Discussion

When Insurers Exit: Climate Losses, Fragile Insurers, and the Mortgage Market

by

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Disclaimer

The views expressed here are those of the author and do not necessarily reflect the views of the Federal Reserve Bank of Chicago or the staff of the Federal Reserve System.

The paper

- Uses county-level data on homeowner insurance premiums in Florida to assess how climate change affect the homeowner insurance market and the spillover to the mortgage market and (GSE) securitization.

- Key idea: Traditional insurers withdrew from high risk areas and new entrants were more fragile, exposing households and banks to losses. In response banks tend sell more mortgages in areas with more new insurers.

- The authors document that new entrants are less financially sound and were leniently supervised. Insolvency of insurers drives up delinquency on the county level.

- Variation from homeowner insurance transfer from state-run insurance to alleviate selection by homeowners.

Why we care…

- Climate change reshapes the risk economic agents are exposed to.

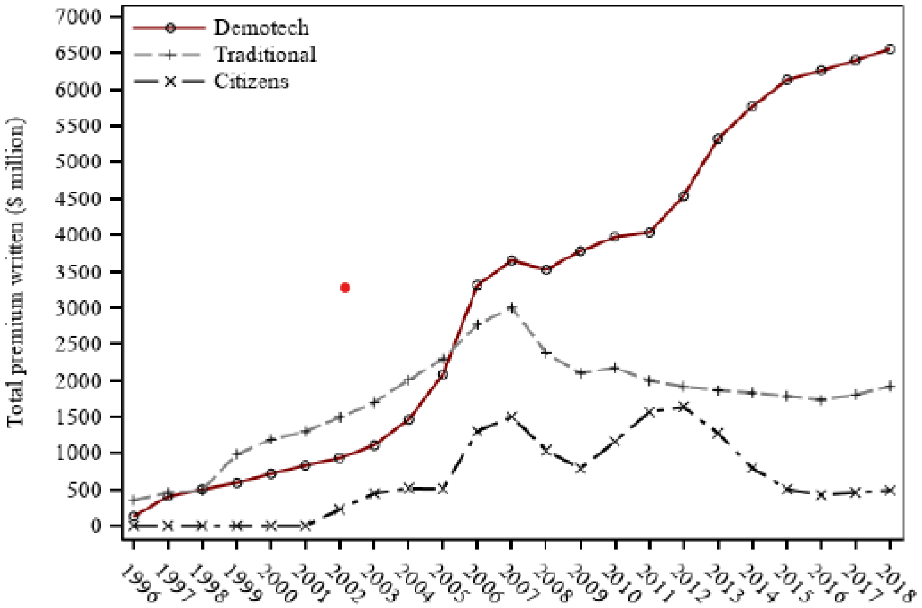
- Withdrawals of insurers from several markets (CA, FL, with more to come) raises the question: who holds the bag?
  - Households?
  - Banks?
  - GSE?

- How should we regulate insurers?
  - And should we trust rating agencies?

- Is the government going to be the insurer of last resort (again)?

New Insurers took over before the 2008 GFC

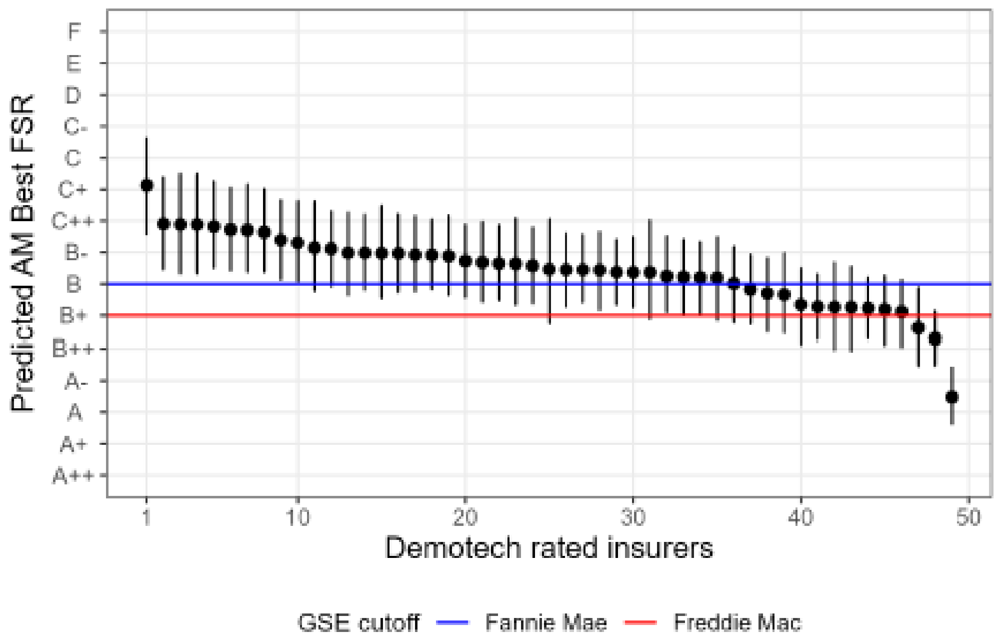
- This is NOT a recent development.
  - Either traditional insurers understood climate change much earlier than everyone else… or
  - Were spooked by Hurricane Charley (Charley was the second-costliest hurricane at the time with losses of about $16bn).



- Nitpick: The share of Demotech insurers in figure 1 appear to be driven by Florida (> 50 percent market share).

Comment I: Ratings

- **Argument:** New insurers game the system using Demotech ratings.



- The regression is not perfect: 60% of variation, so explain what else is in there---note that this is NOT coming from the asset side, if anything Demontech insurers invest more conservatively.

Comment I: Complement to Ratings/Demotech Dummy

- The new insurers are financially weaker.
  - Use premium weighted-county level RBC ratio in regressions
  - Use premium weighted-county level liquid asset ratio in regressions.
  - Use premium weighted-county level reinsurance ratio in regressions.

- Show that these balance sheet variables predict which insurers get liquidated.

→helps to pin down the mechanism by illustrating that the channel is weak balance sheets *within* the Demotech insurers (who have a large market share in total)---links the different parts of the argument.

Identification Police:
What about selection in Demotech lenders?

Authors:
No adverse selection in depopu-lation or securitization timing.

Comment II – Transfer from the Citizen

- By definition, the policy holder within the Citizen pool must be worse than the average policy holder in Florida.
- Hence, the pool of Citizen policy holders is negatively selected relative to the policy holders of traditional insurers---Demotech insurers being able pick the best of the worst does not alleviate selection issue.
- Alleviating this concern needs more work.

Comment III – GSE Regressions

- New and very insightful part of the analysis

- Raises the question about the channel and should be pushed to assess “who holds the bag”
  - Tests insolvent insurer -> more serious delinquencies
  - Is it: delayed insurance payments or no insurance payments/low insurance payments
    - Explain the details for Florida’s Hurricane Catastrophe Fund and why this does not prevent defaults.
  - Can you construct GSE losses?

And the story continues....

Florida Gets 8 New P/C Carriers After Insurance Market Reforms

April 8, 2024

PRINT EMAIL

So far, in 2024, OIR approved 13 companies to assume more than 354,000 policies from Citizens.

In 2023, more than 275,000 policies were assumed from Citizens, reducing Citizen's exposure by more than $113 billion.

Concluding Thoughts

- Great paper.
- Raises important questions about the viability of the homeowner insurance market and the financial consequences of climate change for households and the state more broadly.
- I would like to see a deeper dive into the mechanisms.