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FLORIDA CITIZENS PROPERTY INSURANCE CORPORATION (CPIC)

An Excerpt from: *Residual Market Property Plans -- From Markets of Last Resort to Markets of First Choice*

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Florida Citizens Property Insurance Corporation (CPIC)

1. Overview

Since its establishment in 2002, after the state passed legislation combining two separate high risk insurance pools, known as the Florida Windstorm Underwriting Association and the Florida Residential Property & Casualty Joint Underwriting Association, Citizens Property Insurance Corporation (CPIC) has experienced exponential growth. As a result Florida Citizens has evolved from a market of last resort, becoming the state's largest property insurer in 2006.

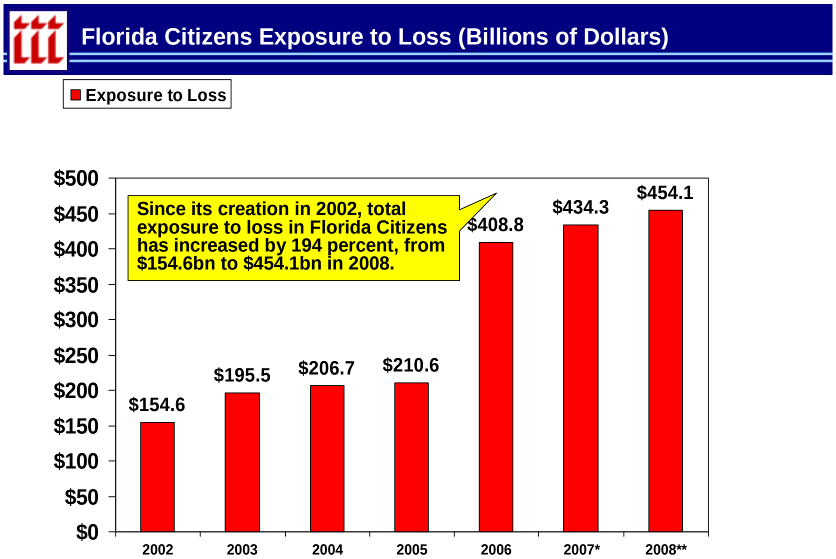
According to PIPSO data, of the 2.6 million total policies (habitational and commercial) insured by the FAIR plans across the U.S. in 2006, 1.5 million or 60 percent were in Florida Citizens. This compares with the 658,085 policies or 44 percent insured by Florida Citizens in 2002. Citizens is a state-regulated association and historically has provided property insurance where it is not available from the regular market. It has tax-exempt status and provides insurance to homeowners, commercial residential properties and a limited number of commercial businesses in coastal high-risk areas and others who are unable to obtain coverage in the private insurance market. Following a new legislative package passed in January 2007 (discussed below), Citizens rates are now competitive with the private market.

CPIC's policy count has been flattening out even while its exposure remains high. As of December 31, 2007, Citizens had 421,505 high risk policies in force (those that were in the old windstorm pool). The CPIC also had about 845,857 personal/residential policies in force, and about 11,161 commercial/residential policies. Total policies in force amounted to 1.3 million at year-end 2007.

As noted earlier, a depopulation plan created by Florida's legislature is designed to reduce the number of policies in Citizens, encouraging new or existing private insurers to take on policies covered by Citizens. From 2003 to 2006, approximately 500,000 policyholders were returned to the private market. In addition, Citizens reduced its exposure by $100 billion. However, the insolvency of major insurance group, the Poe Insurance Companies, added thousands of policies to Citizens at a time when many other insurers were cutting back on policy renewals in coastal areas.

In 2007 and 2008, takeout activity has increased. Seven insurers approved to assume Citizens' policies removed almost 248,000 personal residential policies (with a potential exposure to loss of some $68 billion) from Citizens' books in 2007. In 2008, the Florida OIR has approved plans to remove a further 500,000 policies. As of April 30, 2008, total policies in force had declined to 1.2 million, while total exposure to loss had increased to $454.1 billion (Fig. 17), up from $434.3 billion at March 31, 2007.[1]

[1] *Natural Catastrophe Financing – A Florida Financial Update*, Jason Schupp, Zurich American Insurance Company, May 22, 2008; and Florida Citizens.



*FL Citizens data, as of Mar 31, 2007. **As of April 30, 2008.

Source: PIPSO; Florida Citizens; Zurich American Insurance Co; Insurance Information Institute

Fig. 17

Source: PIPSO; Insurance Information Institute

Legislative Developments

Despite its growing exposure and volatile financial position, Citizens was marked for even further growth following passage of insurance law CS/HB 1A in 2007. The new law significantly expanded the overall role of the state in insuring homes and in the reinsurance markets and included the following specific changes for Citizens:

- Required Citizens to be competitive with the private market by lowering its rates and lowering eligibility standards.
- Authorized Citizens to write multiperil policies (in addition to wind-only policies) in areas eligible for coverage in the high-risk account, and transferred business from the commercial Joint Underwriting Association (JUA) into Citizens.
- Expanded the Citizens assessment base more than four-fold to all lines of property/casualty insurance except for workers compensation and medical malpractice.
- Required executive officer review on routine rate filings (threatens perjury charges and administrative penalties).
- Required premium discounts, even if not actuarially justified.

The upshot of this new law was that the exposure of Florida's policyholders to post-catastrophe taxes and assessments increased dramatically. At the same time, the law did almost nothing to encourage property insurers to offer policies in Florida over the long-term, nor did it reduce the actual risk from hurricanes facing Florida property owners.

In April 2008, another new piece of legislation, The Homeowners' Bill of Rights (SB 2860) was passed by the state legislature. The bill was signed into law by Florida governor Charlie Crist in May 2008. Among the provisions affecting Citizens, the bill:

- Extends the freeze on rate increases for Citizens to the end of 2009. Requires Citizens to make a new recommended actuarially sound rate filing beginning July 15, 2009 and annually after then. The 2009 rate filing may not take effect prior to 1/1/2010.

- Increases the value of homes that can be insured by Citizens from $1 million to $2 million. Homes with a replacement cost of $2 million or more are ineligible for coverage from Citizens, effective January 1, 2009, with limited exceptions.

- Revises the required assessments to fund a Citizens deficit. Lowers the maximum percentage for regular assessments (and the trigger for emergency assessments) to 6 percent of statewide premium for subject lines of business (instead of 10 percent).

- Removes the immediate Citizens policyholder surcharge, but allows for surcharges upon renewal or issuance of policies. Increases the maximum policyholder surcharge upon renewal or issuance of a policy to 15 percent.

- Creates a taskforce to review and report on changes needed to restore Citizens to its former role as a noncompetitive insurer of last resort.

Claims-Paying Capacity

Citizens was hit hard by 2005 and 2004's hurricane seasons, suffering record hurricane damage claims and incurring a deficit in both years. As a result of losses related to Hurricanes Dennis, Katrina and Wilma, Citizens reported an operating deficit of just over $2 billion in 2005. This followed an operating deficit of $1.6 billion in 2004, after Citizens incurred around $2.4 billion in losses from nearly 120,000 hurricane damage claims, of which $1.8 billion came from its high-risk windstorm account.

When Citizens losses exceed its claims-paying capacity in a single year, it is required by state law to impose a statewide assessment on every insurer based on its homeowners line market share in the state. By law, insurers may recoup the amount from policyholders as part of the homeowners insurance rate-making process in the state. The surcharge is shown separately on premium notices when homeowners insurance policies come up for renewal. To cover 2004's shortfall, Citizen's imposed a 6.8 percent surcharge on policyholders, amounting to about $100 per $1,500 in premiums. To offset Citizens' 2005 deficit, hurricane insurance bill (SB 1980) was passed by the state legislature in May 2006, provided for a $715 million appropriation of state general revenue dollars to the fund. This reduced the regular assessment on policyholders from 11 percent to 2 percent. A further 10 percent emergency assessment to pay off the remainder of the deficit was spread over a 10-year period (1.4 percent annually).

Citizens also has the ability to finance loss payments by issuing tax-exempt bonds that carry low interest rates, piggy-backing on the state of Florida's strong credit rating. As part of its financial structuring for the 2006 hurricane season, Citizens undertook a $3.05 billion bond issue in early July 2006 to raise additional capacity. As a result, Citizens had $5 billion in reserves to deal with potential losses in the 2006 hurricane season. However, the credit crisis that began in mid-2007 and continued into 2008 has raised serious concerns regarding Citizens' ability to raise significant sums in the bond markets should a major hurricane strike in 2008.