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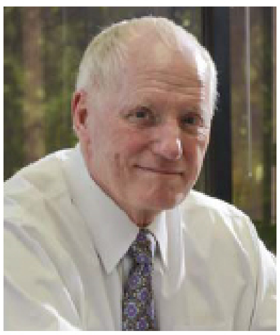
Citizens CEO pledges new, more conservative approach after holiday reflection

By Tim Zawacki

Barry Gilway's more than four decades in the insurance industry may not have fully prepared him for the challenges he would encounter in his first seven months as Citizens Property Insurance Corp. president and CEO. After a recent period of reflection, Gilway told SNL that he plans to make some key changes to his approach to leadership in 2013.



Barry Gilway
President and CEO, Citizens Property Insurance Corp.
Source: Citizens Property Insurance Corp.

"It's been far more difficult than I expected," Gilway said of the circumstances he has confronted during his brief tenure, which began in June 2012.

Well-regarded in the industry for his previous service in various senior management roles at U.S. and Canadian subsidiaries of Zurich Insurance Group Ltd., Gilway left the relative anonymity of his position as CEO of Seattle-based managing general agency Mattei Insurance Services to become the public face of a state-run insurer whose raison d'être — as an insurer of last resort or as a market for affordably priced property coverage — has been the subject of contentious public policy debates for years.

"When the concept of affordability was introduced … it changed the dynamic significantly," Gilway said. "We should be a residual market mechanism. By definition, that means if there is no other market available then we should be there as that last layer of protection. That's what we should exist for, but that's not what we're doing. Today, we openly compete — in some ways, at ridiculous levels — with both personal and commercial lines companies. That was never, ever the intent."

Although its operations are limited to a single state, Citizens ended 2011 as one of the nation's 10 largest homeowners writers on the heels of two years of virtually unabated growth in policies in force. Thus, when the Citizens board selected Gilway over California Earthquake Authority CEO Glenn Pomeroy, his experience in helping Zurich Canada downsize seemed to stand out during a highly unusual series of public job interviews.

Takeout trouble

With the board's efforts to accelerate Citizens' traditional depopulation program and field ideas for alternative structures already well under way when Gilway joined the company, it would be an understatement to say that the new CEO had to hit the ground running.

"Citizens should be the insurer of last resort, and we should only take those policies that the private marketplace simply can't absorb," Gilway told a late June 2012 meeting of the Florida cabinet. Weeks later, the Citizens board convened to consider and discuss various private-sector depopulation proposals intended to make material reductions in the company's one-in-100-year probable maximum loss and, in turn, reduce the potential for painful assessments on its policyholders.

But what appeared to many in the insurance industry as a spirited discussion of innovative ideas to address a market that had been in varying states of disarray since Hurricane Andrew made landfall some two decades prior led a number of Citizens' most outspoken critics to jump to conclusions about the company's intent. When Citizens' board decided in early September 2012 to consider implementation of a plan to issue up to $350 million in 20-year surplus notes in denominations of up to $50 million apiece to a select group of private carriers whose operations, finances and reinsurance programs met certain criteria, those critics blasted the proposal as being tantamount to corporate welfare, a message that some of Florida's news media repeatedly broadcast.

Independent assessments of the surplus notes program are likely to conclude, however, that the program was structured in such a way that it was economically sound for Citizens — so sound that the select companies meeting the rigid criteria are not likely to elect to participate in a structure that would have them assuming and then retaining policies for a period of at least 10 years.

"I think if we got the surplus notes program approved today, I just don't think we'd have any takers. In fact, I'm sure we wouldn't have any takers," Gilway said.

"The positioning was it was a bailout for private industry. Trust me, if it was a bailout for private industry, we'd have companies lined up at the door," he added. "No one wants it. They're saying, 'This is way too restrictive for us.' They're saying, 'Are you kidding me? Keeping [the assumed business] for 10 years? No way!'"

Citizens staff has spent "hundreds of hours" examining various alternatives for depopulation, not limited to the surplus notes plan. But Gilway said there is little appetite for alternatives that depend on a sudden and material increase in rates.

Perhaps complicating the public's perception of those efforts has been the apparent, and somewhat illusory, success of the company's traditional depopulation program in 2012. Seven private carriers — American Integrity Insurance Co. of Florida, First Community Insurance Co., Florida Peninsula Insurance Co., Heritage Property & Casualty Insurance Co., Homeowners Choice Inc.'s Homeowners Choice Property and Casualty Insurance Co. Inc., Southern Fidelity Property & Casualty Inc. and Southern Oak Insurance Co. — removed a total of 277,002 policies from Citizens' personal lines and coastal accounts in 2012, representing more than $75.9 billion in combined exposure. The number of policies and dollar value of exposure removed in 2012 exceeded the amounts achieved by Citizens in the previous three years combined.

But the number of policies actually assumed by the private carriers has not approached the level of takeouts for which the Florida Office of Insurance Regulation has given its approval, as many policyholders choose to opt out from the process. And, Gilway said, assuming carriers typically do not retain the former Citizens business for the three-year period contemplated by the original depopulation agreements.

"The reality is depopulation is simply not working as it was originally intended," he said. "It's coming in the front end as fast as it's leaving."

Citizens on Jan. 8 reported having ended 2012 with 1,314,811 policies in force with total combined exposure of $429.42 billion. A total of 860,502 of those policies are held in the personal lines account, and 446,163 are in the higher-risk coastal account. The remaining 8,146 policies pertain to the commercial lines account.

Despite the 277,002 policies taken out by private carriers in 2012, Citizens policies in force declined only 157,580 during the year. Citizens' budgeted policy count for year-end 2013, as presented at a November 2012 board meeting, totals 1,200,449, including projected depopulation of 156,250 policies.

Shrinking by shopping

Even as Gilway continues to convey a sense of urgency about the need to shrink Citizens' exposure at a faster pace, he decided after spending "a lot of time thinking" over the recent holidays to take a "much more conservative" path to accomplishing his goal. He has proposed a front-end shopping mechanism informally called the Consumer Choice Clearinghouse to ensure that prospective Citizens customers have the ability to compare private-market coverage options to the extent they exist.

The structure, Gilway said, is a "win-win-win" for Citizens, its customers and its agents.

Gilway said about 52% of Citizens' new business comes from captive companies that do not have access to alternative markets. An additional 10% to 15% comes from small agents that have only one appointment. As such, he concluded, "probably somewhere between 65% and 70% of the business is simply not shopped appropriately before it enters Citizens."

He conceded that many of the properties in the coastal account and coverage for mobile homes represent "the kinds of risk that would be in the residual market." But he estimated that as many as 150,000 of the more than 800,000 policies in the personal lines account are rate-adequate and "shouldn't be there." The implementation of rate increases along a statutorily imposed glide path could get additional policies to an actuarially sound rate during the next two to three years, he said.

"I want to focus on looking at the current depopulation program to understanding how it works and how it's not working, and we improve that. I want to look at the front-end system, which could have a significant impact on the flow of new business — it could probably cut it by half. I really want to focus on the analysis of the book of business to see how we get more and more policies closer to rate adequacy in a very measured way over a couple of years," Gilway said.

"I'm not recommending or suggesting any dramatic changes in direction," he added. "I think we need a year to decipher what we saw in 2012 in terms of the increased depopulation activity, do the analysis on the book of business and see how close we come to meeting our objectives over the next couple of years by taking the current, more conservative view. … Instead of coming up with grandiose schemes in 2013 that we're going to air in the public, our focus has to be to stick to the basics and see if we can improve the fundaments. And then let's see what happens to the book."

A full-court press

But the combination of Citizens' state-run status and compliance with Florida's Government-in-the-Sunshine Law effectively allows the public unfettered access to the company's board meetings and meeting materials, a situation that often gives critics the ability to put a negative spin on proposals before Gilway or his colleagues have the opportunity to adequately explain them. It also has facilitated press investigations into matters such as travel expenses incurred by certain Citizens executives and allegations surrounding various personnel matters predating Gilway's tenure that have served as a distraction to the new CEO's ability to adequately convey his vision.

Florida Gov. Rick Scott directed the state's chief inspector general to investigate the termination of employees in the company's Office of Corporate Integrity in November 2012 as he urged Gilway to exercise greater caution with any future decisions affecting internal controls.

While Gilway said he was "absolutely disgusted" with some of the allegations, he criticized the manner in which the media had been describing the office's function and sought to defend the 99.9% of Citizens employees who "bust their tail" on the job. Gilway has since met with Citizens employees to remind them that they are held to a higher standard — something that, he said, is "not inappropriate" given that "we're paid with taxpayer dollars."

He said Citizens performs well when its operations get assessed by third parties. But, he conceded, "that's not the impression people have of Citizens. It's that, 'Geez, we're mismanaged.' But we've got more auditors in here than Carter has liver pills, and we do well in audits."

Indeed, Gilway said dealing with the oft-critical Florida press has been his toughest challenge as Citizens' CEO, and he has taken steps such as meeting with newspaper editorial boards as part of a broader effort to change the public perception of the company. Dealing with state politics has also served as a challenge, but Gilway said he has been able to build some "great alliances" in the Florida Legislature that should serve the company well in the future. The company has already benefited from the work its directors and officers, including CFO Sharon Binnun, have conducted in reintroducing Citizens to private reinsurance markets in Bermuda and London.

Gilway's immediate task is to convince Florida residents that shrinking Citizens is a good thing, even if it comes at the expense of lower rates or broader coverage than might otherwise be available in the private market. Prospects for Citizens policyholders to be assessed surcharges of up to 45% of their premiums in the event of a particularly large natural catastrophe — the likes of which Florida has seen before — may seem unlikely after seven consecutive benign hurricane seasons, and consumers appear willing to trade the longer-term risk of an assessment for the shorter-term lift provided by lower premiums in a difficult economy.

"People look at $6 billion in surplus," Gilway said with respect to Citizens' ability to expand policyholders' surplus to $6.02 billion as of Sept. 30, 2012, from $5.52 billion at year-end 2011. "Well, it's grown because we haven't had a storm in seven years. It's unnatural that we haven't. Sooner or later, the odds are going to catch up, and we're going to have a major storm. That $6 billion is one hit. Then, in year two, we start the assessment mechanism from ground zero, with no surplus: Every dollar of loss above your expected noncat loss ratio is going to be passed on to the policyholder. People ignore that. At some point in time, you have to pay the price for having Florida's coastline and having the sinkhole issues."

Gilway's ability to convey that message — one that some of his constituents may not want to hear — could go a long way toward determining his ultimate success as Citizens' CEO, and his return-to-basics approach should help in that regard. Continued good fortune come hurricane season wouldn't hurt either.