



March 23, 2022

Via email or facsimile. Hard copy via USPS.

The Honorable Ron DeSantis
Governor of Florida
State of Florida
The Capitol
400 S. Monroe St.
Tallahassee, FL 32399-0001

The Honorable Wilton Simpson
President of the Florida Senate
The Capitol, Office 409
404 South Monroe Street
Tallahassee, Florida 32399

The Honorable Chris Sprowls
Speaker of the Florida House of Representatives
The Capitol, Office 420
402 South Monroe Street
Tallahassee, Florida 32399

RE: Demotech, Inc.'s Perspective on the State of the Property Insurance Market in Florida and the Need for Immediate Legislative Reform in a Special Session

Governor DeSantis, President Simpson, and Speaker Sprowls:

Demotech, Inc. has assigned Financial Stability Ratings[®] (FSRs) to property insurers in Florida for 26 years. While reviewing and rating insurance companies operating in Florida, we have closely observed developments within the state's property insurance marketplace and are acutely aware of the difficulties facing the market today. Having authored *Florida Domestic Insurer Report – Point of No Return?* and published it in the Summer 2020 issue of The Demotech Difference, I was disappointed when the current legislative session adjourned without instituting legislative reforms to mitigate the market conditions resulting in substantial premium increases for consumers. However, when the March 21, 2022, issue of The Insurer's headline article stated that Governor DeSantis was "very receptive" to a special session on insurance reform, I wanted to offer our perspective.

Recall that in 1996, when the State of Florida, then Department of Insurance, and the secondary mortgage marketplace needed a rating solution to address the issue of the acceptability of the newly formed "take out insurers" in Florida, they contacted Demotech. We developed a procedure to rate these insurers. Our procedure met the needs of the State of Florida, producers, insurers, consumers, and the secondary mortgage marketplace.



From 1996 to date, we have reviewed and rated the start-ups incorporated to write residential property insurance in Florida. This includes smaller regional insurers as well as subsidiaries of Allstate, Travelers, and Nationwide. Today, the insurers that we review and rate comprise 60% of Florida's residential property insurance marketplace.

We have reviewed the operating results of insurers, affiliates, and holding companies over this period. In the most recent five years, we have requested, and the carriers we review and rate have infused, in excess of \$1.5 billion of capital to sustain the assignment of FSRs of A or better. Despite the reported operating losses attributed to claims procedures, practices, and protocols in Florida that do not exist in other U.S. jurisdictions, our rationale has been, in part, based on the expectation of meaningful legislative reform in the *next* session.

I write today to identify what we see as a pressing need for an immediate special session on insurance reform. The conditions of the property insurance marketplace in Florida are unsustainable and, without the necessary corrective action, many Florida insurers will struggle to maintain adequate surplus, efficient capital sources will avoid the market, private reinsurance costs will become prohibitively expensive, and consumers will ultimately bear the cost.

Based upon the most recently reported operating results, as well as historical operating results of the insurers we review and rate, and if current market conditions remain in place, we anticipate that we will downgrade the Financial Stability Ratings® assigned to a number of companies in the coming weeks. While our review process considers a multitude of factors, important considerations for these Florida-focused carriers include the unique challenges associated with the current operating environment in Florida. We believe that certain meaningful and significant legislative reform, if enacted during a special session prior to the most common renewal date for reinsurance treaties, June 1, may create circumstances permitting us to maintain ratings for some of those insurers currently expected to be downgraded.

In our opinion, three items that would comprise a significant first step forward and benefit the property insurance marketplace include:

1. Legislative reform intended to minimize litigation, including addressing the issue of contingency fee multipliers;
2. The Florida Hurricane Catastrophe Fund's suspension of the rapid cash build-up; and
3. The Florida Hurricane Catastrophe Fund's capability to provide the lower level attachment points required to maintain the net catastrophe retentions of carriers at a reasonable level.

We believe the sustainability of the Florida property insurance marketplace and the financial stability of the insurers operating in Florida depend upon immediate, meaningful legislative action. Further, the timing of any legislative action is of utmost importance as reinsurance negotiations are ongoing in advance of June 1, 2022, reinsurance renewal dates.

In summary, the above items are what we believe are needed in the immediate near term to begin to improve the Florida property marketplace and allow companies the opportunity to maintain FSRs at the A-level. More legislative remedies will be required to address current marketplace issues as well as new issues that are likely to arise.



Thank you for your time and attention.

Sincerely,

Joseph L. Petrelli, ACAS, ASA, MAAA (MBA)
President and co-founder

Sharon M. Petrelli, CPCU, AIAF, CCP, ARe
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Barry J. Koestler, II, CFA
Chief Ratings Officer

Robert M. Warren, CPCU, CPA (Inactive)
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W. Burke Coleman, Esquire
Chief Regulatory and Compliance Counsel

Attachment: *Florida Domestic Insurer Report – Point of No Return?*

Florida Domestic Insurer Report Point of No Return?

By Joseph L. Petrelli

"There is a point at which everything becomes simple and there is no longer any question of choice, because all you have staked will be lost if you look back. Life's point of no return," said Dag Hammarskjöld — Swedish economist and diplomat, the youngest aged person (47) to serve as secretary-general of the United Nations.

Why a quote from a secretary-general of the United Nations? With nearly 200 countries in the world and the wide divergence of their needs, wants, influences and desires, few others can imagine what it takes to keep a diverse group focused and headed in a direction that collectively benefits all. As Demotech approaches our Silver Anniversary as the rating agency of choice in the most difficult property insurance market in the world, the words and wisdom of Dag Hammarskjöld reflect two thoughts that we associate with the status quo of Florida's property insurance marketplace; the solutions instituted in the past have failed the marketplace of today, and, of importance to each stakeholder, Demotech believes that the point of no return (no pun intended for investors in this residential property insurance marketplace) is closer than decision makers think it is.

Dramatic, decisive legislative action is necessary during the 2021 legislative session. This can be the state of Florida's Golden Anniversary gift to residents and consumers. 2020 marked the Golden Anniversary of the state of Florida's efforts to address its geographical exposure to wind. And, contrary to the misinformation disseminated by our critics and competitors, our Silver Anniversary (the state of Florida requested our assistance in 1996) will mark 25 years of relative stability in the post-Andrew marketplace. This assertion rings true despite the history of major disruptions to the residential property insurance marketplace, whether political, regulatory, legislative, judicial, economic, social or meteorological, etc., that Demotech absorbed, adapted, and addressed through our interactive review and analysis process.

An acknowledgement of the state of Florida's Golden Anniversary in the insurance sector provides perspective. The state of Florida established The Florida Windstorm Underwriting Association (FWUA) in 1970 to provide wind insurance in Monroe County, the Florida Keys islands. The footprint of the FWUA was expanded to include all or parts of 29 of Florida's 35 coastal counties. The market dislocations in the aftermath of Hurricane Andrew added Dade, Broward, and Palm Beach to the FWUA's footprint.

In 1992, the Florida Residential Property and Casualty Joint Underwriting Association (FRPCJUA) was created by the legislature. In 1995, the FRPCJUA absorbed the remaining residual mechanism insuring commercial, residential, condominium and apartment buildings.

Ten years later, the legislature merged the FWUA and FRPCJUA into Citizens Property Insurance Corporation, Citizens. Citizens was tasked to write risks in three accounts:

- The High Risk Account providing wind-only policies in limited coastal areas of the state, enabling Citizens to serve the needs of consumers formerly insured with the FWUA;
- The Personal Lines Account providing multi-peril policies throughout Florida to serve the needs of those formerly insured with the FRPCJUA;
- The Commercial Lines Account providing commercial residential policies throughout Florida to serve the needs of those previously insured through the third residual market mechanism merged into Citizens.

As to our Silver Anniversary, some of the events that have occurred during our tenure as Florida's property insurance rating agency of choice reflect what the carriers that we review and rate have had to navigate:

- The impact of judicial activism, AOB and loss multipliers among the most egregious;
- The impact of legislative efforts; favorable — HB 7065 with modest AOB reform in 2019 and negative — HB 1A, years ago under Gov. Charles Crist;
- A litany of named weather events as well as sinkholes;
- Dramatic increases in the cost of reinsurance, particularly 2006, 2019 and 2020 (with 2006 based upon the weather related events of 2004 and 2005, and 2019 and 2020 based upon the limited nature of legislative reform of previously established judicial abuses);
- The insurer of last resort, Citizens, offering premiums more competitive than the private sector;
- The cost to insurers of the Florida Hurricane Catastrophe Fund Rapid Cash Buildup.



A recollection of the past 25 years is incomplete absent a list of the events of the past quarter of a century. Let's review the storms and events from 1996 to date; i.e., from when we were involved in reviewing and rating Florida's domestic residential property insurers.

Florida Events from 1996 to 2019

Year	Storms	Fires
1996	5	0
1997	2	0
1998	6	14
1999	6	13
2000	7	10
2001	5	10
2002	7	0
2003	11	0
2004	6	0
2005	9	0
2006	3	1
2007	8	6
2008	8	1
2009	5	1
2010	5	0
2011	3	1
2012	4	0
2013	2	0
2014	2	0
2015	2	0
2016	4	0
2017	8	3
2018	5	0
2019	6	0
Grand Totals	129	60

Utilizing information from PCS, supplemented by data on the Federal Emergency Management Agency website, indicates Florida has experienced 189 disasters from 1996 through year end 2019.

Hurricane Andrew occurred in 1992, so it was absent from the list of events of the past 25 years. Hurricane Andrew contributed to 19 insolvencies in the state of Florida, with a few more in other jurisdictions. These 19 insolvencies were caused due to an inadequate purchase of vertical reinsurance limit; i.e., the insurer did not buy enough reinsurance coverage.

Despite the 189 disasters that have impacted Florida on our watch, sinkholes, House Bill 1A, AOB, and judicial precedents that resulted in Florida being named a "Judicial Hellhole" by the American Tort Reform Association, the number of insolvencies of Demotech rated carriers focused

on Florida over the past 25 years is lower than the 19 associated with a single event in 1992.

List of insolvencies and dates of failure See next page

Equally important to consumers and stakeholders, the average lead time between withdrawal of our FSR and state action is nearly 10 months. With 12 months as policy term, and the latest Financial Stability Rating* (FSR) available at our site at no cost, ample notice to third parties was provided. For the largest insolvency in the history of Florida, and a top 10 insolvency in the U.S., Demotech's notification for the insurers comprising the Poe Financial Group (Florida Preferred, Southern Family and Atlantic Preferred) was 563 days, more than 18 months, appreciably more notice than that provided by the other rating service that rated the insurers comprising the Poe Financial Group.

Although company-focused financial metrics are critical to any review and analysis process, jurisdictional risk and the relative competitive position of an insurer are among other factors explicitly and implicitly utilized to assign an FSR. No entity operates in a vacuum and the conditions in every market are intrinsic in corporate operating results. Insurance carriers and the ratings assigned to them are no exception to this holistic reality.

Our current view of Florida's current residential property insurance marketplace is that the numerous financial and market based criteria that affect Florida residential property insurance have never been more difficult for carriers to navigate.

- Insurer investor capital appears to be exiting rather than entering Florida.
- Holding company debt, once infused to support growth, strengthen loss and loss adjustment expense reserves without diminution of surplus, or otherwise support the implementation of business models, is at burdensome levels given the operating results of carriers that had to address the natural disasters of 2016 through 2019.
- Although carriers can "true up" reinsurance costs through filings with the State of Florida Office of Insurance Regulation, the financial impact of paying higher reinsurance costs is short-term and the financial impact of "true up" is long-term. With timing being critical, the timing mismatch adversely impacts carriers, given the other conditions.
- The cumulative impact of carrier acceptance of rate revisions at a percentage change that eliminates the time, effort and expense for a hearing and decision, i.e., less than 15 percent, has had a cumulative impact over the past several years.

- Demotech requires carriers to book adequate loss and loss adjustment expense reserves. In an operating environment characterized by stability of claims procedures, protocols and practices, unblemished by judicial decisions that revise claim settlement paradigm, this can be in place. However, an AOB decision, Sebo, Johnson, Joyce and other cases revised the claim settlement landscape. Insurers and the actuaries they depend on were on their heels.
- The revised rules of engagement for claims settlement had undue impact due to the natural disasters of 2016, 2017, 2018, and 2019.

On the critically important issue of loss and loss adjustment expense reserve development, it is important to note that Demotech's financial metric is adequate, not reasonable, loss and loss adjustment expense reserves. This nuance was a catalyst for much of the adverse development reported. Evidently, the concurrent capital infusions that replenished surplus after the reserve strengthening were not as newsworthy as the move toward reserve adequacy.

The substantial increase in reinsurance costs during 2019 and 2020 plus the cost of the Rapid Cash Buildup Program

of the Florida Hurricane Catastrophe Fund impacted revenues and therefore the profitability of carriers. As long-term, informed observers of jurisdictions exposed to catastrophe, Demotech recognizes that carriers experienced operating losses despite the legislative reform enacted in 2019. Absent legislative reform in 2020, the need for meaningful, dramatic legislative reform in 2021 is critical to consumers, insurers, reinsurers and other stakeholders.

The management teams of the carriers that we review and rate have utilized capital infusions and revisions in business models, enterprise risk modelling criteria, catastrophe response plans, and disaster recovery plans to battle political, judicial, legislative and market conditions in the most catastrophe exposed jurisdiction in the world to a draw, and responded to additional rules and requirements associated with COVID-19.

Observers commenting on the demise of the Florida residential marketplace have it wrong. They base their comments on public financial information, rather than the insightful, confidential information and conversations available to Demotech. A partial list of items requested, received, and reviewed include:

List of Insolvencies and Dates of Failure

Company Name	Date Last Rated By Demotech	Date Of State Action	Days Notice
American Superior Insurance Company	10/1/2004	12/15/2004	75
Florida Preferred Insurance Company	6/30/2005	5/31/2006	335
Southern Family Insurance Company	7/23/2004	5/31/2006	677
Atlantic Preferred Insurance Company	7/23/2004	5/31/2006	677
Vesta Fire Insurance Company	8/23/2005	6/28/2006	309
Vanguard Fire and Casualty	8/23/2005	3/26/2007	580
American Keystone Insurance Company	9/11/2009	10/9/2009	28
Magnolia Insurance Company	12/2/2009	4/30/2010	149
Northern Capital Insurance Company	2/18/2010	5/1/2010	72
Coral Insurance Company	3/30/2009	7/26/2010	483
National Group Insurance Company	5/25/2011	10/10/2011	138
HomeWise Preferred Insurance Company	2/19/2010	11/4/2011	623
HomeWise Insurance Company	8/25/2011	11/18/2011	85
Sunshine State Insurance Company	3/4/2014	6/3/2014	91
Sawgrass Mutual Insurance Company	12/1/2017	10/1/2018	304
Florida Specialty Insurance Company*	10/2/2019	10/2/2019	0*
		Average days of notice	308
* Although the insurer was initially declared to be in hazardous financial condition, aspects of the delinquency proceeding instituted by DFS were disputed by the insurer. In an amended order, the court removed the finding of insolvency but it was too late to unring the bell. Treaty commutations and related refunds to reinsurers had been made. The proceedings were initiated by DFS while the company was negotiating its voluntary runoff with OIR.			

- Managing general agency contract and financial statements, when necessary
- Holding company financial statements, when necessary
- Actuarial reports and documents containing appreciably more detail than the actuarial opinion letter, which is a public document
- Independent audits
- Anticipated operating results in the form of pro forma financials in a prescribed format
- Claims adjusting details and reports
- Litigation services
- Asset and investment management contracts
- Disaster recovery plans
- Catastrophe response plans
- Catastrophe modelling output
- A preliminary review of horizontal and vertical reinsurance programs
- A final review of horizontal and vertical reinsurance programs
- Review of rate level indications
- Personal financial statements of key financial supporters.

Conference calls or on-site meetings with key reinsurers located in London or Bermuda supplement company-specific information. We have held on-site meetings at the company's location or our own. Our analysis team consists of long-tenured, credentialed professionals: Barry Koestler, CFA, chief ratings officer, Bob Warren, CPA (inactive), CPCU, client services manager, Sharon Romano Petrelli, CPCU, AIAF, CCP, ARC, vice president and co-founder, and myself, an ACAS, MAAA, MBA, possess collectively 160 years of P&C insurance experience.

Clearly, recent operating results were adversely impacted by the storms of the past several years, increased reinsurance costs, an extended period of judicial activism, and other factors including the impact of COVID-19. Despite all of this, the boards of directors and management teams of dozens of residential property insurers employing tens

of thousands of employees, appointing tens of thousands of agents, insuring the property of millions of Floridians have responded to us by committing to do whatever it takes to remain part of Florida's residential property insurance solution.

Demotech-rated carriers revised their business models, re-evaluated the financial consequences of supporting the most complex, dynamic, catastrophe prone jurisdiction in the world, or otherwise affirmed their willingness to continue to write business in Florida by infusing capital, staying the course of their business models, or merging into those carriers that would do so.

Demotech actively reviews more than 400 insurers countrywide. We work with state specialists in every jurisdiction. The challenge facing Florida's state specialists is the operating environment that has emerged in Florida. Only the legislature has the capability to devise the dynamic, decisive reforms necessary to avoid a point of no return. Through their actions in 2019 and 2020 to date, the carriers have demonstrated their belief that the legislative process of 2021 will resolve the lingering issues that adversely impact consumers and stakeholders alike.

Ayn Rand, the author and philosopher, noted "The hardest thing to explain is the glaringly evident which everybody has decided not to see." From our perspective, the glaringly evident is that conditions in the current residential property insurance market in Florida need to be re-evaluated and re-positioned to focus on the overwhelming majority of Floridians who purchase and procure insurance coverage yet do not have a claim. The status quo is unsustainable.

Part of the solution is returning to a process where all stakeholders are valued and heard. Criticism of an industry that survived the storms of 2004, 2005, Irma, Michael and Matthew, etc. is tantamount to shooting the messenger who brought bad news. The Golden Anniversary of the legislature's initial effort to create a stable insurance marketplace provides an opportunity to assist the stakeholders who have opted to sustain in the residential property insurance marketplace.

Referencing Dag Hammarskjöld once again, "The key to success is this: Never look down to test the ground before taking your next step, only he who keeps his eye fixed on the far horizon will find the right road."



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