Financial Services Commission

Office of Insurance Regulation

House Bill 1A
Presumed rating factors

March 1, 2007

ACKNOWLEDGEMENTS

This report was prepared by

The Florida Office of Insurance Regulation,
Kevin M. McCarty, Commissioner

Project design, calculation of presumed factors, and drafting of the report, including exhibits performed by:

Robert Lee, Actuary, Florida Office of Insurance Regulation

J. Robert Hunter, FCAS, MAAA, Actuary and Consumer Advocate

Reinsurance Analysis by:

Paul Walther, CEO, Reinsurance Directions, Inc.

Peer Review by:

Ken Ritzenthaler, Actuary, Florida Office of Insurance Regulation

Edited by:

Jack McDermott

Technical Support by:

Tom Zutell, Michael Milnes

TABLE OF CONTENTS

EXECUTIVE SUMMARY

In this report, the Presumed Factors are presented by the Office as required under House Bill 1A, passed during the January 2007 special session. There are two kinds of Presumed Factors calculated: one to reflect the savings from the new reinsurance made available under the Act through the Florida Hurricane Catastrophe Fund ("CAT Fund") and the other to reflect the savings from the elimination of the 25 percent Rapid Cash Buildup provision of the previous law. The report shows, in detail, the methodology and calculation employed by the Office to determine the Presumed Factors.

Presumed Factors are the amount by which insurance companies must reduce the hurricane insurance portion of their rates under the law. Presumed factors are **not** the same as overall savings. For example, assume a homeowner had a policy with hurricane insurance cost which comprises 50 percent of the overall cost of the policy. In addition, assume the Presumed Factor for the CAT Fund reinsurance savings was 20 percent and the Presumed Factor representing elimination of Rapid Cash Buildup savings was 5 percent, a total Presumed Factor of 25 percent. The savings the consumer would enjoy in this hypothetical example is 12.5 percent (25 percent times the hurricane portion of the rate of 50 percent).

The Presumed Factors are shown in Section VIII of the report. As previously stated, these do not represent the overall savings but are the factors to be applied by insurance companies to the hurricane portion of the rates. For the convenience of the public, the Office has calculated the average savings (from both the CAT Fund Reinsurance and the Rapid Cash Buildup provisions of the law) by policy type:

Overall Savings	24.3%
Personal Lines Dwelling Savings	23.9%
Tenants	20.3%
Condo Units	25.0%
Mobile Home	26.9%
Commercial Dwelling	28.7%

The savings by region of the state are:

Percent to Total Premium

Cat Fund Region	Personal Dwellings	Personal Tenants	Personal Condo Unit Owners	Personal Mobilehome	Commercial Residential	All Lines
1	10.2%	10.0%	8.9%	12.8%	10.4%	10.2%
2	11.9%	6.4%	6.2%	14.8%	12.0%	11.6%
3	18.2%	15.5%	13.6%	22.4%	18.2%	18.0%
4	22.2%	20.5%	18.7%	27.3%	22.3%	22.1%
5	21.3%	20.5%	17.2%	26.2%	21.6%	21.2%
6	21.1%	16.6%	15.8%	26.1%	21.4%	20.9%
7	23.6%	22.0%	19.7%	29.1%	23.7%	23.5%
8	25.4%	23.1%	19.2%	31.1%	25.4%	25.2%
9	28.2%	26.8%	23.0%	34.7%	28.3%	28.0%
10	30.2%	28.5%	24.3%	37.1%	30.4%	30.0%
11	30.7%	28.7%	24.6%	37.7%	30.7%	30.5%
12	32.5%	29.8%	25.2%	39.9%	32.6%	32.3%
13	35.9%	30.1%	27.9%	44.3%	36.2%	35.6%
14	34.5%	31.1%	25.3%	42.6%	34.9%	34.2%
15	33.4%	33.6%	28.5%	41.1%	33.5%	33.3%
16	39.4%	38.1%	33.7%	48.8%	39.7%	39.4%
17	41.5%	40.7%	34.4%	51.3%	41.9%	41.4%
18	43.8%	43.3%	33.6%	53.9%	43.8%	43.4%
19	41.4%	43.3%	35.5%	50.9%	41.8%	41.4%
20	43.0%	43.3%	35.9%	52.9%	43.2%	42.9%
21	50.9%	46.9%	37.5%	62.9%	51.2%	50.4%
22	52.2%	47.7%	38.4%	64.3%	52.8%	51.7%
23	46.9%	45.4%	37.9%	57.7%	46.9%	46.7%
24	51.1%	48.7%	38.8%	62.8%	51.1%	50.6%
25	52.8%	52.1%	39.0%	64.8%	53.0%	52.3%
Statewide	23.9%	20.3%	25.0%	26.9%	28.7%	24.3%

Maps of Florida and detailed maps of certain parts of the state showing the location of the CAT Fund regions may be found at http://paragonbenfield.com/fhcf/pdf/06ratereport.pdf, starting on page 135. The CAT Fund Regions by zip code are included as Exhibit 12.

The public must be alerted to the fact that these are average savings. There are many reasons why an individual policyholder might experience a different amount of savings when a policy is renewed. One very significant reason is that the actual regional impacts are by zip code and not the broad regions listed above. Another is that the Office allows the insurance companies to make adjustments to the basis of the territorial distribution of the savings to follow the system used by the insurer in its last filing. One example of this is that some insurers capped the increases in some territories and therefore did not have all of the cost included in the premium and therefore must have a lower savings to reflect this fact. This approach is allowed provided the overall savings in the entire state reflect the Presumed Factor and the overall savings are consistent with the calculations made in this report. An additional reason that a policyholder may not experience premium savings equivalent to these figures is that an insurer may have increased rates within the year prior to the policyholder's renewal, and they may not yet have experienced the effects of the rate increase yet.

The methods to be used by the insurance companies in making filings to adopt these Presumed Factors are enumerated in this report to allow insurers to make filings by March 15, 2007 for an effective date of June 1, 2007.

The report also discusses the history of the hurricane insurance situation in Florida since Hurricane Andrew in 1992, including the sharp rise in premium charges faced by the people of Florida and the actions taken by the Florida Legislature and by insurers to help remedy the crisis faced by consumers in the state.

The current crisis in hurricane insurance in Florida has occurred during the same timeframe the insurance industry is achieving record profits on a nationwide basis. The increase in premiums is documented in this report as well as the impact of the historical increase in reinsurance costs in the very recent past. The growth in the Citizen's portion of the market is discussed. This report also demonstrates that the loss ratio in Florida is not much greater than the national average during the last 10 years. The legislative reaction to these market elements in the recent Special Session is outlined, with particular emphasis on the Presumed Factor section of the legislation.

BACKGROUND – THE NEED FOR LEGISLATIVE ACTION

Florida has been at the epicenter of the coastal insurance crisis for well over a decade. From Hurricane Andrew in 1992 to the more recent problems of affordability and availability for residents and businesses on America's coastlines, Florida has been in the forefront of developing a public policy solution to address these market-induced difficulties.

I. Hurricane Andrew

The hurricane insurance crisis in Florida began following Hurricane Andrew in 1992. At that time, Hurricane Andrew was the largest insured loss in American history, with pre-tax payouts of $15.5 billion[1], after estimated deductions for federal tax benefits, this cost was $10.1 billion to the insurance industry.

Hurricane Andrew's impact on the property/casualty insurance industry cannot be underestimated. The industry was truly surprised by the magnitude of the damage, and reacted quickly to reduce risk, which included one insurer threatening to non-renew up to 300,000 homes in Florida.

[1] Insurance Information Institute, website visited on February 15, 2007, under the Catastrophe Issues section.

The Florida Legislature responded to this threat by imposing a moratorium on policy terminations and on rate increases as the Legislature developed a comprehensive response to the crisis. The Legislature solicited input from academics, insurance company representatives, consumer groups and other interested parties to formulate a plan which included the adoption of several changes to the regulatory structure of Florida's insurance marketplace.

These changes included an overhaul of the policy structure, including the introduction of separate percentage hurricane deductibles and caps on replacement cost limits. To leverage greater governmental resources, the Legislature created a risk pool, which became the progenitor of the current Citizens Property Insurance Corporation. This entity became the "insurer of last resort" that guaranteed insurance for those who could not find insurance in the private marketplace.

Another innovation of the Legislature was the creation of the Florida Hurricane Catastrophe Fund ("CAT Fund") established in November 1993 during a special legislative session. Designed to provide a form of protection similar to reinsurance to maintain insurance capacity, the CAT Fund provided reimbursements to insurance companies, for defined levels of catastrophic losses resulting from hurricanes. Insurers writing in Florida are required to participate in the Fund, but can select their level of participation.

In 2006, the CAT Fund was authorized to offer partial reimbursement on an industry-wide level of up to $15 billion[2], following an industry-retained loss of $5.6 billion sustained during the 2004-2005 hurricane seasons. Under this program, individual insurance companies are reimbursed for either 45%, 75%, or 90% of their losses above the retention point, depending on their participation level. The CAT Fund's 2006/2007 Coverage selection report shows that 75.5% of participating companies (representing 95.5% of the CAT Fund's premiums) selected the 90% participation option.[3]

Hurricane Andrew also created a significant impact on premiums. Insurers seemed genuinely surprised by the amount of damage caused by Hurricane Andrew and scrambled to revise their hurricane models. The purpose of the changes in ratemaking techniques was to adopt computer models that projected longer timeframes of experience --- from 1,000 to 10,000 years into the future. The revised models contained projections of periods of intense activity and very large hurricanes, as well as periods of little or no activity.

While this engendered significant premium increases, policymakers in Florida, and around the nation supported these revisions as insurers promised the models' increased accuracy would bring long-term price stability. The subsequent rates were based on these long-term estimates.

With the CAT Fund in place to provide a level of catastrophic hurricane protection, the

[2] In 2007, the limit is $16 billion.
[3] FCHF web site visited on February 19, 2007.

Office of Insurance Regulation ("Office") reported "the private insurance market had largely stabilized by the end of 2003 and into 2004."[4] This is a logical result, as insurers experience stability during periods of low storm activity. This plan worked from the intervening years between Hurricane Andrew and the 2004-2005 hurricane seasons. Yet, eight named storms reached landfall in Florida during a two-year span which tested this framework.

II. Broken Promises and the Hurricane Activity of 2004-2005

In 2004, four hurricanes reached landfall in Florida: Charlie, Frances, Ivan and Jeanne, producing claim payments of $25.1 billion pre-tax ($16.3 billion after taxes);[5] the 2005 season featured an additional four named storms: Dennis, Katrina, Rita and Wilma which caused $10.8 billion pre-tax ($7.0 billion after taxes) of insured damage in Florida.[6]

The promised stability in prices and availability of insurance vanished following the 2004-2005 hurricane seasons. While all areas of Florida were affected, property insurance premiums soared for property risks for homeowners and businesses located on the coastline. Due to the lack of availability of policies from the private insurance market, many policyholders found themselves with policies from Citizens --- the residual market.

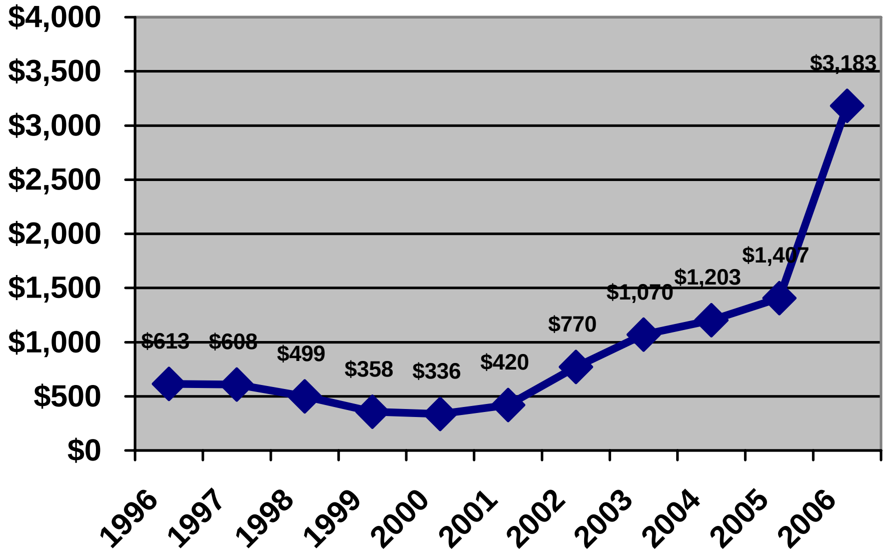
During public hearings held in Florida in 2006, home and business owners offered compelling testimony cataloguing ten-fold rate increases, often as a consequence of being unable to find coverage, and being forced to accept a Citizens policy. Originally designed to be a supplement of insurance capacity – not a direct competitor, Citizens policies were mandated to have the insurance rates higher than the 20 largest insurers in the state.

Premium for Citizens (and its predecessor residual market entities, the Florida Windstorm Underwriting Association and the Florida Residential Property & Casualty Joint Underwriting Association) increased from $336,717,315 in December 2005 to $2,845,210,771 in September 2006, a growth of 745 percent.[7] The expansion is not just due to new property writings, but also incorporates Citizens' rate increases. The chart below demonstrates Citizens' dramatic premium growth in Florida:

---

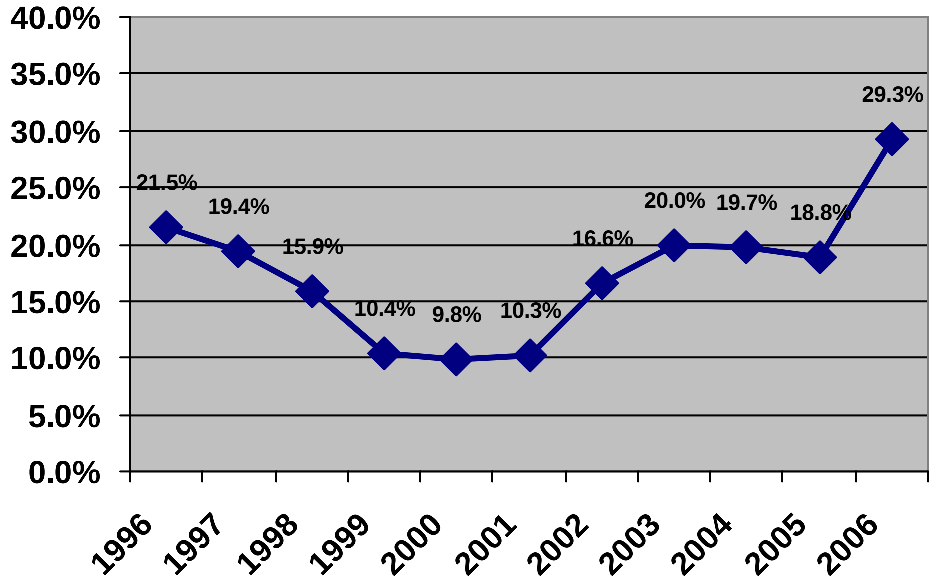
4 The Florida Insurance Market in 2004: The Difference a Decade Makes, Florida Office of Insurance Regulation, March 2005.
5 Hurricane Summary Data. Florida Office of Insurance Regulation, August 2006.
6 Ibid.
7 The increase includes rate changes as well as policy growth. The comparable policy count growth from 2000 to 2006 was from 476,957 to 1,245,183 policies.

Citizens' Premium 1996-2006
(in $ millions)



The residual market has grown to represent nearly 30% of the total residential property insurance market in Florida:

Citizens' Premium Relative to the Florida Residential Market



Not only were Floridians with policies in Citizens experiencing premium increases, but so were those who obtained insurance from the private market. As an example, this report shows rate increases for four large writers in Florida: State Farm Group, AllState Floridian, Universal Property & Casualty and American Strategic:

State Farm Rate Increases 1997-2006

New Business Date	Renewal Date	Percent Increase
8/1997	10/1997	25.6%
9/1997	11/1997	12.2%
9/1998	9/1998	-0.9%
1/2001	4/2001	6.4%
11/2001	1/2002	14.3%
5/2002	7/2002	22.2%
11/2003	1/2004	6.8%
9/2004	1/2005	1.7%
2/2005	4/2005	5.0%
2/2006	4/2006	8.6%
8/2006	11/2006	52.8%
Cumulative Since 2002		**131.3%**

Allstate Floridian Rate Increases 2002-2006

New Business Date	Renewal Date	Percent Increase
9/2002	11//2002	16.0%
1/2004	2/2004	6.3%
8/2005	8/2005	8.7%
10/2005	10/2005	16.3%
2/2007	2/2007	8.2%
Cumulative Since 2002		**68.7%**

Universal Property & Casualty Rate Increases 2001-2006

New Business Date	Renewal Date	Percent Increase
6/2001	8/2001	6.6%
2/2002	4/2002	8.9%
6/2003	7/2003	7.4%
1/2004	3/2004	7.5%
9/2004	9/2004	11.3%
5/2006	6/2006	9.9%
Cumulative Since 2002		**53.8%**

American Strategic Rate Increases 1998-2006

New Business Date	Renewal Date	Percent Increase
3/1998	3/1998	-6.5%
11/1998	1/1999	-0.9%
3/2000	5/2000	-8.6%
3/2002	4/2002	15.1%
12/2003	12/2003	4.6%
2/2005	4/2005	7.8%
3/2006	5/2006	19.7%
6/2006	8/2006	19.4%
Cumulative Since 2002		**85.5%**

Interestingly, American Strategic actually filed three rate decreases from 1998-2000, but this defies the trend. Instead, the private marketplace as illustrated by these four company groups has experienced multiple rate increases which have increased in frequency since the 2004-2005 hurricane seasons. State Farm Florida, the largest private insurer in Florida, increased its rates a formidable 66% during 2006 alone. Not far behind, American Strategic's two increases cumulatively totaled 43 percent during the same timeframe.

Consumers with private sector policies were not the only ones to experience rate increases. To the contrary, Floridians with policies in Citizens also endured rate hikes. Due to the merger of the two residual markets in 2002, it is difficult to produce a comparable timeline for Citizens Corporation. For the purposes of this analysis – rate increases from the Florida Wind Pool were combined with Citizens high risk (wind only) accounts, while data from the Florida Residential JUA were combined with Citizens personal lines accounts:

Citizens' Rate Increases for Personal Lines Accounts 1997 to 2006

New Business Date	Renewal Date	Percent Increase
7/1997	9/1997	18.7%
5/1998	6/1998	2.0%
10/1999	4/2000	0.1%
1/2002	5/2002	10.2%
7/2002	9/2002	1.7%
6/2003	8/2003	25.8%
2/2004	4/2004	2.8%
12/2004	2/2005	1.5%
2/2005	4/2005	23.2%

1/2006	2/2006	-0.3%
4/2006	4/2006	13.3%
Cumulative Since 2002		**104.7%**

Citizens' Rate Increases for High Risk Accounts 2000 to 2006

New Business Date	Renewal Date	Percent Increase
7/2000	7/2000	94.6%
7/2003	7/2003	12.8%
7/2004	7/2004	11.9%
4/2005	4/2005	11.9%
1/2006	1/2006	1.0%
3/2006	3/2006	16.4%
1/2007	1/2007	-3.9%
Cumulative Since 2002		**59.6%**

The rising cost of reinsurance for insurance companies has been one of the primary components fueling the rate increases. Insurance companies require reinsurance to maintain solvency requirements as well as to diversify risk. The majority of reinsurers are located off-shore (the Caribbean and in Europe), and are not regulated by the State of Florida. While the recent storms have made direct insurers skittish about expanding, or even retaining their current property exposure in Florida, the storm activity has had an even greater effect on reinsurers. Over the last two years, reinsurers have significantly reduced their exposure in Florida, and nearly doubled their rates for the reinsurance that is offered.

For many direct writers in Florida, the cost of reinsurance is an unavoidable expense, which has greatly contributed to recent rate requests. As the following table demonstrates, the cost of reinsurance now constitutes 40-50% of the premium dollar:

Reinsurance Cost Per Premium Dollar
Based on Most Recent Rate Filings
2006-2007

Sample Company Group	Reinsurance Cost
Allstate Floridian	39.5%
American Strategic	52.2%
State Farm Group	40.1%
Universal Property & Casualty	40.1%

The insurance industry readily admits the impact of reinsurance costs on premiums:

> "Among the reasons for hefty rate increases is the cost of reinsurance, insurance for insurers. Increases in reinsurance typically have varied from 30 percent to more than 150 percent, according to one reinsurance broker, depending on the riskiness of the business being reinsured. Reinsurance costs for the 2006 hurricane season for one major Florida insurer more than tripled, compared with the same period in 2005."[8]

Florida Insurance Commissioner Kevin McCarty has also noted this effect:[9]

> "Given the current situation, there is little interest in an expanding investment to insure against mega-catastrophes, like hurricanes. For reinsurance contracts that have been written, private insurers are finding that costs have risen dramatically, and reinsurers are changing the conditions of their reinsurance treaties *(or contracts)* forcing insurance companies to retain more of the risk."

Based on these data, the Florida Legislature made a logical decision when it examined the reinsurance market as a source for rate relief, which if structured properly, would not require a subsidy to address.

Regardless of the reasons, the rate stability promised by the industry following Hurricane Andrew has not materialized. Some possible explanations include an overreaction by the industry (including reinsurers) to the recent spate of storm activity. What is especially troubling from a consumer standpoint is the rate increases are not occurring in a vacuum – they are occurring during a period of record insurance industry profits which has resulted in accusations of "price gouging," by consumer groups, and some public officials.

III. Rate Increases Lead to Record Industry Profits

An analysis of the industry "strategy" as it pertains to hurricane risk reveals that insurers have increasingly shed high-risk policies. While the state insurance pools covering residential property like Florida's Citizens Property Insurance Corporation have grown substantially, the industry has engaged in a corporate strategy of reducing risk and raising premiums for residential property while expanding other lines. This has allowed the industry to achieve record profits despite the recent hurricane activity.

In 2004, the Property/Casualty Insurance industry set an industry record by netting an after tax profit of $40.5 billion. In 2005, even considering Hurricane Katrina and other major hurricanes, the industry posted a profit of $48.8 billion[10] -- a new record. In 2006,

---

8 Insurance Information Institute, website visit of February 15, 2007.

9 Testimony before the U. S. House of Representatives Subcommittee on Housing and Business of the Financial Services Committee, June 28, 2006.

10 The $40.5 and $48.8 billion dollar figures are from Aggregates and Averages, A. M. Best and Co., 2005 and 2006 editions.

with no major hurricane activity coupled with premium increases, the industry set yet another profit record, estimated to be $68.1 billion[11]. To put this into perspective the $157.4 billion in profit over the last three years equates to roughly $524 for every man, woman and child living in the United States, or $1,574 per household.[12]

It is true that profit from Florida's insurance market has not been as robust as in other states due to the 2004-2005 storm activity, but an analysis of loss ratios over a longer period of time, 1996-2006, demonstrates that Florida is hardly a "money pit" as often portrayed by the industry. To the contrary, during the past decade, the industry's loss ratio in Florida *(the loss ratio being the percentage of the property/casualty insurance premium dollar used to pay losses due to claims)* was less than 70 percent of the premium. If the 2006 loss ratio estimates are included, this equates to a loss ratio roughly 2% higher than the national average, which is not significant.

Comparison of Loss Ratios
Florida vs. the U.S.
1996-2006[13]

Year	Florida Loss Ratio	U.S. Loss Ratio
1996	58.6%	65.3%
1997	53.9%	60.0%
1998	56.1%	65.2%
1999	59.9%	66.7%
2000	63.3%	69.4%
2001	64.0%	78.8%
2002	61.3%	68.7%
2003	52.4%	62.1%
2004	115.3%	60.4%
2005	83.8%	66.6%
2006	45.4%	54.5%
1996-2006	**66.5%**	**64.7%**

Clearly insurers have reaped windfall profits in some lines of insurance that have offset any losses in residential and commercial property insurance in recent years. One notably profitable line is auto insurance, which experienced healthy profits. From an economic standpoint, the recent storm activity caused only an aberration in industry profitability that was more than offset by profits from other states, and in other lines of insurance. The recent rate increases have also helped ameliorate any potential discrepancies between the premium collected and the risk assumed.

---

[11] Review/Preview, A. M. Best and Co., January 2007.
[12] U.S. Census Bureau, Projections of the Number of Households and Families in the United States: 1995 to 2010.
[13] Aggregates and Averages, *A.M. Best Co.* 1997 to 2006; edition 2006. Estimated for Florida by the Office for USA by *Best's Review/Preview*, January 2007.

The insurance crisis experienced by Floridians is not a result of insufficient premiums or a collapsing insurance marketplace. Instead the crisis has been created by the actions of insurance companies which have coupled rate increases with reduced availability. These actions have created a crisis of affordability and availability in Florida, as well as placed more pressure on the Citizens Property Insurance Corporation to accept risk. These are the factors that prompted the Governor and Florida Legislature to enact changes to the insurance market structure during the 2007 Special Legislative Session.

IV. Florida's New Legislation

In response to the insurance crisis, the Florida Legislature passed House Bill 1A, which Gov. Crist signed into law on January 25, 2007 attached as Exhibit 11 in the technical appendices. The Legislature stated its rationale for this legislation:

> "WHEREAS, homeowners in the State of Florida are struggling under increased insurance costs and increased housing prices as a result of damage caused by hurricanes and tropical storms, and
> WHEREAS, this increase in the cost of property insurance for the state's residents demands immediate attention, and
> WHEREAS, the affordability of property insurance creates financial burdens for Florida's residents and financial crises for some property owners, and
> WHEREAS, in addition to affordability, the availability and stability of property insurance rates are critical issues to the residents of this state, and
> WHEREAS, because there is no single, quick, or easy solution to the current crisis, a comprehensive and creative approach is required, and
> WHEREAS, property insurance is so interwoven with other forms of insurance, through business, regulation, advocacy, purchasing, and other interactions, that the viability of the insurance market in Florida is at risk, and
> WHEREAS, expanding coverage offered by the Florida Hurricane Catastrophe Fund can help to address this crisis, and…
> WHEREAS, strengthening the processes for establishing property insurance rates can help to address this crisis, and…"

Insurance Commissioner Kevin McCarty identified two critical outcomes of this legislation[14]:

- The Bill Increases Reinsurance Capacity by creating more options for private industry to purchase reinsurance at a more inexpensive rate. This is critical as reinsurance costs have been one of the primary drivers contributing to rate increases in 2006.

- The Bill Shifts Some Risk to the Public Sector. In fact, the bill nearly doubles the commitment of the Florida Hurricane Catastrophe Fund.

In addition, the new law will allow Citizens to have actuarially sound rates that are lower than rates charged by the private sector, and will allow easier access to Citizens' policies.

---

[14] State of the Florida Market, January 30, 2007.

By passing this bill, the Florida Legislature adopted comprehensive and far-reaching reforms. The bill addressed the problems of availability and affordability of private reinsurance, which has led to substantial premium increases for many Floridians and has also contributed to increases in the number of people insured by Citizens Property Insurance Corporation. Although some aspects of the implementation of this Legislation continue to evolve, this was a crucial first step to bring relief to the citizens of Florida.

To address market dislocations in Florida, the legislation created an emergency program which will be effective through the 2009 hurricane season. The legislation requires the Florida Hurricane Catastrophe Fund to offer reinsurance coverage of up to $12 billion in addition to the $16 billion of reinsurance that would have been available for 2007 under the existing law. Insurers will now have the option to purchase this new reinsurance in $1 billion increments up to the $12 billion limit. The new legislation retains the option of allowing insurers to elect participation levels giving them 90 percent coverage, 75 percent coverage or 45 percent coverage.

Although actuarially priced, the additional reinsurance coverage offered through the CAT Fund will be sharply lower in price relative to coverage currently being sold by private reinsurance companies. This savings can be achieved due to the elimination of profit margins incorporated into the rates of private reinsurers, as well as the CAT Fund being a government entity, which has different tax treatment than the private sector.

Insurers are not required to purchase CAT Fund coverage but must incorporate this price savings into their rate filings. Furthermore, the legislation requires all savings from the government provided reinsurance to be passed through to policyholders, specifically, Florida homeowners and businesses.

To meet these new requirements, the legislation requires each insurer writing residential property insurance in Florida to make two rate filings. The first filing must reflect the Office of Insurance Regulation's initial estimate of savings generated under the act. To accomplish this objective, the Office will promulgate a "presumed factor" to reflect savings for the industry.

Shortly after the "presumed factor" filing, insurers are required to make a second filing under the Office's "file and use" law. This filing will "true up" the savings used by the insurer in the initial filing to reflect the actual reinsurance savings. The Legislature deemed these two filings necessary to accelerate the rate savings. Due to time constraints, it is not possible to calculate savings for hundreds of insurers so the Florida Legislature utilized the "presumed factor" approach as a first estimate. Subsequent to this filing, the "true-up" filings will most likely result in upward or downward adjustments based on actual savings.

V. Purpose of this report – outline of contents

This report will develop the presumed factor to be used by all residential property insurance companies. The methodology used to calculate the presumed factor will be explained, followed by the actual calculation. This will be followed by a discussion of how insurance companies should apply the factor to prepare their filings for an effective date of June 1, 2007. Finally, the report will discuss how insurance companies should prepare their filings to test the appropriateness of the presumed factor and to prepare "true up" filings to bring their rates into full compliance with the new law. This will enable the officers of the insurance companies to sign a certification as part of the filing.

VI. Methodology

In mathematical terms, the calculation of a presumed factor is straightforward. It is derived by determining the savings that will result by replacing private reinsurance (currently priced at historically high levels) with reinsurance offered by the state through the Florida Hurricane Catastrophe Fund.

The fact that different private insurers have different reinsurance plans adds to the complexity of these calculations, and requires analysis to determine an estimate of what exactly is being replaced by the CAT Fund and the cost savings associated with that replacement. It is beyond the Office's resources to review all private reinsurance contracts during the limited timeframe specified by the Florida Legislature. Therefore, this report is based upon a sample of twelve insurance companies' reinsurance arrangements, and a calculated rate on line. The companies in the sample include State Farm Florida, Allstate Floridian, Nationwide, Universal Property and Casualty, Universal of North America, St. Johns, American Strategic, Cypress, Florida Family, United Property and Casualty, Teachers and Southern Fidelity.[15]

The Office obtained information from the CAT Fund about each company's CAT Fund premium paid in 2006 and used the CAT Fund payout multiple to determine the 2006 coverage that each insurer purchased from CAT Fund. The Office calculated the insurer's retention, using the CAT Fund multiple for the 90 percent purchase option. The Office determined the 2006 total limit of coverage by adding the retention to the coverage below the CAT Fund retentions.

For this primary calculation, the Office assumed the insurer would purchase the entire $12 billion of new coverage from CAT Fund in addition to the $16 billion already available. As stated previously, the new law requires a savings calculation even if an insurer does not purchase the new coverage.

The Office calculated the insurer's portion of the new $12 billion in coverage using 2006 distributions of coverage below CAT Fund. New retention levels related to this new reinsurance were also calculated. The Office made a determination of the impact of the current insurer reinsurance based upon the information provided, and performed this determination by layer from the rate filing materials and reinsurance contracts of each insurer.

[15] The Office also attempted to review the reinsurance and securitization (CAT Bond) arrangements for USAA. Due to time constraints, the Office determined that due to these complex arrangements it would not be proper to include USAA in the analysis.

Using the premium from these privately secured reinsurance contracts, the Office calculated a rate on line[16] ("ROL") for each insurer for the private reinsurance to be replaced by the new CAT Fund reinsurance. During this analysis, the Office utilized the private reinsurance programs pertained to Florida exposures. The new legislation will impact the various contract entries expanding coverage provided by the CAT Fund, either by reducing (or eliminating) company dependence on the private sector for similar coverage, or by increasing the attachment points[17] of the "private" contracts.

The Office made no adjustment for limits less than 100% or for any incomplete placement of the layers involved. Furthermore, the Office considered only "first event" occurrence limits and premium, disregarding any reinstatement premium provisions and/or any other contract types that companies may have purchased to supplement the basic catastrophe programs, including those contracts covering exposures under the CAT Fund retentions. Once the Office determined the rate on line for the reinsurance to be replaced, the Office had to determine the comparable rate on line for the Florida Hurricane Catastrophe Fund. The CAT Fund's administrator, Paragon/Benfield, performed the calculation and supplied it for this report.

The presumed factors were actuarially distributed using a variety of methods. First, the factors were calculated for the 25 regions of the state adopting the same regions utilized by CAT Fund in its ratemaking.[18] The factors for each region were divided actuarially by coverage option, since an insurer can purchase the TICL coverage in 12 different layers from $1 billion up to $12 billion.

Finally, these calculations were undertaken for the five sub-lines of property insurance affected by the law, Personal Residential Dwelling, Personal Tenants, Personal Condo Unit-Owner, Mobile Home and Commercial Residential.

The Rapid Cash Buildup is shown as a separate presumed factor using actual information from the CAT Fund premium by geographic region subline to reflect the 25 percent being eliminated. This is in addition to the savings generated from the presumed factor for the TICL option.

VII. Calculation of Presumed Factors

In this section of the report, the Office calculates the presumed factors insurers will use in preparing the rate filings to implement the savings authorized by the Florida Legislature. The calculations underlying these presumed factors are displayed.

---

[16] Rate on line or ROL is the price quoted as a percentage of the limit purchased. A 20 percent ROL would, for example, indicate that the premium for a $1 million layer of coverage would be $200,000.
[17] That is, causing the coverage in a layer of private reinsurance coverage to start at a higher dollar amount, which means the coverage for that layer will be less and will cost less.
[18] A list of the regions is attached as Appendix Exhibit 9.

Calculation of the Presumed Factors for Reinsurance Savings.
The first step is the calculation of the rate on line ("ROL") for the sample of private insurers which is included in Exhibit 2 in the technical appendices.

The Office analyzed the sample to determine a reasonable ROL to use for the entire industry. The Office noted that State Farm, with a very low ROL due to transactions with its affiliates, was not representative of the "normal" reinsurance market and was almost half of the premium volume of the sample. Therefore we considered the following data derived from the above sample:

ROL including State Farm as reported, 47% of the sample	17%
ROL excluding State Farm	24%
ROL giving State Farm 10% of the total sample weight	23%
ROL giving State Farm 20%of the total sample weight	21%
Median ROL from the sample	19%
Simple average ROL from the sample (unweighted)	21%
Mid point of range of the sample (10% to 40%)	25%
Simple average of the above estimates of the ROL	21%
Median of the above estimates	21%

As our analysis did not include adjustments for limits less than 100% or for any incomplete placements for the layers involved, the Office determined that a reasonable estimate of the ROL for the private reinsurance being replaced by the new CAT Fund layer is 20 percent.[19]

This must be compared to the ROL of the CAT Fund for the newly available layers of reinsurance. The calculation of the ROL, supplied to the Office by the CAT Fund is displayed in Exhibit 3 in the technical appendices.[20]

The Office needs to estimate the percentage of premium for the hurricane risk to calculate the presumed factors. The estimate, based upon the ISO filings, follows:

[19] It should be noted that the estimate of this ROL made during the special session by Paragon/Benfield, the CAT Fund's vendor, was also 20 percent.
[20] Estimates for 2007 program provided by the CAT Fund. These rates are not expected to be submitted for approval with the State Board of Administration until April 2007.

OFFICE OF INSURANCE REGULATION
INDUSTRY HURRICANE PERCENTAGES SUMMARY
USED IN PRESUMED FACTOR FOR CAT FUND
SOURCE APPROVED ISO FILING 05-00788
TOTAL HOMEOWNERS

Form	Premium*	Hurricane Percentage**
Dwelling	5,822,679,730	51.0%
Tenant	60,263,113	42.3%
Condo-Unit	461,151,085	52.0%
Total	6,344,093,928	51.0%

* June 2006 Quarterly Supplemental reports
** Detail calculation from ISO filing

The factors must also be divided by subline (i.e., Residential, Tenants, Condo Units, Mobile Home and Commercial). The basis for this division is outlined in Exhibit 4 of the technical appendices.

The comparison of the cost of private reinsurance being replaced and the CAT Fund reinsurance replacing it is critical to the development of the presumed factors. The calculation of the presumed factors is displayed in Exhibit 5 of the technical appendices.

In the next section of the report titled, "the Presumed Factors," we display the presumed factors by subline, divided into region of the state and by the limit of new CAT Fund layers purchased by the insurer. To divide the presumed factors by this methodology, we had to estimate the regional impact as well as the impact by layer.

The impact by layer and subline was calculated as shown in Exhibit 6 of the technical appendices.

The first step was to compare the CAT Fund territories with ISO territories to make estimates of how the two territorial systems would interrelate. The following determinations were made:

OFFICE OF INSURANCE REGULATION
HB/SB 1A CAT FUND PRESUMED
FACTOR
ALLOCATION OF ISO TERRITORIES TO 2007 CAT FUND REGIONS

ISO Territory	Cat Fund Region	Comments	Territory Description
5	21		Remainder Monroe
7	18		Key West
10	13		Remainder Martin
12	9	Avg of 1,3,4,5,7,8,10,11,12,13,14,16	See attached summary
18	17	Avg of 16,17	Indian River and Martin east of intercoastal
30	23	Avg of 21,22,24,24,24,24,25	Miami Beach
31	22		Miami-Dade east of intercoastal
32	20	Avg of 15-25 range	City of Miami
33	12	Avg of 12,14,14,12,15,12,11,10,11,11	Hialeah
34	16		Remainder Miami-Dade
35	17	Avg of 9-24 range	Fort Lauderdale,Hollywood
36	22		Broward east of intercoastal
37	13		Remainder Broward
38	14		Remainder Palm Beach
39,40	1		Jacksonville and Remainder Duval
41	2		Duval east of intercoastal
42	13		Pinellas west of intercoastal
43	6		Remainder Escambia
44	8		Remainder Brevard
45	6	Avg of 1,3,4,5,7,8,10,11	See attached summary
46	11	Avg 8-14 range	St Petersburg
47	7	Avg of 4-9 range	Tampa
48	5		Remainder Hillsborough
49	2		Orlando
50	3		Polk
51	3	Avg of 2-3 range	Osceola,Seminole
52	2	Avg of 1-2 range	See attached summary

The summaries for the three ISO territories (12, 45 and 52) as show in Exhibit 7 of the technical appendices.

We estimated the industry loss cost relativity by CAT Fund Region as described in Exhibit 8 of the technical appendices:

8A – Dwelling[21]
8B – Tenants
8C – Condo Unit Owners

Finally, we calculated relativities by CAT Fund Region for distributing the presumed factors, as show in Exhibit 9 of the technical appendices as follows:

[21] Includes Mobile homeowners and Commercial Residential.

9A – Dwelling
9B – Tenants
9C – Condo Unit Owners
9D – Mobile Home Owners
9E – Commercial Residential

Using the above information, we calculated the presumed factors to be used by insurers in making their presumed factor filings for an effective date of June 1, 2007. The calculation of presumed factors by CAT Fund Region and by TICL limit is shown in this series of Exhibits by subline. These are to be used by the insurers in conformity with the Order of the Office in Case No. 89321-07, dated February 19, 2007 in Exhibit 10.

Calculation of the Presumed Factors for Rapid Cash Buildup

The legislation also eliminated a 25 percent "rapid cash buildup" in the CAT Fund. This requires another presumed factor calculation to reflect this law change. The calculation of the effect of removing this 25 percent additional charge as follows:

OFFICE OF INSURANCE REGULATION
HB/SB 1A CAT FUND PRESUMED FACTOR
STATEWIDE ALL LINES CALCULATION
CASH BUILDUP PRESUMED FACTOR

2006/2007 CAT Fund premium including cash buildup (1)	1,068,312,780
25% Cash buildup impact on CAT Fund premium	213,662,556
Percent of CAT Fund premium relative to Citizens	36.7%
25% Cash buildup impact excluding Citizens	135,248,398
Industry Hurricane Premium (2)	3,582,631,652
Percent to Hurricane Premium cash buildup	3.8%
Industry variable expense ratio (3)	23.4%
Industry fixed expense ratio (4)	6.3%
Indicated presumed factor to hurricane premium cash buildup	4.4%

(1) From Payout Multiple Report 2006/2007 from Cat Fund website
(2) From TICL Layers presumed factor calculation
(3) From State Farm, Allstate Floridian, Universal P&C and American Strategic latest approved HO filings
(4) From State Farm, Allstate Floridian, Universal P&C and American Strategic latest approved HO filings

The presumed factor distributed by subline is as follows:

OFFICE OF INSURANCE REGULATION
HB/SB 1A CAT FUND PRESUMED FACTOR
STATEWIDE SUBLINE CALCULATION
CASH BUILDUP PRESUMED FACTOR

Subline	Relativity	Presumed Factor
Residential	0.975	4.3%
Tenants	1.000	4.4%
Condo Units	1.000	4.4%
Mobilehome	1.100	4.8%
Commercial	1.200	5.3%
Total	1.000	4.4%

VIII. Presumed Factors

The presumed factors adopted by the Office for the filings to be made by the insurers effective June 1, 2007 are included in Exhibit 1 of the Technical Appendices as follows:

1A – Dwelling
1B – Tenants
1C – Condo Unit Owners
1D – Mobile homeowners
1E – Commercial Residential

IX. How Insurance Companies Should Apply the Presumed Factors in the June 1, 2007 Presumed Factor Filing

Now that the Office has published the Presumed Factors, two filings are required: A "Presumed Factor" filing, and a "True-up" filing[22].

Insurers must make a presumed factor filing on or before March 15, 2007. The insurers may use a "short form" filing adopting the Presumed Factors as shown in this report. This should be a separate filing using the process established in the I-file system specifically for Presumed Factors. The insurers may make a "long form" filing using the Presumed Factors that reflect a rate decrease that takes the Presumed Factors into account, but does not adopt the Presumed Factors. The rate decreases for the Presumed Factor filing are required by law to be effective for any policies written or renewed on or after June 1, 2007.

[22] See Order in Case No. 89321-07, adopted by the Office on February 19, 2007 for precise details about how these two filings are made see Exhibit 10.

A Presumed Factor filing that adopts the Presumed Factors will only reflect the effects of the Presumed Factors on the rates currently in effect and the elimination of the 25% rapid cash buildup portion of the insurer's Florida Hurricane Catastrophe Fund premium. These "short form" filings are those filings where the insurer can click "Yes" to the question on the I-file System prompt that asks "Is this filing adopting the OIR Presumed Factors and only reflecting the effects of these factors? Filers should know that it is appropriate to click "Yes" and file a short form filing if the filer merely adjusts the territorial Presumed Factors to reflect the filer's own territorial definitions and adjustment of rating factors including base rates as required by the filer's rating system.

A Presumed Factor filing will be made under the "use and file" system and must include all information used in preparing the filing including copies of all reinsurance treaties. This "long form" filing will be required when an insurer clicks "No" to the question in the above paragraph. Such filings are subject to credits and refunds if the Office determines the rate reductions are inadequate. This use and file filing is to be accompanied by a sworn statement from the chief executive officer or chief financial officer of the insurer and the chief actuary or actuary preparing the filing that the filing contains all information used to prepare the filing, includes all the reinsurance treaties, reflects all premium savings that are reasonably expected to result from legislative enactments and are in accordance with generally accepted and reasonable actuarial techniques. The sworn statement must further assert the filing does not contain any untrue statements of a material fact nor does it omit to state a material fact. This "long form" filing can reflect the filer's method of distributing the hurricane reinsurance costs by region as reflected in the most recent approved filing the insurer made for subline rates.

Either of these two filing approaches satisfies the requirements of Emergency Rule 69OER07-1 as it relates to the filing required before an insurer may non-renew or cancel or continue the non-renewal or cancellation of personal residential insurance policies, provided that, consistent with s.627.4133 (2)(c), Florida Statutes, the policyholder receives at least 100 days written notice excluding any time between the effective date of the Emergency Rule and the date of the insurer's Presumed Factor filing. Approval of the filing is not necessary to comply with the filing requirements of the Emergency Rule.

X. How Insurance Companies Should Test the Presumed Factors in Later "True-Up" Filings

After making the Presumed Factor filing, insurers shall make a "True-Up" filing pursuant to the "file and use" provisions of Florida law. This filing must be a complete rate filing reflecting the reductions in loss exposure to the insurer due to all of the provisions of HB1A and the anticipated 2007 reinsurance program. The sworn statement required by HB 1A shall accompany the "True-Up" filing.

The "True-Up" filing shall contain a complete description of the reinsurance program for each company for the 2007 Hurricane Season, including the following:

a) A schematic diagram of all reinsurance coverage, including contract retentions and limits, for both the CAT Fund and private placements.

b) A listing of all reinsurance contracts, including retentions, limits, estimated ceded premium and rates on line (i.e. premium as a percentage of limits) for each contract.

c) Documentation for each contract, either in the form of a treaty or if the treaty is not yet available, in the form of a "reinsurance slip."

The "True-Up" filing may be made at any time after the insurer has submitted its Presumed Factor filing, but shall be made within 90 days from the date of the Presumed Factor filing for insurers with confirmed reinsurance in place for the 2007 Hurricane Season. For all other insurers, the "True-Up" filing shall be made within 90 days from the insurer's receipt of the broker or reinsurer confirmation of new or revised terms of the insurer's reinsurance agreements for the 2007 Hurricane Season, but in no event later than September 30, 2007.

For those insurers who have reduced rates since the enactment of HB 1A, an allowance will be made in the Presumed Factor filing for those early rate reductions.

The new law requires companies to price their products as if they took full advantage of the CAT Fund layers whether they actually bought those layers or not, and it prohibits any extra costs from being passed to policyholders if companies choose to buy reinsurance from more expensive, private sources. Given these new provisions, it will be necessary as part of the insurance company's actuarial review of the filing, to confirm that layers do not overlap the CAT Fund or, if they do, that costs have been backed out of the indicated rate need.

XI. Technical Appendices

Exhibits follow.