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

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

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 and Citizens Property Insurance Corporation both play significant roles in the provision of affordable property insurance coverage for Florida residents. Two consecutive seasons without hurricane activity affecting Florida have given both entities a chance to build resources and otherwise prepare for future storms. Both have significant surplus cash and have taken additional measures to provide further liquidity to ensure that their participants and policyholders, respectively, can be paid in a timely manner. Nonetheless, both would need to rely on their various assessment and/or 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 the responsibility of the insurer. For 2007, the aggregate industry retention was $6.1 billion.

- The FHCF has a mandatory layer providing up to $15.845 billion in industry-wide reimbursement for 2007 and an optional layer providing up to another $12 billion in reimbursement.
- The FHCF pays covered losses first from cash on hand, which is derived primarily from retained reimbursement premiums from participating insurers (in 2007 the FHCF collected $1.4 billion in such premiums) and investment earnings thereon; any shortfall is ultimately paid from the proceeds of post-event bonds secured by emergency assessments levied in amounts sufficient to pay the shortfall 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, and may be levied on most property and casualty insurance premiums in the State.

Table 1-FHCF below shows the net probable maximum loss to the FHCF from storms of the return time specified. The loss calculations were done by Paragon Strategic Services, consulting actuary to the FHCF, and were extracted from their 2007 Ratemaking Formula Report. The complete report may be found at http://www.paragonbenfield.com/fhcf/current/07ratereport.html.

Table 1-FHCF

Florida Hurricane Catastrophe Fund
Net Probable Maximum Loss and Shortfall

Return Time (years)	Gross Probable Maximum Loss [1]	Net Losses to FHCF [2]	Year End Cash Balance[3]	Assessable Shortfall
250	$79,024,292,960	$27,830,000,000	$2,077,600,000	$25,752,400,000
100	$49,846,761,596	$27,830,000,000	$2,077,600,000	$25,752,400,000
50	$32,158,701,033	$23,452,830,930	$2,077,600,000	$21,375,230,930

Retention	**$6,100,000,000**
Limit of Coverage	**$27,830,000,000**
Co-Pay	**10%**

[1] Represents gross loss to all Florida residential policyholders from a storm of the indicated return time (source -- 2007 FHCF Ratemaking Formula Report prepared by Paragon Strategic Solutions see full report at http://www.paragonbenfield.com/fhcf/current/07ratereport.html)

[2] Assumes retention, coverage limits and co-pay shown above

[3] Estimated cash balance as of 12/31/07

Citizens

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:

- High-Risk Account ("HRA"); the HRA 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 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 below presents the aggregate net PML from storms of the return time specified for: (1) the PLA/CLA; (2) the HRA; and (3) all accounts combined. The loss calculations were done by Citizens' internal actuarial staff using RMS RiskLink v7.0 and a blend of 2/3 stochastic rates and 1/3 historical rates.

Table 1-Citizens

Citizens Property Insurance Corporation

Net Probable Maximum Loss and Shortfall

PLA/CLA

Return Time (years)	Aggregate PML (PLA/ CLA)[1]	FHCF Reimbursement[2]	Surplus[3]	Assessable Shortfall
250	$17,794,403,105	$4,610,000,000	$2,527,000,000	$10,657,403,105
100	$10,490,675,819	$4,610,000,000	$2,527,000,000	$3,353,675,819
50	$6,696,581,570	$4,610,000,000	$2,527,000,000	$0

HRA

Return Time (years)	Aggregate PML (HRA)[1]	FHCF Reimbursement[2]	Surplus[3]	Assessable Shortfall
250	$27,117,411,989	$7,352,000,000	$1,383,000,000	$18,382,411,989
100	$16,159,275,959	$7,352,000,000	$1,383,000,000	$7,424,275,959
50	$10,302,054,607	$7,352,000,000	$1,383,000,000	$1,567,054,607

Combined

Return Time (years)	Aggregate PML (PLA/CLA & HRA)[1]	FHCF Reimbursement[2]	Surplus[3]	Assessable Shortfall
250	$44,911,815,094	$11,962,000,000	$3,910,000,000	$29,039,815,094
100	$26,649,951,778	$11,962,000,000	$3,910,000,000	$10,777,951,778
50	$16,998,636,176	$11,962,000,000	$3,910,000,000	$1,567,054,607

[1] All PMLs are weighted 1/3 Historical and 2/3 Stochastic

[2] FHCF Reimbursement is the maximum reimbursement estimated for 2008

[3] Surplus is projected as of 12-31-08

Financing Options

Florida Hurricane Catastrophe Fund

The FHCF undertakes two basic types of financings: (1) pre-event financings to provide liquid funds to reimburse participating insurers in a timely manner; and (2) post-event financings 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 outstanding, totaling $6.3 billion; these financings are 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 should the investment earnings fall short. There are no assessments associated with pre-event bonds. 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 one series of post-event bonds outstanding. These bonds were issued in June, 2006 in the par amount of $1.350025 billion, and were used to pay claims from the 2005 storm season. These bonds are payable from emergency assessments which were levied beginning in January 2007 at the rate of 1% per year for six years. The bonds are scheduled to mature by July 2012.

All outstanding FHCF debt has a AA- rating from both Standard and Poor's and Fitch and a Aa3 rating from Moody's.

The FHCF has the statutory authority to amortize its debt over a term up to 30 years. Given the magnitude of the losses associated with the storms summarized in Table 1 above, the FHCF would in all likelihood 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. Given its current ratings and market conditions prevailing as of 1-28-08, interest rates on such FHCF bonds would range from approximately 2.69% to 4.91% for the final maturity. It should be noted that the recent and ongoing upheaval in the credit markets worldwide has made many financings more difficult to complete. The size and circumstances that would surround a FHCF post-event issue to pay such losses would certainly complicate this process. The ability of the FHCF to complete a significant bond issue at reasonable rates and terms is largely dependent on the resolution of the current market stresses. 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 alternatives to bridge the gap until adequate long-term market access was available. The FHCF statute provides that the FHCF's liability is limited to the amount it can actually raise from bonding.

Citizens

Citizens also undertakes two basic types of financings: (1) pre-event financings to provide liquid funds to pay policyholders in a timely manner. Citizens primarily uses these financings as a "bridge" to reimbursements from the FHCF; and (2) post-event financings designed to provide the ultimate source of payment of covered claims in excess of accumulated surplus and FHCF reimbursements.

Citizens currently has three series of pre-event bonds outstanding, totaling $4.75 billion. It also has 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 billion. In total, these financial arrangements provide $4.55 billion in pre-event liquidity for the HRA and $1.95 billion in pre-event liquidity for the PLA/CLA. Together with Citizens' accumulated surplus, these financings provide the source of immediately available funds to pay claims. For the HRA in 2008, this is projected to be $5.933 billion ($4.55 billion of pre-event financings and $1.383 billion of projected surplus as of 12-31-08), and for the PLA/CLA it is projected to be $4.47 billion ($1.95 billion from pre-event financings and $2.527 billion from projected surplus as of 12-31-08). 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 accumulated premiums if investment earnings fall short. There are no assessments associated with pre-event bonds.

Citizens also has one series of post-event bonds outstanding, in the par amount of $1.06254 billion. 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. Although Citizens' assessment base is now essentially the same as the FHCF, this assessment 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' debt for the PLA/CLA currently carries underlying ratings of A2 from Moody's and A+ from Standard & Poor's; its HRA debt carries ratings of A3 from Moody's and A+ from Standard & Poor's. In addition, all outstanding Citizens' debt has AAA ratings as a result of the use of bond insurance from one of five different insurers.

The ongoing global credit crisis has caused one of those insurers to be downgraded to AA by Fitch, and has several others on negative credit watch for a possible downgrade. These actions and other factors related to the current market situation have caused Citizens' pre-event bonds – which are all variable rate – to trade at higher interest rate levels than they had previously. This has caused Citizens' pre-event financing programs to become more expensive, but has not yet endangered the integrity of the programs. Citizens is monitoring market conditions closely and is evaluating its potential alternatives should the market degradation continue.

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). Most of these assessments 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. Given the magnitude of the losses associated with the storms analyzed in table 1 above, it is likely that Citizens would finance any remaining deficit over a 30-year period. Given its current ratings and market conditions prevailing as of 1-28-08, interest rates on such Citizens bonds would range from approximately 2.89% to 5.11% for the final 30-year maturity. It should be noted again that the recent and ongoing upheaval in the credit markets worldwide has made many financings more difficult to complete. The size and circumstances that would surround a Citizens post-event issue to pay such losses would certainly complicate this process. The ability of Citizens to complete a needed significant bond issue at reasonable rates and terms is largely dependent on the resolution of the current market stresses. If long-term bonding in sufficient amounts is not immediately available, Citizens would need to explore a staged financing schedule and/or interim financing alternatives to bridge the gap until adequate long-term market access was available.

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 below shows the estimated annual assessment impact from the prescribed storm sizes.

Table 2-FHCF

Florida Hurricane Catastrophe Fund
Assessment Impact

Return Time (years)	Gross Probable Maximum Loss [1]	Assessable Shortfall	Required Annual Assessment ($)[2]	Required Annual Assessment %[3]
250	$79,024,292,960	$25,752,400,000	$1,813,000,000	4.90%
100	$49,846,761,596	$25,752,400,000	$1,813,000,000	4.90%
50	$32,158,701,033	$21,375,230,930	$1,502,200,000	4.06%

[1] Represents gross loss to all Florida residential policyholders from a storm of the indicated return time (source -- 2007 FHCF Ratemaking Formula Report prepared by Paragon Strategic Solutions see full report at http://www.paragonbenfield.com/fhcf/current/07ratereport.html)

[2] Annual assessment for 30 years

[3] Assumes assessment base of $37 billion

Citizens

Citizens has a multi-layered assessment regime as prescribed by Florida Statutes. Two important features of the Citizens assessment structure are (1) each account (i.e. the HRA, 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 2008 is as follows (this is not an exhaustive 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 an assessment on non-homestead Citizens policyholders, up to a total of 10%. Non-homestead policyholders in all accounts can be assessed to pay a deficit in any account.

(2) Any remaining deficit is then funded by an assessment on all Citizens' policyholders, again up to a total of 10%. All policyholders in all accounts can be assessed to pay deficits in any account.

(3) Any remaining deficit is then funded by a combination of an additional assessment on Citizens' policyholders – up to an additional 10% - and 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 10% rate, but given the fact that the Citizens' policyholder surcharge is subtracted from it in determining the amount to be levied, its effective maximum rate is somewhat less than 10%.

(4) 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. This effectively gives Citizens the ability to finance any deficit over a 10-year 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 below shows the estimated annual assessment impact for each type of Citizens assessment from the prescribed storm sizes.

Table 2-Citizens

Assessment Impact

Return Time (Years)	Nonhomestead Citizens' Assessment $[1]	Nonhomestead Citizens' Assessment %	Additional Citizens' Assessment $	Additional Citizens' Assessment %	Citizens' Policyholder Surcharge $	Citizens' Policyholder Surcharge %	Regular Assessment $	Regular Assessment %	Emergency Assessment $	Emergency Assessment %[2]	Total Assessments[3]
Combined 1-250	$ 210,000,000	30.0%	$ 1,200,000,000	30.0%	$ 1,200,000,000	30.0%	$ 8,700,000,000	26.4%	$ 17,729,815,094	3.0%	$ 29,039,815,094
Combined 1-100	$ 210,000,000	30.0%	$ 1,200,000,000	30.0%	$ 692,566,766	17.3%	$ 5,021,109,053	15.2%	$ 3,654,275,959	0.6%	$ 10,777,951,778
Combined 1-50	$ 70,000,000	10.0%	$ 400,000,000	10.0%	$ 132,976,316	3.3%	$ 964,078,291	2.9%	$ -	0%	$ 1,567,054,607

= Levied on Citizens' policyholders only

= Levied on non-Citizens' policyholders

1 Assumes nonhomestead policyholders account for $700,000,000 of annual premium

2 Represents the annual assessment percentage for 30 years

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

Conclusion

Citizens and the FHCF are financing mechanisms created to enable Florida to provide insurance to its citizens. While pre-event financing is possible, both entities rely heavily on post-even bond financing to support losses. To that end, multiple hurricanes large enough to erode the claims paying ability of both entities would challenge both Citizens and the private property insurers in the state.

Current conditions in the credit markets, resulting from the sub-prime loan crisis and bond insurance credit quality concerns, could challenge the ability of Citizens and the FHCF to obtain needed financing at reasonable cost. The sub-prime loan stress is continuing to develop in the markets currently and discussions are occurring at the highest levels nationally and internationally to minimize the continued drag of the situation on the market. Steps are also being taken, both from the private markets as well as from the regulatory perspective, to strengthen the capital position of the existing bond insurers in order to allow them to return to their core business. As well, new entrants into the bond markets, with substantial capital bases, are currently being created and licensed. The intent is to return bond insurance capacity to the credit markets expeditiously.