

Guidance on Financial Stability Ratings[®] and Catastrophe Reinsurance Program Reporting for Florida Property Insurers

2014 Update and Addendum

December 5, 2013

February 7, 2014 Clarification

Introduction

The Demotech discussion document, *Guidance on Financial Stability Ratings and Catastrophe Reinsurance Program Reporting for Florida Property Insurers*, published in March 2010, remains in effect as a summary of our procedures and philosophy. This communication serves as an update and addendum to reduce to writing refinements that we believe to be necessary given the changes in the marketplace and reinsurance community.

The purpose of this update is to provide insight on our current requirements and other matters we believe to be relevant to a property insurance company's catastrophe reinsurance program. Consistent with our initial document, nothing in this addendum should be viewed as a safe harbor or bright-line indicator for financial performance that we deem acceptable.

Quarterly Review Update – Third Quarter 2013

Demotech has nearly completed our review and evaluation of the third quarter 2013 financial results for rated companies writing property insurance in Florida. For those companies that we have completed our review, Financial Stability Ratings[®] (FSRs) have been affirmed and are listed on our website, www.demotech.com. We will begin the review and evaluation of year-end 2013 financial statements as soon as they are forwarded to us.

Catastrophe Reinsurance Program Reporting

As the 2013 Atlantic hurricane season is over, Demotech and the carriers that we review and rate have turned our respective attention to the 2014 season. This update was developed to assist management to prepare for the renewal season for catastrophe reinsurance:

- The *Exhibit A – Proposed Data Call* will be distributed in mid-March and is due back to Demotech the first week in April. The *Exhibit A – Final Data Call* and *Exhibit B – Data Call* will be issued in early June and due back to Demotech mid-June. These timeframes are consistent with prior period timeframes.



- The format of **Exhibit A** will remain consistent with prior requests. It is Demotech's expectation that a company will use the most current approved version of its selected catastrophe model. If the company does not provide data based on the most current version, we will require that the company file a supplemental **Exhibit A** using the most recent approved version of the model for comparison. This will also apply to companies utilizing a blended approach.
- It is Demotech's expectation that companies will procure first event limits **EXCEEDING** the 100 year event return period PML including loss amplification/demand surge and secondary uncertainty. This equates to the company providing cover in excess of the 100 year event return period reflected in **Section II** of Demotech's **Exhibit A**. If a company's vertical limit for the first event does not exceed the 100 year event return period based on the information provided in **Section II** of **Exhibit A**, the company is unlikely to be eligible for a Financial Stability Rating[®] at the A level or above.
- Although Demotech has not previously provided publicly available guidance or requirements related to multiple catastrophe event scenarios, **this has changed for the 2014 reinsurance renewal**. For a company to remain eligible for a Financial Stability Rating[®] at the A level or above, it must secure a second event cover in excess of the 50 year event determined by:
 - A first event that exhausts the mandatory layer of the Florida Hurricane Catastrophe Fund (**limited to the 1:100 year event return period**)

and

 - A 50 year event return period PML as reflected in **Section II** of **Exhibit A**.

If a company's second event cover does not exceed a 50 year event return period based on the information provided in **Section II** of **Exhibit A**, the company is unlikely to be eligible for a Financial Stability Rating[®] at the A level or above.

- It is our expectation that rated carriers will also secure reinstatement premium protection, a reasonable multiple event net catastrophe retention and a vertical limit cover for events beyond two events that is viewed as appropriate by Demotech. Each of these expectations is a significant component impacting the evaluation and analysis of the company's overall catastrophe reinsurance program, and therefore, the assignment of a Financial Stability Rating[®].
- Although we have always reviewed and considered the reinsurers active in the reinsurance programs of the carriers that we review and rate, the Financial Stability Rating[®] is directly impacted by our opinion of the financial stability of the reinsurers providing protection.



Summary

Demotech strives to maintain relative consistency as well as evaluation transparency in its review of property writers' catastrophe reinsurance programs. The requirement to provide the data utilizing the most current approved model version, our position regarding the inclusion of demand surge and the review of multiple event scenarios are issues we believe to be pertinent to our review, evaluation and assignment of Financial Stability Ratings®.

The purpose of this update is to communicate the evolution of our data call requirements and other items relevant to a company's catastrophe reinsurance program renewal efforts. As with the originally published *Guidance on Financial Stability Ratings® and Catastrophe Reinsurance Program Reporting for Florida Property Insurers*, nothing in this addendum should be considered or interpreted as a safe harbor or bright-line indicator for acceptable financial performance. If you have any questions, please contact Bob Warren, Barry Koestler or me. We can be reached at 800 354 7207, Bwarren@demotech.com, bkoestler@demotech.com or jpetrelli@demotech.com.

Thank you.

Joseph L. Petrelli
President