Financial Services Commission

Florida Office of Insurance Regulation

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

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Acknowledgement

This report was compiled by Michelle Newell Lovern, Innovative Edge Consulting, Inc., in consultation with the Citizens Property Insurance Corporation accounting and actuarial staff, Florida Hurricane Catastrophe Fund staff, John Forney, Financial Advisor, Raymond James and Associates and Office of Insurance Regulation staff.

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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 FHCF and Citizens both play significant roles in the provision of property insurance coverage for Florida residents. While the storm activity for the last three years was relatively low compared to previous years, both the FHCF and Citizens continue to rely on their various assessment and/or bonding capabilities to pay claims if a storm of sufficient size impacts Florida. The analyses presented in this report summarize these 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 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 remaining losses paid by the insurer. For 2008, the aggregate industry retention was $6.88 billion.

Once the industry retention is met, the FHCF provides a mandatory layer of coverage up to $16.53 billion in industry-wide reimbursement for 2008. The FHCF also provides an optional layer (Temporary Increase in Coverage or TICL) over the mandatory layer of up to another $11.14 billion in reimbursement. The TICL layer was put into place in 2007 for three contract years and expires upon conclusion of the 2009 hurricane season contracts.

The FHCF has several sources of funds to pay covered losses. First it has cash on hand, which is derived primarily from reimbursement premiums from participating insurers (in 2008 the FHCF collected $1.3 billion in premiums) and investment earnings. This is estimated to provide $4.1 billion by the time claims would need to be paid for the 2009 hurricane season. In addition to funds from premiums and investment earnings, the FHCF has completed some pre-event bond financing. Pre-event financing allows the FHCF to be prepared with immediate funds for insurance company reimbursements after a hurricane. Typically, pre-event financing is taxable to the investors and following a hurricane, this would be replaced with post-event bond financing. For 2009, the FHCF will have $3.5 billion in pre-event funds in place for a total of $7.6 billion available for the payment of claims. This amount could be increased if the FHCF finds a suitable reinsurance or capital markets financing arrangement for 2009.

In the event of a hurricane that exceeds the industry retention and the FHCF’s available cash, the FHCF would issue post-event bonds to pay off the pre-event bonds and to provide further funds for the payment of claims. Post-event bonds are secured by the FHCF's authority to levy emergency assessments in amounts sufficient to pay the claims and the costs associated with the bond issue. These assessments can be levied in amounts totaling no more than 6% for any one season, and 10% in aggregate. The current assessment base is $36.6 billion and includes most property and casualty insurance premiums in the state. There are limited exceptions to this assessment base such as medical malpractice, workers' compensation, and crop insurance which has given the FHCF a strong base for bond financing in past years.

Table 1- FHCF below shows the net probable maximum loss to the FHCF from storms of the return time specified. The loss calculations were extracted from the 2008 Ratemaking Formula Report completed by the consulting actuary to the FHCF, Paragon Strategic Services. The complete report may be viewed at: http://fhcf.paragonbenfield.com/pdf/08ratereport.pdf.

Table 1 - FHCF

Return Time (years)	Gross Maximum Probable Loss	Net Losses to FHCF	Projected 12/31/08 Fund Balance	Projected Amount of Assessment
250	$87,193,096,997	$27,670,000,000	$2,786,272,000	$24,883,728,000
100	$52,946,547,707	$27,670,000,000	$2,786,272,000	$24,883,728,000
50	$34,408,230,204	$24,407,038,551	$2,786,272,000	$21,620,766,551

Retention	$6,878,000,000
Limit of Coverage	$27,670,000,000
Co-Pay	10%

The premiums, industry retention, and probable maximum loss estimates above are based on 2008 data. Once the FHCF contract is approved for 2009, new estimates will be available. These numbers are expected to increase slightly for industry premium and retention. It would also potentially increase the fund balance by December 31, 2009.

Citizens Property Insurance Corporation

Citizens provides property insurance coverage in Florida to individuals and businesses 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 geographical 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 - Loss calculations are as of October 31, 2008 and were completed by Citizens' internal actuarial staff using RMS RiskLink v7.0 and a blend of 2/3 stochastic rates and 1/3 historical rates. Note: The RMS RiskLink v. 7.0 model, used for this report, is not approved by the Hurricane Loss Projection Methodology Commission and is therefore not acceptable to the Office of Insurance Regulation for use in ratemaking.

Table 1 - Citizens

PLA/CLA Return Time (years)	Aggregate PML	Estimated FHCF Reimbursement	Projected 12/31/09 Surplus	Projected Amount of Assessment (1)-(2 +3)
250	$14,175,000,000	$3,241,000,000	$2,625,000,000	$8,309,000,000
100	$8,624,000,000	$3,241,000,000	$2,625,000,000	$2,758,000,000
50	$5,666,000,000	$3,241,000,000	$2,625,000,000	0

HRA Return Time (years)	Aggregate PML	Estimated FHCF Reimbursement	Projected 12/31/09 Surplus	Projected Amount of Assessment (1)-(2 +3)
250	$26,484,000,000	$6,227,000,000	$1,692,000,000	$18,565,000,000
100	$15,871,000,000	$6,227,000,000	$1,692,000,000	$7,952,000,000
50	$10,099,000,000	$6,227,000,000	$1,692,000,000	$2,180,000,000

Combined Return Time (years)	Aggregate PML	Estimated FHCF Reimbursement	Projected 12/31/09 Surplus	Projected Amount of Assessment (1)-(2 +3)
250	$40,155,000,000	$9,468,000,000	$4,317,000,000	$26,370,000,000
100	$24,393,000,000	$9,468,000,000	$4,317,000,000	$10,608,000,000
50	$15,632,000,000	$9,468,000,000	$4,317,000,000	$1,847,000,000

Financing Options

Florida Hurricane Catastrophe Fund

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

The FHCF currently has two pre-event bond issues, initially totaling $6.3 billion and two series of post-event bonds outstanding. The pre-event Series 2006B notes for $2.8 billion will be defeased by February 2009. A contingent liquidity instrument was purchased in August 2008 from Berkshire Hathaway that would be triggered when the FHCF reaches the TICL layer. The par value was $4 billion and remains in effect until May 15, 2009. While there are no assessments associated with pre-event bonds, the post-event are payable from emergency assessments which were levied beginning January 2007 at the rate of 1% per year for eight years.

The FHCF has the statutory authority to amortize its debt over a term of up to 30 years and has the ability to issue such bonds on a tax-exempt basis to pay covered claims. 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 alternative to bridge the gap until adequate long-term market access was available.

Citizens Property Insurance Corporation

Citizens also undertakes two basic types of financings: (1) pre-event to provide liquid funds to pay policyholders promptly (this financing is used primarily as a "bridge" to reimbursements from the FHCF); and (2) post-event designed to provide the ultimate source of payment of covered claims in excess of accumulated surplus, FHCF reimbursements and private reinsurance recoveries.

Citizens currently has two series of pre-event bonds, totaling $14.75 billion outstanding with a standby bond purchase agreement with the State of Florida for $750 million and a line of credit with a group of commercial banks in the amount of $1.67 billion. The line of credit and $1.5 billion of the current bonds outstanding both mature prior to the start of the 2009 hurricane season. There are no assessments associated with pre-event bonds.

Citizens has one series of post-event bonds outstanding, in the par amount of $1.06254 billion. These bonds are being repaid from the receipt of emergency assessments levied March 2007 at the rate of 1.4% per year for 10 years.

In 2008, the non-homestead assessment and additional policyholder surcharge were eliminated from law. The Citizens Policyholder Surcharge maximum was increased to 15% of premium for deficits incurred in any individual account. The Regular Assessment maximum was decreased to 6% of premium or 6% of the deficit, whichever is greater.

Assessment Impact

Florida Hurricane Catastrophe Fund

As outlined above, the FHCF would likely finance for 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 and excluding workers' compensation insurance, medical malpractice insurance, federal flood insurance, and accident and health insurance.

Table 2- FHCF Assessment Impact, below shows the estimated annual assessment impact from the prescribed storms.

Table 2 - FHCF

Return Time (years)	Gross Maximum Probable Loss	Assessment Need Projected	Annual Assessment *	Annual Assessment *
250	$87,193,096,997	$24,883,728,000	$2,311,862,764	6.31%
100	$52,946,547,707	$24,883,728,000	$2,311,862,764	6.31%
50	$34,408,230,204	$21,620,766,551	$2,008,713,000	5.48%

*Annual Assessment for 30 years assumes assessment base of $36.65 billion.

The FHCF assessment is limited to 6% by law. Therefore, in the 100 and 250-year scenarios above, the maximum amount that would be assessed is 6% of the assessable premium.

Citizens Property Insurance Corporation

By statute, Citizens has a multi-layered assessment mechanism. Each account (HRA, PLA, and CLA) has separate assessment authority and the deficit for each account is calculated separately. Therefore, it is theoretically possible to incur overlapping assessments if deficits occur simultaneously in more than one of the Citizens' accounts. Prior assessments have been for the HRA account. Assessments are "one-time" levies to insurance companies except emergency assessments which are remitted by insurance companies as they are collected from policyholders over multiple years. Assessments are applied in three tiers: Citizens Policyholder Surcharge (Tier 1); Regular Assessment (Tier 2); and Emergency Assessment (Tier 3).

The account most likely to incur a deficit in the event of a hurricane is the HRA in which Citizens writes its wind-only program. The HRA Assessment potential is illustrated below:

HRA							
Return Time (years)	Policyholder $	Surcharge %	Regular Assessment $	%	Emergency Assessment $	** %	Total *** Assessments $
250	450,000,000	15.0%	2,019,000,000	6.0%	16,096,000,000	3.3%	18,565,000,000
100	450,000,000	15.0%	2,019,000,000	6.0%	5,483,000,000	1.1%	7,952,000,000
50	450,000,000	15.0%	1,730,000,000	5.1%	0	0.0%	2,180,000,000

Table 2 - Citizens - Assessment Impact, below provides the estimated annual assessment impact for the PLA and CLA accounts. These accounts have not had assessments before and as illustrated below, would not have one in the event of a one in 50-year storm. However, if a 100 or 250-year event occurred, the estimated assessment potential would be as follows:

PLA/CLA*							
Return Time (years)	Policyholder $	Surcharge %	Regular Assessment $	%	Emergency Assessment $	** %	Total *** Assessments $
250	900,000,000	30.0%	4,038,000,000	12.0%	3,371,000,000	0.7%	8,309,000,000
100	900,000,000	30.0%	1,858,000,000	5.5%	0	0.0%	2,758,000,000
50	0	0.0%		0.0%	0	0.0%	0

* The PLA and CLA are separate accounts for deficit calculation and assessment purposes, but are combined for FHCF and credit purposes. It is impossible to accurately show the PML resources situation of these accounts in either separate or combined tables since simplifications must be made in either case that could prove materially inaccurate. As noted, there has never been an assessment in the PLA/CLA accounts and is unlikely to occur in all three accounts simultaneously.

** Represents the annual assessment percentage for 30 years.

*** Total principal amount of assessments levied; does not include interest and other costs on financed emergency assessments.

Conclusion

To ensure the availability of property insurance coverage and manage the catastrophe risk of hurricane activity in Florida, the Florida Hurricane Catastrophe Fund and Citizens Property Insurance Corporation provide a financing mechanism that augments the private insurance market. While serving different purposes, both ultimately rely on a combination of accumulated premiums and broad base public funding to cover deficits and are dependent on the credit markets for 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. Hurricane Wilma, in 2005, with an estimated $11 billion in total claims for the industry did reach the FHCF attachment, of which the FHCF will reimburse approximately $5.2 billion.

Currently, both entities have sufficient liquidity to address a storm of this magnitude. If a one-in-100 year event occurred in Florida, which would be greater than any hurricane since the creation of the FHCF, both Citizens and the FHCF would need to issue bonds for the payment of claims. In recent months, the bond market has experienced turmoil; although no attempt has been made to issue post-event bonds by either entity, both entities retain their high level investment grade ratings from the major ratings agencies. Should a need arise, post-event bonding would occur within six months to two years after an event based on historical loss development and the routine course of the claims paying cycle. The success of that bonding would depend on the market conditions at the time of the bond issue.