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## OFFICE OF INSURANCE REGULATION

DAVID ALTMAIER  
COMMISSIONER

July 21, 2022

Joseph Petrelli  
President  
Demotech, Inc.  
2715 Tuller Parkway  
Dublin, Ohio 43017

VIA: E-MAIL

Mr. Petrelli:

The Florida Office of Insurance Regulation (OIR) has recently learned that Demotech, Inc. (Demotech) has notified approximately 17 Florida domestic property insurance companies that their Financial Stability Rating (FSR) will be downgraded from an "A" to an "S" or an "M." OIR has a strong belief that rating agencies and regulatory agencies in the insurance industry serve two important, but very different, roles. As such, we have endeavored to ensure that Demotech is able to derive its ratings based upon the consistent and objective application of its own standards. However, as OIR learns more about the notice letters sent to companies, and considering the impact these actions would have on millions of Floridians, countless jobs, and Florida businesses, this type of unilateral action warrants further scrutiny. OIR is compelled to take the extraordinary step of scrutinizing these unprecedented actions to protect the Floridians we serve, especially two months into hurricane season. This is an example of inconsistent, monopolistic power of a select rating agency and is trying to exert coercive influence over Floridians and policymakers in an effort to thwart public policy according to its own opinions.

OIR has taken note that Demotech has recently received the Nationally Recognized Statistical Rating Organization (NRSRO) designation through the federally run Securities and Exchange Commission (SEC) and are now required to publicly post their rating methodology. It appears that impacted carriers only received notification of this rating methodology in the last two days through the downgrade notice they received. OIR has reviewed recent letters received by impacted carriers, received feedback regarding conversations between Demotech and impacted carriers, reviewed your personal statements, and **have noted several discrepancies between these recent decisions and the rating methodology posted on Demotech's website.** To ensure actions are not made in a capricious manner and are fairly and consistently applied, the OIR has determined that we would benefit from an understanding of why these discrepancies exist, if Demotech plans to amend its methodology to account for these discrepancies, and if Demotech plans to allow companies to appeal its decision as allowed for in Demotech's posted methodology. Within that context, the OIR makes the following inquiries:

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1. OIR has been advised that many carriers that have been notified of a pending downgrade have reached out to Demotech in an effort to provide additional information. The majority of carriers that have done so have reported to OIR that Demotech has been unwilling to consider additional information. Specifically, Demotech has informed many carriers that additional capital won't prevent the pending downgrade. However, Exhibit 2 notes that Demotech "may afford the affected entity a reasonable time to respond to the notification of Demotech's intent to withdraw and Demotech may consider any new information provided by the entity, including...access to additional capital." Demotech also states that carriers "will be afforded an opportunity to...provide additional information for Demotech's consideration." It appears most of these letters were delivered on July 19, with a downgrade date of July 26 – nearly two months into hurricane season. Does Demotech believe that a reasonable time to respond is one week? If Demotech has chosen not to allow carriers to provide additional information, does Demotech intend to amend its methodology to state this? If Demotech has chosen not to consider access to additional capital, does Demotech intend to amend its methodology to state this? If not, does Demotech intend to communicate this to carriers in any other fashion?
2. In a document published on its website labeled "Exhibit 2 – Rating Procedures and Methodology" there are references in multiple places of an appeal process. However, other than as outlined above, there does not appear to be a formal appeal process in place. Does Demotech intend to allow carriers an opportunity to formally appeal ratings downgrades? Your notice letters to carriers did not outline this process. If so, does Demotech intend to more thoroughly describe the appeals process, including when Demotech will entertain new information and/or capital contributions, and when it won't?
3. Similarly, Exhibit 2 states that, "(w)hile Demotech acknowledges and recognizes the importance of the profitability of the entity assigned a rating, we believe that balance sheet strength and financial integrity are the ultimate determinates of the long-term financial stability required..." However, most carriers are reporting to us that Demotech has placed a strong emphasis on underwriting results. While profitability is important, the ability of companies to withstand unprofitable years from a surplus position is even more important. Does Demotech plan to clarify its new position in updated methodology? If not, does Demotech plan to communicate to carriers in another fashion the increased importance placed on profitability?
4. Rating methodologies typically consider legislative changes or actions which impact ratings; however, your recent comments seem to imply that Demotech's rating methodology contemplates the absence of policy as the mechanism to rate carriers. Demotech's opinion of what policy proposals should be passed, especially in a state it does not reside, is not a fair and consistent approach to rating. Did Demotech expect the positive benefits from recent Florida legislation to happen overnight? If not, does Demotech believe that seven weeks after passage of this legislation is a reasonable timeframe for years of litigation to cease? If not, what other factors did Demotech consider when making the assertion that the claims environment will continue to be unfavorable, given the positive progress the Florida legislature has made? Did Demotech expect carriers to immediately reflect underwriting results as of first quarter, despite the fact that first quarter results occurred before the effective date of SB 2D? Did Demotech consider allowing carriers to show quarters of underwriting results *after* the effective date of SB 2D before asserting that the claims environment would continue to be unfavorable? If Demotech's future legislative proposals are not passed, can carriers be expected to play as pawns in a political game?

OIR does not regulate private rating agencies, and it is very important that this request not be misconstrued in any way as a request that Demotech deviate from its rating methodologies or as advocacy by OIR for or on behalf of any one or several insurance companies with respect to their assigned FSR. OIR's primary concern is the protection of Floridians from harmful, unilateral action.

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We've highlighted some significant discrepancies between Demotech's published standards and those it has recently applied. Given the potential impact of Demotech's financial ratings, OIR believes Demotech should perform a more comprehensive review, using consistent standards, of the proposed ratings prior to their effective date. Additionally, in the interest of stabilizing the private market and ensuring companies have all necessary information to take appropriate corrective action, we strongly encourage Demotech to clearly communicate its rating standards and methodology prior to these ratings becoming effective. As it stands, Demotech has not provided companies a meaningful path for review or appeal of these ratings and has been inconsistent in its application of its own posted methodology.

We are confident that as a credit rating agency, and a newly minted NRSRO, Demotech would agree that its rating standards should be applied objectively and consistently.

Please provide all applicable responses no later than Monday, July 25, 2022. We appreciate your transparency in this regard.

Sincerely,



David Altmaier  
Commissioner

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