CURRENT STATE OF PROPERTY INSURANCE
April 2009

GLOBAL

High catastrophe losses and the continuing international credit crises pushed property catastrophe rates up by 8% at the 1/1/08 reinsurance renewal period, according to a briefing on global reinsurance market conditions published in early January.

For the US, rates rose on average by 11%, but there were wide variations dependent upon loss experience and zone (Gulf of Mexico programs are seeing prices up 40%).

Looking forward, another above-average catastrophe year or another financial surprise could negatively impact rates . . . however, a resolution of the credit crises could restore asset values and improve the financial conditions of insurers and reinsurers. The first half of 2009 will be a "waiting game," with dramatic events having the potential to either negatively or positively impact the market and pricing.

FLORIDA

Citizens Property Insurance Corporation is the state-run, taxpayer-backed insurer of last resort – and largest purchaser of reinsurance through the Cat Fund. The Florida Hurricane Catastrophe Fund (FHCF) was created after Hurricane Andrew hit south Florida to offer private insurers cheap backup coverage, or "reinsurance" . . . necessarily expanding Florida's exposure to storm losses.

As part of Gov. Crist's "get-tough" stance on property insurance rates, legislative action in 2007 froze Citizen's rates at 2005 levels until January 2010. Unfortunately, those rates have not been commensurate with the risk it's assumed – meaning CPIC rates don't accurately reflect what it can expect to pay out after a major storm.

Responding to taxpayers' complaints and concerns about the state's multibillion-dollar claim exposure, elected officials want to keep rates in check and reduce the size of CPIC. In 2008, Florida's Office of Insurance Regulation approved more than a dozen new insurers to take about 400,000 policies out of Citizens. But in doing so, the state has been pushing some of these new insurers to write far more policies relative to their surplus than is considered safe by traditional property insurers (FL's premium-to-surplus ratio is 2:1 – traditional property insurers use a 1:1 ratio). That means that insurers who meet Florida's much higher ratio are automatically considered much riskier by industry rating standards and major rating companies. (Louisiana, another state eager to attract new insurers, requires more than double what Florida requires) Those new FL insurers are assuming more risk relative to the premiums they write, not to mention they're operating in a volatile environment. . . . of the 14 insurers approved to take policies out of Citizens in 2008, only one has been rated by A M Best – and that rating is "weak."

Now with State Farm pulling out of Florida, about 1.2MM policies will be dumped into state insurers, which means massive expansion of Citizens . . . that will put taxpayers at even greater risk when the next big hurricane hits because Citizens is woefully underfunded, along with the state's reinsurer, the FHCF.

It also threatens the credit rating of not only the state, but the dozens of small private insurers that have recently set up shop in the state. Those insurers – many untested in a catastrophic event – depend on the state's ability to borrow money to help them pay their claims after a major storm. Unfortunately, the state's borrowing capacity is dwindling as the gap between the state's hurricane obligations and its ability to meet them grows.

IMMEDIATE PROBLEMS

Today, the state-created CPIC and the FHCF are seriously overexposed and are expected to run out of cash to pay claims if a major hurricane hits. Small, start-up property insurers, whose financial strength is questioned by independent rating agencies, may also run out of cash after a major storm. All Floridians face the threat of paying thousands of dollars in assessments – a "hidden hurricane tax" – on their home, auto, boat and business insurance policies if CPIC and FHCF can't pay claims after a hurricane. The magnitude of that debt, if hit by an Andrew-type hurricane this year, would be about $14,000 per household.

Plugging the $18BL Cat Fund hole . . .
The fund is obligated to pay out $29BL if a catastrophic hurricane slams the state – far exceeding its immediate resources by more than $21BL, according to the fund's financial advisor. The Fund has about $7.6BL on hand now . . .

Normally, it would seek to issue new tax-exempt bonds in order to make up the difference. But its senior managing underwriters (Goldman Sachs, JPMorgan, and Citi) estimate that only about $3BL of capacity might be available in the bond market today because of ongoing credit problems, leaving a potential shortfall of $18BL.

The Fund's finance team will evaluate a number of options, including taxable, pre-event bonding, some kind of put option, and purchasing traditional reinsurance. Last year, the FHCF spent $224MM to purchase a put option from Berkshire Hathaway that would have required BH to buy $4BL of the Cat Fund's bonds in the event of a major storm . . . that option was not invoked and expired 12/31. It's believed that such a large put option may not be available today because of market conditions.

Making Citizens actuarially sound . . .
There is a two-prong effort to shore up CPIC – liquidity necessary to pay claims this year and the future need to be actuarially sound.

In March, CPIC received authority to sell up to $2.5BL in bonds – debt needed to provide liquidity to pay claims . . . the plan is to issue tax-exempt, fixed rate debt with maturities from one to five years – if market conditions cooperate. However, it may be problematic marketing these bonds given that S&P in January placed a negative outlook on Citizens' A-plus rating for its "high-risk" account bonds in light of the state's deteriorating economic conditions.

Current law requires that CPIC make an actuarially sound rate filing to take effect on 1/1/10, and annually thereafter – unless lawmakers block it. In 2007, Citizens provided a theoretical rate increase that would be necessary to make it actuarially sound. Those estimates ranged from 12.6% to 56% . . . meaning that 2009 estimates would be at least in that range, if not higher. (Reinsurers are seeking higher rates as a result of the huge losses they paid last year from hurricanes Gustav and Ike, not to mention the financial markets' meltdown. March estimates range from 15% to 30% over 2008 rates - bearing in mind that Citizens is still at 2005 rate levels . . . and these are average rate increases, Gulf Coast rate increases will be highest).

WHAT DOES THIS MEAN FOR FLORIDA BUSINESSES?

Businesses can expect significantly higher property insurance premiums over the next 12 to 24 months.

All Florida insurance policies (both commercial and personal) will have increased assessments . . . the amounts of the increased assessments will depend on the severity of this year's storm season.

Businesses will need to re-visit their property insurance programs – such as the structure of the program (loss limits) and higher retentions – to offset these increases. Obviously, some of these changes will be problematic for lenders . . . so negotiation will be needed to find a balance between lender requirements and insurance program affordability.

Budgets should be adjusted now in anticipation of these increases.

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