

# FLORIDA HOMEOWNERS OPERATIONAL AUDIT

The Florida Homeowner's market is unique. Following the storms of 2004 and 2005 many insurers withdrew from the market. The state created a number of insurance and reinsurance facilities with the goal of making insurance more available and affordable. Over time, however, the lack of significant storm activity and a more insurer-friendly state government improved the insurance market. Citizens de-populations created opportunities for a number of new entrants.

The cat reinsurance market has gone in opposite direction. Years of strong rate increases have given way to a very competitive market due to the influx of Insurance Linked Securities. With a lower cost of capital and vast resources these investors have put pressure on catastrophe reinsurance rates. Profit margins are well below historical averages; many suggest that this is the "new normal". Given these low rates, how can reinsurers select the cedants that offer the best return? Modeling, of course, is a given, but ILS pricing has effectively homogenized the market. Reinsurers report little differential in margins across contracts in the Florida market. Is there a qualitative assessment that can help reinsurers in their catastrophe treaty underwriting? The Operational Audit was designed for this purpose.

The goal of the Operational Audit is to provide reinsurers with an evaluation of the following five key areas of their cedant:

- Strategy: Are they growing the book, reducing it, or optimizing for PML management;
- Underwriting: What size/age/construction is their target dwelling; approach to ITV's, inspections, and policy language;
- Pricing: What metrics and tools do they use to manage the portfolio; use of wind mitigation credits;
- Catastrophe Data Quality: Capture and validation of primary and secondary modifiers;
- Claims: How are prepared to handle a large volume of catastrophe claims, and their use of outside adjusters, and approach to litigation.

The audit begins with a meeting with the leadership in each of these areas followed by a review of underwriting and claims files. The audit takes 1 1/2 to 2 days to complete. The written report will describe about a dozen of the insurer's business and underwriting practices and roll that up into the five key areas. These areas are scored using a method developed by Lighthouse Consulting, LLC.

The audit is especially useful to a reinsurer when several of their cedants are evaluated. Differences between the companies will be evident and can be a helpful consideration when evaluating treaty renewal terms. In addition, the scores will be matched against aggregate scores of companies audited by Lighthouse. Contact us for a sample evaluation.

Our experience with this audit has been positive from both reinsurers and their insureds. The insureds recognize how critically important their cat protections are and appreciate the opportunity to present their company in more depth than a short marketing trip to Bermuda would allow. Reinsurers benefit from the quantitative scoring that can assist with treaty renewal decisions.