# Citizens Property Insurance Corporation

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

February 2016

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*The data contained in this report is unaudited. This report is prepared by Raymond James as financial advisor to Citizens Property Insurance Corporation.*

# 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 Citizens Property Insurance Corporation (Citizens) 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 Citizens. Section 627.35191 Florida Statutes follows:

> **§ 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

Citizens plays an important role in the provision of property insurance coverage for Florida residents unable to find coverage in the private market. Ten consecutive seasons without hurricane activity affecting Florida has given Citizens an opportunity to accumulate resources in preparation for future storms. Citizens has significant financial resources as of the end of 2015, with estimated combined surplus of approximately $7.5 billion. In addition to its surplus, Citizens' financial resources also include pre-event debt totaling approximately $4.2 billion that provides liquidity, and a risk transfer program that transfers approximately $3.9 billion through traditional reinsurance markets and the capital markets, and approximately $3.1 billion through the Florida Hurricane Catastrophe Fund (FHCF).

Notwithstanding the diversity and magnitude of its financial resources, if Florida is impacted by an extreme storm or series of storms, Citizens may need to rely on its assessment capability and / or post-event financing to meet its policyholder obligations.

As a result of significant depopulation and ten consecutive years without major hurricane losses, Citizens' current financial position is its strongest to date. Citizens has accumulated substantial levels of surplus and is also expecting to structure a sizeable risk transfer plan (through traditional reinsurance markets and capital markets) to bolster its claim paying resources in 2016. Major catastrophic losses, either from an extreme single event or from multiple events that result in a deficit to any of Citizens' accounts and levying of the emergency assessment, may require Citizens to issue post-event bonds in order to meet its cashflow needs. Repayment of these post-event bonds would be funded through the collection of the associated emergency assessment. For a 1-100 year event, Citizens is projected to have no assessment burden; the potential assessment burden for a 1-250 year event is at a historical low with a potential annual emergency assessment rate of 0.30% based on a 30-year amortization at a 5% interest rate.

The analyses presented in this report summarize Citizens' claims-paying resources and how Citizens would apply these resources after an event or series of events.

## Aggregate Net Probable Maximum Loss

Through three accounts, Citizens provides property insurance coverage in Florida to individuals and businesses that meet statutory criteria. While these accounts are maintained separately for financial purposes (including deficit and assessment calculations), two of the accounts – the Personal Lines Account (PLA) and Commercial Lines Account (CLA) – are combined for purposes of FHCF coverage and bond security. A summary of the three accounts follows:

- Coastal Account: The Coastal Account provides wind-only and multi-peril coverage for policyholders (residential and commercial) in defined geographic areas near the coast.

- Personal Lines Account: The PLA provides residential multi-peril and ex-wind coverage throughout Florida.

- Commercial Lines Account: The CLA provides commercial residential (condominium association, etc.) and commercial nonresidential coverage throughout Florida.

Table 1 presents the projected aggregate net Probable Maximum Loss (PML), including 10% of loss to account for Loss Adjustment Expenses, from storms of the return time specified for: (1) the PLA/CLA; (2) the Coastal Account; and (3) all three accounts combined. The loss calculations are as of December 31, 2015 and were prepared by Citizens using AIR Atlantic Tropical Cyclone Model v15.0.1 as implemented in Touchstone v3.1.0. Table 1 also presents Citizens' projected payment sources for each return time, including surplus, FHCF mandatory coverage reimbursement and private risk transfer, and identifies any shortfalls which would require the levy of the policyholder surcharge, regular assessment (Coastal Account only) and / or emergency assessment.

**Table 1**
**($ in millions)**

**Coastal**

| Return Time (Years) | PML (Coastal)[1] | Projected FHCF Reimbursement | Projected Payment from Surplus[2] | Private Reinsurance / Catastrophe Bonds[3] | Assessable Shortfall |
|---|---|---|---|---|---|
| 250 | $10,103 | $1,794 | $3,252 | $2,243 | $2,814 |
| 100 | $6,304 | $1,794 | $2,273 | $2,236 | $0 |
| 50 | $3,979 | $1,794 | $1,767 | $418 | $0 |

**PLA/CLA**

| Return Time (Years) | PML (PLA/CLA)[1] | Projected FHCF Reimbursement | Projected Payment from Surplus[2] | Private Reinsurance / Catastrophe Bonds[3] | Assessable Shortfall |
|---|---|---|---|---|---|
| 250 | $4,294 | $983 | $3,312 | $0 | $0 |
| 100 | $2,458 | $983 | $1,475 | $0 | $0 |
| 50 | $1,408 | $879 | $529 | $0 | $0 |

**Total Coastal & PLA/CLA[4]**

| Return Time (Years) | PML (Coastal and PLA/CLA)[1] | Projected FHCF Reimbursement | Projected Payment from Surplus[2] | Private Reinsurance / Catastrophe Bonds[3] | Assessable Shortfall |
|---|---|---|---|---|---|
| 250 | $14,398 | $2,777 | $6,564 | $2,243 | $2,814 |
| 100 | $8,761 | $2,777 | $3,748 | $2,236 | $0 |
| 50 | $5,387 | $2,673 | $2,296 | $418 | $0 |

[1] *All PMLs reflect single event modeled losses as of December 31, 2015 per AIR Atlantic Tropical Cyclone Model v15.0.1 as implemented in Touchstone v3.1.0 based on Standard Sea Surface Temperature (SSST), including demand surge, excluding storm surge, and including 10% of loss to account for Loss Adjustment Expense. The PML numbers are higher by approximately 5% for aggregate events or losses.*

[2] *Surplus is unaudited as of 12/31/15 and includes 2016 net projected income without any new additional reinsurance coverage for the 2016 season.*

[3] *Private reinsurance/catastrophe bonds are estimated amounts per Citizens' existing risk transfer program for 2016. These amounts are preliminary, however, and may change subject to market conditions.*

[4] *Total PMLs are a sum of the PLA/CLA and Coastal PMLs in this analysis to be consistent with FHCF allocation. Combined PMLs are marginally different than the sum of the individual PMLs at these return times.*

*Numbers may not foot due to rounding.*

## Financing Options

Citizens may undertake two basic types of financings: (1) pre-event financing – to provide liquid funds to meet policyholder obligations in a timely manner (Citizens uses this financing primarily as a "bridge" to ultimate claims-paying resources such as FHCF reimbursements or assessments); and (2) post-event financing – to provide the ultimate source of payment of covered claims in excess of accumulated surplus, FHCF reimbursements, other private reinsurance recoveries, Citizens policyholder surcharges, and regular assessments (Coastal Account only).

Citizens currently has five series of pre-event bonds outstanding (four in the Coastal Account in the amount of approximately $3.1 billion and one in the PLA/CLA in the amount of approximately $1.0 billion), totaling approximately $4.1 billion. Of this total, $798 million in the Coastal Account and $125 million in the PLA/CLA will mature prior to the 2016 hurricane season, leaving approximately $3.2 billion in total external pre-event liquidity (approximately $2.3 billion in the Coastal Account and $900 million in the PLA/CLA) available for the 2016 season. Together with Citizens' accumulated surplus, this external pre-event liquidity provides the source of immediately available funds to pay claims. For 2016, liquidity sources in the Coastal Account are projected to total approximately $5.6 billion (approximately $3.3 billion of estimated surplus in addition to $2.3 billion of pre-event bonds). Similarly, liquidity sources in the PLA/CLA available for 2016 are projected to total approximately $5.2 billion (approximately $4.3 billion of estimated surplus in addition to $900 million of pre-event bonds). Citizens' pre-event bonds are serviced primarily from the investment earnings on the bond proceeds (which are retained pending their need to pay future claims) and from the collection of policyholder premiums. There are no assessments associated with pre-event bonds.

For 2016, Citizens is currently projected to purchase approximately $2.8 billion in reinsurance from the FHCF (approximately $1.8 billion for the Coastal Account and approximately $983 million for PLA/CLA). In addition, Citizens has approximately $2.2 billion of existing multi-year risk transfer (traditional reinsurance and capital markets) available for 2016. Citizens is currently evaluating market conditions, however, and may consider purchasing additional risk transfer in 2016, which would marginally reduce the projected assessable shortfall.

During 2015, Citizens defeased its remaining post-event bonds that were issued in order for Citizens to meet its policyholder obligations from the 2005 storms. The associated assessments were also eliminated for all policies issued or renewed on or after July 1, 2015. As such, Citizens has no post-event bonds outstanding.

Citizens' outstanding debt has long-term underlying ratings of A+/AA-/A1 from Standard & Poor's, Fitch, and Moody's, respectively.

Three assessment tiers must be used by Citizens in a statutorily prescribed manner to fund any deficits caused by storm losses (see the following section for a description of each assessment type). The Citizens policyholder surcharge is collected over a 12 month period and the regular assessment (Coastal Account only) is due within 30 days of billing. As a result of their relatively short collection periods, these "one-time" levies require no financing. However, if Citizens experiences losses sufficient to exhaust both of these one-time levies, Citizens is obligated to levy an emergency assessment. Emergency assessments can be levied over time in the amount of up to 10% of aggregate state-wide assessable premium per year, per account, and may be used to secure post-event bond financing. Citizens does not have a specific maturity limitation on its indebtedness, though the analysis in this report assumes that Citizens would finance any remaining deficit over a 30-year period.

Supply and demand factors have pushed debt issuance to record highs as investors have sought higher-yielding alternatives to government securities while issuers have taken advantage of relative all-time low interest rates. As evidenced in the table below, the corporate bond market has topped $1 trillion each year since 2010 as interest rates have been consistently at historically low levels. After declining significantly in 2011, municipal issuance rebounded strongly in 2012 with a 30% increase. In 2015, the municipal bond market was 12% higher than 2014 and 13% higher than 2013, with $378 billion in total issuance.

| | Municipal | | | | Corporate | |
|---|---|---|---|---|---|---|
| Year | Tax-Exempt ($B) | Taxable ($B) | Total ($B) | % Change | Par ($B) | % Change |
| 2009 | $323 | $84 | $410 | 5% | $902 | 28% |
| 2010 | $279 | $151 | $433 | 6% | $1,063 | 18% |
| 2011 | $247 | $31 | $295 | -32% | $1,012 | -5% |
| 2012 | $335 | $32 | $382 | 30% | $1,365 | 35% |
| 2013 | $277 | $35 | $335 | -12% | $1,414 | 4% |
| 2014 | $292 | $23 | $338 | 1% | $1,474 | 4% |
| 2015 | $350 | $28 | $378 | 12% | $1,509 | 2% |

*Source: SIFMA*

Although financial market conditions have significantly improved over the last six years and are currently expected to be conducive to favorable debt issuance, it is not possible to guarantee financial market conditions into the future. If long-term bonding in sufficient amounts is not immediately available, Citizens may need to explore alternatives, including the levying of emergency assessments with no financing, issuing bonds in multiple tranches over time and / or other interim financing alternatives.

## Assessment Impact

Citizens has a three tier assessment structure as prescribed by Florida Statutes. Two important features of the Citizens assessment structure are (1) each account (i.e. the Coastal, PLA, and CLA) calculates its deficit separately, and each account has separate assessment authority. Therefore, there is the potential for overlapping assessments caused by deficits in more than one of Citizens' accounts; and (2) unlike emergency assessments, Citizens' regular assessments and policyholder surcharges are one-time levies that cannot be financed. With these factors in mind, the basic construct of Citizens' assessments for 2016 is as follows (note that this is a high-level summary and is therefore not exhaustive and may omit certain precise attributes):

(1) Any deficit in an account (defined generally as losses and expenses in excess of surplus, FHCF reimbursement and private reinsurance) is first funded by Citizens' policyholder surcharge, up to a maximum of 15% of Citizens policyholder premium, per account.

(2) For the Coastal Account only, any remaining deficit is then funded by a regular assessment of up to 2% of written premium on insurance companies writing most types of property and casualty policies in Florida. There is no regular assessment for the PLA/CLA.

(3) Any remaining deficit is then funded through the collection of emergency assessments, which can be levied directly on policyholders of most property and casualty lines in Florida at the greater of 10% of the assessment base or 10% of the remaining deficit per account. This effectively gives Citizens the ability to finance any deficit over a 10-year period, although Citizens could choose to finance the assessment over a longer period. These emergency assessments would typically be used to secure post-event bonds, the proceeds of which would be used to pay policyholder claims in a timely manner.

Table 2 on the following page presents the estimated assessment impact, by assessment type, for each of the three return periods.

## Table 2
## ($ in millions)

**Coastal**

| Return Time (Years) | Assessable Shortfall ($ in MM) | Citizens' Policyholders Surcharge[1] $ Amount in MM | Citizens' Policyholders Surcharge[1] % | Regular Assessments[1] $ Amount in MM | Regular Assessments[1] % | Emergency Assessments Total $ Amount in MM[2] | Emergency Assessments Annual $ Amount in MM | Emergency Assessments Annual %[3] |
|---|---|---|---|---|---|---|---|---|
| 250 | $2,814 | $136 | 15.0% | $799 | 2.0% | $1,878 | $122 | 0.30% |
| 100 | $0 | $0 | 0.0% | $0 | 0.0% | $0 | $0 | 0.00% |
| 50 | $0 | $0 | 0.0% | $0 | 0.0% | $0 | $0 | 0.00% |

**PLA/CLA**

| Return Time (Years) | Assessable Shortfall ($ in MM) | Citizens' Policyholders Surcharge[1] $ Amount in MM | Citizens' Policyholders Surcharge[1] % | Regular Assessments[1] $ Amount in MM | Regular Assessments[1] % | Emergency Assessments Total $ Amount in MM[2] | Emergency Assessments Annual $ Amount in MM | Emergency Assessments Annual %[3] |
|---|---|---|---|---|---|---|---|---|
| 250 | $0 | $0 | 0.0% | $0 | 0.0% | $0 | $0 | 0.00% |
| 100 | $0 | $0 | 0.0% | $0 | 0.0% | $0 | $0 | 0.00% |
| 50 | $0 | $0 | 0.0% | $0 | 0.0% | $0 | $0 | 0.00% |

**Total Coastal & PLA/CLA[4]**

| Return Time (Years) | Assessable Shortfall ($ in MM) | Citizens' Policyholders Surcharge[1] $ Amount in MM | Citizens' Policyholders Surcharge[1] % | Regular Assessments[1] $ Amount in MM | Regular Assessments[1] % | Emergency Assessments[4] Total $ Amount in MM[2] | Emergency Assessments[4] Annual $ Amount in MM | Emergency Assessments[4] Annual %[3] |
|---|---|---|---|---|---|---|---|---|
| 250 | $2,814 | $136 | 15.0% | $799 | 2.0% | $1,878 | $122 | 0.30% |
| 100 | $0 | $0 | 0.0% | $0 | 0.0% | $0 | $0 | 0.00% |
| 50 | $0 | $0 | 0.0% | $0 | 0.0% | $0 | $0 | 0.00% |

Policyholder surcharge levied on Citizens policyholders only
Regular assessments levied on non-Citizens policyholders only
Emergency assessments levied on both Citizens and non-Citizens policyholders

*[1] These assessments are one-time assessments for the first year only. Citizens policyholders surcharges are based on projected written premiums of $909 million for 2016. Citizens' regular assessments are based on a projected assessment base of approximately $40.9 billion for 2015.*

*[2] Total amount of assessments represents the gross amount financed over 30 years using an assumed interest rate of 5%. There is a high probability, but not any certainty that assessable shortfalls can be financed at assumed interest rates. The amount which can be financed after an event may be smaller and is subject to market conditions.*

*[3] Represents annual assessment amount over a 30 year period using an assumed interest rate of 5% and projected emergency assessment base of approximately $40.9 billion based on actual collections for 2015 through the third quarter and projected for the fourth quarter based on the lowest quarterly growth rate of the actual collections in 2015 through the third quarter of 3.7%.*

*[4] Total PMLs are a sum of the PLA/CLA and Coastal PMLs in this analysis to be consistent with FHCF allocation. Combined PMLs are marginally different than the sum of the individual PMLs at these return times.*

*Numbers may not add due to rounding.*

## Conclusion

Significant depopulation driven by the continued interest of the private market in Citizens' policies along with ten consecutive years without major hurricane losses have largely contributed to the substantial levels of Citizens' surplus. Further, Citizens is projected to have a significant amount of private risk transfer (through traditional reinsurance markets and capital markets) available for 2016, further strengthening Citizens' claims paying resources. For catastrophic losses which exceed Citizens' available surplus and risk transfer program, Citizens will rely on its policyholder surcharge, regular assessment (Coastal Account only) and post-event bonding for claims paying capacity.

For major catastrophic losses, either from an extreme single event or from multiple events that result in a deficit to any of Citizens' accounts and activation of the emergency assessment, Citizens may issue post-event bonds in order to meet liquidity demands. Repayment of these post-event bonds would be funded through the collection of the associated emergency assessment. Citizens' financial position is the strongest since Citizens was created; for a 1-100 year event, Citizens is projected to have no assessment burden, and the projected assessment burden for a 1-250 year event is at an all-time low with a potential annual emergency assessment rate of 0.30%. In addition, conditions in the financial markets have improved during recent years, resulting in additional financing capacity for large issues due to strong demand and historically low interest rates. There can be no guarantee, however, that adequate financing capacity will be available to Citizens following a major catastrophic event that would require post-event financing.

The ability of Citizens to pay claims in full and in a timely manner remains critical to the people whose homes and businesses are insured, and the Florida economy in general.