

AGENDA
FINANCIAL SERVICES COMMISSION
Office of Insurance Regulation
Materials Available on the Web at:
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May 11, 2010

MEMBERS

Governor Charlie Crist
Attorney General Bill McCollum
Chief Financial Officer Alex Sink
Commissioner Charles Bronson

Contact: Monte Stevens
(850-413-2571)

9:00 AM
LL-03, The Capitol
Tallahassee, Florida

<u>ITEM</u>	<u>SUBJECT</u>	<u>RECOMMENDATION</u>
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1. Property Insurance Update

ATTACHMENT 1

FOR INFORMATION



OFFICE OF INSURANCE REGULATION

KEVIN M. McCARTY
COMMISSIONER

FINANCIAL SERVICES
COMMISSION

CHARLIE CRIST
GOVERNOR

ALEX SINK
CHIEF FINANCIAL OFFICER

BILL McCOLLUM
ATTORNEY GENERAL

CHARLES BRONSON
COMMISSIONER OF
AGRICULTURE

April 29, 2010

The Honorable Alex Sink
Chief Financial Officer
Florida Department of Financial Services
The Capitol, PL 11
Tallahassee, FL 32399-0301

Dear Chief Financial Officer Sink:

I am responding to your hand-delivered letter dated April 23, 2010. Before responding to your specific questions, I would like to address the actions the Office has taken that may merit further explanation.

On April 1, 2010, OIR issued an Order doing away with the requirement that certain insurers provide three years of continuous coverage for policies removed from Citizens Property Insurance Corporation.

The Office has issued orders authorizing insurers to remove policies from Citizens Property Insurance Corporation (Citizens) that included requirements that Florida take-out companies provide three years of continuous coverage. This requirement originated years ago when companies received take-out "bonuses" and were required to maintain the policies for three years to earn the bonuses. In the past, Citizens would audit the takeout escrow account prior to releasing the bonuses to ensure the policies were still in force. This dynamic has changed substantially in recent years as Citizens no longer pays take-out bonuses, and consumers have the option to "opt out" and remain in Citizens. The companies affected by the Office's order removed policies from Citizens less than three years ago so the bonuses were not an issue. When this option first became available in 2007, only 5% of policyholders elected to opt out and keep their Citizens coverage. However, in recent take-outs, a much higher proportion of the policyholders in the less risky areas of the state has exercised the right to opt out and stay with Citizens. As a result, the take-out companies are left with only the riskiest portion of the selected policies. The final book of business following the take-outs is much different from the anticipated risk portfolios modeled prior to the take-out.

The Office had several conversations with take-out companies about this "selection bias" for Citizens take-out policies. The companies reported this selection of policies raised the company's Probable Maximum Loss (PML). Consequently, reinsurance costs increased dramatically for these companies. In

• • •
KEVIN M. McCARTY • COMMISSIONER
200 EAST GAINES STREET • TALLAHASSEE, FLORIDA 32399-0305 • (850) 413-5914 • FAX (850) 488-3334
WEBSITE: WWW.FLOIR.COM • EMAIL: KEVIN.McCARTY@FLOIR.COM

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some cases, the companies informed the Office that if the companies could non-renew a few thousand policies, it would reduce reinsurance costs to a level that was financially feasible. The Office has encouraged companies to reevaluate risk portfolios given this selection bias, and has assured companies there will be no penalties issued by the Office should companies need to reduce their exposure prior to the three-year timeframe. The companies are still bound by their take-out contracts with Citizens, and this action may make them ineligible for future take-outs under their current contracts.

On April 7, 2010, OIR found that Northern Capital Insurance Company was insolvent, and requested the initiation of receivership proceedings.

During my presentation to the Financial Services Commission on March 23, 2010, I mentioned the Office had two companies in administrative supervision – Northern Capital Insurance Company was one of these companies. Northern Capital first filed an impaired financial statement on March 1, 2010 and the Office made the referral to DFS on April 7, 2010.

OIR is monitoring the unsound financial condition of Magnolia Insurance Company in administrative supervision. The Company continues to have homeowners' policies in force in Florida, and there is limited time between now and hurricane season for OIR to protect these policyholders.

During my presentation to the Financial Services Commission on March 23, 2010, I mentioned the Office had two companies in administrative supervision – Magnolia Insurance Company was the second of these two companies. The public supervision has been successful in reducing Magnolia's policy count from roughly 74,000 to 30,000 from December 2009 to present, and in preparing the company's data so that the information is useful for the receiver, Florida Insurance Guaranty Association (FIGA), and Citizens. The Office is referring this company for receivership so that policies are cancelled by the beginning of hurricane season.

On April 12, 2010, OIR issued an Informational Memorandum doing away with requirements for property insurers to purchase a specific level of catastrophe reinsurance. According to the Memorandum, OIR no longer requires any specific level of catastrophe reinsurance such as the 1 in 100 year probable maximum loss level.

Except for companies included in the Capital Incentive Build-Up Program, there is no specific level of catastrophe reinsurance mandated by rule or law in Florida. The Office's regulatory philosophy has remained consistent: to utilize the best methods for protecting Florida's consumers in the event of an active hurricane season.

In the past, the Office has focused on the large-storm scenario similar to Hurricane Andrew, and has included a 1-in-100 year mega-storm as one of its stress tests. This standard is common industry practice and is required by some rating agencies. However, the Office has learned the use of this standard as a stress test has created unintended consequences – specifically, it has given international reinsurers an advantage in the negotiation process, which has allowed them to charge exorbitant rates for the highest level of insurance coverage.

While the Office's underlying philosophy has been consistent – to best utilize reinsurance to protect Floridians – the Office does acknowledge a shift in its emphasis, which was codified in the recent Informational Memorandum to the industry. The Office is more closely examining insurers' retentions per event, and insurers' ability to reinstate their reinsurance following a series of storms similar to the storm scenarios in 2004-2005. Although the emphasis has shifted, the Office still reviews the vertical coverage.

In specific answer to your questions:

1. ***Is there any authorized property insurer in the State of Florida that has been found by OIR to be impaired or insolvent in the past year that OIR has allowed to write new policies or to renew policies? If so, please provide me with the name of the company, and the rationale behind OIR's decision to permit any company to continue to writing or renewing policies while impaired or insolvent.***

The Office has not authorized any company to write new policies once the company was found to be impaired or insolvent. With respect to Northern Capital, prior to a filed statement showing an impairment or insolvency, the Office instructed Northern Capital to discontinue writing new policies. On February 19, 2010, the Office informed the company that it could not write new policies, but could renew policies until further instructions from the Administrative Supervisor. This was only considered because at that point in time, there was a potential buyer conducting due diligence for a potential purchase of the company. Non-renewals would cause uncontrolled deterioration of the book of business rendering any sale of the company impractical. It should also be noted that during the few weeks prior to the referral of the company for receivership proceedings, the company had already sent notices of renewal for the next 45-day period. Section 627.4133, Florida Statutes, requires a minimum of 100 days notice of non-renewal. The Office was aware at the time that either a buyer would come forth or the company would be referred for receivership within a few weeks.

2. ***The OIR's Informational Memorandum dated April 12, 2010, states that OIR is not requiring any specific level of catastrophic reinsurance such as the 1 in 100 year probable maximum loss level.***
 - a) ***Given this statement, is there a uniform standard which all authorized Florida property insurers are required to meet with regard to hurricane exposure? If so, what is this uniform standard?***
 - b) ***Why is OIR doing away with the requirement for property insurers to maintain a specific level of catastrophe reinsurance?***

As stated previously, there is currently no standard in rule or in statute. Even without a legal requirement, most companies acquire reinsurance for a minimum 1-in-100 year storm as a matter of common industry practice. Based on our experience in reviewing last year's reinsurance data call combined with early reports from companies negotiating this year's

reinsurance treaties – we have learned that a concrete 1-in-100 year standard negatively impacts the marketplace.

The problem occurs when unregulated global reinsurers have advance knowledge that direct writers are required to purchase coverage for a specific level. This creates inequities in the negotiation process. Economists refer to this situation as “inelastic demand” which gives advantages to the seller, and disadvantages to the buyer. The practical result is that reinsurers are dramatically increasing the marginal cost for the last layer of coverage below the 1-in-100 year event -- the assumption is that insurers have no choice but to purchase this coverage. If this situation is allowed to continue, it could lead to a decrease in competition, an increase in rates, and additional costs that are ultimately passed on to policyholders in the form of higher premiums.

The Office is encouraging companies to consider non-traditional risk transfers in addition to their traditional reinsurance programs at the higher layers for additional capacity and to enhance competitive pricing. More importantly, using the lessons of both the 2004 and 2005 hurricane seasons, a series of medium-sized storms are far more likely to impact our state than a once-in-a-century storm. The Office has focused its financial stress tests to ensure companies have the financial wherewithal to handle a series of storms in addition to measuring their capability to fund the proverbial storm of biblical proportions.

Ironically, a company reinsuring for a 1-in-100 year event may not be in the best financial posture to endure an active hurricane season. For example, a private insurer in Florida with a surplus of \$300 million may purchase reinsurance coverage for a 1-in-250 year storm. However, if the company retains the first \$150 million in damage per event, two medium sized storms costing the company \$150 million each would exhaust this company's surplus.

In contrast, another company with only \$20 million in surplus may purchase reinsurance for a 1-in-80 year event. However, this company's retention may only be \$4 million per event. This company could handle four medium-sized storms without exhausting its surplus. Based on this underlying dynamic of the marketplace, the Office advised companies, “The Office is not requiring any specific level of catastrophe reinsurance such as the 1 in 100 year probable maximum loss. Rather, the Office will look at the entire spectrum of catastrophe risk for each insurer recognizing it is equally important to protect the surplus of the insurer from multiple storms of a smaller magnitude.”

The Office has not changed its fundamental approach to the review of reinsurance, but instead has gained experience by analyzing the data from the Office's reinsurance data call. The Office adjusted its review based upon the ever-changing Florida insurance marketplace. By describing this holistic approach outlined in the Office's memorandum, the Office is attempting to create rate relief that will directly affect policyholders of our state by helping to stabilize rates, which are directly impacted by reinsurance pricing. While brokers and other financial beneficiaries have received increased commissions based on inflated prices for

reinsurance -- their interests should not be elevated above the interests of the people of the State of Florida.

3. *In an Order dated April 1, 2010, OIR released certain take-out insurers from their contractual obligation to retain take-out policies for at least three years.*

a.) *How many policies will be affected by OIR releasing the take-out insurers from this three-year obligation?*

The Office has requested that each company provide information about its anticipated number of non-renewed policies. Based on preliminary information the Office has received, the Office estimates approximately 32,500 policies will be non-renewed over the course of the coming year as a result of this order.

The Office has given companies specific instructions to minimize the impact to policyholders as needed. The non-renewals should occur at the normal expiration date, and policyholders should be provided with the minimum statutory 100-day notice. This will provide a controlled non-renewal process that will transpire over the next year and will allow agents and policyholders sufficient time to obtain a policy in the private insurance marketplace without presuming that Citizens is their only alternative. The number of non-renewals and the non-renewal process will vary based on the company, and the company's need to reduce its PML and its reinsurance expenses.

b.) *What actions is OIR taking to facilitate placing these policies in the private market?*

Since the Office has allowed companies to non-renew policies as opposed to cancel policies, agents will have time to place policies with private insurers. In addition, policyholders may directly access the Florida Market Assistance Program (FMAP), which is designed to assist consumers to obtain insurance coverage in the voluntary market.

c.) *This three-year standard was in place to provide a commitment by insurers to their policyholders, and to provide stability in our property insurance marketplace. What public policy interests are advanced by releasing these take-out insurers from their obligation to retain take-out policies?*

As stated previously, the original purpose of this requirement was to ensure that companies receiving take-out "bonuses" maintained the policies for the required timeframe to earn the bonuses. This dynamic has changed substantially in recent years as Citizens no longer pays take-out bonuses, and consumers have the option to "opt out" and remain in Citizens. The result is that the companies' final book of business following the take-out was not reflective of the risk portfolios modeled prior to the take-out.

The decision promotes the public policy interest of allowing companies to lower their PML, reduces reinsurance expenses, and consequently, assists in maintaining insurer solvency for companies operating in Florida.

4. *Pursuant to Section 624.82, Florida Statutes, OIR can disclose information relating to the supervision of an insurer if the Office finds that it is in the best interest of the public, the insurer in supervision, or its insureds? What information at this time does OIR believe should be disclosed with regard to companies presently in supervision to serve the best interests of the public or its insureds?*

The Office does not have any information to disclose about companies in administrative supervision at this time.

As I stated during my March 23, 2010, presentation to the Financial Services Commission, "Some have criticized the Office for not informing the public earlier about insurers experiencing financial problems. However, it should be noted that the insurance industry is the most transparent of all industries in the financial marketplace. Similar to the banking industry, under the laws of Florida some of the Office's regulatory work is, and should be, confidential as to not cause the proverbial 'bank run' by policyholders or frighten potential investors."

The Florida Legislature expressly provided confidentiality for the administrative supervision process. While much of this information is confidential by law – the DFS Division of Rehabilitation and Liquidation is aware of companies that are in administrative supervision to prepare for potential receiverships.

5. *What further action does OIR believe needs to occur prior to hurricane season to ensure that authorized property insurers are financially capable of meeting their obligations through the course of the 2010 hurricane season?*

I have mentioned several factors affecting the industry during my presentations before the Financial Services Commission. To reiterate, we should address the cost-drivers that are hindering insurance companies' bottom lines. In addition, we should strengthen solvency requirements by increasing minimum capital to \$15 million for insurers. Another provision that would help the marketplace is to allow the Office to waive Section 627.4133, Florida Statutes, to allow companies to give only 45-days notice for non-renewing policies if the Office determines the company is in financial distress. These provisions are contained in the current version of S.B. 2044, Senator Garrett Richter's bill.

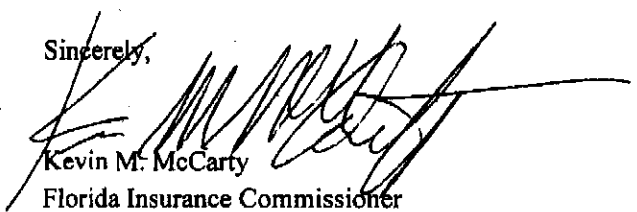
All of the actions taken by the Office are intended to support and promote the private insurance marketplace in Florida while protecting policyholders. Increasing competition for reinsurance, promoting access to capital markets for insurers, and allowing insurers to recalibrate a book of business to facilitate increased financial stability is paramount for maintaining a viable private marketplace in Florida. This

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viable private marketplace allows the state to access the global reinsurance market and potential global capital.

The Office will accommodate any meeting with you or your staff to discuss confidential information specific to insurance companies.

Sincerely,



Kevin M. McCarty

Florida Insurance Commissioner

STATE OF FLORIDA
CHIEF FINANCIAL OFFICER
ALEX SINK

April 23, 2010

Commissioner Kevin McCarty
Office of Insurance Regulation
200 East Gaines Street
Tallahassee, Florida 32399

Dear Commissioner McCarty:

Thank you for briefing the Financial Services Commission on March 23, 2010, regarding the state of Florida's domestic property insurance market. Recently, there have been a series of actions by the Office of Insurance Regulation with regard to Florida's property insurance market that merit further explanation by the Office:

- On April 1, 2010, OIR issued an Order doing away with the requirement that certain insurers provide three years of continuous coverage for policies removed from Citizens Property Insurance Corporation;
- On April 7, 2010, OIR found that Northern Capital Insurance Company was insolvent, and requested the initiation of receivership proceedings;
- OIR is monitoring the unsound financial condition of Magnolia Insurance Company in administrative supervision. The company continues to have homeowners' policies in force in Florida, and there is limited time between now and hurricane season for OIR to protect these policyholders.
- On April 12, 2010, OIR issued an Informational Memorandum doing away with the requirements for property insurers to purchase a specific level of catastrophe reinsurance. According to the Memorandum, OIR no longer requires any specific level of catastrophe reinsurance such as the 1 in 100 year probable maximum loss level.

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Many of these actions by OIR appear to represent a fundamental shift in strategy with regard to the regulation of property insurance companies. In light of the recent insolvency of Northern Capital, the unsound financial condition of Magnolia, and these other strategic changes announced by OIR, I would appreciate your detailed written response to the following questions:

1. Is there any authorized property insurer in the State of Florida that has been found by OIR to be impaired or insolvent in the past year that OIR has allowed to write new policies or to renew policies? If so, please provide me with the name of the company, and the rationale behind OIR's decision to permit any company to continue writing or renewing policies while impaired or insolvent.
2. The OIR's Informational Memorandum dated April 12, 2010, states that OIR is not requiring any specific level of catastrophic reinsurance such as the 1 in 100 year probable maximum loss level.
 - a) Given this statement, is there a uniform standard which all authorized Florida property insurers are required to meet with regard to hurricane exposure? If so, what is this uniform standard?
 - b) Why is OIR doing away with the requirement for property insurers to maintain a specific level of catastrophe reinsurance?
3. In an Order dated April 1, 2010, OIR released certain take-out insurers from their contractual obligation to retain take-out policies for at least three years.
 - a) How many policies will be affected by OIR releasing the take-out insurers from this three-year obligation?
 - b) What actions is OIR taking to facilitate placing these policies in the private market?
 - c) This three-year standard was in place to provide a commitment by insurers to their policyholders, and to provide stability in our property insurance marketplace. What public policy interests are advanced by releasing these take-out insurers from their obligation to retain take-out policies?

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4. Pursuant to Section 624.82, Florida Statutes, OIR can disclose information relating to the supervision of an insurer if the Office finds that it is in the best interest of the public, the insurer in supervision, or its insureds. What information at this time does OIR believe should be disclosed with regard to companies presently in supervision to serve the best interests of the public or its insureds?
5. What further action does OIR believe needs to occur prior to hurricane season to ensure that authorized property insurers are financially capable of meeting their obligations through the course of the 2010 hurricane season?

I appreciate your written response to these questions on or before April 29th so that the members of the Financial Services Commission can review your responses in advance of our next meeting. If in addition to your written responses you include any type of chart with data in your response, please be sure to thoroughly explain the chart or data so we can follow your analysis.

Sincerely,



Alex Sink

AS/ij

cc: Governor Charlie Crist
Attorney General Bill McCollum
Commissioner Charles Bronson