Reciprocal Exchanges

Excerpt from the April 2024 Conning Commentary

A Model For Homeowners Markets In Crisis

The Florida homeowners insurance market has experienced an influx of new insurers, specifically insurers structured as reciprocal exchanges. We count seven new reciprocal exchanges with a total of $1.7 billion in capital that have entered the Florida market. All except one were formed or substantially capitalized within the past three years. These new entrants represent true startups sponsored by third-party capital, as well as offshoots of existing insurers. The offshoots were formed both to take out policies from Citizens Property (the Florida homeowners market of last resort) as well as to renew existing policies from affiliates.

The reciprocal form appears to be the structure of choice for entering or re-entering the Florida market. However, the reciprocal form is not the only attraction. The newer entrants see an opportunity to capitalize on recent reforms to the Florida market and to take advantage of a stronger rate environment. They are also able to immediately build a portfolio through renewals of other companies' policies as well as through selected take-outs from Citizens Property. Arguably these are examples of more creative solutions to provide needed capacity in a dislocated market, as well as for companies to remain in a market and continue to service agents and insureds.

Why the gravitation to the reciprocal structure? We believe it is for the same reason that many large national insurers have a limited Florida presence—to limit the risk of ruin exposure to the parent balance sheet.

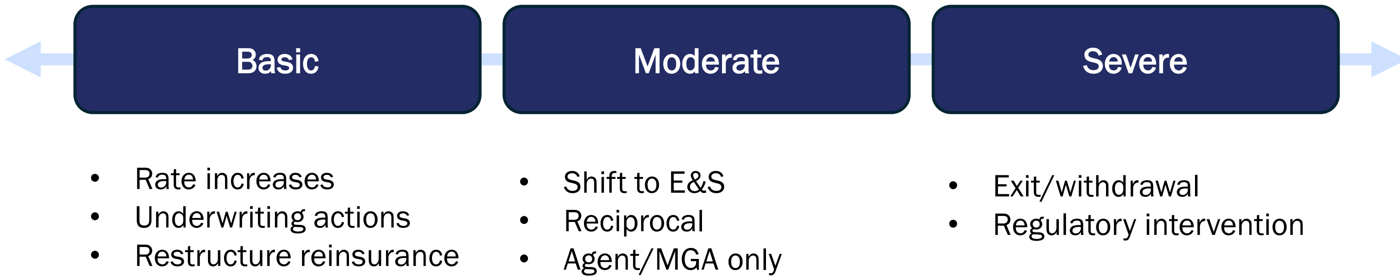
A reciprocal is a form of mutual insurer, owned by the policyholders and managed by an attorney-in-fact. Members or subscribers are charged an amount in addition to their policy premium (typically 10%) as a contribution to surplus. This contribution allows a reciprocal to build surplus faster than through purely retained earnings.

The highest-profile recent reciprocal example is Trusted Reciprocal Underwriters Exchange (or TRUE). TRUE is a Florida-domiciled reciprocal insurer that was formed by American Family in 2020. It writes homeowners insurance in Florida and other cat-exposed regions. On January 5, 2024, private equity firm Gallatin Point made a $1.25 billion investment in TRUE in the form of a surplus note. Gallatin Point also acquired a majority interest in the attorney-in-fact.

The TRUE investment represents an innovative approach to a market segment in need of capacity. The use of a reciprocal structure allows for mutualization of the risk, coupled with significant financial backing from a private equity investor and an experienced management team.

A reciprocal is also an admitted market insurer. An admitted insurer is an advantage from the standpoint of both regulators and agents. The reciprocal form is "regulatory-friendly" by providing new capital from an admitted company. Likewise, agents prefer not to have to go to the nonadmitted market and can tell their customers they have the protections of state guaranty funds.

Spectrum of Insurer Actions



Prepared by Conning, Inc.

The Florida market is like no other homeowners market in the country. The leading insurers consist of not well-known Florida specialists as well as some of the large names. The state has a long history of booms and busts, evident by the market share growth and contraction of Citizens. It is probably the single most catastrophe-exposed market in the country, while also being the best modeled and most attractive one for reinsurers—at times.

These reciprocal insurers, as well as stock companies, are welcome competitors for insureds and regulators alike, providing needed capacity and insurance choices. If reciprocal structures work in the Florida market, why would they not be a potential solution in other dislocated property markets?

Background

Examples of property-casualty insurers de-risking are everywhere and are most prevalent in personal lines. De-risking is a polite term for insurers flat-out exiting certain states, risks, and lines of business.

From the perspective of the insurer, these actions are understandable. Primary insurers have been through a lot just in the past two years—between the effects of economic and social inflation and the reinsurance reset in January 2023. The "last straw" for many companies was the loss experience in 2023, where numerous insurers incurred devastating storm losses, particularly across the Midwest and with a disproportionate impact on mutual companies. These losses led to decreases in surplus—in some cases, substantial surplus declines—and inevitably rating downgrades. Some have made the comparison of "Iowa being the new Florida."

While these exits are the immediate reaction to the current environment, they are ultimately not the solution for insurers, customers, and regulators. A combination of factors needs to occur, ranging from rate increases and reunderwriting actions to a shift in how the business is written (i.e., E&S) to more dramatic ones like the exits we have witnessed.

Ultimately insurers need to make an adequate return on their capital. The above actions are among many insurers can take in the near term to restore profitability and put them on a more solid financial footing. Insurers also need to do more to serve their clients and maintain relationships and ultimately to remain relevant.

Other market solutions

Conning has written extensively about the innovative nature of the excess and surplus lines market, most comprehensively in a piece titled *The World's Most Innovative Insurance Market* in mid-2022. We also published a study in late 2023 called *Traveling Light*, which discussed how asset-light businesses are fostering a more responsive insurance market.

We believe many solutions to today's insurability challenges are embedded in the capital-light vehicles such as reciprocal exchanges and MGA business models as well as the surplus lines market.

New Reciprocal Exchanges
$ in millions

Company	Date Formed	Sponsor/ Affiliation	Surplus Note	Products/ States	Notes
Trusted Reciprocal Underwriters Exchange (TRUE)	2020	American Family, Gallatin Point	$1,250	Cat-exposed homeowners in Florida	Gallatin Point invested $1.25 billion in surplus note in January 2024, majority interest in AIF
Orange Insurance Exchange	9/2023	Griffin Highline	25	Florida property	Founded by Griffin Highline in collaboration with Cabrillo Coastal General Agency
Loggerhead Reciprocal Interinsurance Exchange	Early 2021	Chou Associates	30	Florida homeowners	Offered renewals to Bankers Insurance and Progressive, both of which exited Florida
Condo Owners Reciprocal Exchange (CORE)	11/2023	HCI Group	N/A	Florida commercial residential policies	Assumed $75 million of in-force premiums from Citizens Property in February 2024
Manatee Insurance Exchange	1/2024	Safepoint Insurance	25	Florida property insurance	Plans to renew Safepoint's Florida book of business
Kin Interinsurance Network	6/2019	Kin Insurance Inc.	131.5	Florida property insurance	Affiliated reciprocal Kin Interinsurance Nexus Exchange for other states; surplus note 9/2023
Tower Hill Insurance Exchange	1/2022	Tower Hill Insurance Group	205	Florida homeowners	Renewed Tower Hill Florida policies into THIE beginning mid-2022; surplus note 2022
Ovation Home Insurance Exchange	4/2024	Windward Risk Managers	N/A	Florida homeowners	Begin selling policies in 2024Q2 organically and assumptions from Citizens
Total			**$1,667**		

Prepared by Conning, Inc. Source: company press releases and news articles

The E&S market has expanded dramatically since 2018, fulfilling its role as the relief valve for more difficult-to-place risks. Nowhere is this more prevalent than in the Florida and California homeowners markets as well as the market for cyber insurance. For high-value homes in cat-exposed states, a common solution for insurers has been to shift how the business is written—to the nonadmitted market, which has the benefit of rate and form freedom.

Another example of an innovative approach was AIG's effective conversion from its role of insurer/ risk bearer for high-net-worth clients to one of an MGA. The move was a de-risking step for AIG (consistent with other prior de-risking actions), shifting large homeowner risks off its balance sheet. Acting as an MGA allows AIG to maintain a relationship with insureds while providing access to a broader range of capacity providers and earning an MGA fee in the process. AIG announced this arrangement in February 2023 in partnership with Stone Point Capital.

Are risks finding a new home?

Insureds need risk transfer solutions, and insurers are in the business of accepting risk. Someone has to bear the risk. Perhaps the analogy is akin to what has developed in the catastrophe reinsurance market, which has been the evolution of matching risks with the most appropriate and efficient capital sources. As we have seen in this market, that capital source may not be a rated insurer or reinsurer, but rather the capital markets via ILS funds.

This analogy may be an extreme comparison to our example of Midwest personal lines business, but there are examples of innovation that could be and are highly applicable. Perhaps the reciprocal form can help bridge the gap for other dislocated markets (i.e., currently across the Midwest). Past examples have shown how new capital can enter a market, both from existing insurers and from third-party private equity investors.

Steve Webersen

Meet the Author

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