

**Castle Key Insurance Company and  
Castle Key Indemnity Company  
OIR Filing #s 11-09496 and 11-09497  
Hearing of July 19, 2011**

Stephen A. Alexander FCAS, MAAA  
Actuary  
Office of the Insurance Consumer Advocate

**S. 627.0613, F.S.: Consumer advocate.—The Chief Financial Officer must appoint a consumer advocate who must represent the general public of the state before the department and the office. The consumer advocate must report directly to the Chief Financial Officer, but is not otherwise under the authority of the department or of any employee of the department. The consumer advocate has such powers as are necessary to carry out the duties of the office of consumer advocate, including, but not limited to, the powers to:**

**(1) Recommend to the department or office, by petition, the commencement of any proceeding or action; appear in any proceeding or action before the department or office; or appear in any proceeding before the Division of Administrative Hearings relating to subject matter under the jurisdiction of the department or office.**

**(2) Have access to and use of all files, records, and data of the department or office.**

**(3) Examine rate and form filings submitted to the office, hire consultants as necessary to aid in the review process, and recommend to the department or office any position deemed by the consumer advocate to be in the public interest...**

## CERTIFICATION

- I, Stephen A. Alexander, Actuary with the Office of the Insurance Consumer Advocate do certify that, based on my knowledge, my recommendations are consistent with accepted actuarial principles and Florida law.



Stephen A. Alexander, FCAS, MAAA, MBA

Florida Exclusive Residential Property Insurers  
 In-Force Direct Written Premium Greater Than \$20 Million  
 2010 Calendar Year  
 Homeowners, Mobile Homeowners, Tenants and Condos  
 Loss Adjustment, Commission and Brokerage, Taxes, Licenses and Fees,  
 General and Other Acquisition Expenses Per Policy

Rank	Company	Domicile	Premiums Inforce	Policies Inforce	Average Premium	Expense Per Policy	Weiss Rating
1	American Bankers Ins Co Of FL	FL	21,619,985	86,048	251	115	B-
2	Edison Ins Co	FL	30,515,489	14,262	2,140	220	D-
3	Castle Key Ins Co	IL	140,548,185	138,862	1,012	291	B-
4	Capitol Preferred Ins Co	FL	32,650,902	27,380	1,193	297	D
5	Castle Key Ind Co	IL	100,676,570	125,562	802	298	B
6	American Traditions Ins Co	FL	43,181,343	50,720	851	303	D+
7	Florida Farm Bur Gen Ins Co	FL	42,135,653	33,932	1,242	357	B-
8	American Southern Home Ins Co	FL	14,053,806	12,994	1,082	359	B
9	Ark Royal Ins Co	FL	40,150,514	31,254	1,285	360	U
10	Omega Ins Co	FL	39,892,707	35,941	1,110	361	D-
11	First Community Ins Co	FL	36,034,222	32,106	1,122	392	C
12	Florida Farm Bureau Cas Ins Co	FL	73,053,521	51,603	1,416	398	B
13	ASI Assur Corp	FL	78,668,466	63,884	1,231	399	C+
14	Modern USA Ins Co	FL	29,373,656	33,227	884	400	D+
15	First Floridian Auto & Home Ins Co	FL	31,407,554	23,160	1,356	405	B-
16	Universal Prop & Cas Ins	FL	617,426,675	522,531	1,182	408	E+
17	Florida Family Ins Co	FL	69,994,548	61,714	1,134	409	C
18	Nationwide Ins Co Of FL	OH	94,249,058	78,729	1,197	425	B-
19	American Strategic Ins Corp	FL	66,665,638	56,615	1,178	429	B+
20	ASI Preferred Ins Corp	FL	71,912,163	62,436	1,152	430	C+
21	Citizens Prop Ins Corp	FL	1,219,824,421	735,288	1,659	440	U
22	Homewise Ins Co	FL	124,032,735	82,914	1,496	456	C
23	Auto Club Ins Co of FL	FL	33,485,728	26,543	1,262	461	C
24	Cypress Prop & Cas Ins Co	FL	58,829,138	48,722	1,207	465	D
25	Olympus Ins Co	FL	85,969,802	54,397	1,580	481	D
26	American Integrity Ins Co of FL	FL	73,572,635	51,122	1,439	489	D
27	Southern Fidelity Ins Co Inc	FL	73,955,362	48,747	1,517	508	C
28	Security First Ins Co	FL	127,047,236	89,691	1,416	510	C
29	Sunshine State Ins Co	FL	82,304,180	54,103	1,521	516	E+
30	Universal Ins Co of NA	FL	105,904,628	69,882	1,515	519	C
31	Peoples Trust Ins Co	FL	37,280,022	28,954	1,288	526	D
32	Tower Hill Prime Ins Co	FL	118,459,615	74,613	1,588	533	D-
33	Homeowners Choice Prop & Cas Ins Co	FL	134,882,111	64,636	2,087	537	D
34	St Johns Ins Co Inc	FL	254,713,886	166,859	1,527	546	D
35	State Farm FL Ins Co	FL	975,350,804	580,308	1,681	574	D
36	Royal Palm Ins Co	FL	147,916,087	86,055	1,719	589	E+
37	Tower Hill Preferred Ins Co	FL	112,299,280	63,960	1,756	599	D
38	Tower Hill Select Ins Co	FL	88,090,868	50,952	1,729	605	D
39	Southern Oak Ins Co	FL	64,039,527	35,452	1,806	621	D
40	United Prop & Cas Ins Co	FL	135,498,592	68,792	1,970	621	C-
41	Florida Peninsula Ins Co	FL	167,851,671	99,859	1,681	623	D
42	Federated Natl Ins Co	FL	77,746,652	43,132	1,803	659	U
43	Fidelity Fire & Cas Co	FL	54,044,958	25,966	2,081	671	D+
44	Gulfstream Prop & Cas Ins Co	FL	62,470,037	35,815	1,744	721	C-
45	First Protective Ins Co	FL	88,705,222	38,368	2,312	755	D-
46	Argus Fire & Cas Ins Co	FL	28,326,514	13,375	2,118	801	D
47	Privilege Underwriters Recp Exch	FL	32,401,183	3,408	9,507	3,093	B-
			6,239,213,549	4,284,873	1,456	478	

Notes:

Sources are: 1) Insurance Expense Exhibits filed with the NAIC, 2) the 12/31/10 QUASR Reports filed with Office of Insurance Regulation, and 3) <http://www.weissratings.com>



# Issues

- **Contingency Provision**
- **Debt Provision**
- **Profit Provision**
- **Overhead Expenses**

# Contingency Provision

# Actuarial Standard of Practice Contingency Provision

- A contingency provision for ratemaking purposes is:
  - “a provision for the expected differences, if any, between the estimated costs and the average actual costs, that cannot be eliminated by changes in other components of the ratemaking process”.

**ALLSTATE INSURANCE GROUP\*  
HOMEOWNERS  
COUNTRYWIDE**

**CONTINGENCY FACTOR SUPPORT  
ACCIDENT YEARS 1996-2003**

1) Total estimated loss from unexpected events:**	\$388,265,584
2) Total countrywide ex-cat accident year losses:	\$14,082,669,021
3) Indicated contingency provision as percentage of ex-cat loss:	2.8%
4) Indicated contingency provision as percentage of total loss:	2.1%
5) Indicated contingency provision adjusted for expenses:	1.9%
6) Selected contingency provision:	2.0%

\* Allstate Insurance Company, Allstate Indemnity Company, Allstate Property and Casualty Insurance Company, Allstate Country Mutual Insurance Company, Allstate Fire and Casualty Insurance Company, Castle Key Insurance Company and Castle Key Indemnity Company

\*\* Events include oil tanks, slab losses, mold losses, drug lab damage, water back-up

# Debt Provision

# Debt Provision

- **“Debt is one of the main ways Castle Key raises capital to fund ongoing corporate operations, as well as improve the business. The debt provision represents the cost of debt, or expected quantifiable future interest payments to bondholders. The provision is shown on Attachment D, Exhibit 9.”**
  - Source: Castle Key Insurance Company Explanatory Memo, Page 9

**CASTLE KEY INSURANCE COMPANY AND CASTLE KEY INDEMNITY COMPANY  
FLORIDA  
HOMEOWNERS**

**CALCULATION OF DEBT PROVISION**

	<u>Amount</u>
(1) Outstanding Debt	\$58
(2) After-tax Cost of Debt**	4.0%
(3) Earned Premium	\$243
(4) After-Tax Debt Provision [ (1) * (2) / (3) ]	0.9%
(5) Federal Tax Rate	35.0%
(6) Pre-tax Debt Provision [ (4) / (1 - (5)) ]	1.4%

\*\*Treasury Department Estimate based on the yield to maturity for the outstanding debt at 12/31/2009  
Dollar values are in millions

Insurance Consumer Advocate  
Castle Key Insurance Company

2010 Liabilities

	<u>Current Year</u>	<u>Prior Year</u>
Losses	\$52,438,248	\$51,648,017
Loss adjustment expenses	10,235,741	10,284,656
Other expenses (excluding taxes, licenses and fees)	0	39,994
Taxes, licenses and fees (excluding federal and foreign income taxes)	1,031,680	2,345,166
<b>Borrowed money \$0 and interest thereon \$0</b>	<b>0</b>	<b>0</b>
Unearned premiums	130,612,259	104,999,912
Advance premium	3,146,693	2,572,676
Ceded reinsurance premiums payable (net of ceding commissions)	7,118,626	32,477
Amounts withheld or retained by company for account of others	1,465,573	410,136
Remittances and items not allocated	669,500	796,650
<b>Payable to parent, subsidiaries and affiliates</b>	<b>139,736</b>	<b>17,766</b>
Reserve For Uncashed Checks	2,796,055	3,177,918
Accounts Payable	865,084	994,207
Deferred Gain On Asset Transfer From Subsidiary	93,488	219,048
<b>Total liabilities</b>	<b>\$210,612,682</b>	<b>\$177,538,624</b>

Source:

Castle Key Ins. Co. 2010 Statutory Annual Statement

# Profit Provision

# AM Best Rating

- “OLDWICK, N.J., AUGUST 23, 2010
- **A.M. Best Co. has affirmed the financial strength rating of B- (Fair) and issuer credit ratings of "bb-" of Castle Key Group (Castle Key) and its members (headquartered in St. Petersburg, FL). The outlook for all ratings is negative. (See below for a detailed listing of companies.)**

**The ratings and outlook reflect Castle Key's continued unprofitable operating performance and weak risk-adjusted capitalization, particularly as measured by A.M. Best on a catastrophe stress tested basis. As Castle Key is the dedicated Florida property writer for its parent company, Allstate Insurance Company (Allstate), Castle Key continues to maintain significant exposure to hurricanes, with a corresponding substantial reliance on catastrophe reinsurance.**

- **In addition, the group's reinsurance program relies heavily upon the Florida Hurricane Catastrophe Fund (FHCF), including the purchase of Temporary Increase in Coverage Limits (TICL). As previously indicated, A.M. Best remains concerned regarding the ability of the FHCF to fund all obligations in the event of a severe hurricane, based largely on its contingent capital structure. Accordingly, the structure of Castle Key's catastrophe reinsurance program negatively impacts A.M. Best's view of its risk-adjusted capitalization.**
- **Partially offsetting these negative rating factors is the enhancement provided by Allstate in terms of historical financial support, although Castle Key is separately capitalized and not reinsured by Allstate, as well as operational and risk management initiatives.**
- **A.M. Best expects that parental support regarding the claims paying ability of Castle Key commensurate with its rating level will be maintained in the event of frequent and/or severe hurricane activity.”**

Exhibit 2  
Sheet 2

**AM Best**  
**Financial Strength Ratings**

Rating	Description	Risk of Ruin
A++/A+	Excellent	0.06%
A/A-	Excellent	0.19%
B++/B+	Good	0.75%
B/B-	Good	2.06%
C++/C+	Fair	3.41%
C/C-	Fair	6.02%
D	Weak	7.27%

Notes:

Source is AM Best's Impairment Rate and Rating Transition Study - 1977 to 2008, published May 1, 2009. Risk of ruin is for within one year.

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Castle Key Insurance Group

Return on Policyholder Supplied Funds

	<u>@3/31/11</u>	<u>@3/31/10</u>
█ (1) Invested Assets	304,216,661	293,244,785
█ (2) Policyholder Surplus	146,355,152	150,839,557
█ (3) GAAP Equity	168,308,425	173,465,491
█ (4) Policyholder Supplied Funds	135,908,236	119,779,294
█ (5) Investment Income	7,084,506	
█ (6) Rate of Return on Invested Assets	2.37%	
█ (7) Investment Income on GAAP Equity	4,052,645	
█ (8) Investment Income on Policyholder Supplied Funds	3,031,861	
█ (9) Direct Earned Premium	224,820,387	
█ (10) Return on GAAP Equity	1.80%	
█ (11) Return on Policyholder Supplied Funds	1.35%	

## Notes:

- (1) - Castle Key Insurance Company and Castle Key Indemnity Company first quarter 2011 financial
- (2) statements.
- █ (3) (2) x 1.15 based on actuarial judgment
- █ (4) (1) - (3). Conservatively assumes all GAAP Equity is invested.
- █ (5) 3/31/10 - 3/31/11
- █ (6) (5) / (1) Average
- █ (7) (6) x (3) Average
- █ (8) (6) x (4) Average
- █ (9) 3/31/10 - 3/31/11
- █ (10) (7) / (9)
- █ (11) (8) / (9)

Insurance Consumer Advocate  
Castle Key Insurance Group

Selected Underwriting Profit and Contingency Provision

	CK	CK	
	<u>Insurance</u>	<u>Indemnity</u>	<u>CK Group</u>
█ (1) Risk Free Rate			0.25%
█ (2) Equity Risk Premium			5.20%
█ (3) Risk of Ruin			<u>3.41%</u>
█ (4) Required Return on Equity after Federal Income Tax (FIT)			8.86%
█ (5) Average FIT Rate			35.00%
█ (6) Required Return on GAAP Equity before FIT			13.63%
█ (7) Direct Written Premium	134,808,288	71,108,152	\$205,916,440
█ (8) Policyholder Surplus	136,219,774	14,619,783	\$150,839,557
█ (9) Estimated GAAP Equity	156,652,740	16,812,750	\$173,465,491
█ (10) Required Return on Premium before FIT			11.48%
█ (11) Investment Income on Policyholder Supplied Funds			1.35%
█ (12) Indicated Underwriting Profit Provision			10.13%
█ (13) Selected Contingency Provision			0.00%
█ (14) Selected Debt Provision			0.00%
█ (15) Selected Underwriting Profit Provision			10.15%

## Notes:

- █ (1) Estimated one year Treasury Bill yield. Yield as of 7/12/11 equals .18%.
- █ (2) "Market Risk Premium Used in 2010 by Analysts and Companies: A Survey with 2,400 Answers", Pablo Fernandez and Javier del Campo
- █ (3) Exhibit 2, Sheet 3 and actuarial judgment
- █ (4) (1) + (2) + (3)
- █ (5) Based on actuarial judgment
- █ (6) (4) / (1 - (5))
- █ (7) 4 times first quarter of 2011
- █ (8) @3/31/11
- █ (9) (8) x 1.15 based on actuarial judgment
- █ (10) ((9) / (7)) x (6)
- █ (11) Exhibit 2, Sheet 2
- █ (12) (10) - (11) and s. 627.062(2)(b)4., F.S.
- █ (13) Based on actuarial judgment
- █ (14) Based on actuarial judgment

# Overhead Expenses

CASTLE KEY INSURANCE COMPANY AND CASTLE KEY INDEMNITY COMPANY  
PERSONAL PROPERTY LINES EXCLUDING EARTHQUAKE  
EXPENSE EXPERIENCE FOR OTHER ACQUISITION AND GENERAL EXPENSES

	FLORIDA DATA*			ALLSTATE INSURANCE GROUP**		
	Other Acquisition Expense			Other Acquisition Expense		
	2007	2008	2009	2007	2008	2009
1. Direct Premium	\$429,384	\$233,513	\$203,190	\$6,460,818	\$6,411,175	\$6,317,744
2. Other Acquisition Expense Incurred***	15,620	11,691	10,948	\$347,131	\$312,264	\$306,880
3. Ratio (2)/(1)	0.0364	0.0501	0.0539	0.0537	0.0487	0.0486
4. Three Year Average			0.047			0.050
5. Proposed Provision						0.047

  

	General Expense			General Expense		
	2007	2008	2009	2007	2008	2009
	1. Direct Premium	\$429,384	\$233,513	\$203,190	\$6,460,818	\$6,411,175
2. General Expense Incurred	3,360	6,926	666	\$199,719	\$239,767	\$210,879
3. Ratio (2)/(1)	0.0078	0.0297	0.0033	0.0309	0.0374	0.0334
4. Three Year Average			0.014			0.034
5. Proposed Provision						0.034

SOURCE: Insurance Expense Exhibits  
(000 Omitted)

\* Castle Key Insurance Company and Castle Key Indemnity Company

\*\* Allstate Insurance Company, Allstate Indemnity Company, Allstate Property and Casualty Insurance Company, Allstate County Mutual Insurance Company, Allstate Fire and Casualty Insurance Company, Castle Key Insurance Company and Castle Key Indemnity Company

\*\*\* Reduced by the amount of Payment Fees collected, allocated expenses from countrywide advertising programs and includes Premium Write offs

Exhibit 4

Insurance Consumer Advocate  
Castle Key Insurance Company

Trended Expenses

▶ (1) Midpoint of Experience Period	7/1/2008
▶ (2) Midpoint of Prospective Rate Period	11/1/2012
▶ (3) Number of Days to Trend	1,584.25
▶ (4) Average Annual Trend Rate	1.7%
▶ (5) Trend Factor	1.076
▶ (6) Castle Key Historical Other Acquisition Expense	0.047
▶ (7) Castle Key Historical General Expense	0.014
▶ (8) Trended Other Acquisition Expense	0.051
▶ (9) Trended General Expense	0.015

Notes:

(1),(2),

(4),(6)

&(7) Castle Key Ins. Co. Exhibit 2

▶ (3) (2) - (1)

▶ (8) (5) x (6)

▶ (9) (5) x (7)

# Summary

**Office of the Insurance Consumer Advocate**  
**Castle Key Insurance Company**

**Selected Rate Increases**

Policy Type	(1)	(2)	(3)	(4)
	On-Level Earned Premium (\$000's)	Earned House- Years	Company Selection	ICA Selection
HO-2&3	\$96,800	76,368	29.1%	22.1%
HO-5	53,360	31,058	42.6%	35.2%
HO-8	254	232	29.1%	10.0%
HO-4	1,152	4,535	0.0%	-10.1%
HO-6	18,628	32,571	7.0%	0.8%
	\$170,193	144,764	30.7%	23.7%

**Office of the Insurance Consumer Advocate**  
**Castle Key Insurance Company**

**Assumptions at Issue**

	<b>ICA</b>	<b>Company</b>
<b>Debt Provision</b>	<b>0.0%</b>	<b>1.4%</b>
<b>Contingency Provision</b>	<b>0.0%</b>	<b>2.0%</b>
<b>Profit Provision</b>	<b>10.2%</b>	<b>9.3%</b>
<b>General Expense</b>	<b>1.5%</b>	<b>3.6%</b>
<b>Other Acquisition Expense</b>	<b>5.1%</b>	<b>5.0%</b>

**Office of the Insurance Consumer Advocate**  
**Castle Key Insurance Company**

**Issue Impacts on Rate Indications**

	<u>HO 2&amp;3</u>	<u>HO 5</u>	<u>HO 8</u>	<u>HO 4</u>	<u>HO 6</u>	<u>Total</u>
<b>Company Indication</b>	<b>29.1%</b>	<b>42.6%</b>	<b>10.0%</b>	<b>-4.2%</b>	<b>7.0%</b>	<b>30.6%</b>
<b>Debt Provision</b>	<b>-1.8%</b>	<b>-1.8%</b>	<b>0.0%</b>	<b>-1.8%</b>	<b>-1.8%</b>	<b>-1.8%</b>
<b>Contingency Provision</b>	<b>-2.6%</b>	<b>-2.6%</b>	<b>0.0%</b>	<b>-2.6%</b>	<b>-2.6%</b>	<b>-2.6%</b>
<b>Profit Provision</b>	<b>1.1%</b>	<b>1.1%</b>	<b>0.0%</b>	<b>1.1%</b>	<b>1.1%</b>	<b>1.1%</b>
<b>General and Other Acquisition Expenses</b>	<b>-2.1%</b>	<b>-1.9%</b>	<b>0.0%</b>	<b>-2.9%</b>	<b>-2.6%</b>	<b>-2.1%</b>
<b>ICA Indication</b>	<b>22.1%</b>	<b>35.2%</b>	<b>10.0%</b>	<b>-10.1%</b>	<b>0.8%</b>	<b>23.7%</b>

# Castle Key Indemnity Company

**Office of the Insurance Consumer Advocate**  
**Castle Key Indemnity Company**

**Indicated and Selected Rate Increases**

	(1)	(2)	(3)	(4)	(5)
Policy Type	On-Level Earned Premium (\$000's)	Earned House- Years	Company Indication	Company Selection	ICA Indication
HO-2&3	\$21,074	14,768	60.3%	33.5%	46.5%
HO-5	\$25,147	14,385	71.7%	38.7%	58.5%
HO-4	\$9,448	42,967	23.3%	23.3%	16.7%
	\$55,669	72,119	59.2%	34.1%	46.9%

Note:

Based on the same expense, profit and trend assumptions for Castle Key Insurance Company, except no change in trend assumptions for HO-4 policies.