to offer "complete replacement cover," a promise to "cover insured damage or loss to your home buildings for whatever it costs to repair or rebuild them." Floridians once had this coverage available, called "guaranteed replacement cost," but it was almost completely eliminated in the 1990s after insurers experienced losses from claims.

Why would an Australian insurer offer this coverage after the U.S. experience? I believe it reflects market competition and confidence that prices can be adjusted as needed.

Contrast that to Florida, where insurers must comply with detailed rate regulation statutes and administrative rules to change prices. They have to file voluminous quantities of data, fill out many long forms, answer scores of complex questions and provide detailed "actuarial justification" for rate changes. In homeowners insurance, companies also face public hearings, and if they cannot reach an agreement with regulators, they have to go through arbitration and possibly to court to avoid selling their products at a loss. Implementing a major homeowners price change in Florida can take months or longer.

STUDY IN CONTRASTS: Actuary Rade Musulin discovers kangaroos and a different regulatory environment in Australia. "It is harder to lower a rate in Florida than it is to raise a rate in Australia."

Ian Waldie / Getty Images / Taronga Zoo, Sydney

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And in personal automobile insurance, where there is no market "crisis," even rate decreases require complex filings. It is harder to lower a rate in Florida than it is to raise a rate in Australia.

Tough rate regulation is popular with consumers, and some of Florida's political leaders justify it as necessary to protect consumers from rapacious insurance companies. Few political leaders, even among the strongest pro-business advocates of free markets, dare to speak out in favor of market-based pricing in insurance. To be fair, there are examples of well functioning markets with a high degree of regulation. Florida's regulators have worked very hard to streamline their systems and have shown immense courage in approving unpopular rate increases.

Nonetheless, the supply of property insurance cannot meet the demand, leaving many consumers with no choice but Citizens and its prices. Meanwhile, many of the remaining insurers have reduced coverage and imposed higher deductibles.

Clearly, something is wrong. Of course, much of the immediate problem can be attributed to aftershocks of recent hurricanes, but the market was in serious difficulty long before Charley hit in 2004. But if rates are excessive, as some maintain, or even if rates are adequate, as Florida law requires, why would profit-driven insurers decline to compete for business? Perhaps the process is part of the problem. If insurers lack confidence in their ability to adjust future prices to reflect future conditions, even adequate prices today may not provide a sufficient incentive to offer coverage. Put another way, when the process is perceived to be difficult and uncertain, insurers will require higher rates than indicated by actuarial formulas to offer a given amount of coverage. This factor may help us understand why regulators say rates are adequate, while insurers "vote with their feet" and fail to offer coverage.

Another interesting contrast between Florida and Australia can be found in automobile insurance. In addition to market-based pricing for most coverages, New South Wales (where I live in Sydney) has enacted tough restrictions on attorney advertising and a "compulsory third party" reparations scheme. The result is little litigation and unlimited

medical and rehabilitation coverage for those injured as a result of someone else's negligence.

This is the type of reform that seems out of the question in Florida, where insurers oppose increased benefits for personal injury protection, providers oppose fee schedules and attorneys oppose limits on the "right" to sue. As a result, the Florida Legislature has been paralyzed on the issue and unable to pass meaningful automobile insurance reform.

The system here seems to produce reasonable prices. If you have a clean record, a major insurer offers full coverage on a typical automobile for $910 (in U.S. dollars) a year in Sydney, $605 in suburban Brisbane and $540 in the smaller city of Townsville. For a $250,000 home with $125,000 in contents and an all-perils $500 deductible, the annual premium is $540 in suburban Sydney, $520 in suburban Brisbane and $1,010 in suburban Darwin, an area highly exposed to cyclones. As there are no residual markets or catastrophic funds here, these premiums carry no risk of assessments.

Australia has had some serious insurance problems. Several years ago, a major insurer, HIH, went insolvent, prompting a strong focus on ethics and financial reporting. Australia's assumed reinsurance market experienced severe difficulties in the 1990s and has yet to recover. Nonetheless, it is an example of a well-functioning market where competition, rather than regulation, is the main tool used to deliver fair prices. Australian regulation on solvency and market conduct is very thorough, focused on assuring that insurers deliver on the promises they make to policyholders.

There is nothing inherently wrong with either rate regulation or litigation, but neither is essential to delivering good coverage at a fair price. Unfortunately, in Florida the debate has become so poisoned that policy-makers seem unwilling to even consider alternatives to the current system.

Currently, the property insurance market is so traumatized that an abrupt change in rate regulation would prove too disruptive for an already-stressed population. However, regulatory reform might be appropriate in lines where there is no market crisis, such as automobile. If successful, it could then be a component of a future property insurance strategy after the current crisis passes and the positive effects of investments in mitigation are realized.

Unless something changes, it appears unlikely that Florida can attract sufficient private capital to avoid a de facto state takeover of hurricane risk. It may turn out that a state takeover is the best option, but that outcome should be the result of a deliberate choice, rather than something Florida stumbles into following a market collapse. Florida needs fresh ideas to develop the best long-term strategy for addressing its hurricane problem. All options should be on the table, even a concept as radical as relying on the market to regulate prices in the world's largest capitalist economy. FT

Rade Musulin is an actuary and was vice president/operations, public affairs and reinsurance for the Florida Farm Bureau Insurance Cos. until May.