Financial Services Commission

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

February 2010

Table of Contents

The Office would like to thank Citizens Property Insurance Corporation and the Florida Hurricane Catastrophe Fund for contributing data to this report. The data contained in this report has not been audited.

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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.

Introduction

The Florida Hurricane Catastrophe Fund (the "FHCF")and Citizens Property Insurance Corporation ("Citizens") both play significant roles in the provision of property insurance coverage for Florida residents. Four consecutive seasons without hurricane activity affecting Florida have given both entities an opportunity to augment resources and otherwise prepare for future storms. Both have significant financial resources as of the end of 2009: Citizens has estimated policyholders' surplus of $3.8 billion, and the FHCF has estimated net assets of $4.5 billion. In addition to these resources, both entities have entered into pre-event financing arrangements that provide additional liquidity. Nonetheless, both would need to rely on their various assessment and/or bonding capabilities to pay claims if a storm or storms of sufficient size impacted Florida. The analyses presented in this report summarize those resources and how each entity would apply them after an event.

Aggregate Net Probable Maximum Loss

Florida Hurricane Catastrophe Fund

The basic structure of the FHCF is as follows:

- The FHCF provides reimbursement to participating insurers (which comprises virtually all admitted insurers writing residential property insurance in Florida as well as Citizens) for their covered losses from hurricanes after each insurer has met its retention, or deductible. After the retention is met, the FHCF reimburses covered losses at up to 90%, with the remainder the responsibility of the insurer. For 2009, the aggregate industry retention was $7.22 billion.
- The FHCF has a mandatory layer of coverage providing up to $17.175 billion in industry-wide reimbursement for 2009.
- The FHCF also has three optional layers of coverage.
    - The Temporary Increase in Coverage Layer ("TICL") layer, (Section 215.555(17), Florida Statutes), which provides optional coverage to all participants above the mandatory layer. For 2009, this layer could have provided up to $10 billion of additional coverage; however, actual coverage purchased by participants was $5.56 billion. For 2010, TICL is $8 billion. The analysis contained in this report assumes that <u>all</u> such coverage is purchased.
    - An additional amount of reimbursement coverage of up to $10 million per company for certain companies as described in Section 215.555(4)(b)4. Florida Statutes. In 2009, $441 million of such coverage was purchased.
    - The Temporary Emergency Additional Coverage Options ("TEACO") layers, (Section 215.555(16), Florida Statutes), which provide for coverage at lower retention levels but significantly higher rates, ranging from 75% to 85% of the coverage purchased. No TEACO coverage was purchased in 2009.

- The FHCF pays covered losses first from cash on hand, which is derived primarily from retained reimbursement premiums from participating insurers (in 2009 the FHCF collected approximately $1.466 billion in such premiums) and investment earnings; any shortfall is designed to be paid from the proceeds of post-event bonds secured by emergency assessments levied in amounts sufficient to pay debt service on the bond issue and associated costs. These assessments can be levied in amounts totaling no more than 6% for any one season, and 10% in aggregate, and may be levied on most property and casualty insurance premiums in the State.

Table 1-FHCF

The table below shows the net probable maximum loss to the FHCF from storms of the return time specified. The loss calculations shown below were derived from the FHCF 2009 Ratemaking Formula Report done by Paragon Strategic Services, consulting actuary to the FHCF. The complete report may be found at http://fhcf.paragonbenfield.com/pdf/09ratereport.pdf

Return Time (years)	Gross Probable Maximum Loss [1]	Net Losses to FHCF [2]	Projected Year-End Fund Balance [3]	Assessable Shortfall
250	$90,588,242,766	$23,173,000,000	$4,498,000,000	$18,675,000,000
100	$58,099,025,250	$23,173,000,000	$4,498,000,000	$18,675,000,000
50	$38,388,320,250	$23,173,000,000	$4,498,000,000	$18,675,000,000

Retention	$7,223,000,000
Mandatory Coverage	$17,175,000,000
TICL Coverage	$5,560,000,000
Limited Apportionment Company Coverage	$441,000,000

[1] Represents gross loss to all Florida residential policyholders from a storm of the indicated return time multiplied by 1.05 to allow for 5% LAE

[2] Assumes retention and coverages shown below the table

[3] Estimated FHCF operating cash as of 12/31/09

Citizens

Citizens provides property insurance coverage in Florida to individuals and businesses that meet specified statutory criteria. Citizens provides its coverage through three accounts. These accounts are separate for virtually all financial purposes, including deficit calculation and assessments. Two of the accounts – the PLA and CLA – are combined for purposes of FHCF coverage and bond security. A summary of the three accounts is as follows:

- High-Risk Account ("HRA"); the HRA provides wind-only and multi-peril coverage for policyholders (residential and commercial) in defined geographic areas near the coast.
- Personal Lines Account ("PLA"); the PLA provides comprehensive multi-peril policies to homeowners throughout Florida.
- Commercial Lines Account ("CLA"); the CLA provides commercial residential (condominium association, etc.) and commercial nonresidential wind-only and commercial nonresidential multi-peril coverage throughout Florida.

Table 1-Citizens

The table below presents the aggregate net PML from storms of the return time specified for: (1) the PLA/CLA; (2) the HRA; and (3) all accounts combined. The loss calculations were done by one of Citizens reinsurance brokers, AonBenfield, using RMS RiskLink v.8.0a.

PLA/CLA

Return Time (years)	Aggregate PML (PLA/CLA) [1]	FHCF Reimbursement [2]	Surplus [3]	Assessable Shortfall
250	10,274,640,000	3,084,000,000	2,601,000,000	4,589,640,000
100	6,060,638,000	3,084,000,000	2,601,000,000	375,638,000
50	3,952,375,000	1,351,375,000	2,601,000,000	0

HRA

Return Time (years)	Aggregate PML (HRA)	FHCF Reimbursement	Surplus	Assessable Shortfall
250	19,918,496,000	5,654,000,000	1,619,000,000	12,645,496,000
100	11,241,678,000	5,654,000,000	1,619,000,000	3,968,678,000
50	6,981,698,000	5,362,698,000	1,619,000,000	0

Combined

Return Time (years)	Aggregate PML (PLA/CLA & HRA)	FHCF Reimbursement	Surplus	Assessable Shortfall
250	30,193,136,000	8,738,000,000	4,220,000,000	17,235,136,000
100	17,302,316,000	8,738,000,000	4,220,000,000	4,344,316,000
50	10,934,073,000	6,714,073,000	4,220,000,000	0

[1] All PMLs are single event, and are calculated using exposures as of September 30, 2009

[2] FHCF Reimbursement assumes that Citizens purchases TICL layer

[3] Surplus is projected as of December 31, 2010

Financing Options

Florida Hurricane Catastrophe Fund

The FHCF undertakes two basic types of financing: (1) pre-event financing to provide liquid funds to reimburse participating insurers in a timely manner; and (2) post-event financing designed to provide the ultimate source of payment of covered claims in excess of cash on hand.

The FHCF currently has one pre-event bond issue outstanding, totaling $3.5 billion in principal amount; prior to the expenditure of proceeds to pay future claims, this debt is designed to be paid primarily from the interest earnings on the invested proceeds of the bonds (which are retained pending their use to pay future claims) and from reimbursement premiums should the investment earnings fall short. There are no assessments associated with pre-event bonds of the FHCF. If the proceeds of pre-event bonds are ever used to pay claims, it is likely that the FHCF will refinance such bonds using post-event bonds secured by emergency assessments.

The FHCF also has two series of post-event bonds outstanding, both of which were used to pay claims from the 2005 hurricane season. The debt service on these bonds and the associated assessment are summarized in the table below:

	Series 2006A Bonds[1]		Series 2008A Bonds		Total Post-Event Debt Service			Annual
	Principal	Interest	Principal	Interest	Principal	Interest	P&I	Assessment %
2010	$269,485,000	$42,536,825	$0	$29,865,356	$269,485,000	$72,402,181	$341,887,181	1.00%
2011	282,660,000	29,362,575	0	29,865,356	282,660,000	59,227,931	341,887,931	1.00%
2012	296,795,000	15,229,575	0	29,865,356	296,795,000	45,094,931	341,889,931	1.00%
2013	0	0	300,000,000	29,865,356	300,000,000	29,865,356	329,865,356	1.00%
2014	0	0	325,000,000	15,450,425	325,000,000	15,450,425	340,450,425	1.00%
Total	**$848,940,000**	**$87,128,975**	**$625,000,000**	**$134,911,850**	**$1,473,940,000**	**$222,040,825**	**$1,695,980,825**	

1 Original bonds were issued in the amount of $1.35 billion – these amounts represent currently outstanding bonds.

All outstanding FHCF debt has a AA- rating from both Standard and Poor's and Fitch and a Aa3 rating from Moody's.

The FHCF has the statutory authority to amortize its debt over a term of up to 30 years. Given the magnitude of the losses associated with the storms summarized in "Table 1 – FHCF" above, the FHCF would probably use this full term for any bonds associated with the financing of these losses. The FHCF has the ability to issue such bonds on a tax-exempt basis to pay covered claims. It should be noted that the recent and ongoing upheaval in the credit markets worldwide has made financing more difficult to complete. The size and circumstances that would surround a FHCF post-event issue to pay such losses would complicate the issuance process. Given these factors, it is uncertain whether the FHCF could in fact complete a bond issue or series of bond issues of the size necessary to pay all covered losses. If long-term bonding in sufficient amounts is not immediately available, the FHCF would need to explore a staged financing schedule and/or interim financing alternatives to bridge the gap until adequate long-term market access was available. The FHCF statute provides that the FHCF's liability is limited to the amount it can actually raise from bonding and other available claims payment sources.

Citizens

Citizens also undertakes two basic types of financing: (1) pre-event financing to provide liquid funds to pay policyholders in a timely manner (Citizens primarily uses these financing as a "bridge" to ultimate claims-paying resources such as FHCF reimbursements or assessments); and (2) post-event financing designed to provide the ultimate source of payment of covered claims in excess of accumulated surplus and FHCF reimbursements.

Citizens currently has two series of pre-event bonds outstanding (both for the HRA), totaling $1.896 billion. Of this amount, $625 million will mature prior to the 2010 hurricane season. It also has a standby bond purchase agreement for the HRA with the State of Florida for $750 million. This also will expire prior to the 2010 hurricane season. For the PLA/CLA, Citizens has a line of credit with a group of commercial banks in the amount of $400 million, which will expire on May 6, 2010. What remains for the 2010 hurricane season is $1.271 billion in external pre-event liquidity for the HRA, and no external liquidity for the PLA/CLA.[1] Together with Citizens' accumulated surplus, this external liquidity provides the source of immediately available funds to pay claims. For the HRA in 2010, this is projected to be $3.012 billion ($1.271 billion of existing pre-event financing and $1.741 billion of projected surplus as of 12-31-10), and for the PLA/CLA it is projected to be $2.879 billion (all from projected surplus as of 12-31-10). Citizens' pre-event bonds are paid primarily from the investment earnings on the proceeds of such bonds (which are retained pending their need to pay future claims) and from accumulated premiums if investment earnings fall short. There are no assessments associated with pre-event bonds.

Citizens also has one series of post-event bonds outstanding, in the remaining par amount of $920.96 million. These bonds are being repaid from the receipts of emergency assessments that were levied beginning in March 2007 at the rate of 1.4% per year for 10 years. Although Citizens' assessment base is now essentially the same as the FHCF, this assessment is levied on the historical base, which includes a much more limited range of property and casualty insurance premiums than does the current base.

Citizens' outstanding debt – all of which is for the HRA - has long-term underlying ratings of A2 from Moody's and A+ from Standard & Poor's, and short-term ratings of MIG-1 from Moody's and SP-1+ from Standard & Poor's.

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[1] Citizens is considering alternatives for enhancing its external liquidity sources prior to the start of the 2010 hurricane season.

Citizens has a number of different assessments which it must use in statutorily prescribed ways to pay any deficits caused by storm losses (see the following section for a description of these various assessments). Most of these assessments are "one-time" levies and therefore do not require financing. Only if Citizens experiences losses sufficient to use all of this "one-time" assessment authority is it obligated to levy emergency assessments; these assessments can be levied over time and used to secure post-event bond financing. Citizens does not have a specific maturity limitation on its indebtedness, but the analysis in this report assumes that Citizens would finance any remaining deficit over a 30-year period. It should be noted again that the recent and ongoing upheaval in the credit markets worldwide has made many financing more difficult to complete. The size and circumstances that would surround a Citizens post-event issue to pay losses would complicate this process. Given these factors, it is uncertain whether Citizens could in fact complete a bond issue or series of bond issues of the size necessary to pay all covered losses. If long-term bonding in sufficient amounts is not immediately available, Citizens would need to explore a staged financing schedule and/or interim financing alternatives to bridge the gap until adequate long-term market access was available.

Assessment Impact

Florida Hurricane Catastrophe Fund

As described above, the FHCF would probably attempt to finance shortfalls of the size created by the storms shown in Table 1-FHCF using post-event tax-exempt bonds amortized over a 30-year period. These bonds would be repaid using emergency assessments on all property and casualty lines of business including surplus lines but excluding workers' compensation insurance, medical malpractice insurance, federal flood insurance, and accident and health insurance.

Table 2-FHCF below shows the estimated annual assessment impact from the prescribed storm sizes.

TABLE 2 - FHCF

Florida Hurricame Catstrophe Fund Assessment Impact

Return Time (years)	Gross Probable Maximum Loss [1]	Assessable Shortfall	Required Annual Assessment ($) [2]	Required Annual Assessment (%) [3]
250	90,588,242,766	18,675,000,000	1,430,083,734	4.10%
100	58,099,025,250	18,675,000,000	1,430,083,734	4.10%
50	38,388,320,250	18,675,000,000	1,430,083,734	4.10%

[1] Represents gross loss to all Florida residential policyholders from a storm of the indicated return time multiplied by 1.05 to allow for 5% LAE (source - 2009 FHCF Ratemaking Formula Report prepared by Paragon Strategic Solutions - see full reports at http://fhcf.paragonbenfield.com/current/09ratereport.html

[2] Annual Assessment for 30 years assuming interest rate of 6.5%

[3] Assumes assessment base of $34.925 Billion

Citizens

Citizens has a multi-layered assessment regime as prescribed by Florida Statutes. Two important features of the Citizens assessment structure are (1) each account (i.e. the HRA, PLA, and CLA) calculates its deficit separately, and each account has separate assessment authority. Therefore, there is the potential for overlapping assessments caused by deficits in more than one of the Citizens' accounts; and (2) with the exception of emergency assessments, all Citizens' assessments are "one-time" levies rather than multi-year assessments that can be financed. With these factors in mind, the basic construct of Citizens' assessments for 2010 is as follows (this is not an exhaustive description, but rather a "big-picture" summary):

(1) Any deficit in an account (defined generally as losses in excess of surplus) is first funded by an assessment on Citizens policyholders, up to a total of 15%.

(2) Any remaining deficit is then funded by a regular assessment on insurance companies writing most types of property and casualty policies in Florida. The regular assessment can statutorily be levied at up to a 6% rate.

(3) Any remaining deficit is paid from the proceeds of emergency assessments, which can be levied directly on policyholders of most property and casualty lines in Florida at the greater of 10% of the assessment base or 10% of the remaining deficit. This effectively gives

Citizens the ability to finance any deficit over a 10-year period, although it could choose to finance it over a longer period. These emergency assessments would typically be used to secure post-event bonds, the proceeds of which would be used to pay policyholder claims in a timely manner.

Table 2-Citizens below shows the estimated annual assessment impact for each type of Citizens assessment from the prescribed storm sizes.

TABLE 2 - Citizens

Assessment Impact

	Citizens' Policyholders Surcharge		Regular Assessments		Emergency Assessments		Total Assessment
Return Time (years)	$ Amount	%	$ Amount	%	$ Amount	% [a]	$ Amount [b]
Combined 1/250	1,035,000,000	45.0%	5,855,640,000	18.0%	10,344,496,000	2.40%	17,235,136,000
Combined 1/100	720,638,000	31.3%	1,956,000,000	6.0%	1,667,678,000	0.40%	4,344,316,000
Combined 1/50	0	0.0%	0	0.0%	0	0.00%	0

Levied on Citizens' policyholders only.
Levied on non-Citizens' policyholders only.
Levied on both Citizens' and non-Citizens' policyholders

[a] Represents the annual assessment percentage for 30 years
[b] Total principal amount of assessments levied, does not include interest and other costs on financed emergency assessments

Conclusion

The Florida Hurricane Catastrophe Fund and Citizens Property Insurance Corporation provide an important financing mechanism to supplement the private insurance marketplace. Together, they ensure the availability of property insurance coverage in Florida, as well as assist in managing catastrophe risk from hurricane activity. While serving different purposes, both entities ultimately rely on a combination of accumulated premiums and broad base public funding to cover deficits; they are also dependent on the credit markets for financing (both pre-event and post-event financing).

Although Florida experienced significant hurricane activity during the calendar years 2004-2005, most of the storms were not large enough for all insurance companies to reach their FHCF attachment points. Both Citizens and FHCF have improved their financial position over the last four years. Based on the long term accepted models used for this report, Citizens would have enough resources to handle a 1-in-50 year storm (estimated to be a $38.4 billion event), without assessments. This assumes payment from the FHCF.

However, if a 1-in-100 year storm (estimated to be a $58.1 billion event) or 1-in-250 year storm (estimated to be a $90.6 billion event) occurred, both entities would need to issue bonds to pay claims. While both entities continue to maintain their high-level investment grade ratings from the major rating agencies, the success and cost of this post-event bonding strategy would depend on the market conditions at the time of the issuance of the bonds.