

Financial Services Commission

Florida Office of Insurance Regulation



Annual report of aggregate net probable maximum losses,
financing options, and potential assessments

February 2007

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Addendum to Annual report of aggregate net probable maximum losses, financing options, and potential assessments

Subsequent to the initial publication of the Annual Report of Aggregate Net Probable Maximum Losses, Financing Options, and Potential Assessments of the Florida Hurricane Catastrophe Fund (FHCF) and Citizens Property Insurance Corporation (Citizens), released on February 4, 2007, the Office of Insurance Regulation (Office) received updated figures from both Citizens and the FHCF. Please note the amended tables below.

NOTE: The Office was unable to perform some of the necessary calculations for this report due to the fact that Citizens cannot calculate its surplus information prior to the February 1 deadline for the report. Additionally, the information regarding the premium base available for assessment by both Citizens and the FHCF is updated annually through statutory reporting requirements by mid-March of each calendar year. The Office recommends that the report's submission date be pushed back in order for all necessary information to be gathered prior to drafting the report each year.

Table 1

FHCF				
Return Time	Ground Up Loss	FHCF Cap	Available Cash	Shortage
250	\$74,699,981,357	\$15,850,000,000	\$2,000,000,000	\$13,850,000,000
100	\$47,370,702,055	\$15,850,000,000	\$2,000,000,000	\$13,850,000,000
50	\$30,616,831,160	\$15,850,000,000	\$2,000,000,000	\$13,850,000,000
Retention	\$6,100,000,000			
Cap	\$15,850,000,000			

Table 2

Citizens Property Insurance Corporation

Return Time	Aggregate PML	Retention	Net Loss Above FHCF Retention	Net Losses	Shortage (\$7 billion available)	Projected 2007 Net Income	Liquidity Gap
250	\$39,789,264,248	\$2,056,158,000	\$31,887,006,248	\$33,943,164,248	-\$26,943,164,248	\$1,862,951,726	-\$25,080,212,522
100	\$23,956,102,892	\$2,056,158,000	\$16,053,844,892	\$18,110,002,892	-\$11,110,002,892	\$1,862,951,726	-\$9,247,051,166
50	\$15,637,617,596	\$2,056,158,000	\$7,735,359,596	\$9,791,517,596	-\$2,791,517,596	\$1,862,951,726	-\$928,565,870

Table 3

Financing		Annual Interest Expense AA rating			Principal Amortization		
Return Time	Amount to Finance	5 years	10 years	20 years	5 years	10 years	20 years
250	\$13,850,000,000	\$527,685,000	\$552,615,000	\$591,395,000	\$2,770,000,000	\$1,385,000,000	\$692,500,000
100	\$13,850,000,000	\$527,685,000	\$552,615,000	\$591,395,000	\$2,770,000,000	\$1,385,000,000	\$692,500,000
50	\$13,850,000,000	\$527,685,000	\$552,615,000	\$591,395,000	\$2,770,000,000	\$1,385,000,000	\$692,500,000

	Annual Interest Expense A rating			Principal Amortization		
	5 years	10 years	20 years	5 years	10 years	20 years
	\$552,615,000	\$574,775,000	\$614,940,000	\$2,770,000,000	\$1,385,000,000	\$692,500,000
	\$552,615,000	\$574,775,000	\$614,940,000	\$2,770,000,000	\$1,385,000,000	\$692,500,000
	\$552,615,000	\$574,775,000	\$614,940,000	\$2,770,000,000	\$1,385,000,000	\$692,500,000
Rates @ Aa rating- S&P	3.81	3.99	4.27			
Rates @ A rating - S&P	3.99	4.15	4.44			

Annual report of aggregate net probable maximum losses, financing options, and potential assessments

Purpose and Scope

Section 627.3519, Florida Statutes, enacted in 2006, requires the Financial Services Commission to provide a report to the Legislature regarding the aggregate net probable maximum losses, financing options and potential assessments of both the Florida Hurricane Catastrophe Fund (FHCF) and Citizens Property Insurance Corporation (Citizens). More specifically:

§ 627.3519 Annual report of aggregate net probable maximum losses, financing options, and potential assessments.--No later than February 1 of each year, the Financial Services Commission shall provide to the Legislature a report of the aggregate net probable maximum losses, financing options, and potential assessments of the Florida Hurricane Catastrophe Fund and Citizens Property Insurance Corporation. The report must include the respective 50-year, 100-year, and 250-year probable maximum losses of the fund and the corporation; analysis of all reasonable financing strategies for each such probable maximum loss, including the amount and term of debt instruments; specification of the percentage assessments that would be needed to support each of the financing strategies; and calculations of the aggregate assessment burden on Florida property and casualty policyholders for each of the probable maximum losses. The commission shall require the fund and the corporation to provide the commission with such data and analysis as the commission considers necessary to prepare the report.

Recent Developments

As the report was being compiled, the Florida Legislature met in special session from January 16-22, 2007 to consider legislative changes designed to stabilize the Florida property insurance market and provide rate relief to Florida's policyholders. With the passage of House Bill 1A, the Legislature made a number of significant changes to the market framework. The changes adopted by the Legislature and signed by the Governor will have a profound impact on the information required for this report.

This 2007 report provides the required information germane to the market prior to the passage of House Bill 1A. The report for February, 2008 will provide information based on the changes implemented in House Bill 1A, enacted in the Special Legislative Session, 2007A.

Aggregate Net Probable Maximum Loss

Florida Hurricane Catastrophe Fund

Table 1 below presents the aggregate net probable maximum loss (PML) for the Florida Hurricane Catastrophe Fund based on their 2006 Ratemaking report.

Table 1

Florida Hurricane Catastrophe Fund					
Return Time	Total Loss	FHCF Exposure	FHCF Cap	Available Cash	Shortage
250	\$74,699,981,357	\$68,599,981,357	\$15,850,000,000	\$2,700,000,000	\$13,150,000,000
100	\$47,370,702,055	\$41,270,702,055	\$15,850,000,000	\$2,700,000,000	\$13,150,000,000
50	\$30,616,831,160	\$24,516,831,160	\$15,850,000,000	\$2,700,000,000	\$13,150,000,000
Retention	\$6,100,000,000				
Cap	\$15,850,000,000				

SOURCE: Data used in this analysis was obtained directly from the Florida Hurricane Catastrophe Fund and from the Florida Hurricane Catastrophe Fund 2006 Ratemaking Formula Report available at <http://www.paragonbenfield.com/fhcf/current/06ratereport.html>.

For storms of specific periods -- one in fifty, one in one hundred, and one in two hundred fifty years, the second column shows the aggregate loss PML. The FHCF exposure begins after an aggregate industry retention of \$6.1 billion in losses, and is capped at a maximum exposure for the FHCF of \$15.85 billion. Due to financing activity during 2006, accompanied by a lack of storms, resulted in the FHCF having approximately \$2.7 billion to pay claims. The last column shows the amount of funds the FHCF would need to raise to cover contractual losses using either its assessment authority or through bond financing. It should be noted that the amount of funding needed is the same regardless of a fifty, one hundred, or two hundred fifty year event, as the fund's cap is exhausted at a level lower than the fifty year event loss. As a result, regardless of the event scenario considered, a deficit of approximately \$13.15 billion would occur.

Citizens

Table 2 below presents the aggregate net PML for Citizens Property Insurance Corporation.

Table 2

Citizens Property Insurance					
Return Time	Aggregate PML	Retention	Net of Retention and FHCF	Net Losses	Shortage (\$7 billion currently available)
250	\$39,789,264,248	\$2,056,619,347	\$3,773,264,490	\$5,829,883,837	\$0
100	\$23,956,102,892	\$2,056,619,347	\$2,189,948,355	\$4,246,567,702	\$0
50	\$15,637,617,596	\$2,056,619,347	\$1,358,099,825	\$3,414,719,172	\$0

SOURCE: Data used in this analysis was obtained from Citizens Property Insurance Corporation and uses 12/31/06 aggregate data based on RMS Model output. Results were weighted 2/3 Stochastic Rates, 1/3 Historical Rates.

As a result of the assumption of policies from the Poe Group in 2006, Citizens' aggregate PML rose dramatically. Using the 2006 retention guide, Citizens' loss retention is \$2.056 billion before gaining access to FHCF coverage. Citizens Corporation purchases coverage from the FHCF at the 90% option, meaning that Citizens will be responsible for 10% of the losses above the retention level, but below the cap. The fifth column in Table 2 shows the losses payable by Citizens after accounting for the retention level and the FHCF coverage. The last column shows the amount of any deficit incurred. It should be noted that as a result of the bond financing undertaken by Citizens during 2006, along with the absence of hurricanes, approximately \$7 billion is now available to pay claims before deficits occur. These reserves are sufficient to cover losses from the one in fifty and one in one hundred events, as well as the one in two hundred fifty year event.

Financing Options

Florida Hurricane Catastrophe Fund

The pre-event financing undertaken by the FHCF during 2006 was accomplished through a combination of taxable and tax-exempt securities. In the event scenarios considered, the deficit of \$13.15 billion would be financed on a post-event basis, so it is contemplated that the financing would be accomplished through tax exempt securities.

The FHCF has maintained an AA rating until recently, when the rating was downgraded to AA- on January 25, 2007. The example in Table 3 shows a range of financing options of 5, 10 and 20 years for both a tax exempt AA index rate and an A index rate, in order to demonstrate the effects should the FHCF's rating be further downgraded. Table 3 below shows the annual interest cost for each combination of rate and maturity. Additionally, an amortization schedule for the principal is included. While there are a variety of methods to amortize principal, for the ease of presentation, it is assumed the principal is amortized on a straight-line basis.

Table 3

Financing							
Return Time	Amount to Finance	Annual Interest Expense AA rating			Principal Amortization		
		5 years	10 years	20 years	5 years	10 years	20 years
250	\$13,150,000,000	\$501,015,000	\$524,685,000	\$561,505,000	\$2,630,000,000	\$1,315,000,000	\$657,500,000
100	\$13,150,000,000	\$501,015,000	\$524,685,000	\$561,505,000	\$2,630,000,000	\$1,315,000,000	\$657,500,000
50	\$13,150,000,000	\$501,015,000	\$524,685,000	\$561,505,000	\$2,630,000,000	\$1,315,000,000	\$657,500,000
		Annual Interest Expense A rating			Principal Amortization		
		5 years	10 years	20 years	5 years	10 years	20 years
		\$524,685,000	\$545,725,000	\$583,860,000	\$2,630,000,000	\$1,315,000,000	\$657,500,000
		\$524,685,000	\$545,725,000	\$583,860,000	\$2,630,000,000	\$1,315,000,000	\$657,500,000
		\$524,685,000	\$545,725,000	\$583,860,000	\$2,630,000,000	\$1,315,000,000	\$657,500,000
Rates @ AA rating- Standard & Pools		3.81	3.99	4.27			
Rates @ A rating – Standard & Pools		3.99	4.15	4.44			

NOTE: Rates based on January 29, 2007 data from Standard & Pools

Citizens

As shown in Table 2, no financing would be required under the given scenarios.

Assessment Impact

Florida Hurricane Catastrophe Fund

Table 4 below provides some information on the impact of the FHCF reducing the possible \$13.15 deficit through assessments.

Table 4

Assessment	Amount Needed
Return Time	
250	\$13,150,000,000
100	\$13,150,000,000
50	\$13,150,000,000
Assessment Base 2005 (2006 available February 2007)	

Total w/ Residual Market	\$31,713,757,508
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Deficit as a % of Base Assessment	
Return Time	
250	41.46%
100	41.46%
50	41.46%

6% Emergency Assessment			
Return Time			Years to Recovery
250	\$1,902,825,450.48		7
100	\$1,902,825,450.48		7
50	\$1,902,825,450.48		7

Based on the premium written in the eligible lines of business, the assessment base is approximately \$32 billion. As the table shows, the \$13.15 possible deficit represents nearly 42% of the assessable base. As an upper measure of the impact, using the 6% emergency assessment rate, approximately \$1.9 billion could be raised annually. At that level, as the table shows, it would take 7 years to recover the deficit.

Citizens

Again, following from Table 2, no assessments would be needed for the given event scenarios.

Summary

The information provided in this report is intended to provide an overview of the financial impact of severe storms on the FHCF, Citizens, and ultimately Florida’s policyholders. The tables provided show that under the one in fifty, one in one hundred, or one in two hundred fifty year events, the FHCF will reach its cap, and would be required to cover a deficit of \$13.15 billion. With the information provided, it would appear that Citizens would not realize any deficits following the prescribed events. If any were necessary, Citizens could use its present statutory authority, either through a bond issue or assessments, to raise capital to withstand these events without the need for additional statutory authority.

It is important to note that the information provided here is an estimate. Changes in catastrophe model results, significant changes in the underlying risk assumed, and changes in the premiums written by FHCF or Citizens would have a substantial impact on the actual results.