Insurance Company Solvency Regulation

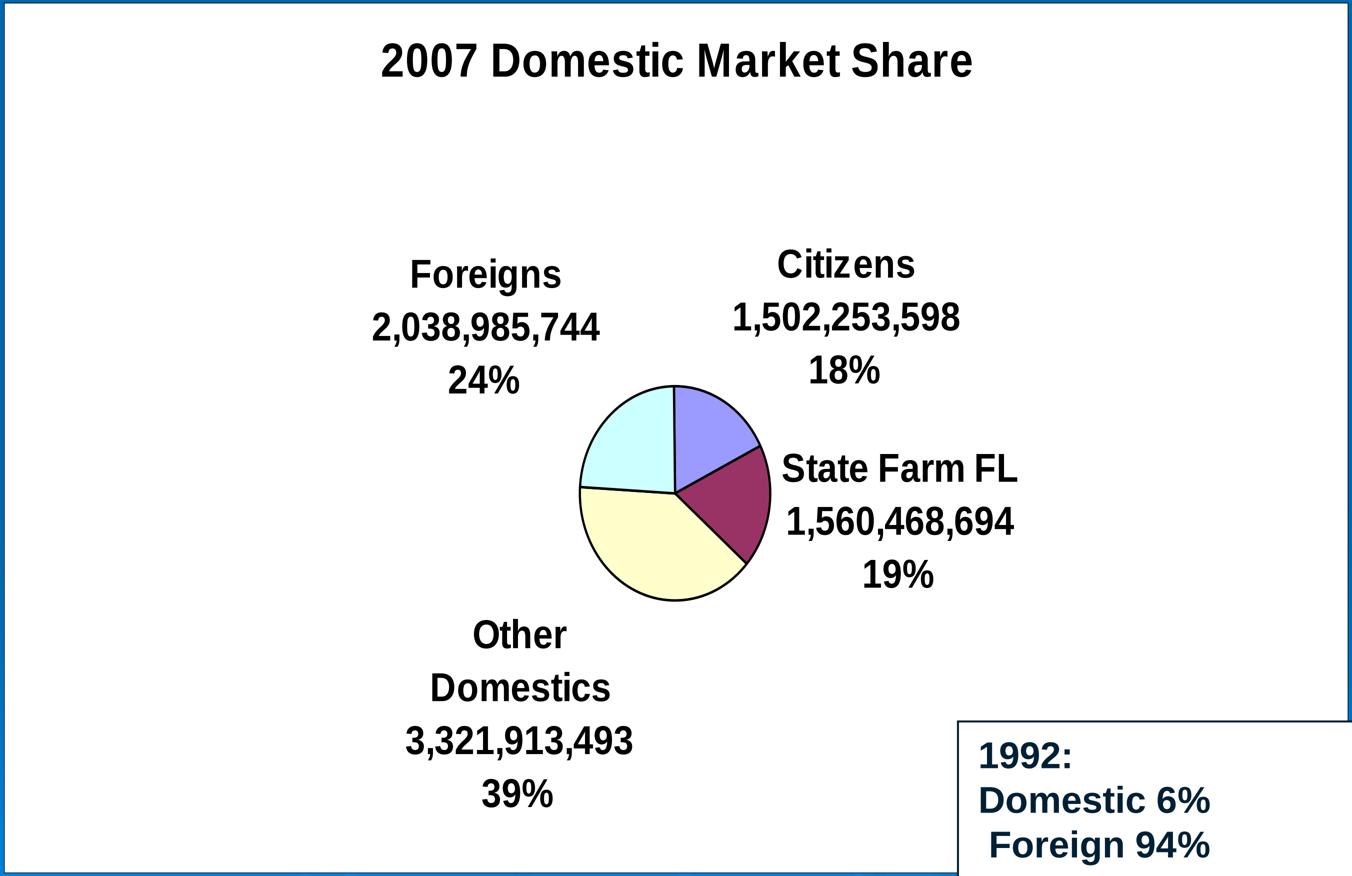
An Overview for the Financial Services Commission

Presented by
Insurance Commissioner Kevin M. McCarty
January 13, 2009

Overview

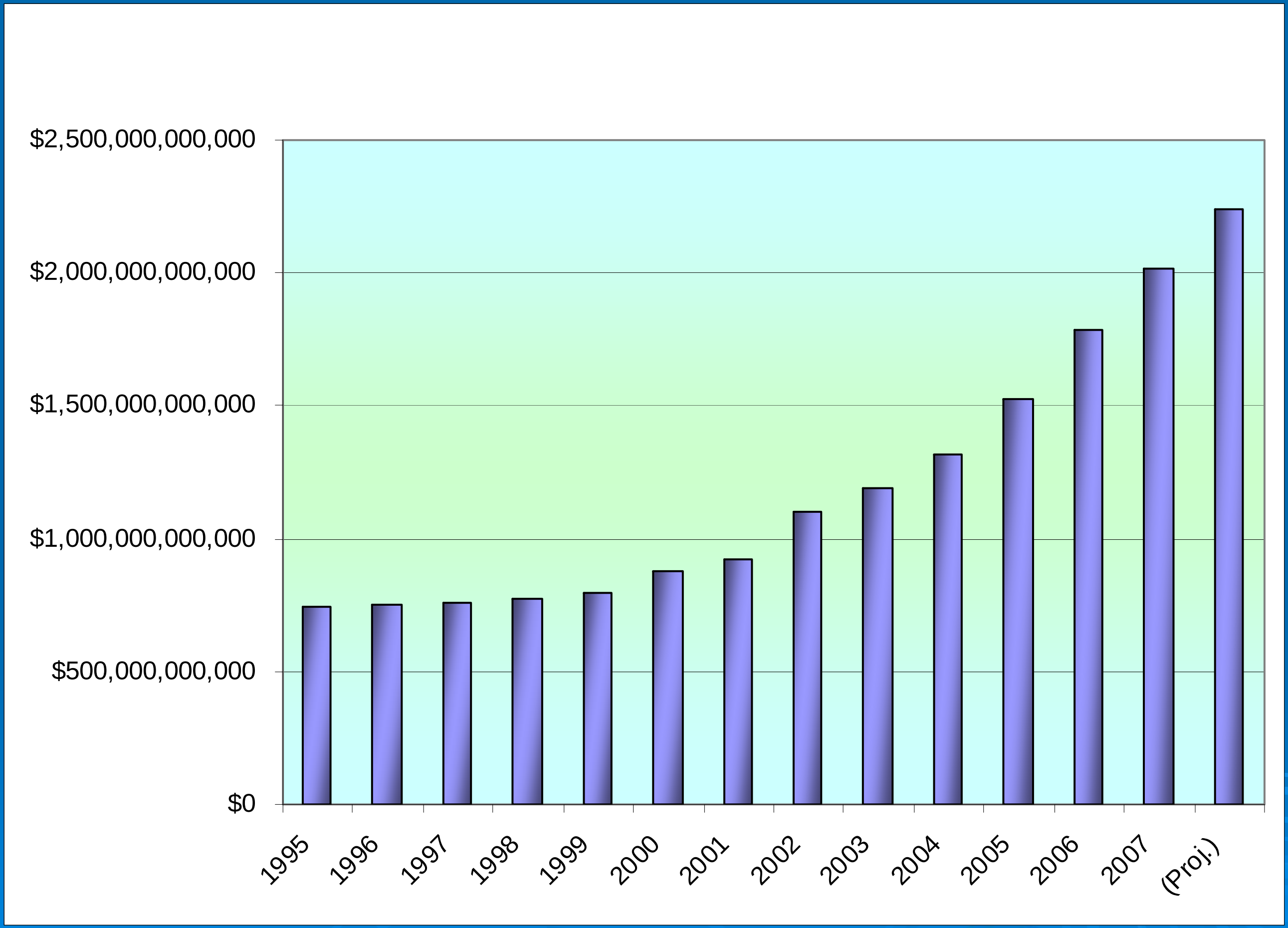
- Evolution of the Florida property market since Hurricane Andrew
- Solvency tools used by the Office
  - Financial Statement Review
  - Examinations
  - Florida-unique Catastrophe Reinsurance Analysis
- Investment risks and credit market conditions
  - Systemic risk analysis

Residential Homeowners Insurance Market
(multi-peril HO only)



1992:
Domestic 6%
Foreign 94%

Florida Residential Property Exposure is Increasing



Source: FHCF 2008 Ratemaking Report, March, 2008

2007 Financial Results for Residential Property Insurers in Florida

Type of Business	Direct Written Premium	Pure Direct Loss Ratio
Private Residential (1)	$13.5 billion	24.34%
Commercial Multiperil (non-liability)	$1.44 billion	21.98%
Federal Flood	$861 million	2.93%
Aggregate (all P/C lines)	$42 billion	43.54%
(1) Fire, Allied lines, Homeowners multiperil,		
Data: NAIC 2007 Annual statements		

National Average Direct Loss Ratio for Homeowners 50.37%

New Domestic Property Insurers Licensed During 2006

Name	Status Date	Line of Business	Initial Capital
*AMERICAN CAPITAL ASSURANCE CORP.	6/30/2006	HO & Comm Res	$50 million
*AMERICAN INTEGRITY INSURANCE Co. OF FL	9/13/2006	Homeowners	9.5 million
AMERIPRISE INSURANCE Co.	10/10/2006	Homeowners	46 million
AUTO CLUB INSURANCE Co. OF FLORIDA	11/22/2006	Homeowners	11 million
EDISON INSURANCE Co.	1/4/2006	Homeowners	10 million
HOMEWISE PREFERRED INSURANCE Co.	5/31/2006	Homeowners	9 million
NORTHERN CAPITAL INSURANCE Co.	5/4/2006	Homeowners	6.8 million
RANCHERS AND FARMERS INSURANCE Co.	1/6/2006	Homeowners	5 million
*ROYAL PALM INSURANCE Co.	3/31/2006	Homeowners	65million
SAFE HARBOR INSURANCE Co.	5/4/2006	Homeowners	6 million
		TOTAL	$218.3 million

*Yellow type represents capital build-up fund participants

**Minimum Capital requirement is $5 million for Homeowners, but depends on business plan

Property Insurers Licensed during 2007

Name	Status Date	Line of Business	Initial Capital
*PRIVILEGE UNDERWRITERS RECIPROCAL EXCHANGE	1/23/2007	Homeowners	$51 million
AMERICAN KEYSTONE INSURANCE COMPANY	2/8/2007	Homeowners	9 million
HOMEOWNERS CHOICE PROPERTY & CASUALTY INS CO	5/10/2007	Homeowners	15 million
*MODERN USA INSURANCE COMPANY	5/31/2007	Mobilehome	14 million
*OLYMPUS INSURANCE COMPANY	5/31/2007	Homeowners	50 million
AMERICAN COASTAL INSURANCE COMPANY	6/21/2007	Commercial Resid	50 million
MAIN STREET AMERICA PROTECTION	10/9/2007	Homeowners	10 million
LANDMARK ONE INSURANCE COMPANY	10/19/2007	Homeowners	9 million
ARK ROYAL INSURANCE COMPANY	11/9/2007	Homeowners	10 million
			218 million

Homeowners Insurers Licensed in 2008

Insurance Company	Date of COA	Starting Surplus
➢ People's Trust Insurance Company	3/6/08	10 million
➢ Avatar Property & Casualty	4/14/08	10 million
➢ ASI Preferred	4/14/08	10 million
➢ Magnolia Insurance Company	4/28/08	20 million
➢ ACE Insurance Co. of the Midwest	7/10/08	50 million
➢ Infinity P&C	12/2/08	10 million
➢ Total 2008		$110 million

- Total New Company starting surplus 06-08 $546.3 million

62 residential property insurance companies currently writing in Florida have been licensed since Hurricane Andrew in 1992

Insurance Capital Build-Up Incentive Program
Senate Bill 1980 from 2006 Legislative Session

Companies that received a Surplus Note:	Date Application Received	$ Amount Surplus Note	$ Amount Contributed by Insurer	Total $ Amount New Capital
American Capital Assurance Corp	6/29/2006	$25,000,000	$25,000,000	$50,000,000
American Integrity Insurance Co. of Florida	5/25/2007	$7,000,000	$7,000,000	$14,000,000
Cypress P&C	6/30/2006	$20,500,000	$20,500,000	$41,000,000
First Home Insurance Company	1/22/2007	$14,500,000	$29,000,000	$43,500,000
Florida Peninsula Insurance Co.	6/16/2006	$25,000,000	$25,000,000	$50,000,000
Modern USA	5/25/2007	$7,000,000	$7,000,000	$14,000,000
Olympus Insurance Co.	4/25/2007	$16,500,000	$33,500,000	$50,000,000
Privilege Underwriters Reciprocal Exchange	12/6/2006	$17,000,000	$34,000,000	$51,000,000
Royal Palm Insurance Co.	6/27/2006	$25,000,000	$25,000,000	$50,000,000
Southern Fidelity Insurance Co.	6/14/2006	$25,000,000	$25,000,000	$50,000,000
St. Johns Insurance Co.	6/15/2006	$20,000,000	$20,000,000	$40,000,000
United P & C	6/16/2006	$20,000,000	$20,000,000	$40,000,000
Universal P & C	6/15/2006	$25,000,000	$25,000,000	$50,000,000
Total Requested		$247,500,000	$296,000,000	$543,500,000

Companies were withdrawing from Coastal Areas before HB1A

From Allstate's SEC filing for 3rd Quarter 2006 (publicly available on SEC website)

Actions we have taken or are considering to attain an acceptable catastrophe exposure level in our property business include:

• removing wind coverage from certain policies and allowing our agencies to help customers apply for wind coverage through state facilities such as wind pools;

• changes in rates, deductibles and coverage;

• limitations on new business writings;

• changes to underwriting requirements, including limitations in coastal and adjacent counties;

• not offering continuing coverage to some existing policyholders;

• purchase of reinsurance or other forms of risk transfer arrangements;

• discontinuing coverage for certain types of residences; and/or

• withdrawal from certain markets.

Examples of catastrophe exposure actions taken during 2006, related to our risk of hurricane loss, include purchasing additional reinsurance on a countrywide basis for our personal lines property insurance, and in areas most exposed to hurricanes; **a limitation on personal homeowners new business writings in coastal areas of Texas, Louisiana, Mississippi, and certain other states; and not offering continuing coverage on select policies in eight coastal counties in the state of New York, which may continue for several years. Additionally, we have entered into a reinsurance agreement to cede losses incurred on 120,000 personal property policies in the state of Florida**

Emphasis added

State Farm Projected Decreases

State Farm Florida Insurance Company
Florida Homeowners
Projected Annual Written Premium Calculation

Historical Values

Month	Year	Monthly Written Premium
October	2007	104,112,304
November	2007	88,878,451
December	2007	107,047,920
January	2008	73,976,263
February	2008	83,894,833
March	2008	93,184,358
April	2008	88,016,391
May	2008	95,687,808
June	2008	109,664,095
July	2008	97,747,374
August	2008	99,794,655
September	2008	81,860,045
Total		1,123,864,497

September 2008 PIF	844,994
Twelve Month Written Premium Per September 2008 PIF	1,330.03

2008 Projected Written Premium

Selected Year End 2008 Written Premium Per PIF	1,330.03
Expected 2008 PIF	811,187
Expected 2008 Written Premium	1,078,900,288

2009 Projected Written Premium

Expected Premium Change Due to Increased Building Costs	5.0%
Selected Year End 2009 Written Premium Per PIF	1,396.53
Expected 2009 PIF	732,468
Expected 2009 Written Premium	1,022,912,020

2010 Projected Written Premium

Expected Premium Change Due to Increased Building Costs	5.0%
Selected Year End 2010 Written Premium Per PIF	1,466.35
Expected 2010 PIF	675,791
Expected 2010 Written Premium	990,949,057

(1) PIF projections based on removal of planned non-renewals that began March 1, 2008 and a lapse rate of 8% given current underwriting guidelines for new business.

State Farm recoupment filing, December 5, 2008

Residual Markets

Across the country, companies are pulling away from catastrophe-exposed areas and residual markets are growing.

❖Nationally, total catastrophe exposure to residual markets at year end 2007 was over $670 billion, covering nearly 2.9 million policyholders, nearly **triple** the number from 2000

❖Alabama: As of November 2008, pool covered 10,700 policies with insured value of 1.8 billion, up from 7,800 properties in 2007 (37% increase)

❖Massachusetts: FAIR plan covers 40% of market on the catastrophe exposed Cape.

❖Mississippi: Wind pool up from 1,600 polices in 2006 to over 36,000 policies currently .

❖North Carolina: Currently about $72 billion in exposure, about $2.4 billion in claims capacity.

❖Texas: TWIA exposure is about $65 billion, over 14 counties plus part of Harris county (Houston). Policy count has grown from 69,000 policies at end of 2001 to over 229,000 policies by October 2008 . Half of the exposure is in Galveston county. Currently, TWIA has cash and reinsurance of about $2.1 billion.

❖FLORIDA CITIZENS: Citizens' policy count has dropped from 1,344,240 on November 30, 2007 to 1,093,138 as of November 30, 2008.

Source: Insurance Information Institute

Solvency Regulation

- International
- National
- Florida

OIR Solvency Tools and Process Financial Analysis:

- **Sworn Financial Statement Filings – Quarterly & Annual**

  Florida Tools:
  Compliance Spreadsheet
  Florida Review Template

  NAIC Tools:
  Financial Analysis Handbook
  Financial Analysis Solvency Tools
  Insurance Regulatory Information System
  Analyst Team Summary
  Company Profile Report

Financial Examinations

- Each domestic company is examined **at least** once every five years. Upon licensure, the new company is examined each of its first three years of operation.

- The Office uses a “Risk Focused” examination approach. This approach allows the examination team to identify the areas for a company that have the greatest potential of risk. This is accomplished by the following:

  - Planning Meetings between the examination team and Office analysis staff
  - Interviews of all top management for the company upon initiation of the exam
  - Onsite examination reviewing all systems including IT, Claims Handling, and Accounting functions for the company.
  - Full Actuarial review of reserves

Insurance Professionals

- Reinsurance Specialists
- Financial Analysts
- Actuaries
- Certified Public Accountants
- Information Technology Professionals
- Certified Financial Examiners

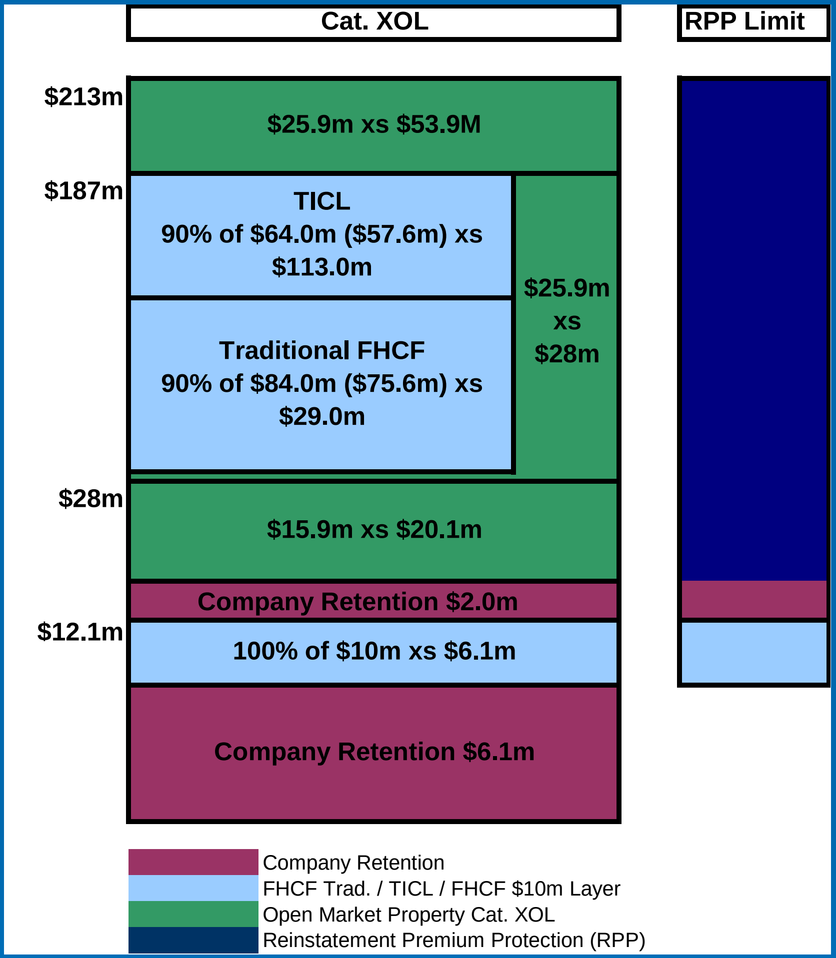
- National Association of Insurance Commissioners Accreditation Process

The Office conducts weekly and quarterly solvency meetings to discuss troubled or potentially troubled companies and plan appropriate regulatory action.

Annual Reinsurance Data Call

- Unique to Florida
- Complement to Existing Solvency Tools

Large Retention Example



The chart above represents a reinsurance structure for a small Florida domestic insurer. The retention for a 1 in 100 year storm is $8.1 million for an insurer with $12.7 in surplus. This insurer's reinsurance program would be unacceptable because the retention from one storm would put the insurer's surplus below the minimum required amount.

Investment Risk and Credit Market Conditions

- ❖A license to operate as an insurer should never be confused as a complete guarantee of financial health and profitability. These are private companies and sometimes economic conditions can create financial distress to one degree or another.

- ❖Solvency regulation is designed to reduce financial risks for the policyholder by proactive early detection of potential insurer distress.

- ❖Current market conditions have impacted insurers to varying degrees and will likely continue. It is important to remember that the insurance industry represents a third or more of the institutional investment market.

Recent Analyses of Systemic Risks

Each individual investment owned by an insurance company in the US is reported on the insurer's statutory financial statements, which are all public documents. These statements can be viewed at www.naic.org.

Using the resources of the NAIC's Securities Valuation Office (SVO), the Florida Office of Insurance Regulation and regulators in other states have conducted timely, focused queries to identify the exposure of the industry and the exposure of each specific domestic company to risks from the following:

Subprime Mortgages – including Countrywide
FNMA and Freddie Mac Securities
Collateralized Debt Obligations, Credit Default Swaps, and Financial Guarantees
Bear Sterns
Lehman
Washington Mutual
All Structured Finance Holdings

- To date, due to conservative investment policy regulation and detailed oversight and monitoring, there have not yet been any catastrophic insurer failures resulting from investments at the insurance company level. AIG's problems did not arise from the regulated insurance companies.

- To date, Florida domiciled companies have not had significant holdings in any of these specific asset groups. Overall market declines for otherwise unaffected securities are likely to have some impact on year end financial statements.

- Our proactive monitoring also included stress testing of Florida insurer equity portfolios; no significant solvency concerns have been detected.