Study of Recent Legislative Changes to Florida Property Insurance Mechanisms

Prepared for Associated Industries of Florida

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Summary of key findings

- Recent Florida legislation, aimed at reducing homeowners insurance premiums, will increase the amount of hurricane claims that will be financed post-event through bonds — and future premium assessments to repay the principal and the interest charges associated with those bonds
- Post-event funding through bonds, to pay for claims in excess of cash resources, could range up to $50 billion or more if there is a major 2007 hurricane
- Per household, total nominal assessment costs to pay off the bonds could range from approximately $1,700 for a moderate hurricane to $14,000 for a major hurricane; these costs would be spread over the next 10 to 30 years in the form of assessments on auto and homeowners, and business insurance
  - This compares to an estimated average premium savings in 2007 of $265 per household as a result of the recent legislative changes
  - We did not consider the compounding effect of hurricanes in 2008 or subsequent years; while major hurricanes in multiple years is unlikely, in such scenarios assessments could double or triple these figures
- Even a series of smaller storms across the state, similar to the 2004 season, would lead to assessments that exceed the incremental savings created by the legislation
- The amount of savings and potential assessments vary across the state; an effect of post-event funding through assessments is to have lower hurricane risk areas subsidize higher risk areas

Background on the Florida property insurance market

- In addition to private insurers and reinsurers, the property insurance system in Florida is supported by three state-sponsored mechanisms:
  - Citizens Property Insurance Corporation ("Citizens"), which provides primary insurance coverage to those unable to obtain it from private insurers
  - The Florida Hurricane Catastrophe Fund ("FHCF"), which provides excess reinsurance coverage to both private insurers and Citizens
  - The Florida Insurance Guaranty Association ("FIGA"), which pays the claims of bankrupt private insurers
- Both Citizens and the FHCF collect premiums for the coverage that they provide; in addition all three entities have the authority to issue bonds to cover any claims in excess of their available cash resources, and to levy future premium assessments to repay the principal and the interest charges associated with those bonds
  - In other words, unlike private insurance, Citizens and FHCF are supported by a mixture of pre-event and post-event funding
  - The extent of post-event funding that may be required depends on the number and size of future hurricanes; if a major hurricane occurs the level of bonding and assessments could be substantial
- *Recent legislative changes have expanded the entities' scope of operations in several respects*
  - Citizens scope of operations is expanded in several ways, and they are no longer required to charge rates above those of private insurers
  - The layers of reinsurance offered by FHCF have been expanded

The AIF has asked Tillinghast to analyze the Florida property insurance market, focusing on two primary questions

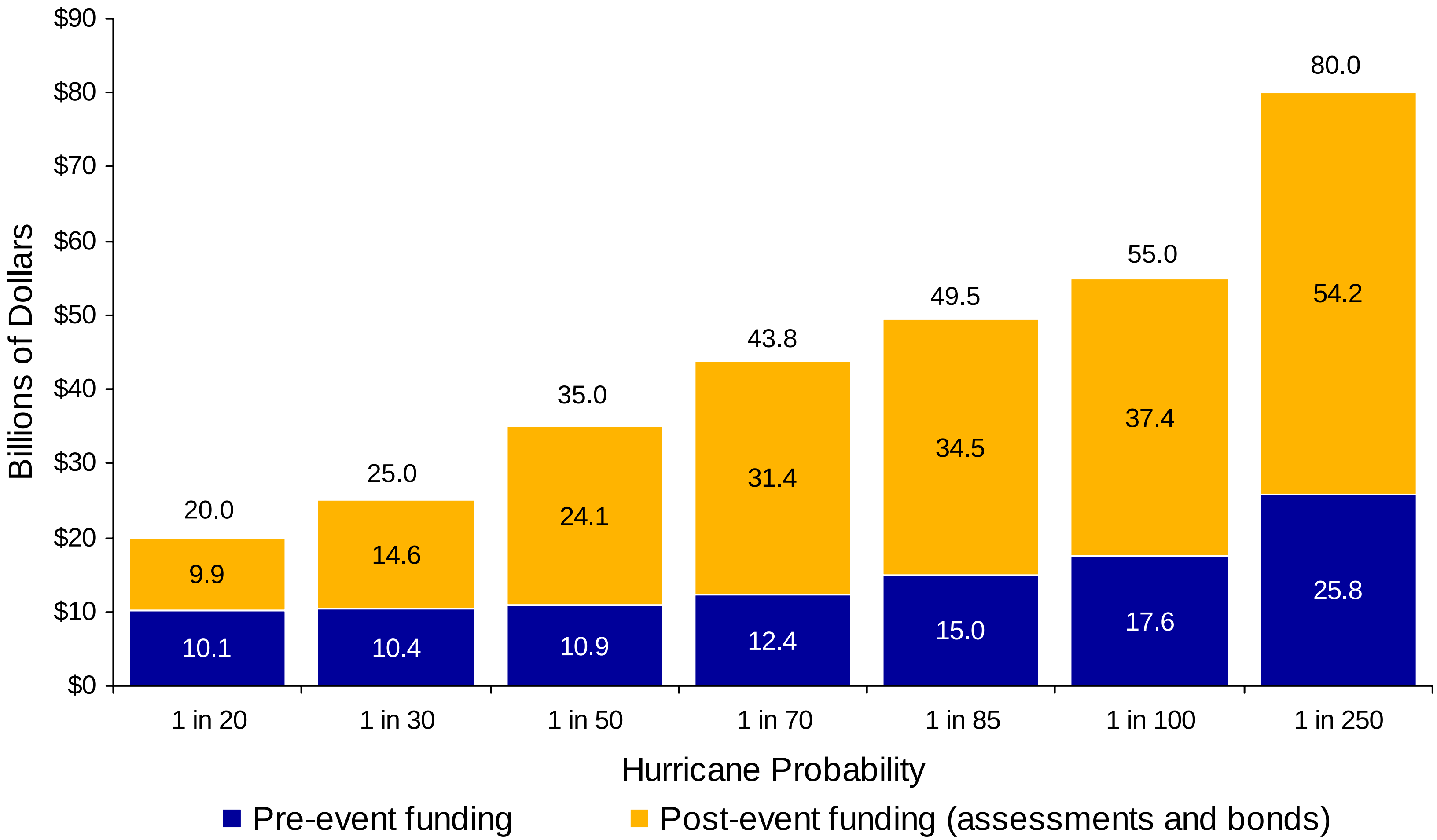
1. Beyond the cost of insurance premiums, what is the potential cost of post-hurricane assessments to Floridians under different 2007 scenarios?
2. How do immediate premium savings to consumers through recent legislation compare to potential costs to consumers, which may be accumulated over time through annual assessments and indirect price increases?

- Our goal in producing this study is to inform the policy debate; Tillinghast does not take a position pro or con on the Florida mechanisms, nor on the recent legislative changes to them

Background on the assessment mechanisms

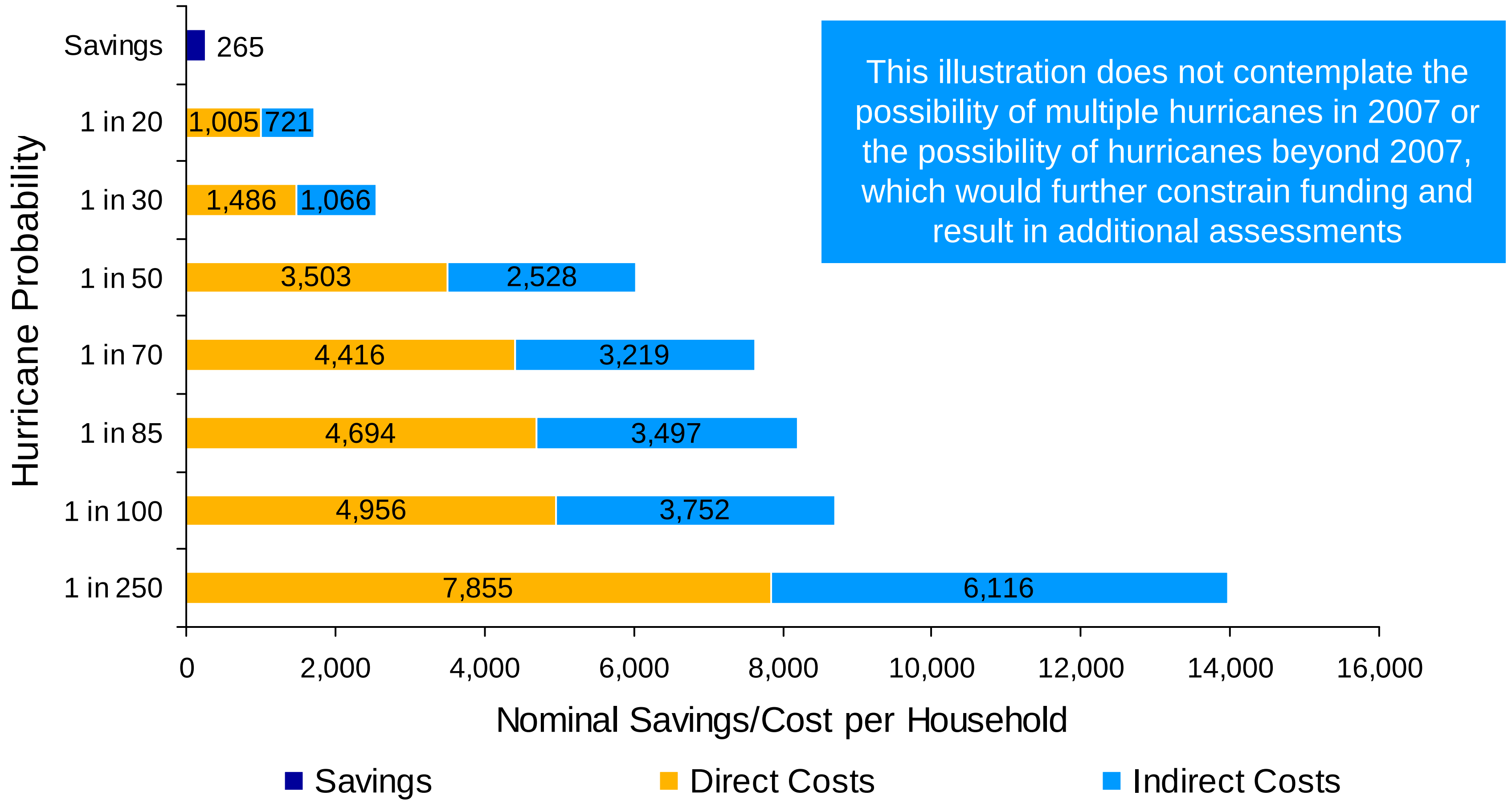
- In the event of a major storm or series of storms, wind-related claims in excess of available cash resources of the private carriers and state mechanisms will need to be financed via the issuance of bonds by Citizens, FHCF, and FIGA; the principal and interest on these bonds will be repaid by assessments on Florida policyholders
  - Assessments will now be levied on various types of property/casualty insurance, including homeowners, auto, commercial property, and liability
  - Assessments would have occurred regardless of the recent legislative changes; however, since the recent legislative changes expand the overall exposure of Citizens and FHCF, they also increase the amount and duration of assessments that may need to be levied in the event of a major storm
- Bonds will be financed over the course of several years, and interest charges will add to the cost paid by policyholders
- The potential cost to consumers will be felt two ways
  - Directly through assessments on the homeowners and auto insurance premiums consumers pay
  - Indirectly, as business owners will pass on the cost of assessments on their commercial insurance premiums (other than Worker's Compensation) to consumers through higher prices on goods and services

In the event of an active hurricane season in 2007, most claim payments will be funded after-the-fact



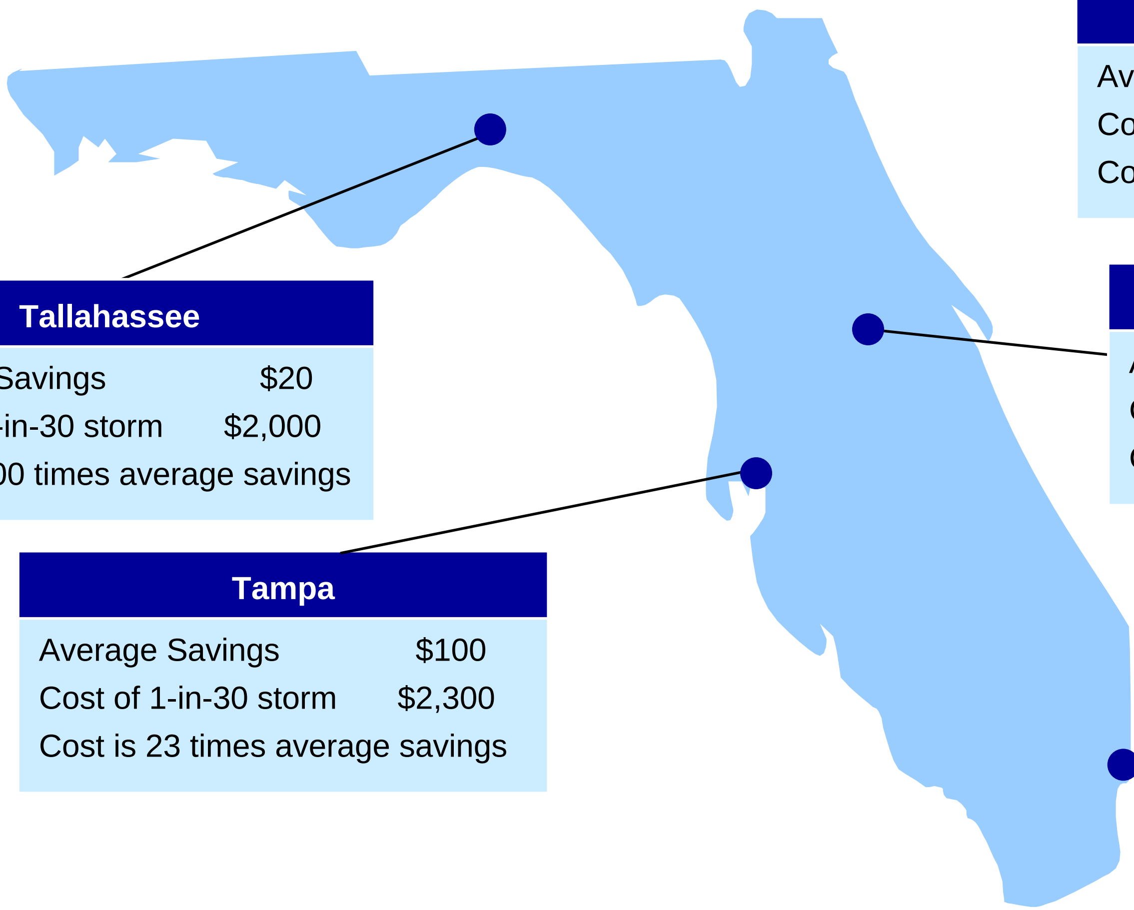
Notes: Pre-event funding includes funds available to Citizens, FHCF, and private carriers, plus contingent funding available through private reinsurance to pay claims in 2007. Post-event funding is on a present-value basis and does not include cumulative financing costs. Probabilities are expressed as “odds of a single storm of this magnitude or greater happening in the 2007 season”.

Potential long-term costs of 2007 hurricanes could overshadow 2007 premium savings for consumers



Notes: Assumed average homeowners premium per household is $1,300 in 2007. Savings for 2007 premiums reflects 24.3% savings on hurricane costs, which are assumed to be 63% of total premiums. These savings are based on the statewide OIR estimate. Actual savings may be less. Direct costs include assessments paid by policyholders on homeowners and personal auto premiums. Indirect costs include assessments on commercial lines passed onto consumers through higher prices. Amounts expressed here are the nominal costs, or the total cost of borrowing including financing charges paid over the term of the bond.

Savings for typical policyholders are highest in coastal areas, but exposure to the nominal cost of future assessments and surcharges is not proportionate to savings...



Statewide Average	
Average Savings	$265
Cost of 1-in-30 storm	$2,550
Cost is 10 times average savings	

Tallahassee	
Average Savings	$20
Cost of 1-in-30 storm	$2,000
Cost is 100 times average savings	

Orlando	
Average Savings	$30
Cost of 1-in-30 storm	$2,075
Cost is 69 times average savings	

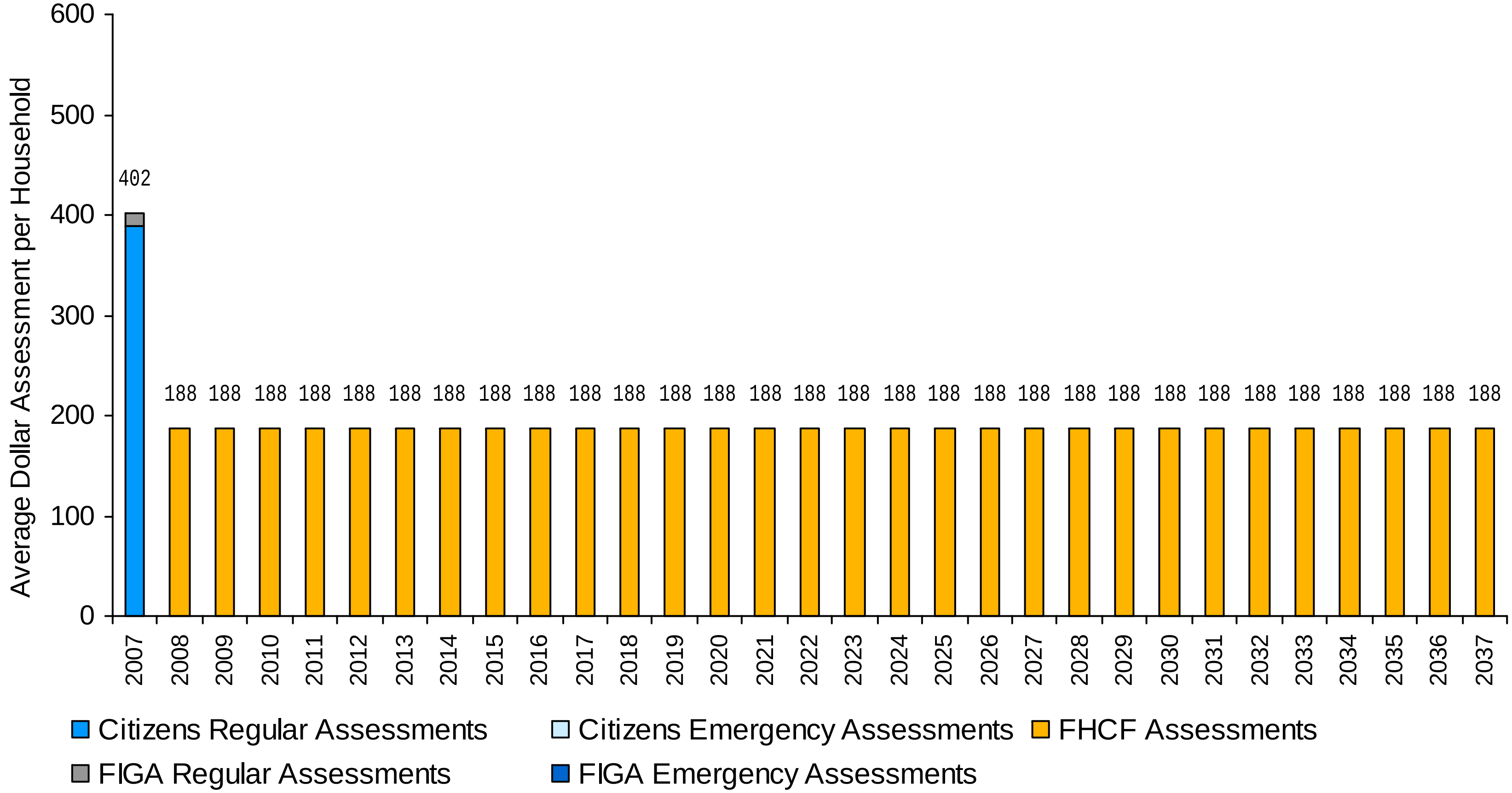
Tampa	
Average Savings	$100
Cost of 1-in-30 storm	$2,300
Cost is 23 times average savings	

Miami	
Average Savings	$1,120
Cost of 1-in-30 storm	$3,375
Cost is 3 times average savings	

...meaning that policyholders in lower risk areas would subsidize high-risk area policyholders if a major event were to occur.

Note: Cost includes direct assessments and indirect costs to repay bond principal and financing charges. This illustration assumes that homeowners rates in Miami, Orlando, Tallahassee and Tampa are 180%, 53%, 46% and 76% of statewide average premiums, respectively.

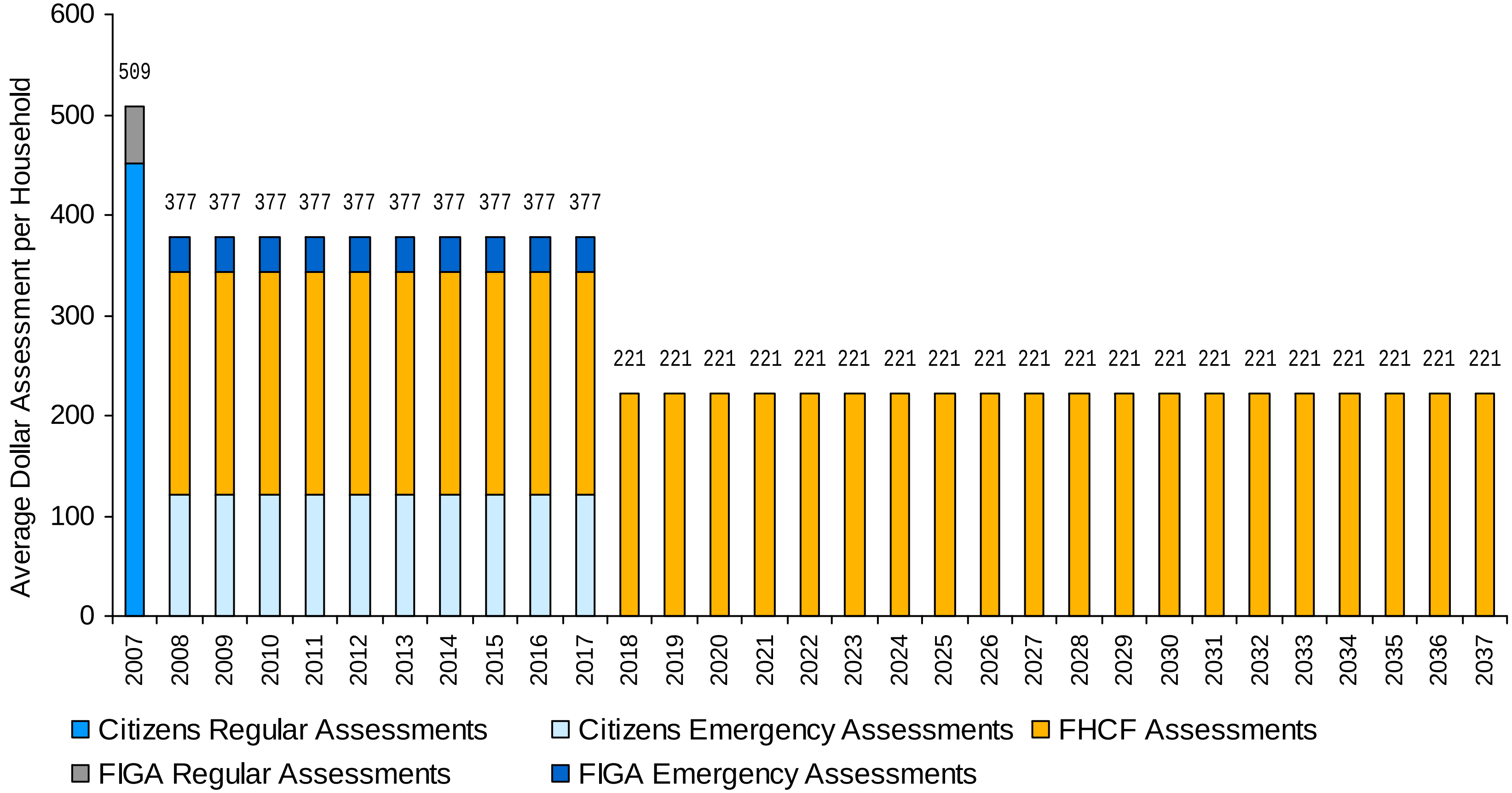
Annual assessments per average household would extend out thirty years under various scenarios (here, a 1 in 50 storm in 2007)



This illustration does not contemplate the possibility of multiple hurricanes in 2007 or the possibility of hurricanes beyond 2007, which would further constrain funding and result in additional assessments

Note: Number of households is based on 2007 households and is not adjusted for future population growth.

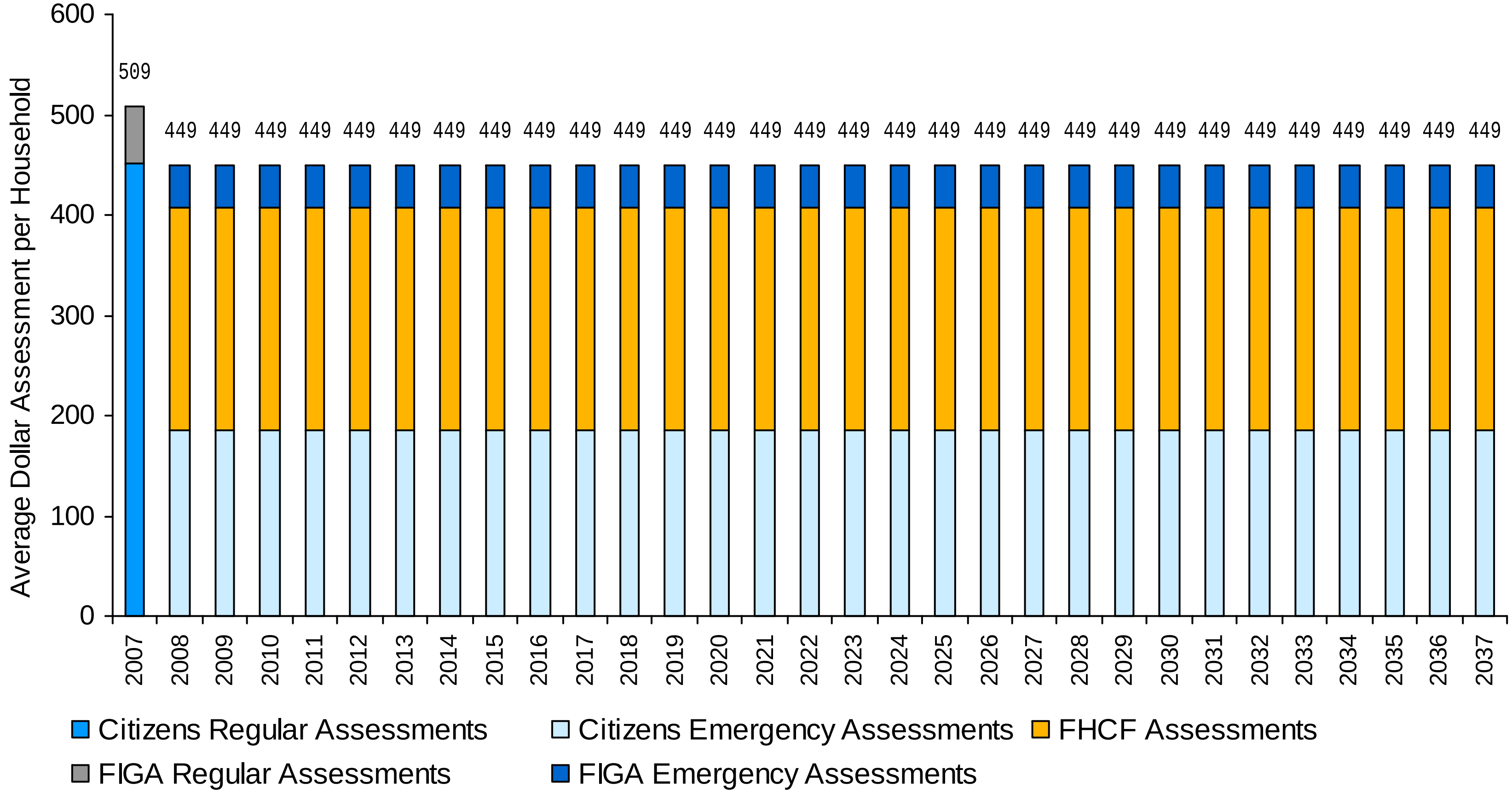
Annual assessments per average household would extend out thirty years under various scenarios (here, a 1 in 100 storm in 2007)



This illustration does not contemplate the possibility of multiple hurricanes in 2007 or the possibility of hurricanes beyond 2007, which would further constrain funding and result in additional assessments

Note: Number of households is based on 2007 households and is not adjusted for population growth.

Annual assessments per average household would extend out thirty years under various scenarios (here, a 1 in 250 storm in 2007)



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Note: Number of households is based on 2007 households and is not adjusted for population growth.

The expansion of Citizens' role may result in potential future assessments that are greater than those depicted in our study

- As indicated in the chart below, a number of legislative changes may cause Citizens exposure to grow
  - In our analysis, we have assumed that Citizens exposure remains at levels reported at the end of 2006; some growth may occur prior to the 2007 hurricane season
  - To the extent that Citizens grows over the next several years, the potential size of assessments would also grow
- Also, assessments resulting from a major storm will now be passed on to more policyholders with insurance in multiple lines (homeowners, auto, commercial, etc.)
  - Drivers and business owners would be effectively subsidizing homeowners risk in Florida

Entity	Description of legislative changes	Impact on Assessment Exposure
FHCF	■ Reduction of premium by eliminating 25% rapid cash build-up factor ■ Offering additional layers of coverage	■ Reduces available resources to pay for wind-event and may result in larger deficit which would be paid through future assessments on policyholders ■ Increases potential deficit to be paid through assessments
Citizens	■ Rate rollback and Citizens is no longer required to offer "non-competitive" rates ■ Loosened eligibility requirements ■ Authorized to write commercial exposures ■ Assessment base expanded	■ Reduces available resources and may lead to increase in aggregate potential exposure to wind storm ■ Total assessment amount unchanged, but "who pays" changes

Appendix

- Assumptions
- Reliances and Limitations
- Sources

Assumptions

- Assessments for pre-existing liabilities for Citizens, FHCF and FIGA are excluded
- Funds available to pay claims for the 2007 hurricane season (premiums plus existing capital)
  - Citizens can sustain $2 billion in losses prior to issuing assessments for deficits
  - FHCF can sustain $3 billion in losses prior to issuing bonds
- Citizens and FIGA assessments
  - In the event of deficit, the entity will issue the maximum regular assessment prior to issuing bonds for any remaining deficit
  - Emergency assessments are used to make annual bond payments (interest and amortization)
  - Assessments are paid by policyholders and collected by insurers
- Citizens, FHCF and FIGA bond issues
  - Term is ten years, unless emergency assessments are insufficient to make annual coupon payments, in which case the bond term is 30 years
  - Interest rate is 5% per annum
  - Other costs related to issuance are not included

Assumptions (cont'd)

- FHCF coverage layers
  - No insurers purchase TEACO ($3.05 BB excess of $3.05 BB)
  - All insurers purchase TICL (90% of $13.3 BB excess of $23.7 BB)
  - These assumptions may not reflect actual insurer decisions
- There are 7,300,000 Florida households in 2007
- Premium assessment bases applicable to 2007 hurricanes
  - Citizens: $33.0 BB; FHCF: $36.9 BB; FIGA: $20.7 BB
- In the absence of the changes mandated by the recent legislation, claims in excess of capital available to the various private and state entities would still be financed through the same mechanisms (bonding and assessments) currently available to Citizens and FHCF, but at a different level
  - We have not quantified these costs and therefore cannot provide a comparison between potential costs incurred under the current regime versus costs under the previous regime

Reliances and limitations

- The conclusions in this document rely on data from Citizens Property Insurance Company, the Florida Hurricane Catastrophe Fund, the Florida Insurance Guaranty Association, and the Florida Office of Insurance Regulation
- The purpose of this document is to examine the potential effect of recent Florida legislation concerning property catastrophe insurance; it is not intended nor necessarily suitable for any other purpose
- The outcomes depicted are meant to illustrate events estimated to occur under various scenarios; actual results will of course depend on actual events and other variations from our assumptions
  - Hurricane probabilities are expressed as “odds of a single storm of this magnitude or greater happening in the 2007 season”

Sources of information

- Citizens
  - 2004 and 2005 financial statements
  - 2006 quarterly financial statements through September 30
  - Fiscal year 2007 operating budget
  - Plan of operation as amended through February 13, 2007
  - Rate filing from May 19, 2006
  - Probable maximum loss curves as of December 31, 2006
- FHCF
  - 2005 and 2006 financial statements
  - Other publicly-available information
- FIGA
  - 2005 financial statement
  - Plan of operation
- U.S. Census Bureau
  - Data on population and the number of households
- A.M. Best
  - Industry direct written premiums by line, for Florida