



Demotech, Inc.

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

2016 Update and Addendum

January 13, 2016

Background on Demotech's Assistance to Floridians

In the early 1990s, in the aftermath of Hurricane Andrew and the devastation caused by that single storm, more than twenty insurance carriers domiciled in Florida were placed into liquidation. Others were merged into affiliates.

In response to the decline in the availability of property insurance, carrier withdrawals from the market or limitations on agency production and to stabilize the property insurance marketplace, the State of Florida developed the Florida Residential Property Casualty Joint Underwriting Association (JUA) to provide homeowners insurance coverage. The JUA became the leading writer of homeowners insurance.

In 1996, the State of Florida, (then) Department of Insurance and the JUA initiated an effort to depopulate the JUA by encouraging the writing of homeowners insurance from the private sector. An initial effort extended financial incentives to companies that depopulated the JUA.

Concurrently in 1996, the mortgage lending industry, given the necessity of acceptable insurance company ratings for hazard insurance policies provided to their borrowers, required that the legislation include a provision that *the newly capitalized insurance company be acceptable to the secondary mortgage marketplace*. Given that these insurance companies would be start-ups, they would be unrated unless the international rating agencies (that had abandoned Florida-focused property insurers subsequent to Hurricane Andrew) took action.

With the international rating agencies unwilling or unable to assist, the State of Florida, Department of Insurance, and the secondary mortgage marketplace needed a solution. They contacted Demotech. We developed a procedure to rate the newly formed insurers. Our procedures met the needs of the State of Florida, insurance agents, insurers, consumers and were acceptable to the secondary mortgage marketplace. For example, in 1996, we were the company that identified American Strategic Insurance and its affiliates as an exceptional carrier.

Today, Demotech reviews and rates more than fifty insurers that write nearly 55% of Florida's homeowners' insurance marketplace. These carriers include subsidiaries of Nationwide and Allstate as well as independent regional insurers.

We believe that a viable property insurance marketplace is comprised of carriers with robust vertical and horizontal property catastrophe reinsurance programs.

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Introduction

The Demotech discussion document, *Guidance on Financial Stability Ratings and Catastrophe Reinsurance Program Reporting for Florida Property Insurers*, was initially published in March 2010, and its updates remain 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.

Quarterly Review Update – Third Quarter 2015

Demotech has completed our review and evaluation of the third quarter 2015 financial results for rated companies writing property insurance in Florida. Financial Stability Ratings® (FSRs) have been affirmed as appropriate on our website, www.demotech.com. We will begin the review and evaluation of year-end 2015 financial information as it is forwarded to us.

As companies have participated in Citizens' efforts to depopulate, this participation in takeouts, as well as direct premium growth, has resulted in significant premium growth for some. This growth has taken place during a period of relatively soft catastrophe reinsurance pricing and an absence of significant hurricane activity. Although catastrophe reinsurance pricing conditions may change, our attributes of acceptable catastrophe reinsurance programs are likely to be constant or strengthened.

Catastrophe Reinsurance Renewal Considerations

Although Demotech has not changed our criteria or requirements associated with a qualifying catastrophe reinsurance program for the 2016 renewal, we will be evaluating each carrier's concentration of coastal business, asking carriers to explain how management identified and evaluated geographic concentrations of business and the relative effect on the overall catastrophe reinsurance program.

Because each company has unique characteristics within its book of business and each company's catastrophe reinsurance program tends to reflect that uniqueness, Demotech will not develop benchmarks or standards for addressing concentrations within the coastal geographic regions for Florida property writers. However, we may need to review this exposure or request additional information to determine how management has identified, modeled, and provided coverage for this exposure as part of our annual review of the *Exhibit A - Proposed Data Call* filing, due later this spring.

Demotech will continue to review catastrophe reinsurance programs relative to the company's consideration for its Occurrence Exceedance Probability (OEP), Aggregate Exceedance Probability (AEP), and Tail Value at Risk (TVAR). For some companies, particularly those with significant growth, we may request additional information regarding management's view and consideration of the company's TVAR relative to the proposed catastrophe reinsurance renewal program.



Consideration for a Financial Stability Rating® Upgrade

Although the dearth of significant storms and reduced catastrophe reinsurance costs, to name two factors, have resulted in an improvement in overall financial stability, Demotech will continue to address rating decisions, including upgrades, on an individual company basis. We will not be publishing specific criteria regarding qualification for consideration for upgrade. No request for consideration for a rating upgrade will be entertained in calendar year 2016 until we have fully reviewed a company's statutory annual financial statement, audit report, statement of actuarial opinion as regards loss and loss adjustment expense reserves, catastrophe reinsurance program renewal information, rate level adequacy as prepared by a credentialed actuary, or such other information we deem necessary.

Summary

The primary purpose of this update is to communicate the evolution of our data call requirements and other items relevant to 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.

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