Financial Services Commission

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

February 2013

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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. Seven consecutive seasons without hurricane activity affecting Florida have given both entities an opportunity to accumulate resources to prepare for future storms. Both have significant financial resources as of the end of 2012: Citizens has an estimated combined policyholders' surplus of approximately $6 billion, and the FHCF has an estimated fund balance of approximately $8.5 billion. In addition to these resources, Citizens has outstanding pre-event financing and the FHCF is developing a potential pre-event financing for additional liquidity for 2013 and future seasons. Nonetheless, both would need to rely on their various assessment and/or post-event 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 being the responsibility of the insurer. For 2012, the aggregate industry retention was $7.389 billion and is projected to be $7.213 billion for 2013.
- The FHCF has a mandatory layer of coverage providing up to $17 billion in industry-wide reimbursement for 2012 and is projected to remain at $17 billion for 2013.
- The FHCF also has a Temporary Increase in Coverage Limit ("TICL"), (Section 215.555(17), Florida Statutes), which provides optional coverage to all participants above the mandatory coverage. For 2012, this coverage could have provided up to $4 billion of additional coverage; however, actual coverage purchased by participants was $23 million. For 2013, maximum available TICL is $2 billion, but is projected to be purchased only in minimal amounts.
- The FHCF pays covered losses first from its fund balance, which is derived primarily from accumulated reimbursement premiums from participating insurers (for 2012 the FHCF collected over $1.32 billion) 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 ($ in millions)

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 2012 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/12ratereport.pdf

Return Time (Years)	Gross Probable Maximum Loss[1] ($ in MM)	Net Losses to FHCF[2] ($ in MM)	Projected Year-End Fund Balance[3] ($ in MM)	Assessable Shortfall ($ in MM)
250	$82,424	$17,023	$9,877	$7,146
100	$54,934	$17,023	$9,877	$7,146
50	$37,249	$17,023	$9,877	$7,146

Coverages	Amount ($ in MM)
Retention	$7,389
Mandatory Coverage	$17,000
TICL Coverage	$23

[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% loss adjustment expenses pursuant to FL Statutes 215.555(4)(b)1.

[2] Based on actual coverages purchased by FHCF participating insurers in 2012 as shown in the table above.

[3] FHCF fund balance is estimated as of 12/31/13.

Numbers may not add due to rounding.

Citizens Property Insurance Corporation

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:

- Coastal Account; the Coastal Account 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 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 ($ in millions)

The table below presents the aggregate net PML from storms of the return time specified for: (1) the PLA/CLA; (2) the Coastal Account; and (3) all accounts combined. The loss calculations are as of December 31, 2012 and were done by Citizens using AIR Clasic2 v13.0.

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PLA/CLA
($ in Millions)

Return Time (Years)	PML (PLA/CLA)[1]	FHCF Reimbursement[2]	Surplus[3]	Private Reinsurance / Catastrophe Bonds[4]	Assessable Shortfall
250	$11,531	$2,548	$3,369	$0	$5,614
100	$6,656	$2,548	$3,369	$0	$739
50	$3,791	$2,548	$1,242	$0	$0

Coastal
($ in Millions)

Return Time (Years)	PML (Coastal)[1]	FHCF Reimbursement[2]	Surplus[3]	Private Reinsurance / Catastrophe Bonds[4]	Assessable Shortfall
250	$19,403	$3,499	$3,011	$1,750	$11,143
100	$11,665	$3,499	$3,011	$1,750	$3,405
50	$7,331	$3,499	$3,011	$775	$46

Combined (PLA/CLA & Coastal)
($ in Millions)

Return Time (Years)	PML (PLA/CLA and Coastal)[1]	FHCF Reimbursement[2]	Surplus[3]	Private Reinsurance / Catastrophe Bonds[4]	Assessable Shortfall
250	$30,934	$6,047	$6,380	$1,750	$16,757
100	$18,321	$6,047	$6,380	$1,750	$4,144
50	$11,121	$6,047	$4,254	$775	$46

[1] All PMLs are single event and 100% Standard Sea Surface Temperature (SSST) and include loss amplification and exclude storm surge, and are calculated using exposures as of December 31, 2012. Combined PMLs are a sum of the PLA/CLA and Coastal PMLs.

[2] FHCF reimbursement is only for mandatory coverage since Citizens did not purchase TICL coverage in 2012.

[3] Surplus is unaudited and estimated as of 12/31/12 and includes 2013 net projected income.

[4] Private reinsurance / catastrophe bonds is an estimated amount per Citizens' adopted budget for fiscal year 2013.
Numbers may not add due to rounding.

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 does not have any pre-event debt outstanding and is currently developing a potential pre-event financing of up to $2 billion. The proceeds of this pre-event financing are expected to be available for the 2013 season. Pre-event 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. 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, 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:

Bond	Series 2008A Bonds		Series 2010A Bonds		Total Post-Event Debt Service			Annual
Year	Principal	Interest	Principal	Interest	Principal	Interest	P&I	Assessment %
2013	$300	$30	$0	$33	$300	$63	$363	1.30%
2014	325	15	0	33	325	49	374	1.30%
2015			342	33	342	33	376	1.30%
2016			333	16	333	16	350	1.30%
Total	$625	$45	$676	$116	$1,301	$162	$1,463	

Note: Dollars are in Millions. Principal on Series 2008A and 2010A Bonds is due on July 1.

All outstanding FHCF debt has a AA- rating from Standard & Poor's, a AA rating from 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 reshaped global financial landscape in the wake of the 2007-2008 financial crisis has made large financings more difficult and costly to execute. The size and circumstances that would surround a FHCF post-event issue to pay such losses may further 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 at assumed interest rates or at any interest rate in a timely manner. If long-term bonding in sufficient amounts is not immediately available, the FHCF would need to explore alternatives, including the levying of emergency assessments with no financing, a staged financing schedule and/or interim financing alternatives. 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 Property Insurance Corporation

Citizens also undertakes two basic types of financings: (1) pre-event financing to provide liquid funds to pay policyholders in a timely manner (Citizens primarily uses this 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, FHCF reimbursements, other reinsurance recoveries, Citizens policyholder surcharges, and regular assessments for the Coastal Account only.

Citizens currently has four series of pre-event bonds outstanding (three for the Coastal Account totaling $3.61 billion and one for the PLA/CLA totaling $1.50 billion), totaling $5.11 billion. Of this amount, $760 million will mature prior to the 2013 hurricane season ($560 million for the Coastal Account and $200 million for the PLA/CLA). What remains for the 2013 hurricane season is $4.350 billion in external pre-event liquidity ($3.05 billion for the Coastal Account and $1.30 billion for the PLA/CLA). Together with Citizens' accumulated surplus, this external liquidity provides the source of immediately available funds to pay claims. For the Coastal Account in 2013, this is projected to be $6.06 billion ($3.05 billion of remaining pre-event financing and $3.01 billion of estimated surplus as of December 2012 and 2013 budgeted net income), and for the PLA/CLA, it is projected to be $4.67 billion ($1.30 billion of remaining pre-event financing and $3.37 billion of estimated surplus as of December 2012 and 2013 budgeted net income). 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 policyholder premiums. 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 $617.7 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. In December 2010, Citizens' Board of Governors authorized a reduction in the annual assessment rate to 1.0%. Although Citizens' assessment base is now essentially the same as the FHCF, the assessment for these bonds 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 has long-term underlying ratings of A+ from Standard & Poor's, A+ from Fitch, and A2 from Moody's, and short-term ratings of SP-1+ from Standard & Poor's, F1+ from Fitch, and MIG-1 from Moody's.

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). Citizens' policyholders surcharge and regular assessments for the Coastal Account only 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 reshaped global financial landscape in the wake of the 2007-2008 financial crisis has made financings of this type and magnitude more difficult and costly to complete. The size and circumstances that would surround a Citizens post-event issue to pay such losses would further complicate the issuance process. If long-term bonding in sufficient amounts is not immediately available, Citizens would need to explore alternatives, including the levying of emergency assessments with no financing, a staged financing schedule and/or interim financing alternatives.

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 ($ in millions) below shows the estimated annual assessment impact from the prescribed storm sizes.

Return Time (Years)	Assessable Shortfall ($ in MM)	Required Annual Assessment ($ in MM)[1]	Required Annual Assessment (%)[2]
250	$7,146	$576	1.66%
100	$7,146	$576	1.66%
50	$7,146	$576	1.66%

[1] Assumes annual assessment for 30 years using an interest rate of 7%. There is no certainty that assessable shortfalls can be financed at assumed interest rates, or at any interest rates. The amount which can be financed after an event could be significantly smaller and is subject to market conditions.

[2] Assumes annual assessment base of $34.640 billion, which is the actual base as of December 31, 2011. If this base shrinks in size, required assessment percentages would be higher than shown above.

Numbers may not add due to rounding.

Citizens Property Insurance Corporation

Citizens has a multi-layered assessment structure as prescribed by Florida Statutes. Two important features of the Citizens assessment structure are (1) each account (i.e. the Coastal, 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 2013 is as follows (this is not an exhaustive or technically precise 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 Citizens' policyholders surcharge, up to a total of 15% per account.

(2) Any remaining deficit for the Coastal Account only 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 2% rate, again for the Coastal Account only.

(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 per account. 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 ($ in millions) below shows the estimated assessment impact for each type of Citizens assessment from the prescribed storm sizes.

Combined (PLA/CLA & Coastal)
($ in Millions)

Return Time (Years)	Assessable Shortfall ($ in MM)	Citizens' Policyholders Surcharge[1]		Regular Assessments[1]		Emergency Assessments		
		$ Amount in MM	%	$ Amount in MM	%	Total $ Amount in MM[2]	$ Amount in MM	Annual %[3]
250	$16,757	$1,446	45.0%	$629	2.0%	$14,682	$1,183	3.4%
100	$4,144	$1,221	38.0%	$629	2.0%	$2,294	$185	0.5%
50	$46	$46	1.4%	$0	0.0%	$0	$0	0.0%

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

[1] These assessments are one-time assessments for the first year and are not ongoing. Citizens' policyholders' surcharge is based on projected written premiums of $3.214 billion for 2013. Citizens' regular assessments are based on an assessment base of $31.426 billion for 2013.

[2] Total amount of assessments represents the gross amount financed over 30 years using an assumed interest rate of 7%. There is no certainty that assessable shortfalls can be financed at assumed interest rates, or at any interest rates. The amount which can be financed after an event could be smaller and is subject to market conditions.

[3] Represents annual assessment amount over a 30 year period using an assumed interest rate of 7% and annual assessment base of $34.640 billion as of December 31, 2011. If this base shrinks in size, required assessment percentages would be higher than shown above.
Numbers may not add due to rounding.

Conclusion

As a result of seven consecutive years without major hurricane losses, both Citizens and the FHCF have more cash and surplus on hand to pay claims than in years past. The estimates of potential for assessment by either entity presented in this year's report are lower than last year. For significant events beyond the cash and surplus capacity, both entities rely on bonding and other revenue sources for claims paying capacity.

For catastrophic losses, either from an extreme single event or from multiple events, Citizens will bond to pay claims and assess to repay the bonds. The potential assessment burden is estimated to be lower this year than last. The potential assessment burden for the FHCF is, as well, lower than last year.

In the event bonding for either entity is required, conditions in the national markets used by Citizens and the FHCF have improved over recent years; although, of course there cannot be a guarantee that all bonding can be placed.

The ability of both entities to pay claims in full and in a timely manner remains critical to the health of the Florida insurance market, the people whose homes and businesses are insured, and the Florida economy in general.