

Insurance Capital Build-Up Incentive Program

**Administered by the
State Board of Administration of Florida**

**Annual Report to the President of the Senate and the
Speaker of the House of Representatives**

February 1, 2009

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Purpose and Scope

Section 215.5595(9), Florida Statutes requires the State Board of Administration to submit a report to the President of the Senate and the Speaker of the House of Representatives by February 1 of each year as to the results of the Insurance Capital Build-Up Incentive Program and each insurer's compliance with the terms of its surplus note.

Introduction & History

The Insurance Capital Build-Up Incentive Program (Program), administered by the State Board of Administration (SBA or Board), was created in s. 215.5595, F.S. for the purpose of providing an incentive for investors to commit additional capital to Florida's residential insurance market and to write a minimum level of premiums for residential hurricane coverage.

The Legislature appropriated \$250 million for the Program. The Legislature specified that \$2.5 million (or 1 percent of the appropriated amount) was to be set aside to pay the administrative costs and fees incurred during the duration of the program, leaving \$247.5 million available to enter into surplus note agreements with insurers.

The SBA approved an emergency rule (Rule19ER06-3, F.A.C.) on May 31, 2006, in order to implement the program. The emergency rule was subsequently incorporated into Rule 19-15.001, F.A.C. The SBA emergency rule established time frames for insurers to submit their application under the Program. The first time frame was June 1 to June 15, 2006. The second time frame was June 16 to July 1, 2006. The final time frame was July 2, 2006 to June 1, 2007. Upon receiving the first set of applications, the SBA, in consultation with the Florida Office of Insurance Regulation (OIR), reviewed applications, focusing on the financial condition of the insurer and the insurer's business plan. Applications received during each successive timeframe were reviewed only if funds were still available to loan. If more funds were applied for than available, the law allowed for prioritization by the SBA. But as it worked out, prioritization was not necessary. The funds requested matched the funds available as some insurers adjusted their request in order to help maximize the benefits of the program. The SBA received a total of 20 applications from insurers requesting approximately \$356 million in Surplus Note proceeds. As illustrated in Table 1 below, a total of \$247.5 million was loaned out to 13 companies. Each company submitting an application by July 1, 2006 was required to make a contribution of new capital to its surplus at least equal to the amount of the Surplus Note. Those companies applying after July 1, 2006 were each required

to make a contribution of new capital to their surplus that was at least twice the amount of the Surplus Note. New capital contributed by each insurer was verified via bank confirmation before Surplus Note proceeds were distributed. The Surplus Notes issued, combined with the total amount of new capital contributed by the companies (\$296 million), created \$543.5 million in new unencumbered capital, allowing insurers to write additional residential property insurance coverage.

TABLE 1

<u>Companies Receiving a Surplus Note</u>	<u>Date of Surplus Note</u>	<u>Amount of Surplus Note</u>	<u>Amount Contributed by Insurer</u>	<u>Total Amount of New Capital</u>
American Capital Assurance Corp	11/21/06	\$25,000,000	\$25,000,000	\$50,000,000
American Integrity Insurance Co. of Florida	06/27/07	\$7,000,000	\$7,000,000	\$14,000,000
Cypress Property and Casualty	02/02/07	\$20,500,000	\$20,500,000	\$41,000,000
First Home Insurance Company*	06/27/07	\$14,500,000	\$29,000,000	\$43,500,000
Florida Peninsula Insurance Co.	01/03/07	\$25,000,000	\$25,000,000	\$50,000,000
Modern USA	06/28/07	\$7,000,000	\$7,000,000	\$14,000,000
Olympus Insurance Co.*	06/28/07	\$16,500,000	\$33,500,000	\$50,000,000
Privilege Underwriters Reciprocal Exchange*	06/13/07	\$17,000,000	\$34,000,000	\$51,000,000
Royal Palm Insurance Co.	12/20/06	\$25,000,000	\$25,000,000	\$50,000,000
Southern Fidelity Insurance Co.	09/12/06	\$25,000,000	\$25,000,000	\$50,000,000
St. Johns Insurance Co.	07/31/06	\$20,000,000	\$20,000,000	\$40,000,000
United Property and Casualty	09/22/06	\$20,000,000	\$20,000,000	\$40,000,000
Universal Property and Casualty	11/09/06	<u>\$25,000,000</u>	<u>\$25,000,000</u>	<u>\$50,000,000</u>
		\$247,500,000	\$296,000,000	\$543,500,000

*Companies applying after 07/01/06

Terms of Surplus Notes

(Note: All information is as of January 15, 2009)

According to s. 215.5595(2)(f), F.S., each Insurer’s “surplus note must be repayable to the state with a term of 20 years. The surplus note shall accrue interest on the unpaid principal balance at a rate equivalent to the 10-year U.S. Treasury Bond Rate, require the payment of only interest during the first three years, and include such other terms as approved by the board. The board may charge late fees up to five percent for late payments or other late remittances. Payment of principal, interest, or late fees by the insurer on the surplus note must be approved by the Commissioner of Insurance, who shall approve such payment unless the Commissioner determines that such payment will substantially impair the financial condition of the insurer.”

Principal

Principal payments are scheduled to be made in equal quarterly installments, beginning in year three of the loan(s), with due dates to coincide with interest payment dates (i.e. January 1, April 1, July 1, and October 1). Although s. 215.5595(2)(f), F.S requires the payment of only interest during the first three years, principal payments can be made during this time frame at the option of the insurer (provided the payments are approved by the Commissioner). None of the loans have reached the three year mark and no voluntary principal payments have

been made, thus the outstanding principal balance at 01/15/09 remains at \$247.5 million. Table 2 below summarizes anticipated flow of funds from scheduled principal repayments:

TABLE 2

Payment Date	No of Companies	Total Principal Amount
10/01/2009	3	\$ 955,882
01/01/2010	7	\$ 2,426,471
04/01/2010	8	\$ 2,727,941
07/01/2010 *	13	\$ 3,639,706

*and every quarter thereafter

Interest

The interest rate on the Surplus Notes is adjusted quarterly for the term of the Surplus Note based on the 10-year Constant Maturity Treasury rate. The interest rate is determined two business days prior to the payment date in order to set the rate for the following quarter. Additional interest may be charged to companies failing to meet the minimum writing ratio (further explained later). Table 3 below shows interest rates and total interest billed by quarter.

TABLE 3

For Quarter Ending	Interest Rate	Total Interest Paid
09/30/2006	5.22%	274,775.00
12/31/2006	4.63%	1,109,913.87
03/31/2007	4.70%	2,087,452.78
06/30/2007	4.64%	2,235,320.00
09/30/2007	5.12% *	3,541,872.21
12/31/2007	4.58% *	3,503,794.43
03/31/2008	4.11% *	4,067,131.27
06/30/2008	3.47% *	3,899,918.74
09/30/2008	3.99% *	4,016,119.46
12/31/2008	3.61% *	<u>2,338,908.34</u>
		\$ 27,075,206.10

*additional penalty interest charged to some companies for not meeting the minimum writing ratio

As Table 3 indicates, total interest paid since inception of the program is \$27,075,206.10. These funds have been invested in the SBA's Commingled Asset Management Program Money Market account (CAMPMM), where it has accumulated \$685,713.87 in investment earnings.

Late fees

The statute gives the SBA the authority to charge up to five percent for late payments or other late remittances. All payments to this date have been made on time, thus no late fees have been charged or collected.

Compliance

Provisions of the Surplus Note and the statute require each insurer to 1) meet minimum writing ratios, 2) maintain a minimum required surplus, and 3) maintain a level of surplus and reinsurance sufficient to cover in excess of its 1-in-100 year probable maximum loss, as further detailed in the following sections. In order to monitor compliance with these requirements, the Note requires each company submit a Quarterly Written Premium Report (Form SBA 15-3) to the Office of Insurance Regulation (OIR) and the SBA. Failure to submit the Quarterly Written Premium Report is considered a condition of default on the Note.

If an insurer is in default with the provisions of the Surplus Note, the consequences include:

- Increasing the interest rate
- Accelerating the repayment of principal and interest
- Shortening the term of the Note
- Calling the Note and demanding full payment

Currently, no company is in default with the provisions of the Surplus Note.

1) Writing Ratio

The statute, as originally signed into law, required as a condition of the Surplus Note that the insurer commit for the life of the Note to a minimum writing ratio of net written premium to surplus of at least 2:1 (except for insurers writing residential property insurance covering only manufactured housing; American Integrity Insurance Company of Florida and Modern USA Insurance Company falling under that criteria). For example, the insurer would need to write \$2 in premiums for every \$1 of surplus. In order to monitor compliance with this requirement, a section of the Quarterly Written Premium Report (submitted by insurers quarterly) requires insurers to provide information on their direct premiums written, assumed premiums written, and ceded premiums. Each insurer's writing ratio is determined by OIR and certified quarterly to the Board.

The Surplus Note recognized that due to an insurer's financial situation, it might not be able to immediately achieve the 2:1 ratio without causing financial stress. As long as a company was in the process of aggressively implementing its business plan, a reasonable delay in reaching the 2:1 ratio was considered acceptable. For each company, language was incorporated in the Note to address this situation and provide the proper incentive to meet the goals of the Legislature. If the insurer did not meet the time frame required by the Note, the Board and the insurer agreed to additional interest charges and repayment of a portion of the Note. Additional Interest charges are 25 basis points or 450 basis points, depending on the

degree the insurer is out of compliance. Several insurers were not able to meet the required minimum writing ratio by the agreed upon date and have paid additional interest charges. The Writing Ratio Summary Report indicates which companies were required to pay additional interest charges as a result of failing to meet the writing ratio requirements.

During the 2008 legislative session, CS/CS/SB 2860 was passed and consequently signed into law by the Governor. Section (2) of the bill relates to the Insurance Capital Build-Up Incentive Program (s. 215.5595, F.S.). The law relaxed the writing ratio requirements somewhat (s. 215.5595(2)(d), F.S.), and allowed for renegotiation of the Surplus Notes (s. 215.5595(10), F.S) for those insurers with existing Surplus Notes with the SBA. As a result, 11 Surplus Notes were renegotiated to incorporate the new time frames with the revised ratios. The law now allows for the meeting of either a net or gross writing ratio. The requirements phase in over three calendar years. The phase in for the net writing ratio is 1:1 for the first year (2008), 1.5:1 for the second year, and 2:1 for the third year. The gross writing ratio phases in over the three years as 3:1, 4.5:1, and 6:1.

The Writing Ratio Summary report, showing each insurer's writing ratio(s) and compliance, is prepared each quarter. The most recent Writing Ratio Summary Report is provided at the end of this report and is available on the Insurance Capital Build-Up Program website at <http://www.sbafla.com/fsb/Home/InsuranceCapitalBuildUpIncentiveProgram/tabid/413/Default.aspx>.

2) Minimum Required Surplus

As a condition of the Surplus Note, each insurer must maintain a minimum surplus which includes the Surplus Note proceeds and new capital equal to \$50 million (\$14 million for insurers writing only manufactured housing policies). In order to monitor compliance with this requirement, a section of the Quarterly Written Premium Report (submitted by insurers quarterly) requires insurers to provide information on their Total Admitted Assets, Liabilities, and Capital and Surplus. Insurers not meeting the Minimum Required Surplus for any quarter must provide a detailed explanation showing how the surplus was calculated and why it is below the required amount. If the insurer fails to meet the minimum required surplus, the insurer is considered to be in default on the loan except for the following circumstances:

- situations involving the payment of losses resulting from a catastrophic event or a series of events resulting in catastrophic losses
- situations where Minimum Required Surplus is reduced as a result of the accounting treatment for deferred acquisition costs
- situations where Minimum Required Surplus is reduced as a result of the repayment of principal on the Surplus Note

3) 1-in-100 Year Probable Maximum Loss

The 2008 Legislature provided for an additional condition of the Surplus Note requiring the insurer to maintain a level of surplus and reinsurance sufficient to cover in excess of its 1-in-100 year probable maximum loss, as determined by a hurricane loss model accepted by the

Florida Commission on Hurricane Loss Projection Methodology as certified by the OIR annually. Failure to do so results in the insurer defaulting on the Surplus Note.

Funds Transferred to General Revenue

During the 2009 legislative special session, SB 28A was passed by the Legislature and consequently signed into law by the Governor. The bill added language to the Insurance Capital Build-Up Incentive Program (s. 215.5595, F.S.) requiring all future principal, interest, and late fees received from insurers be transferred to General Revenue within 30 days of receipt. Also during the 2009 special session, section 16 of the appropriations bill directed the SBA to transfer to General Revenue all unrestricted moneys received as repayments of principal, interest, and late fees received from insurers to date, as well as accumulated investment earnings. As such, approximately \$26,685,604 (as of 01/15/09) is available for transfer to General Revenue. The remainder of the moneys (with a cost of \$1,075,316 and market value of \$672,253) have been frozen by the SBA and will be transferred to General Revenue when the SBA releases all restrictions on the funds.

Also to be transferred to General Revenue is the investment income earned on the original appropriation of \$250 million. Before loans were made to insurers, the appropriated funds earned approximately \$8,616,486 while invested in CAMPMM. The amount available for immediate transfer is approximately \$8,085,992. The remainder (with a cost of \$530,494 and a market value of \$331,648) will be transferred to General Revenue when the SBA releases all restrictions on the funds.

Insurance Capital Build-Up Incentive Program
Writing Ratio Summary Report

Required Writing Ratio Date	Southern Fidelity Ins Co		United P&C Ins Co		Universal P&C Ins Co		American Capital Assur Corp		Royal Palm Ins Co		Florida Peninsula Ins Co		Cypress P&C Ins Co		Privilege Underwriters Reciprocal Exchange		American Integrity Ins Co		First Home Ins Co		Modern USA Ins Co		Olympus Ins Co	
	11/15/07	8/1/07	12/31/07	6/1/07	3/31/08	6/1/07	7/1/07	1/1/08	12/31/08	12/31/08	12/31/08	12/31/08	12/31/08	12/31/08	12/31/08	12/31/08	12/31/08	12/31/08	12/31/08	12/31/08	12/31/08	12/31/08	12/31/08	12/31/08
09/30/2006 Meets WR	1.08	0.21	0.72	n/a	0.10	0.65	n/a	0.10	n/a	0.76	n/a	0.80	0.90	n/a	0.08	2.54	0.20	0.00	0.11	0.19	0.58	0.59	0.78	0.71
12/31/2006 Meets WR	1.04	0.32	1.34	n/a	2.05	n/a	0.65	n/a	0.76	n/a	0.80	0.90	n/a	0.08	2.54	0.20	0.00	0.11	0.19	0.58	0.59	0.78	0.71	
03/31/2007 Meets WR	1.26	1.87	2.34	n/a	1.87	n/a	0.76	n/a	0.76	n/a	0.80	0.90	n/a	0.08	2.54	0.20	0.00	0.11	0.19	0.58	0.59	0.78	0.71	
06/30/2007 Meets WR	1.00	1.60	0.10	n/a	1.69	n/a	0.79	n/a	0.56	0.56	0.10	1.48	n/a	0.08	2.54	0.20	0.00	0.11	0.19	0.58	0.59	0.78	0.71	
09/30/2007 Meets WR	1.12	1.29	1.47	n/a	1.83	n/a	0.64	n/a	1.69	1.18	1.18	1.15	n/a	0.08	2.54	0.20	0.00	0.11	0.19	0.58	0.59	0.78	0.71	
12/31/2007 Meets WR	1.18	1.26	1.32	n/a	1.39	n/a	0.76	n/a	2.13	1.37	1.37	1.12	n/a	0.08	2.54	0.20	0.00	0.11	0.19	0.58	0.59	0.78	0.71	
03/31/2008 Meets WR	1.10	1.01	1.04	n/a	1.26	n/a	0.82	n/a	2.02	2.05	2.05	0.90	n/a	0.08	2.54	0.20	0.00	0.11	0.19	0.58	0.59	0.78	0.71	
06/30/2008 Meets WR	0.95	0.90	1.49	n/a	1.66	n/a	0.85	n/a	2.52	1.76	1.76	0.54	n/a	0.08	2.54	0.20	0.00	0.11	0.19	0.58	0.59	0.78	0.71	
09/30/2008 - Gross*	6.85	1.70	3.17	10.21	1.18	3.82	3.47	1.33	3.82	3.47	1.33	1.33	0.41	0.08	2.54	0.20	0.00	0.11	0.19	0.58	0.59	0.78	0.71	
09/30/2008 - Net Meets WR	1.09	0.99	1.82	2.95	0.88	2.16	1.82	0.61	2.16	1.82	0.61	0.61	0.13	0.08	2.54	0.20	0.00	0.11	0.19	0.58	0.59	0.78	0.71	

Failure to meet minimum writing ratio results in penalty interest of 25 bps or 450 bps, according to the terms set forth in the Note

company assessed 25 bps penalty
company assessed 450 bps penalty

n/a - Minimum Writing Ratio is not yet required to be met based on the required writing ratio date agreed upon at the execution of the Surplus Note.

(1) - For newly formed Insurers writing only manufactured housing policies, the ratio provisions are provided in Section 624.4095 F.S.

*Beginning with the 09/30/08 quarter, companies could meet the minimum writing ratio by meeting a net ratio of 1:1, OR a gross ratio of 3:1 for the remainder of 2008