



**LIMITED SCOPE EXAMINATION REPORT
OF
FEDNAT INSURANCE COMPANY**

NAIC Company Code: 10790

**Sunrise, Florida
as of
December 31, 2018**

**BY THE
FLORIDA
OFFICE OF INSURANCE REGULATION**

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January 20, 2020

David Altmaier
Commissioner
Office of Insurance Regulation
State of Florida
Tallahassee, Florida 32399-0326

Dear Commissioner:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, Rule 69O-138.005, Florida Administrative Code, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted a limited scope examination of the gross and net Loss and Loss Adjustment Expenses (LAE) reserves as of December 31, 2018, of:

FedNat Insurance Company
14050 NW 14th Street, Suite 180
Sunrise, Florida 33323

hereinafter referred to as “the Company.” Such report of examination is herewith respectfully submitted

SCOPE OF EXAMINATION

This was a limited scope examination of FedNat Insurance Company as directed by the Florida Office of Insurance Regulation (“the Office”). To the extent applicable, the limited scope examination was conducted in accordance with the guidance of the National Association of Insurance Commissioners (NAIC) Financial Condition Examiner’s Handbook, the NAIC Accounting Practices and Procedures Manual and the Florida Administrative Code. This examination was limited to particular risk areas of operational processes and the focus is less comprehensive than a full-scope examination. This report is for a limited-scope examination, and is not intended to communicate all matters of importance for an understanding of the Company’s financial condition.

The field work commenced on January 1, 2020 and concluded as of January 20, 2020. The limited scope examination included material events occurring subsequent to December 31, 2018 and noted during the course of the examination as they related solely to the areas within the limited scope of the examination detailed in the following paragraph.

This examination was conducted by SL FINANCIAL, Inc. and, covered the gross and net Loss and Loss Adjustment Expense (LAE) reserves as of December 31, 2018, to consider the impact of the following factors:

- The Company experienced rapid growth in Florida and other states, therefore exposing its carried reserves to risk of material adverse deviation.
- The Company experienced one-year and two-year adverse development which were booked below the actuary’s point estimate.

REINSURANCE

The reinsurance agreements reviewed complied with NAIC standards with respect to the standard insolvency clause, arbitration clause, and intermediary clause, transfer of risk, and reporting and settlement information deadlines.

Reinsurance Assumed

The Company assumed reinsurance during the period of this examination. In previous years, the Company had assumed reinsurance from JRG Reinsurance Company, Ltd. As of December 31, 2018, the Company no longer assumes premium from this Bermuda domiciled company.

Reinsurance Ceded

The Company had a catastrophe reinsurance program, which consisted of the Florida Hurricane Catastrophe Fund (FHCF), excess of loss treaties placed with the private market, and a property quota-share program. The property quota-share reinsurance is a form of proportional reinsurance that is utilized by the Company to provide coverage for its homeowners' property policies for wind related catastrophes in Florida. The FHCF treaty also provides coverage for losses sustained in Florida as a result of hurricanes and represents only a portion of the company's reinsurance coverage for its Florida policies.

The reinsurance contracts were reviewed by the Company's appointed actuary and were utilized in determining the ultimate loss opinion.

LOSSES AND LOSS ADJUSTMENT EXPENSES

The Company's Board of Directors appointed, and the Company contracted with an outside actuarial firm, who rendered an opinion that the amounts carried in the balance sheet as of December 31, 2018, made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

Achille Sime Lanang, FIAF, FSA, MAAA, CERA of SL FINANCIAL, Inc., reviewed the Losses and Loss Adjustment Expenses carried in the Company's balance sheet as of December 31, 2018 and he concluded that the net carried reserves are reasonable but are deficient on a gross of reinsurance basis.

Data

The Company provided the following data and information to perform the actuarial analysis in addition to data and information provided for past reports:

- Paid and incurred Losses and Loss Adjustment Expenses data and open and reported claim count data by state and coverage as of December 31, 2018.
- Details of the 2018 and 2019 reinsurance agreements.
- Paid and incurred Losses and Loss Adjustment Expenses data and open and reported claim count data used in the KPMG reserve study at December 31, 2018.
- Miscellaneous information obtained from discussions with the Company personnel.

There were no exceptions or findings as of December 31, 2018 related to Losses and Loss Adjustment Expenses.

Analysis

The analysis followed the risk-focused examinations phases, with emphasis on:

- Detailed review of the Company's 2018 Statement of Actuarial Opinion (SAO), Actuarial Opinion Summary (AOS) and Appointed Actuary Report (AAR).
- Review of 2018 Annual Statement and Quarterly Statement as of June 30, 2019.
- Assessment of pricing and underwriting risks through discussion with the Company's management.
- Substantive and independent testing of the Company Loss and Loss Adjustment Expenses (LAE) reserves as of December 31, 2018.

SUMMARY OF FINDINGS

Current examination comments

The Company experienced rapid growth of its Florida homeowners' book of business between 2012 and 2016, therefore increasing its exposure to Assignment of Benefit (AOB) lawsuits throughout Florida. Furthermore, the Company has recently undergone changes in its claims operations, expanded into several additional states, while exiting personal automobile and commercial general liability insurance lines. While it is desirable for the Company to reduce concentration risk, additional risks brought by the entrance in new markets should not be underestimated. After considering the aforementioned risk factors along with the Company's mitigation actions, it is reasonable to conclude that those risks and uncertainties related to those risks, could be expected to result in material adverse deviation in the Company's carried reserves for unpaid losses and loss adjustment expenses.

A significant portion of the analysis focused on the review of the structure of the Company's opining actuary's report, along with Statement of Actuarial Opinion (SAO) and Actuarial Opinion Summary (AOS) as of 12/31/18. These documents contained generally standard language. As required, the opining actuary discussed its relationship with the Company along with its role in setting up reserves, scope, reconciliation of historical data used in the actuarial report to Schedule P of the 2018 Annual Statement, change in estimates from prior analysis, comments on risk and uncertainties affecting actuarial estimates and other disclosures and comments on reinsurance collectability and IRIS Ratios.

Finally, the Company's opining actuary rightly referred to NAIC Instructions on requirement that its findings be presented to Board of Directors and documented to the minutes of the Board. It is recommended, given the aforementioned risk and uncertainties, that this presentation to the Board be more specifically documented in the Company's opining actuary's reports.

To determine the reasonableness of the Company's booked reserves, the following actuarial reports prepared in support of the actuary's SAO as of 12/31/18 were reviewed:

Range of Estimates		
(All amounts in \$000)		
	Net Loss and LAE Reserve	Gross Loss and LAE Reserve
A. Office Actuary's Range of Reasonable Estimates		
a) Low End of Range	125,124	311,317
b) High End of Range	147,924	336,726
B. Office Actuary's Point Estimate	140,078	328,025
C. Company Carried Reserve	135,024	296,337
D. Difference Between Company Carried Reserve and the Office Actuary's Estimates		
a) Low End of Range	9,900	(14,980)
b) High End of Range	(12,900)	(40,389)
c) Point Estimate	(5,054)	(31,688)

The examination actuary concluded that the net carried losses and Defense and Cost Containment ("DCC") reserves are within a range of reasonable point estimates, but the gross carried losses and DCC reserves are \$14,980,000 less than the minimum amount necessary to be within the actuarial range of reasonableness. Therefore, the examination actuary determined that the net loss and DCC reserves booked by the Company in the 2018 Annual Statement were reasonable, while the gross reported losses and DCC reserves were not within the range of reasonableness.

Given the timing of the examination, the examination actuary was also able to review development during 2019 on reserves as of 12/31/18. Part 3 Loss Reserve Development of Quarterly Statement as of 6/30/19 suggests a \$7,854,000 unfavorable development on the carried reserves as of 12/31/18. This unfavorable development is barely within the above-mentioned range and below the materiality standard of 10% of the Company's net carried reserves or \$13,500,000 set by the opining actuary. This finding supports the reasonableness of the net carried reserves while

highlighting the significance of risk and uncertainties that could result in material adverse deviation in the Company's reported reserves for unpaid losses and loss adjustment expenses.

The Company is responsible for losses ceded to a reinsurer if the reinsurer is unable to perform. It is essential that the reinsurer be provided with an accurate estimate of the losses the reinsurer may be obligated to pay, and that the reinsurer reserve for those losses.

Statement of Actuarial Opinion

For examination purposes, the examination actuary opined that the carried reserve amounts make a reasonable provision for all net unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements, but a deficient provision on a gross of reinsurance basis.

The provision for all gross unpaid losses and loss adjustment expenses is \$14,980,000 less than the amount necessary to be within the range of reasonable estimates.

- **We recommend that, given the significant risk and uncertainty in actuarial estimates, the Appointed Actuary's findings should be formally presented to the Board, and specifically documented in the opining actuary's reports. Further, that the estimate of the gross reserves be adjusted to provide the reinsurer with a more accurate estimate of the reinsurer's potential losses.**
- **We also recommend that the Company's opining actuary review the procedures used to establish the gross carried loss reserves.**

CONCLUSION

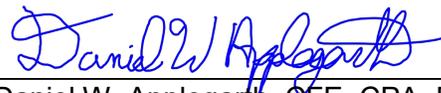
The insurance examination practices and procedures as promulgated by the NAIC have been followed in this limited scope examination of the loss reserves of **FedNat Insurance Company** as of December 31, 2018.

In addition to the undersigned, Achille Sime Lanang, FIAF, FSA, MAAA, CERA, consulting actuary of SL FINANCIAL, Inc. and Jeffrey Rockwell, Financial Examiner/Analyst Supervisor of the Office participated in the examination.

Respectfully submitted,



Achille Sime Lanang, FIAF, FSA, MAAA,
CERA, AFFI, CAS
SL FINANCIAL, Inc.
Representing the Florida Office of
Insurance Regulation



Daniel W. Applegarth, CFE, CPA, PIR
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P&C Financial Oversight Florida Office of
Insurance Regulation