



Demotech, Inc.

State of Florida Senate Banking and Insurance Committee
Submitted via email to burgess.steve@flsenate.gov

Senator David Simmons, Chairman
Senator Jeff Clemens, Vice Chair

Meeting - Wednesday, January 16, 2013
Agenda item - Citizens Property Insurance Corporation

Chairman Simmons, Vice Chairman Clemens, and members of the Senate Banking and Insurance Committee, my name is Joseph Petrelli, ACAS, MAAA, FCA. I am a member in good standing of the Casualty Actuarial Society, American Academy of Actuaries and the Conference of Consulting Actuaries. I am the President of Demotech, Inc. and I prepared this written testimony on behalf of Demotech, Inc.

Demotech, incorporated in 1985, is a financial analysis firm serving the Property and Casualty and Title insurance industries. In 1989, we entered the insurance company ratings sector to level the playing field and assist financially stable insurers that had been ignored, neglected or under-rated by existing rating agencies.

My experience encompasses more than 40 years of progressively responsible actuarial and financial analysis experience. My professional experience includes four years at the Insurance Services Office in New York City, four years at Agway Insurance Company in upstate New York and two years at Nationwide Mutual Insurance Company. I have been self-employed since June 1980. In addition to actuarial designations, I have a Bachelors of Science degree in Actuarial Science from The College of Insurance in New York City and a Masters in Business Administration from The Ohio State University.

Neither Demotech nor I have been compensated for offering this testimony. I my hope that my comments are viewed as those of an informed third party sharing his professional opinion and observations, accumulated through extensive analysis of the property insurance marketplace within Florida over the period 1996 to date, with the Senate Banking and Insurance Committee.

Recall that in the mid-1990s, hurricanes devastated properties along the Florida coastline and simultaneously devastated Florida's property insurance marketplace. As a result, a large number of insurance carriers rated by A. M. Best were forced into liquidation. To enhance availability, the State of Florida developed the (then) Florida Residential Property Casualty Joint Underwriting Association (JUA) to provide homeowners insurance and related property coverage. Subsequently, the JUA evolved into Citizens Property Insurance Corporation.

In 1996, the State of Florida, then Department of Insurance (DOI) and the JUA initiated an effort to depopulate the JUA. The depopulation effort included legislation to permit the State of Florida to offer financial incentives to insurers that depopulated the JUA. The legislation included guidelines and procedures to ensure that the DOI could expedite processing the insurers that would be formed for the purpose of capitalizing on the financial incentives.

Concurrently, the mortgage lending industry requested a provision requiring that the newly capitalized insurance companies would be acceptable to the secondary mortgage marketplace. When the State of Florida and the secondary mortgage marketplace needed a solution to this dilemma, they contacted Demotech. Ms. Madeline McGucken, then with the Government and Industry Division within what was then the Florida Department of Insurance, contacted Albert LeQuang at Freddie Mac.



Although it may seem difficult to review and rate newly formed carriers, Demotech has been extremely effective in doing so since our initial efforts in Florida, back in 1996. We were able to assist because our Financial Stability Ratings[®] of A or better (A, A' and A'') had been acceptable to Fannie Mae and Freddie Mac since 1989 and 1990, respectively. To assist consumers, agents, reinsurers and the Florida marketplace, we developed a procedure to review and rate newly capitalized insurers. Our process assisted the State of Florida, insurance agents, insurance companies, consumers, reinsurers and the secondary mortgage marketplace.

Today, we review, rate and formally follow 45 carriers writing 51% of the homeowners insurance in the State of Florida. We do not review and rate Citizens (20%), State Farm of Florida (11%) or several other carriers now rated by other entities that Demotech initially reviewed and rated. These carriers write the balance of the homeowners' insurance market in Florida.

Having reviewed, analyzed and rated virtually all new entrants to Florida's homeowner's insurance marketplace as well as many other private sector participants in Florida's marketplace, we have observed the situation in Florida transition to a juncture where our ability to review and rate new entrants or those that participate in significant takeouts from Citizens at the A, A' and A'' levels that are presently accepted by Fannie Mae and Freddie Mac. As such, we have taken a proactive approach to sustain a financially stable, predominantly private sector response, for consumers in the State of Florida.

Specifically, in September 2012, Demotech requested that Fannie Mae and Freddie Mac revise their single family hazard insurance acceptability criterion, on a countrywide basis, to reflect the acceptance of "carriers rated by Demotech, Inc. must have an "S" or better Financial Stability Rating[®]." This request was designed to expand eligibility to carriers rated S or better as opposed to A or better.

The documentation that we submitted included a comparison of the survival rate of carriers that we designated as S comparing favorably to the survival rate of insurers otherwise acceptable to Fannie Mae and Freddie Mac, over an extended fifteen year period of comparison. In addition, we included an independent Florida State University analysis entitled *A Comprehensive Examination of Insurer Financial Strength Ratings*. This analysis utilized nine years of carrier ratings obtained from A. M. Best, Fitch, Standard & Poor's, Moody's and Demotech, and, provided additional support to our request.

In summary, Demotech has concluded that the circumstances impacting Florida's homeowners insurance marketplace in conjunction with our on-going evaluation of the financial stability of insurers is such that as many as five of the carriers that we currently review, analyze and rate may no longer qualify for a Financial Stability Rating[®] of A or better. Concurrently, we believe that carriers rated S or better can provide consumers, agents, reinsurers and regulators with a substantial degree of financial stability that, based upon a fifteen year comparison of long-term survival rates, is superior to other insurer rating standards currently in use.

Although a change of this nature will have some impact on the property insurance marketplace countrywide, it could have immediate impact on Florida, given that we review and rate 51% of the homeowner's insurance marketplace. As such, we petitioned Fannie Mae and Freddie Mac to revise its guidelines so that Demotech's introduction of a Financial Stability Rating[®] of S would not adversely impact the property insurance marketplace in Florida. As of this date, Demotech has not been advised that our request was approved by either of the GSEs. Given that Demotech will introduce this level of rating in the next 90 days, we remain hopeful that our well-documented request will be honored.

I thank the Chairman and Vice Chairman and the members of the Committee for their kind attention. Demotech and I appreciate the opportunity to update the Senate Banking and Insurance Committee on our efforts to continue to support financially stable insurers writing homeowner's insurance in Florida. I would be pleased to present testimony in person or be available to answer questions at a future meeting of the Committee.