Florida Hurricane Catastrophe Fund

Annual Report of Aggregate Net Probable Maximum Losses,
Financing Options, and Potential Assessments

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Table of Contents

	Page
Purpose and Scope	3
Introduction	3
Aggregate Net Probable Maximum Losses	4
Financing Options	5
Assessment Impact	7
Conclusion	7

The data contained in this report has not been audited.

Annual Report of Aggregate Net Probable Maximum Losses, Financing Options, and Potential Assessments

Purpose and Scope

Section 627.35191, Florida Statutes, enacted in 2013, requires the Florida Hurricane Catastrophe Fund (FHCF) to provide a report to the Legislature and the Financial Services Commission regarding the aggregate net probable maximum losses, financing options, and potential assessments of the FHCF. More specifically:

> **§ 627.35191 Annual report of aggregate net probable maximum losses, financing options, and potential assessments.** No later than February 1 of each year, the Florida Hurricane Catastrophe Fund and Citizens Property Insurance Corporation shall each submit a report to the Legislature and the Financial Services Commission identifying their respective aggregate net probable maximum losses, financing options, and potential assessments. The report issued by the fund and the corporation must include their respective 50-year, 100-year, and 250-year probable maximum losses; analysis of all reasonable financing strategies for each such probable maximum loss, including the amount and term of debt instruments; specification of the percentage assessments that would be needed to support each of the financing strategies; and calculations of the aggregate assessment burden on Florida property and casualty policyholders for each of the probable maximum losses.

Introduction

The FHCF plays a significant role in the provision of property insurance coverage for Florida residents. Eight consecutive seasons without hurricane activity affecting Florida have given the FHCF an opportunity to accumulate resources to prepare for future storms. The FHCF has significant financial resources as of the end of 2013, with an estimated fund balance of approximately $9.70 billion. In addition to these resources, the FHCF also has $2 billion in proceeds from outstanding pre-event debt, providing additional liquidity for 2014 and future seasons. Nonetheless, the FHCF might still need to rely on emergency assessments and post-event bonding capabilities to pay claims if a storm or storms of sufficient size impacted Florida. The analyses presented in this report summarize those resources and how the FHCF would apply them after an event.

Aggregate Net Probable Maximum Loss

The basic claims payment structure of the FHCF is as follows:

- Except for certain de minimis exemptions, all admitted insurers writing residential property insurance in Florida, including Citizens Property Insurance Corp., are required by Section 215.555, Florida Statutes to obtain FHCF reimbursement coverage.

- The FHCF reimburses each participating insurer for a portion of its hurricane losses under residential policies. The insurer has the option of selecting a coverage percentage of 90%, 75%, or 45%. The vast majority choose the 90% coverage level.

- An insurer's FHCF reimbursement coverage is triggered after it meets its retention (the functional equivalent of a deductible). For the contract year that began on June 1, 2013 and ends on May 31, 2014, the aggregate retention for all participating insurers was $7.213 billion. Aggregate retention for the contract year beginning on June 1, 2014 is projected to be $7.075 billion. Once an insurer's losses exceed its share of the aggregate industry retention, it triggers coverage. It is not a requirement that aggregate insurer losses exceed the aggregate industry retention prior to any insurer being eligible for FHCF reimbursement.

- The maximum obligation of the FHCF for a given contract year is specified by statute. The current maximum is $17 billion. Each insurer's reimbursement coverage is limited to a share of the $17 billion maximum obligation.

- An insurer's reimbursement premium, retention, and coverage limit are based on its total insured values by ZIP code as of June 30, which must be reported by each insurer annually by September 1 of each year.

- The claims-paying resources of the FHCF include:

    - Cash derived from current and past accumulation of reimbursement premiums and investment income. The cash balance is used before any of the other claims-paying resources are used. The cash balance as of December 31, 2013 was projected to be $9.70 billion. The FHCF collected approximately $1.25 billion in reimbursement premium from participating insurers for the

2013 contract year and is projected to collect $1.25 billion in reimbursement premium for the 2014 contract year.

- Proceeds from pre-event financing. The FHCF currently has $2 billion in proceeds from the Series 2013A pre-event bond issue.

- Proceeds from post-event debt. Post-event debt is repaid from emergency assessments on most Florida property and casualty premiums of both admitted and non-admitted lines of business (the exceptions are workers' compensation, medical malpractice, accident and health, and federal flood insurance). Post-event resources could also include funds from assessments levied without the issuance of debt. The maximum assessment percentage is 6% with respect to any one contract year's losses and 10% with respect to all contract years' losses combined.

- Recoverables from reinsurance and other risk-transfer mechanisms. No such risk-transfer mechanisms are in place as of the date of this report.

Table 1 shows the net probable maximum loss to the FHCF from storms of the return time specified. The loss calculations were derived from the FHCF 2013 Ratemaking Formula Report prepared by Paragon Strategic Solutions, Inc., consulting actuary to the FHCF. The complete 2013 Ratemaking Formula Report can be found at http://fhcf.paragonbenfield.com/pdf/13ratereport.pdf

Table 1
($ in millions)

Return Time (Years)	Gross Probable Maximum Loss[1]	Maximum Net Losses to FHCF[2]	Adjusted Net Losses to FHCF[3]	Projected Year-End Fund Balance[4]	Assessable Shortfall[5]
250	$79,459	$17,000	$16,545	$11,010	$5,535
100	$50,511	$17,000	$15,549	$11,010	$4,539
50	$33,512	$17,000	$13,918	$11,010	$2,908

Coverages	Amount
2014 Retention (Projected)	$7,075
Mandatory Coverage	$17,000

[1] Represents gross loss to all Florida residential policyholders from a storm of the indicated return time multiplied by 1.05 to allow for 5% loss adjustment expenses pursuant to Section 215.555(4)(b)1, FL Statutes.
[2] Based on the assumption that the FHCF operates as a single industry entity with a single industry retention and industry limit that apply to industry gross losses from total industry exposure.
[3] Based on the assumption that the total FHCF net losses is the sum of losses from approximately 160 individual companies, each with its own retention, limit and exposure distribution. Under this assumption it is unlikely for all insurers to exhaust the total of all FHCF coverage. Adjusted loss information for 2014 is not yet available, and may be different from that shown as derived from the 2013 Ratemaking Formula Report.
[4] FHCF fund balance is projected as of 12/31/14.
[5] Adjusted Net Losses to FHCF less Projected Year-End Fund Balance.
Numbers may not add due to rounding.

Financing Options

The FHCF undertakes two basic types of financing: (1) pre-event financing to provide liquid funds to reimburse participating insurers in a timely manner; and (2) post-event financing designed to provide the ultimate source of payment of covered claims in excess of cash on hand.

The FHCF has $2.0 billion of Series 2013A pre-event debt outstanding. The proceeds of this pre-event financing are expected to be available to pay future claims, beginning with the 2014 season. Pre-event interest expenses are designed to be paid primarily from the interest earnings on the invested proceeds of the bonds (which are retained pending their use to pay future claims) and from reimbursement premiums. There are no assessments associated with pre-event bonds of the FHCF. If the proceeds of pre-event bonds are ever used to pay claims, the FHCF can levy emergency assessments to pay back the bonds or the FHCF can refinance such bonds using post-event bonds secured by emergency assessments.

The FHCF also has two series of post-event bonds outstanding, which were used to pay claims from the 2005 hurricane season. The debt service on these bonds and the associated assessment are summarized in Table 2.

Table 2
($ in millions)

Bond Year	Series 2008A Bonds		Series 2010A Bonds		Total Post-Event Debt Service			Annual Assessment %
	Principal	Interest	Principal	Interest	Principal	Interest	P&I	
2014	$325	$15	$0	$33	$325	$49	$374	1.30%
2015			342	33	342	33	376	1.30%
2016			333	16	333	16	350	1.30%
Total	**$325**	**$15**	**$676**	**$83**	**$1,001**	**$98**	**$1,099**	

Note: Principal on Series 2008A and 2010A Bonds is due on July 1.
Totals may not add due to rounding

The FHCF's outstanding debt has long-term ratings of AA-/AA/Aa3 from Standard & Poor's, Fitch, and Moody's, respectively.

The FHCF has the statutory authority to amortize its debt over a term of up to 30 years. Given the magnitude of the losses associated with the storms summarized in Table 1 above, the FHCF could use this full term for any bonds associated with the financing of these losses. The FHCF has the ability to issue such bonds on a tax-exempt basis to pay covered claims. It should be noted that the reshaped global financial landscape in the wake of the 2007-2008 financial crisis has made large financings more difficult and costly to execute. The size and circumstances that would surround an FHCF post-event issue to pay such losses may further complicate the issuance process. Given these factors, it is uncertain whether the FHCF could in fact complete a bond issue or series of bond issues of the size necessary to pay all covered losses at assumed interest rates, or at any interest rate, in a timely manner. It may be difficult to pay all covered losses from one bond issuance and the FHCF would most likely execute multiple financings. If long-term bonding in sufficient amounts is not immediately available, the FHCF may need to explore alternatives, including the levying of emergency assessments with no financing, issuing bonds in multiple tranches over time and/or interim financing alternatives. The FHCF statute provides that the FHCF's liability is limited to the amount it can actually raise from bonding and other available claims payment sources. The timing of reimbursements to insurers can vary depending on whether insurers need to pay their policyholders quickly, such as might occur with a category five hurricane causing a large number of total losses, or slowly due to a covered hurricane where large losses are due to many partial losses materializing over a number of years.

Assessment Impact

As described above, in situations involving rapid loss development the FHCF would probably attempt to finance shortfalls of the size created by the storms shown in Table 1 using post-event tax-exempt bonds amortized over a 30-year period. These bonds would be repaid using emergency assessments.

Table 3 shows the estimated annual assessment impact from the prescribed storm sizes.

Table 3
($ in millions)

Return Time (Years)	Assessable Shortfall	Required Annual Assessment[1]	Required Annual Assessment (%)[2]
250	$5,535	$446	1.23%
100	$4,539	$366	1.01%
50	$2,908	$234	0.65%

[1] Assumes annual assessment for 30 years using an interest rate of 7%. There is no certainty that assessable shortfalls can be financed at assumed interest rates, or at any interest rates. The amount which can be financed after an event could be significantly smaller and is subject to market conditions.

[2] Assumes annual assessment base of $36.185 billion, which is the actual base as of December 31, 2012. If this base shrinks in size, required assessment percentages would be higher than shown above. If this base grows in size, required assessment percentages would be lower than shown above.
Numbers may not foot due to rounding.

Conclusion

As a result of eight consecutive years without major hurricane losses, the FHCF has more cash on hand to pay claims than in past years. In addition, it has $2 billion in pre-event bond proceeds. For significant events beyond the cash and pre-event bond proceeds, the FHCF relies on bonding and other revenue sources for claims paying capacity.

For catastrophic losses, either from an extreme single event or from multiple events, the FHCF will likely bond to pay claims and assess to repay the bonds. The potential assessment burden is estimated to be lower this year than last. In the event bonding is required, conditions in the financial markets have improved over recent years; although, of course there cannot be a guarantee that all bonding can be placed.

However, to serve its catastrophic purpose, the FHCF would most likely need to execute post-event financings over a 12 month period in order to accommodate participating insurers that experience rapid loss development and exhaust their FHCF payout limits.

The ability of the FHCF to pay claims in a sufficient and timely manner is critical to the health of the Florida insurance market, property owners and residents, and the Florida economy in general.