

Idea Exchange

Sun Sets on Sunshine State Insurance

On March 4, 2014, Demotech Inc. withdrew the Financial Stability Rating (FSR) assigned to Sunshine State Insurance Co. after being advised that the company would be unable to file its December 31, 2013 annual statement in a timely manner. Equally as important in the decision to withdraw the FSR was the rationale presented by management in their initial verbal communication to Demotech that several years of independently audited financial statements would likely need to be materially revised due to previous reporting errors associated with reinsurance contracts.

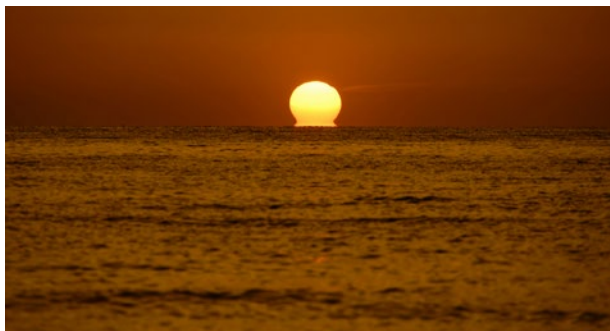


By Joseph Petrelli
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On June 3, 2014, the company was ordered into liquidation. Although the company reported in excess of \$7,000,000 of surplus in its March 31, 2014 financial statement to regulators, the court deemed continued operation to be hazardous to policyholders.

Recent articles have stated that Sunshine State would need to restate its 2008 and all subsequently issued independently audited financial statements in order to address the errors. This would mean that nearly one-third of its operating history could need to be restated. Similarly, if the matter to be addressed in this situation is reinsurance related, the affirmative statements related to reinsurance that were presented in the annual loss and loss adjustment expense reviews prepared by a professional actuary will likely need to be revised as well.

Demotech reviewed, analyzed and rated Sunshine State starting in 1997. Each time the company filed a quarterly or annual statement with the National Association of



Insurance Commissioners, the signatories on the jurat page attested to the accuracy of the financial statement. Demotech also reviewed and analyzed documents prepared by the independent third parties that prepare annual reports, such as the independent auditors who opine on whether the financial statements of the company are fairly presented as well as the consulting actuary's perspective on loss and loss adjustment expense reserves and certain reinsurance matters contained in the actuary's report.

From time to time, insurance carriers and their independent consultants may have differences that need to be addressed, reconciled and resolved; however, wholesale restatements of previous financial statements, particularly when necessary over a

number of consecutive years, as the Sunshine State situation appears to suggest, require that Demotech move quickly to withdraw or revise an FSR. Financial information, whether presented to a rating service issuing an opinion as to the financial strength or financial stability of an insurer or a regulator such as the Florida Office of Insurance Regulation (OIR), must be accurately presented and indicative of the underlying financial condition of the insurer being reviewed.

The reinsurance companies associated with the catastrophe reinsurance program are not required to monitor their client's treatment of reinsurance. Once the reinsur-

ance treaty is negotiated, executed and purchased, the responsibility of the reinsurer is to respond to a covered event. How the ceding company internally records and accounts for its reinsurance transactions is an internal matter for management. Guidance, procedures, processes and protocols for the proper recordation are outlined in the instructions from the NAIC, but again it is the

responsibility of management to implement appropriate procedures and ensure that those procedures are subsequently followed. Assurance of such compliance is presented in the notes to financial statements and general interrogatories in the sworn quarterly and annual statements that are relied upon.

In the Sunshine State case, it appears that by deciding to liquidate an insurance company despite a reported surplus of more than \$7,000,000 at March 31, 2014 rather than giving the company additional time to raise capital, the Florida OIR has made it clear that the financial results reported to third parties must be accurate and consistent with the underlying financial condition of the carrier and that management, not policyholders, will be held responsible when restatements of prior period results are required. ■

Petrelli is the president of Demotech, a financial analysis firm specializing in evaluating the financial stability of regional and specialty insurers. Since 1985, Demotech has been assigning Financial Stability Ratings® (FSRs) for property/casualty insurers and title underwriters. FSRs are a leading indicator of financial stability, providing an objective baseline of the future solvency of an insurer. Demotech reviews and evaluates insurers based on their area of focus and execution of their business model rather than solely on financial size. This philosophy was the catalyst for the Demotech Company Classification System, which was developed and published in Insurance Journal, in order to stratify and categorize insurers into operational categories. Visit www.demotech.com for more information.