



April 25, 2011

Representative Fred Costello
Florida House of Representatives
120 S. Florida Ave.
DeLand, FL 32720

Re: Citizens Assessments – The Hidden Hurricane Tax (HB 1243/SB1714)

Dear Fred:

Last week you asked me to give you some background information on Citizens Property Insurance Corporation and the potential for policyholder assessments. I'll try and do that in this letter.

BACKGROUND

Timeline

1970 – the **Florida Windstorm Underwriting Association** (“FWUA”) or (“windpool”) was created to provide wind-only insurance coverage to Florida businesses and homeowners in coastal areas that were particularly vulnerable to hurricane damage.

1992 – Hurricane Andrew struck Florida on August 24th. At the time, Allstate and State Farm wrote 75% of the homeowners insurance in Florida.

After the hurricane, these two companies (and many others) wanted the state of Florida to assume 100% of the hurricane risk. As you might expect, the Legislature was reluctant to take that step. Two special sessions were held post Hurricane Andrew and as a result two new state sponsored non-profit entities to supplement FWUA were created:

1. **Florida Residential Property and Casualty Joint Underwriting Association** (“FRPCJUA”) – to provide homeowner’s insurance to Floridians who could not obtain insurance coverage in the private market.
2. **Florida Hurricane Catastrophe Fund** (“FHCF”) – to provide low cost reinsurance to insurance companies that were willing to continue insuring homes in Florida.

The role of these two entities was to write homeowner’s risks at actuarially sound rates. The Legislature hoped that the private market would continue to provide the majority of the coverage to Florida homeowners.

To finance the new companies, the Legislature agreed that FWUA and the two new entities could “assess” (i.e., tax) other insurance policies in the state of Florida if the companies needed money to pay losses. Since the Internal Revenue Service required that the “assessments” be “broad based” in order for the entities to be exempt from US income tax, the decision was made to give the FHCF the authority to tax all property and casualty insurance policies except those covering

workers' compensation, medical malpractice, accident and health, and flood (these categories represent approximately 90% of the property and casualty insurance market in Florida). The assessment authority of the FWUA and the FRPCJUA was limited to all "property" insurance policies (excluding auto and liability).

2002 - FRPCJUA and FWUA merged to create Citizens Property Insurance Corporation ("Citizens"). Citizens operates three separate accounts. The High Risk Account ("HRA") is primarily wind-only policies covering commercial and residential risks in areas formerly covered by FWUA. The Personal Lines Account ("PLA") is full coverage homeowners policies in areas outside the windpool. The Commercial Lines Account ("CLA") is commercial lines business in areas outside the windpool.

2007 - the Legislature expanded the assessment authority of Citizens to match the broad assessment authority granted to the FHCFC. This authorized Citizens to levy assessments on liability and auto policies.

CURRENT SITUATION

Citizens Market Share

When evaluating the proper role of Citizens, the size and health of the private sector for homeowner's insurance is an important point that's often overlooked. Citizens is the largest writer of homeowner's insurance in the state of Florida with more than 1.3 million policies (as of 3/31/11), but **85%** of Floridians insure their homes with private sector companies like Security First.

Here's the picture in Volusia County at December 31, 2010:

Policies In-force					
	Total Market	Citizens	Citizens Share	Security First	Security First Share
HO3 (Residential)	23,794	5,687	4.6%	4,227	3.4%
Wind-only		12,774	10.3%		0.0%
HO6 (Condo Unit Owners)	18,247	1,671	9.2%	900	4.9%
DP3 (Dwelling Fire)	19,945	3,617	18.1%	1,266	6.3%
Mobile Home	14,502	4,171	28.8%		0.0%
HO4 (Tenants)	6,848	414	6.0%		0.0%
Farmowners	14		0.0%		0.0%
Total	183,350	28,334	15.5%	6,393	3.5%

This chart excludes homes insured by the unregulated excess and surplus lines market (i.e., Lloyd's of London) and foreclosed homes owned by banks which are insured by the commercial market. It also excludes homes, mobile homes, and condominium units that don't purchase insurance. In short, the chart overstates the percentage of Florida homeowners that purchase insurance from Citizens.

You will note that Security First writes a significant number of policies in Volusia County. We are willing and able to write more business in Volusia County but Citizens competitive advantage makes it impossible. For example, Citizens rates on homes built prior to 1994 are about 20% less than our rates, even in non-coastal areas. Citizens statewide rate advantage developed because the legislature in 2007 froze Citizens rates at their 2005 level and subsequently the legislature limited Citizens' rate increases to a maximum of 10% per policy per year. The result of these legislative changes is that Citizens' rates are nowhere near actuarially sound. Public filings indicate that last fall Citizens' average rate need was approximately 55% more than existing rate levels.

CITIZENS ASSESSMENT AUTHORITY

Citizens expects to generate about \$3 billion in premium income in 2011. But as a result of their broad assessment authority Citizens has the statutory authority to level assessments on almost every insurance policy in Florida (auto, liability and homeowners).

Citizens is quick to point out their assessment authority is a unique and highly effective feature of their financing when pitching bonds to investors and rating agencies. They describe the ability to assess as a "cumulatively unlimited *sales tax-like assessment capability on a broad base of premiums*" and the assessments are "like a broad-based sales tax on an essential product".

WHAT HAPPENS IF A HURRICANE HITS FLORIDA THIS YEAR?

If a hurricane hits Florida this year, Citizens has the following financial resources to pay claims:

1. **Operating Surpluses from prior years** - \$2.486 billion for the HRA and \$2.913 billion for the PLA/CLA account. Citizens cannot co-mingle the money in the accounts
2. **Florida Hurricane Catastrophe Fund Reimbursements** - provided the single event loss exceeds \$1.675 billion for the HRA account and/or \$1.078 billion for the PLA/CLA account. Each account has a separate reimbursement contract with the FHCF
3. **Citizens Policyholder Surcharges** - up to 15% of premium per account for HRA, PLA, and/or CLA deficits – total maximum surcharge is 45% of annual premium or \$1.165 billion
4. **Regular Assessments on Non-Citizens Policyholders** - up to 6% of premium per account for HRA, PLA and/or CLA deficits. Maximum assessment 18% on premium base of \$30 billion - \$5.4 billion
5. **Emergency Assessments on All Policyholders** - up to 10% of premium per year per account for HRA, PLA, and or CLA deficits- Maximum annual assessment – 30% on premium base of about \$35 billion - \$10.5 billion

HOW MUCH WOULD A 100-YEAR HURRICANE COST FLORIDA?

If you look at Citizens in total (HRA, PLA, and CLA combined), it is estimated that a single 100 year event (1/100 = .01 or 1% chance) striking Florida this year would cost Citizens \$23.464 billion in claims. That loss would be paid by the following:

Accumulated Surplus	\$ 5,400,000,000
FHCF Reimbursements	\$ 6,352,000,000
Citizens Policyholder Surcharges (45% of premium) <i>Paid by Citizens policyholders only</i>	\$ 1,165,000,000
Regular Assessments (10% of premium) <i>Paid by Non-Citizens policyholders only*</i>	\$ 3,500,000,000
Emergency Assessments (20% of premium) <i>Paid by everyone with an insurance policy in Florida*</i>	\$ 7,047,000,000
Total	\$23,464,000,000

**excludes workers' compensation, medical malpractice, accident and health, and life insurance policies.*

What the above chart illustrates is that if you are a Citizens' policyholder you could be assessed up to 65% of your premium to pay for the damage caused by a large catastrophe. If you are not a Citizens' policyholder you could still face up to a 30% surcharge on your insurance policy's premium.

Significant loss caused by a major storm could require both Citizens and the FHCF to issue bonds to promptly pay the claims. While financial advisors have assured us that the bond markets could absorb a large debt issue there is no guarantee that would occur. If the state had to absorb a large debt it's likely that Citizens, and the people of Florida, could foot the bill. However, it's not at all clear what would happen the following year. Citizens would have significant debt and no surplus. Citizens would be approaching the following hurricane season in a precarious financial position.

At some point there is a limit to how much Citizens could borrow. There is also probably a limit on how much your constituents would pay to subsidize insurance for people who live on the beach, particularly if they knew that about one third of Citizens' customers are insuring a second home.

Why are assessments unfair?

The question isn't if, but when a hurricane hits, who bears the cost? As currently structured, if Citizens' surplus and the FHCF were depleted surcharges would be levied first on Citizens' policyholders and then assessments would be levied on the vast majority of Florida insurance policyholders.

Only twenty percent (20%) of the assessments will be paid by homeowners' insurance policies (and over 80% of the homeowners assessed would be non-Citizens' policyholders). Forty percent (40%) of the assessments will be paid by auto insurance policies. Another thirteen percent (13%) of the assessments will be paid by commercial insurance policies including those policies covering apartments. The remaining twenty-seven percent (27%) of any assessment will be paid by all the other lines of property and casualty insurance (inland marine, ocean marine, fidelity, surety, credit, etc.)

I would guess that one third (1/3) of Floridians live in rental housing and I would also guess that most of them own cars. This means that a significant portion of any regular or emergency assessment will fall on those Floridians who can't afford to own a home.

In effect, assessments are a very regressive form of taxation on those who can least afford to pay.

WHY SHOULD THE LEGISLATURE ALLOW THIS TO CONTINUE?

Security First Insurance Company is willing to write the business in Volusia County written by Citizens but we can't do it at the rates charged by Citizens. We spend 40% of every premium dollar on reinsurance. That's a great deal of money. But, spending that money means Security First can pay for a one hundred year event without assessments. It also means that if there was a repeat of the four hurricanes that hit Florida in 2004, Security First could pay all its claims while losing less than 10% of the company's accumulated surplus. And, most importantly, Security First could continue insuring our customers' homes in 2012.

I know there are at least several of our competitors who are willing to write additional business and who are financially sound. However, they cannot compete with a company that charges inadequate rates, buys no reinsurance other than the FHCF, and pays no taxes.

Proposed Legislation

HB1243 and SB1714 attempt to reduce the size of Citizens by increasing rates, decreasing the number of risks that are eligible for Citizens coverage, reducing the coverage provided by Citizens policies, and increasing the emergency assessments on Citizens policyholders. The bills, particularly the rate increases, have proven to be controversial.

WHY IS IT IMPORTANT TO RAISE CITIZENS' RATES?

1. Raising Citizens' rates will reduce the probability of assessments on Citizens' policyholders and the 85% of your constituents that are not insured by Citizens because:
 - a. Citizens will have more money to pay claims; or
 - b. they will use at least a portion of their increased revenue to purchase reinsurance
2. Raising Citizens' rates increases the probability that at least some of the homeowners in Citizens will consider purchasing an insurance policy from the private sector. This will remove an unfunded liability from your constituents who are, unwillingly, agreeing to finance Citizens deficits.

WHAT ABOUT THE PEOPLE WHO CAN'T AFFORD THESE RATE INCREASES?

There are several possible approaches to this problem:

1. Authorize the Board of Governors of Citizens to grant premium waivers to customers who really need help in paying their premium; or
2. Require the 40% of Citizens' customers who live in homes that are insured for more than \$200,000 to pay the actuarially indicated rate and put everyone else on a glide-path to actuarially sound rates; or
3. Limit the rate increases on the homes that are likely to be occupied by Floridians with the lowest incomes (homes insured with a dwelling fire policy for less than \$100,000 and mobile homes built prior to 1994).

Having said that, I want to make it very clear Citizens can, and should, be much smaller because the private sector can provide that same insurance without the risk of assessments. I think passage of HB 1243/SB1714 would be a step in the right direction.

I'm sorry that this letter is so long but it's a complicated subject and I wanted to give you some of the historical background in case you have to answer the same kind of calls from constituents that I did.

Let me know if you need anything else on this subject.

Locke Burt
Chairman and President
Security First Insurance Company

cc: Senator Evelyn Lynn
Senator John Thrasher
Representative Dorothy Hukill