



Episode 1,026: Insurance: Another Industry Warped by Government

Guest: Stacey Giuliani

WOODS: So you've been in insurance for a long time, as I just told people, and looking over the notes that you sent me, wow, wow, wow, is insurance far away from where you'd want it to be as a libertarian. I knew there was some government involvement, but this is just unbelievable.

I don't want to go in any particular order. Let's start toward the end of your notes with something that affects me personally, because with Hurricane Irma, there was the possibility of flooding. Now, my area did not flood in Central Florida, but I'm not sure – I mean, I'm still waiting for my house to be built, but in the meantime on the rental property I have, I have renter's insurance, which does not include flood insurance. So I was just crossing my fingers at that point, because as of a few days before, they're not giving you flood insurance when they know this thing is coming. And so I want to know to what extent is flood insurance basically just government subsidies and to what extent is it real insurance?

GIULIANTI: That's a great question. The answer is that it's virtually all government subsidies. When you talk about flood insurance, if you have flood insurance, whether it's through our company, Florida Peninsula, or Edison or any other company, most likely it's not actually through your insurance company. It's really through the National Flood Insurance Program, the NFIP.

So people like us, the carriers, even it's a State Farm, perhaps, they're selling it as an agent. They're just taking kind of a commission and they're selling the government's product, because it's obviously vastly under charged for what it covers. Right now, I think the NFIP is something like \$25 billion in debt. Again, that's the government but it's problematic because no private company wants to ride it and lose \$1, much less \$25 billion. So it's almost all subsidized.

There are some private insurance companies like ours that sell an extra policy if you're outside a typical flood zone or if you want something, say, above their limit, which varies. But let's say the government will limit you at 300,000. You may need coverage from, say, 300-600,000 as an example if that's what your house is worth. And so private companies will sell that second part, but again, most of the flood insurance is really just a government program. It's really just government-ghosted.

WOODS: Why is that? Is it because flood insurance would just be unaffordable for people otherwise?

GIULIANTI: The answer is it would be unaffordable in the sense that it doesn't make financial sense. There's a couple reasons for that. First of all, people are still allowed to build in flood plains. If we allow private companies to charge what they need to charge, one of two things are going to happen. Either people aren't going to be able to build in those areas because it's going to be simply too expensive in those flood-prone areas, or they're going to pay the amount that's necessary if they choose to live there.

But you'll see that there's probably – I think 3 or 4% of flood policy holders are responsible for 35 or 40% of all flood claims. Let me try to say that in an easier way. Very few people, less than 4% of the people, are using up a third of the flood claims, and about 30% of the flood money is the flood payments, because they're constantly building in areas that they shouldn't be building in because the prices aren't set at where you and I, Tom, if we had an insurance company and we started a flood company, we'd have to charge, say, \$1,000 for your house to be properly covered. And instead, most flood policies are \$200 or \$300 a year. They're just not priced high enough for the private market to want to jump in.

WOODS: So of course the result of this is that people make building and residential decisions they would not make otherwise and we get a lot more damage occurring than would occur otherwise. What could be more obvious than that?

GIULIANTI: That's right. When you have these kinds of flood insurance subsidies, if you get rid of them, obviously you're going to reduce property losses because people won't be building or maintaining their homes in areas that are prone to flood. The government knows where items are going to flood. They call them – they have various names for the zones, the A zones, the O zones, the B zones. They know where people are going to normally flood. And you also have people that end of dying. They lose their lives because of these floods, and yet these same people are building back in those same areas.

And it ends of being what we call a moral hazard, where people are building in an area because the taxpayers are taking on most of the risk. So you can say it's 25 billion in debt, but it's us. It's the taxpayers paying for people to live in areas that we know are not safe. We've got engineers that have gone out in government and private engineers saying this is not a place you should be building, and yet people are still building there and it's causing damage that we're paying for that doesn't make it what we call actuarially sound. The numbers don't bear out.

The private companies could do it, but like I said, one of two things would happen. People would not be building there; they wouldn't be living there. Or they'd have to pay a lot more money because they wouldn't be expecting the taxpayers to give them a handout or a bailout every time flood waters roll through the area.

WOODS: All right, now flood insurance is an issue that applies only to some people in the country. Let's talk about some more fundamental issues surrounding insurance. Let's go right to various regulations, which I assume are at the state level on insurers. Like for example, an insurance company has to be licensed, which means it has to meet certain minimum requirements, particularly like capital requirements.

So let's just stop right there. I can see both sides of the argument there. On the one hand, I could see the libertarian case – I'm not saying they're equally valid. I'm saying I can understand both sides. The libertarian case would be: the more requirements you put on insurance companies, the fewer insurance companies there will be, and therefore, the higher the premiums will be. But on the other hand, the concern on the other side would be: but if these companies don't have sufficient capital, they could be selling policies that they can't make good on. So how do you balance that?

GIULIANTI: That's an absolutely good question. I mean, obviously the market can cover that. Obviously people are going to be much more likely to go with a company that has been around, that's proven themselves, that can show financially they've got surplus or monies put away. They've got reinsurance, which is the insurance that covers insurance companies. So there are ways for the private market. There are private companies that rate – like in Florida, we have a company called Demotech and it's kind of like a Best's or – it's a rating company that lets consumers and other people in government and business know how safe an individual insurance company is based on their looking at the books, etc.

So when you talk about minimum capital requirements, sure, there probably should be some minimum capital requirements. But when we started – a group of gentlemen and I started Florida Peninsula Insurance and then later Edison Insurance in 2005, the minimum capital requirements to start an insurance company, a homeowners' company in Florida – do you want to take a guess at what that was? The minimum amount of money you had to have in a bank account to start an insurance company at that time, 12 years ago, 13 years ago.

WOODS: I don't know; tell me.

GIULIANTI: \$5 million. That's it.

WOODS: Ah, okay.

GIULIANTI: There are houses probably not far from where we're living that are \$5 million. One house.

WOODS: Yeah.

GIULIANTI: So it wasn't like the government said you had to have \$100 million. It was a very low bar.

WOODS: Right.

GIULIANTI: So that wasn't necessarily a major problem to getting companies started. But there is a – I can argue, I can see that companies should have a certain amount of minimum funds in order to get into the insurance business, but even in Florida, it really wasn't all that much until recently. And now I think it's about \$20 million, which is still not a large sum of money to start a property insurance carrier in one of the largest states in the country.

WOODS: All right, so more important than the capital requirements and stuff like that is that what you're telling me is that rates are set or approved by regulators; rates are by territory, not by individual – I don't know what that means, but you can explain that to me – and rebating, giving money back to the buyer, is prohibited. Explain what all this means and why that matters.

GIULIANTI: That's a great question. When I say rates are approved by the regulators, in most places, if you go buy a vehicle or you go buy a garbage can or you go buy a television, how much somebody can charge is not set by anybody. It's set by the market. So the invisible hand says this price is how much you can sell it to make a profit. Perhaps you want to discount it to gain market share. Whatever you want to do in order to build up your customer base and sell a particular product.

In insurance, we have to go to the regulators in the state and say we want to sell this product for this amount of dollars. That's what we want to do. We want to sell it for this price. And they can say yes or no. And you would think that they would say yes as long as it's a sufficient amount. The problem is sometimes regulators will say no, that's too much. Sometimes you'll do an actuarial study and they'll say you need to raise your rates 10%. But you don't want to be uncompetitive, so you only raise it 5%. Or if they say that it's 25% and the state may say we're not letting you raise it 25%. This is an election year. You're not going to get 25%, so you'd better find a way to raise 15% even if you've got to lose some money in the short term.

So we aren't allowed to change to market conditions, to jump up and down to sell a product in a particular area or in a particular time frame that makes sense. So reinsurance costs, like costs that we pay may go up, but the state may say, *Well, you're going to have to take that raise over the next couple years. The people can't handle that.* So if they told anybody else in any other industry or in most other industries, there'd be an outcry. But insurance is always thought of as almost a charity in some sense, that, nah, you can't raise rates on people so fast. It's more of a service to people, and so we're not going to allow that. So we don't have the ability to kind of adapt to the times, which most other industries have, and it puts us behind the 8 ball and it requires us sometimes to raise rates really big because we haven't been able to raise them in the short term.

And when you talk about rates are by territory, not by individual, again, we are allowed to say, okay, this part of Orange County in Orlando, Florida, for instance, the premium is going to be \$1,500. We can't say, well, we like you better or you're in a slightly better area or we want to try to do something where we can reduce the price. It's really done on these hard territories. Sometimes it's geographic; sometimes it's zip codes.

And so we don't have the ability where, in a libertarian-type, free market economy, we should be able to say we're going to sell based on this individual, what they do, how they live their life, maybe what kind of job they have, how good they are at paying back their bills from credit. And so we can make an accurate risk assessment and maybe charge that person less. Whereas the person who doesn't care about their house and they leave things outside and it looks like an abandoned car facility, we would raise rates on those people. And we're not allowed to do that.

WOODS: Yeah. Yeah, yeah. See, I didn't realize any of this. I assumed insurance had to be heavily regulated, but I didn't know the exact form that it took. Now, you say you have very little to no flexibility on rates, deductibles, maximum limits, exclusions, and rate filing procedures. So you're being second guessed on all that?

GIULIANTI: Second guessed, third guessed on all of that. I mean, it's a very big, bureaucratic nightmare. And it's not just Florida, because Florida has some very good regulators and they try their best. The problem is the legislature and the regulators from the top down put so many requirements on you, and so if I feel like saying, *You know what? I want to lower my rates by 10% in a given area*, that's probably a six-month process to get that approved and to go through that. It's like I can say, *You know what? Hamburgers, the meat's cheaper and my competition is charging less so I'm going to drop my price*. You can't do that.

And then when you lower your rates – let's say it takes you six months – remember, it's got to work its way through your policy base. So let's assume you have equal amount of people every single month that are renewing. Only one-twelfth of your policyholders each month are going to receive that new bill. So it takes a year to work through a particular rate increase, a rate decrease.

Same thing with deductibles. You're told you can offer a \$500 deductible, a \$1,000 deductible, a \$2,500 deductible. But if you or I say, *You know what? I'm really not going to make a claim unless it's less than \$5,000 or \$10,000. I'll put the money aside, and it if it's less than 10, I don't want to bother them. Let me take care of it. I also don't want to get thrown out of the program or what have you for too many claims*. You can't do that. It's very, very regulated so that the creativity that you'd see in other industries doesn't exist.

And that's why insurance is such an old-fashioned industry. That's why when you hear about InsurTech or some new companies that are coming up, it's surprising because insurance is really a slow type of process where, until recently, people were using paper applications. And only in the last few years has it really gone electronic. And so if we wanted to change something – I wanted to offer a product where there's a different exclusion or I want to change the limits – again, it's a six-month process and normally they will tell you no if it's not already being done.

WOODS: Wow.

GIULIANTI: Mm hmm.

WOODS: All right, now, there are a couple other things in here that are interesting to me because it sounds like, up to now, we've been talking about how insurance companies do business, how they want to do business, and how government is overseeing everything. But then it looks like, even when you want to innovate in ways that would be socially beneficial, you're being restricted there.

So here are two bullet points: limits to the type of coverages that can be sold, reducing our ability to change to market conditions and solve societal problems. So I'd like to flesh that out. And then: standardizing forms eliminates our ability to change to

market conditions and solve problems or abuses. So that's two in a row in which you're trying to solve problems and government makes it harder. What are these problems and how is government getting in the way?

GIULIANTI: Well, it could be something as simple as — for instance, we get a water claim. So a pipe bursts. You would assume that most people call their insurance company right away or within a couple of days. The average time it takes for someone to report a water loss claim, at least in the state of Florida, is 21 days. Three weeks after a water loss, people still are just reporting it to their insurance company. So why can't some insurance companies say, *You know what? I'll give you a lower premium, but I want you to report it within 48 hours and I want you to use our cleanup crew. We're going to use a cleanup crew that's preferred. We're going to pay them directly, but we trust them, we know them, we've vetted them. We want to do something like that.*

The state would say no. That's a creative way to say we're going to lower your premium, but we're going to require something out of you. We're going to want you to call us within a couple of days from a water loss. We'll make it clear in the policy. We'll tell your agent, but that's something that would solve a problem that we see where people wait weeks and weeks to call in a water loss. By then, you've got the floors are damaged, the dry wall's damaged, the electrical is damaged, and it's a much more expensive proposition, which of course costs everybody, right? Because that's what insurance is: it's everybody putting money into a pool that's then paid out when there's some type of loss to somebody that's a part of that pool.

So one of the things that insurance likes to do is say, *Hey, what's the problem?* Right now, you have people jumping on the cyber risk bandwagon. So there's a cyber risk. It could be anything from data loss to identity theft or corporate identity theft, which causes some kind of damage. Products like that take very long because the regulators don't know how to deal with that. So if a homeowner's company wanted to add on something that covered data loss and had to work out a price for that, it's very difficult. Instead of saying, *Look, let us charge a price. If the market doesn't think it's worth it, they won't pay for it, and if they do think it's worth it, we can alternate the price up or down depending on what kind of losses we see.*

And the same thing with the water loss problem. It should be where an insurance company can jump in and try to solve those types of issues. And you're going to see it in auto — although we don't sell auto, you're going to see it in the auto field with the self-driving cars. There's going to be some kind of bureaucratic regulation, some kind of oversight saying this is how you have to do it.

And so when we have a form, some type of form that we want to utilize or change, it's almost always rejected by regulators because it's not the ISO form, which is the standards office for insurances that comes up with a lot of the initial forms. And, *Well, it hasn't been vetted and we're bureaucrats and we don't want to do something that's going to get us fired or get someone looking at what we're doing.* As opposed to letting private companies say, *Look, we want to sell a golf cart insurance policy as an add-on and we want to do X, Y, and Z to it. Why can't we do that? Well, we've got to look at it. We've got to see what other states are doing.* You're six months into a problem you haven't solved.

WOODS: All right, then let me ask about – I'm curious about private ratings agencies. I was not familiar with these, and whatever they are, I feel sure they'd be playing a much larger role in the absence of the existing regulatory apparatus, but what are they and what do they do?

GIULIANTI: Well, you have well-known names like A.M. Best and you have some of the local or regional ones called, like for instance Demotech. And basically they are, just like you have in the financial services market where somebody will have a bond rated AAA or AAAA, and I'm not a financial expert on that side of the aisle. But you'll look at insurance and we have something similar, whereby they will come in and they'll look at your books; they'll look at your reinsurance; they'll look at how much money you have put away in surplus; what your reserves are, which is what you foresee are going to be your claims that you're going to pay out; what your loss controls are; do you have a real accounting firm working for you; are you audited. And they put all that together and they give you a rating. For instance, the companies that I work for are A exceptional.

And so you'll have these ratings so that people can look and say, I don't need to ask the government whether or not something is safe. I've got an individual private rating company like an A.M. Best, like a Demotech that already looks. It doesn't mean that they're not going to make mistakes over time, because obviously they do. But they get involved really, really heavily in what you do. And so a lot of times, the companies will tell you that, *We need to see you buying more reinsurance or more backup coverage*, and so we'll go out and do that, not because the government told us, but because a private agency. That's the way it should work. A private agency says, *If we're going to give you an A+, you need to go and do these various things. You need some more reinsurance. You need to have more money saved in your saving account in your surplus.* And we'll go out and do that.

And so it's not always that you need the government hammering us and telling us what we need to do. There are already private agencies out there that are professionals, they've been around for decades, and they're extremely educated people that are looking out for the customer. And they're looking out for their own reputation. They don't want to tell someone to buy a company that later gets flushed down the toilet because it wasn't as solvent or as safe as it should have been.

WOODS: Now, look, I've heard stories from people – I don't know. Maybe I haven't really, now that I think about it. Maybe it's just whiners and complainers. But every time I've had to deal with an insurance company, I've had no problem at all. I almost never, ever have to file a claim. In fact, I'm not sure I ever have. At least I know I've had to contact them and have things done and they've done them for me with no problem. But I think some people, they'll remember that one time the insurance company wouldn't honor something for them or this or that, and so they'll think, well, good thing we have the government to keep an eye on these people or think of what they'd get away with. They wouldn't honor their requirements or their obligations and so on. But for some reason, insurance companies in particular seem to generate suspicion among the public, so how do you get them to think in terms of laissez faire?

GIULIANTI: That's a great question, and I'll tell you from my own experience, although I've been in the insurance law field for 25 years, the first half of that was representing

policy holders against insurance companies. In other words, I would represent people and sue insurance companies for the first half of my career. So based on my background, I understand people being suspicious of insurance. I certainly was, and when we started this company, Florida Peninsula, we wanted to do something a bit differently. And I'm not of the camp that there never needs to be any regulation. At least at this stage, I think you can work towards kind of a *laissez faire*.

But people are sometimes suspicious of insurance companies. Of course the answer can be you go to another insurance company. If one insurance company doesn't do a good job or gets a low rating, whether it's from a financial stability company like a Demotech or an A.M. Best, or whether or not you look online and the Yelp review isn't as good as it should be, you go to another company. In a state like Florida, there is so much competition. Even a company like ours might only have 2 or 3% of the market. You've got literally, Tom, hundreds of companies in the state of Florida. Now, you may not be able to name more than five or six, and most people can't, but there are hundreds of companies trying to sell you policies, about 50 to 75 of which are very active even in a state like Florida. And certainly other states like New York or California will have even more. So there already is a lot of competition.

And you find that all of these companies are trying to do the best they can. You know, when I was on the outside, I said, *Wow, the insurance companies, they don't want to pay*. And the fact is that's completely not true. First of all, they're losing customers. Second of all, even in a large type of claim, they normally have reinsurance backstops, so they're sharing that risk with other companies.

But what happens is people will think that something is covered and it's not covered. That's really where we get probably 99% of our problems. If people understood that, I think they'd be more happy with their insurance company. In other words, if you have a loss, your pipe bursts, you call it in, we clean it up, we fix the problem, we write you a check or have it repaired through some kind of managed repair program, those customers are typically happy. But what happens is someone might say water washed in, it came in from the sewer system on the street and it washed in. And that may not be covered. That may be sewer backup and that may not be covered by your policy. So no matter what we tell somebody, they're extremely upset because they feel like everything should be covered. Right? I mean, I have a homeowner's policy. Everything should be covered.

And the fact is that's our job. Our job and our agent's job is to explain to people what's covered. And so I think if more people knew what was covered and what wasn't covered, they'd be a lot less upset. I think their anger comes from – it's not that insurance companies will deny a claim that's completely payable. I'm telling you that does not happen. But what happens is you think it's payable because you're not an expert or a lawyer for the insurance company or an adjustor or an agent, and you think, *Wow, shouldn't flood be covered? It's damaging my house*. But in big, bold letters it says any time water is on the ground, which is what flood is, it's not covered.

So I think it's more educating people about what's covered and what's not covered and people will be less upset, which I think will lead to more of a *laissez-faire* attitude and I think will allow the government to back off.

In addition, you just have to allow people to try new things. If the companies like ours are trying new things that people need – small boat insurance, golf cart insurance, maybe animal liability for dangerous breeds – those types of things are typically not permitted by the regulators. If you let us try that, the insurance companies will find out quickly whether or not they can make a dollar at it and whether or not it's something they want to continue pushing on with.

WOODS: What are some other aspects of insurance that we haven't hit yet where government involvement causes perverse outcomes?

GIULIANTI: The biggest one, most states – Texas has it; a lot of states have it. Florida has one called Citizens Property Insurance Company. It's basically the government is competing with you. So if you check your own state, any state, you're going to find they have these types of pools. But in Citizens in Florida and some of the other major urban states, they're much more of a competitor. So not only am I competing with the State Farms and the Allstates of the world, I'm competing with the government itself. The government – which, by the way, doesn't pay income tax. I have to pay income tax. My company has to pay corporate tax. The government, the Citizens, which used to be called the Joint Underwriting Association but they didn't want people thinking it was a government program, they don't pay income tax. They don't really have to buy reinsurance, which the regulators and the private companies like Demotech and A.M. Best require us to buy. They don't have to buy any of that.

They can lose money, because if they lose money, they have the right to go after the taxpayers or even their own and other policyholders and take money out. I don't know if you know that. But if Citizens loses money, they can go after their own people and say, *Well, we didn't have enough money. You need to put some more money in.* They can go to you. You don't even have a Citizens policy, Tom, and they can go after you and take that money and say, well, just like the taxpayers have to pay for that. You own a policy in an auto. We're going to put a little extra charge on that, your homeowner's, your boat insurance, your renter's insurance, and we're going to put that money into Citizens in order to pay for their own policyholders.

So they charge less, they don't go by the same rules that the other private carriers are, and they take business from us. And so that's something that should almost be out of hand not permitted. Forget about a *laissez faire*. But even in just a good, old-fashioned "the government shouldn't be competing with private industry." And that's something that I think most people don't know. They feel like, well, it's just another company.

And again, you'll see that in other states where they have similar government insurance. It's supposed to be a backstop. So if you have a really awful house and you really don't have a lot of money, there's a place where you can go while you're getting everything up to snuff. In Florida, it's just a regular company run by the government that will compete with you. And people want to keep their jobs, so they're not trying to shrink it as much as they could. They want to keep it going because a lot of people have a lot of jobs at stake in those types of entities.

WOODS: Well, it sounds to me then as if there is no hard and fast answer to a question like: does regulation on balance help or hurt the insurance industry? Now, it sounds

like it hurts it, but the average person might listen to all this and say, well, the result of all this is going to be surely higher premiums than would exist on the free market. Somebody's collecting those higher premiums, so maybe this benefits the insurance industry.

GIULIANTI: Well, the reason there are higher premiums is because there's higher losses. So if you allow us to underwrite properly, if you allow us to use some creative forms – Let's cover those things that are coverable. For instance, in floods, let's charge what it takes to cover a flood. It's going to result in less people dying, less people having their property damaged multiple times, and people will make a choice: do you want to live on the ocean in New Jersey and pay a higher premium because of the risk that the tides are going to come in and flood your property, storm or no storm? Or do you want to build more inland? You get to make that choice, but the market prices that choice. And right now, because of the over-regulation, the market isn't pricing it correctly.

And so while I'm not saying that there is no benefit at all to certain types of regulation like minimum capital requirements, allowing a lot more laissez faire would allow insurance companies to try things that they're not allowed to try now. I don't need to have exactly what you're offering. Let me have something that's a bit different. Let me try to do something that might be cheaper or it might be better for a particular area of the state. People in Orange County aren't going to have a lot of ocean-going yachts, whereas people in South Florida or Jacksonville might. So let me do something with my policy where I can cover some of those types of risks based on a particular area. The state doesn't like that. The state likes when you do everything all the same because nobody can be any different. And unfortunately, the market reality isn't that.

And so although I think on balance it keeps rates higher than it should be, most of that money is going back to the policyholders in the form of higher claims because we're not allowed to target those areas or those territories or write the type of programs that are going to make it more efficient for those people. And there are problems that aren't solved. There are things like flood that just aren't going to go away until the private entities are allowed to go in there and charge and set some of their own rules for that.

WOODS: So in a nutshell, I guess there isn't a whole lot that's likely to happen here in the future. I mean, this seems like it's a pretty entrenched system and the general public is almost completely uninformed about the difficulties under which insurance companies operate, and they probably think I'm not going to shed any tears for insurance companies, so nothing ever changes. Is there any bright spot out there?

GIULIANTI: I think the bright spot is that, first of all, people moving towards kind of libertarian perspectives. I think we saw that in the last election. But I think that even more importantly, when people realize what an insurance company is, if we educate them better, I think they'll change their attitude. Because really an insurance company is just a bunch of people – you, me, people on my street – we put money in, just a little bit of money into an account. If one of us has a problem, that money goes to pay for them.

So it's not that insurance companies are these huge behemoths like the guy in the Monopoly game. That is honestly not it. The insurance company is all of us. It's just like it was back in the days of Lloyd's Coffee House in the UK. They were worried about shipping and so everybody would put a little bit in but only if it was necessary in order to pay for somebody's lost ship. It's the same thing now. An insurance company is really just we manage the money for a bunch of people that have all said, Look, if anything happens to one of us, we're going to kick in and pay for it. And so an insurance company isn't just somebody holding money that's their money. It's holding the people's money.

And I think if people started to see that, they'd understand that it's not some evil company. These are really good people that are working to try to make sure that people's lives are put back in order whenever there's a loss.

WOODS: Well, Stacey, I appreciate your brief here on this for people like me who knew nothing about it. I suspected there was something going on. I mean, I knew there had to be something. It's kind of like what goes on with health insurance in different ways. It's not at all what a market economy would look like. There are all kinds of distortions shot through it and it must be annoying to have to deal with it, but you're doing an important service for us. I'm glad you're sticking it out and also informing us. And I'm glad you wrote to me to discuss this, because now people are better informed and that's always a good thing. Thanks again.

GIULIANTI: Thank you so much for having me.