

Privatizing the Hidden Protection Gap in U.S. Natural Disaster Risk: Lessons from Florida

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U.S. Protection Gap is Real and Often Hidden

When disaster risk is insured in partially post-funded public pools, it really isn't.

- Assessments are claims on the future economy, distributed to involuntary payors.
- Recovery aid for uninsured losses comes from past and future taxpayers.

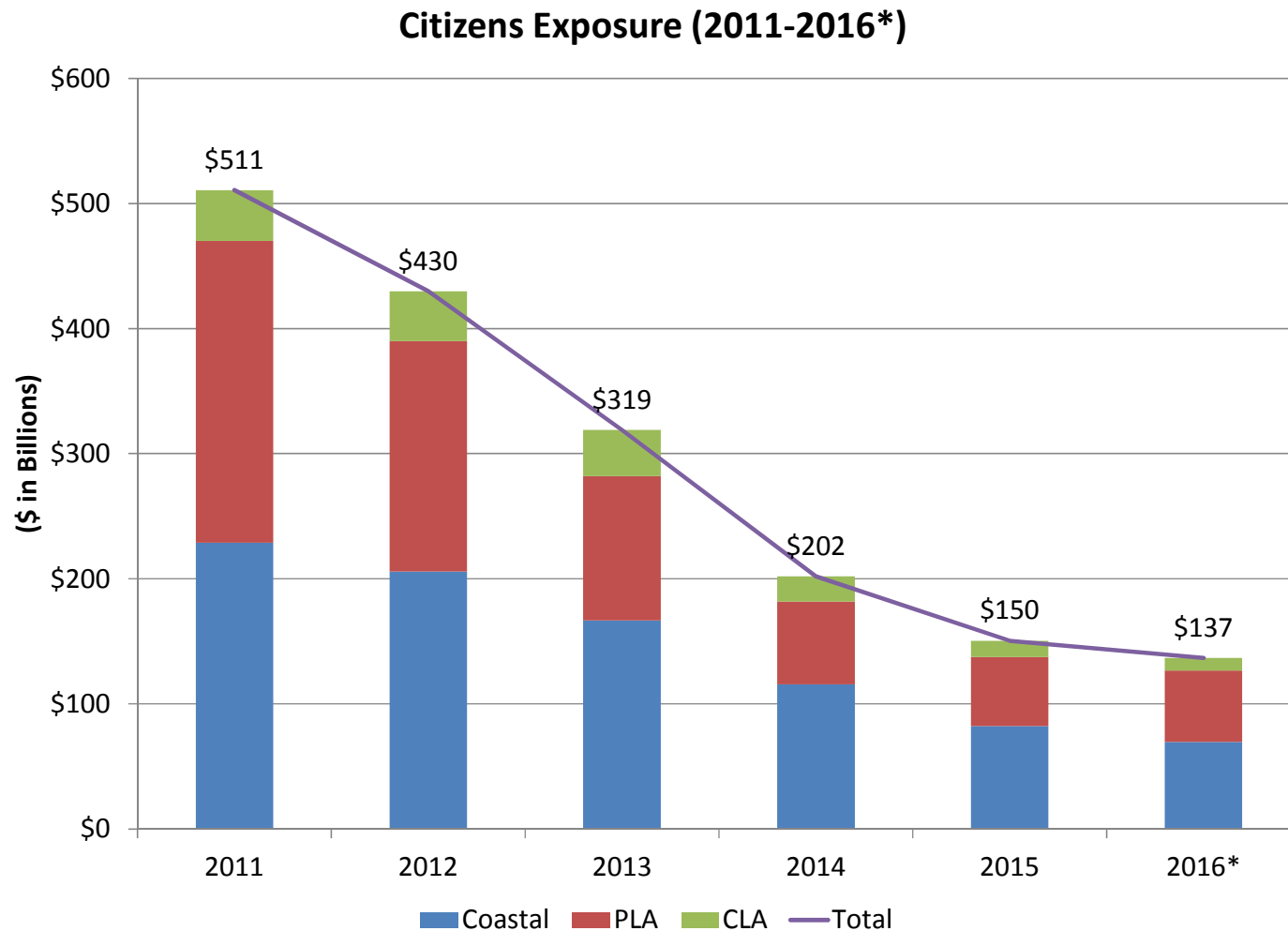
There are at least three large underinsured disaster risk pockets in the U.S.

- California (and New Madrid) Earthquake
 - Low take-up rates. High consumer deductibles. Partially assessment funded.
- Flood
 - National Flood Insurance Program (NFIP) crowds out private risk-bearers and funds nearly all tail risk with U.S. debt.
- East Coast Hurricane
 - Patchwork of state pools spreads risk incompletely and inconsistently; most rely in part on post-storm assessments.

Big strides have been made in shifting underfunded public hurricane risk to global markets.

- Many states have topped up reinsurance and restructured assessments.
- Florida's Hurricane Catastrophe Fund has accumulated cash and become a consistent protector of resources by purchasing traditional reinsurance.
- Florida's Citizens Property Insurance Corp. has aggressively pursued depopulation, screened and underwritten new business, progressed toward rate adequacy and grown its reinsurance program.

Citizens Has Returned to a Historically Low Size and True Market of Last Resort



- Unprecedented hurricane drought, abundant reinsurance capital, and good operational policies with backing of state leaders all drove decline in risk backed by Floridians.

The Pillars of the Citizens Risk-Shifting Strategy

Reduce gross storm risk through **depopulation**

- Formal depopulation plan allows private insurers to jump-start their business by taking blocks of policies midterm:
 - Unearned premium transferred with no ceding commission or holdback
 - Attractive model for startup Florida insurers if price is close to adequate
 - Consumers protected by opt outs and agent decline options, as well as by regulatory review of business plans

Reduce gross storm risk through **screening** new business and renewals

- Online clearinghouse marketplace shops each policy to participating private insurers:
 - Prevents agents with limited market reach from warehousing wind risk in Citizens
 - Helps consumers and agents identify private-market options previously unavailable to them

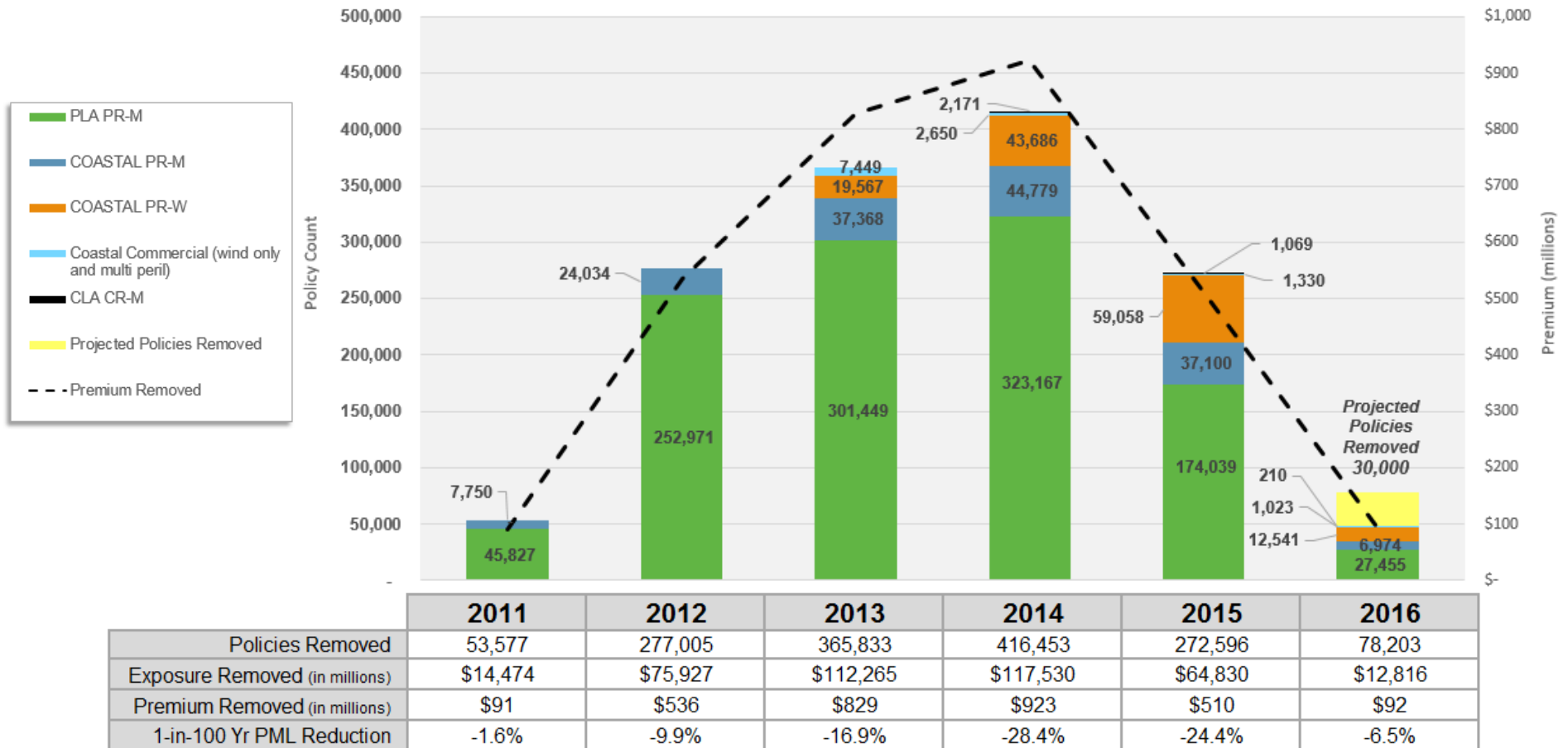
Close competitive price gap by pursuing **actuarially sound rates**

- Glide path allows steady progress toward sound rates without abrupt shocks to consumers
- Strong actuarial methods and regulatory review ensure maximum appropriate revenue is achieved fairly

Reduce NET storm risk through a robust **reinsurance** program

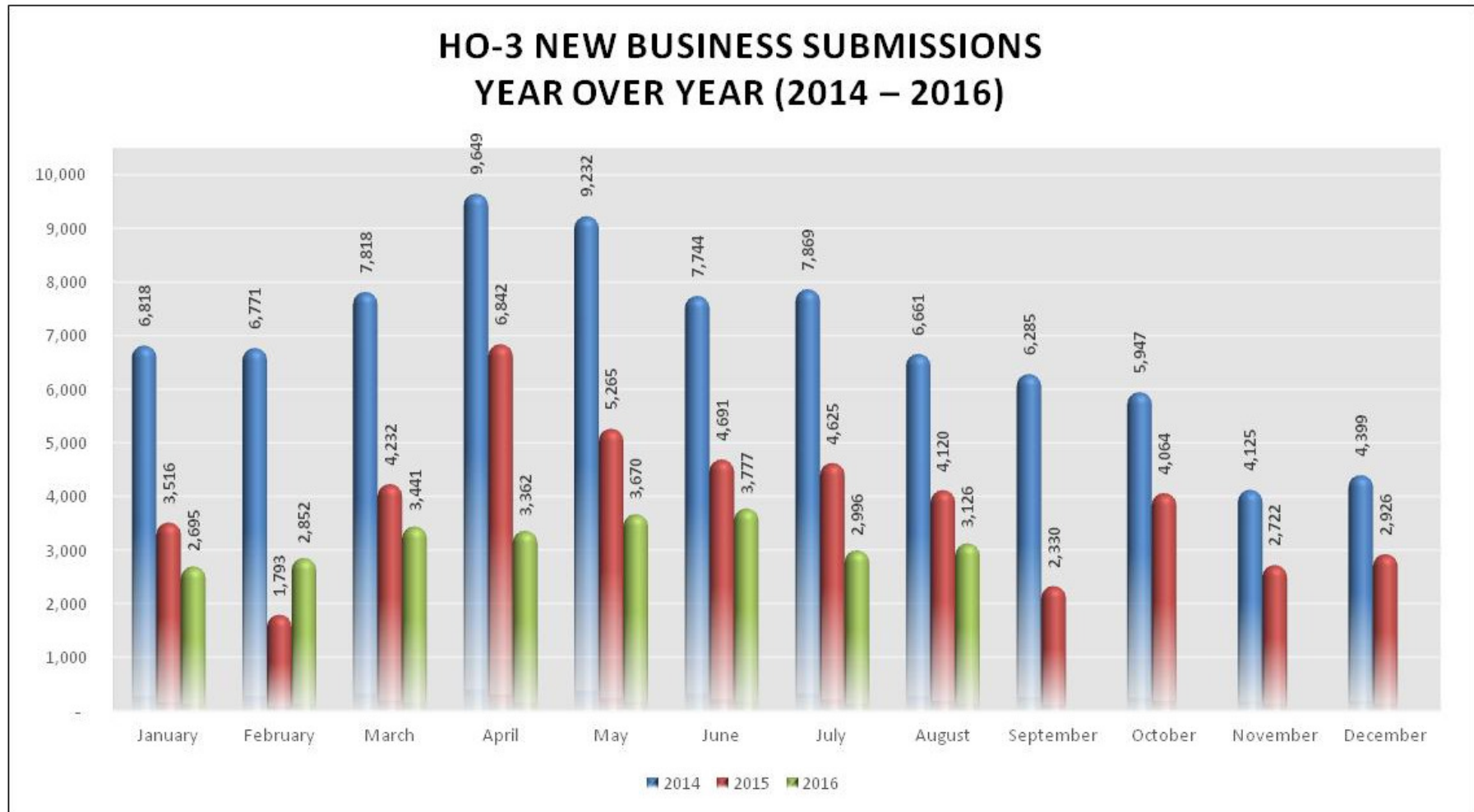
- Uses both cat bonds and traditional reinsurance to leverage price and terms
- Retention ~10-year storm, reinsure to ~100-year storm with minimal copay
- Includes Commercial Nonresidential line, which is not covered by Florida Hurricane Cat Fund
- Uses annual aggregate and multiyear to stabilize costs and address overall risk
- Builds out over time, cementing relationships with markets and public support

Low Capital Costs and Incentives Enable Depopulation



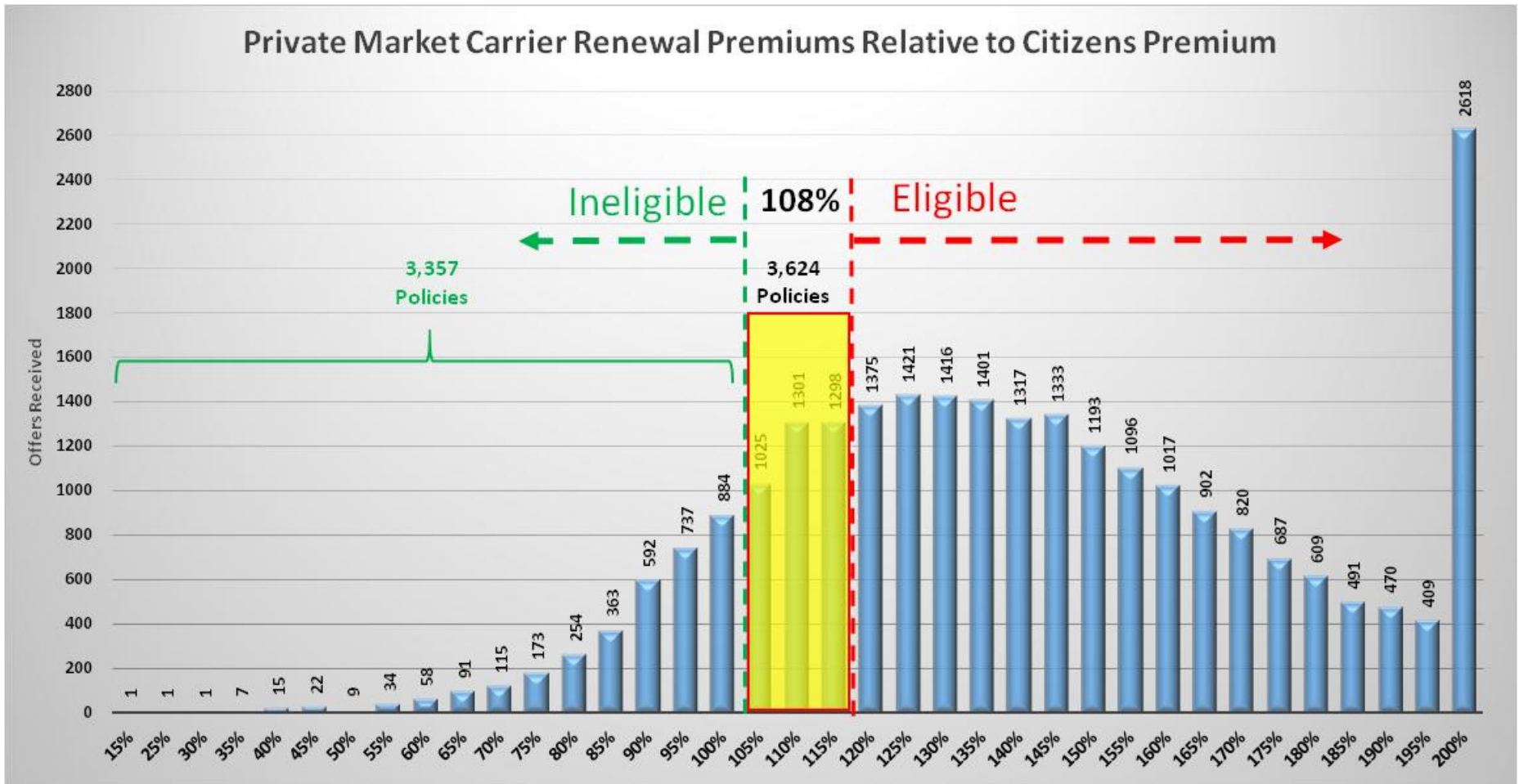
- The removal of ceding commission from depop plan jumpstarted takeout business models.
- Depop preference has shifted from personal multiperil to wind-only and commercial over time as rates become adequate, but fewer policies are removed as true “last resort” risks remain.

Clearinghouse Has Discouraged New Business, But...



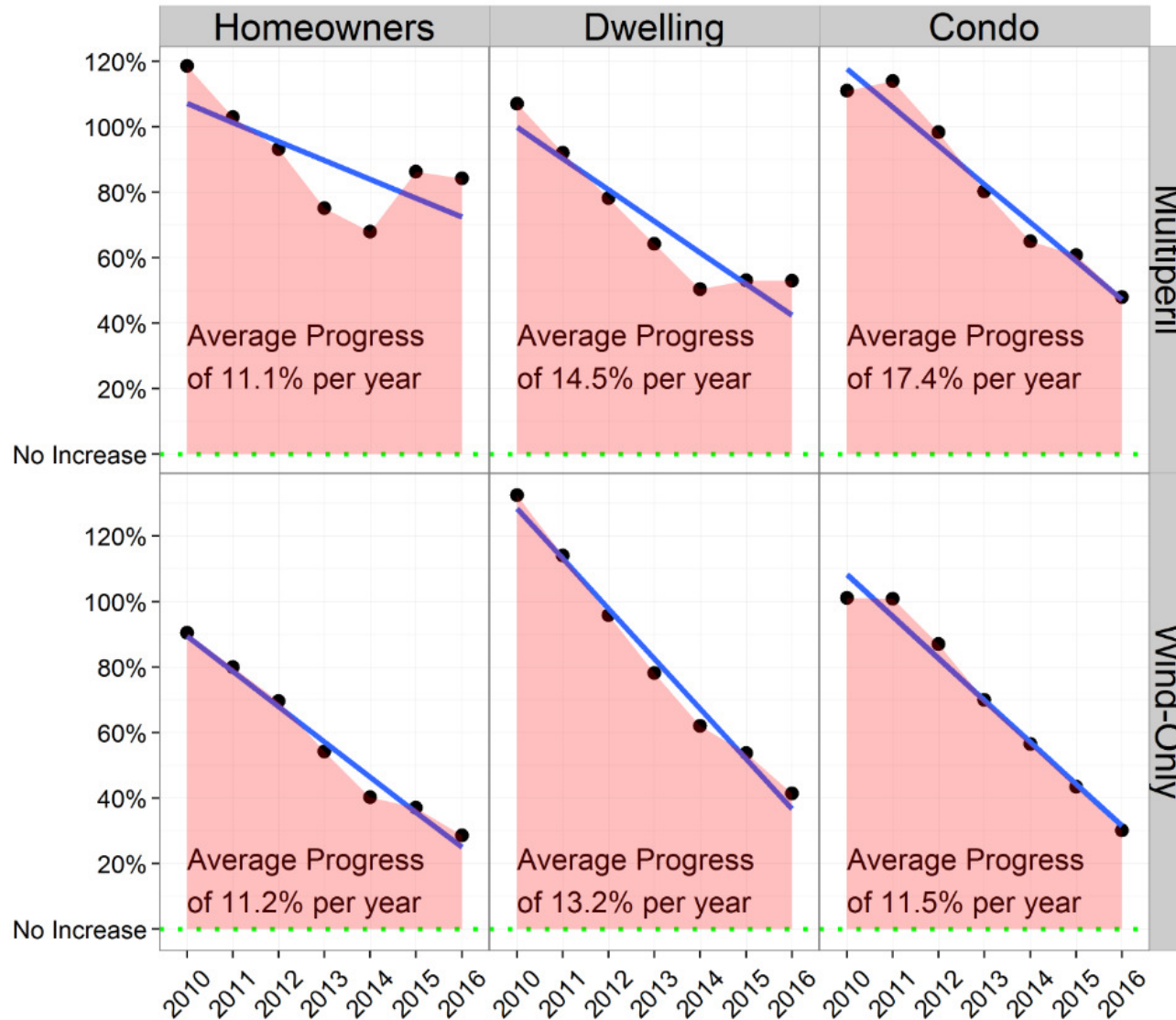
- Monthly new business is down 2/3 from pre-clearinghouse trends.

...Price-Based Eligibility Law Limits Effectiveness



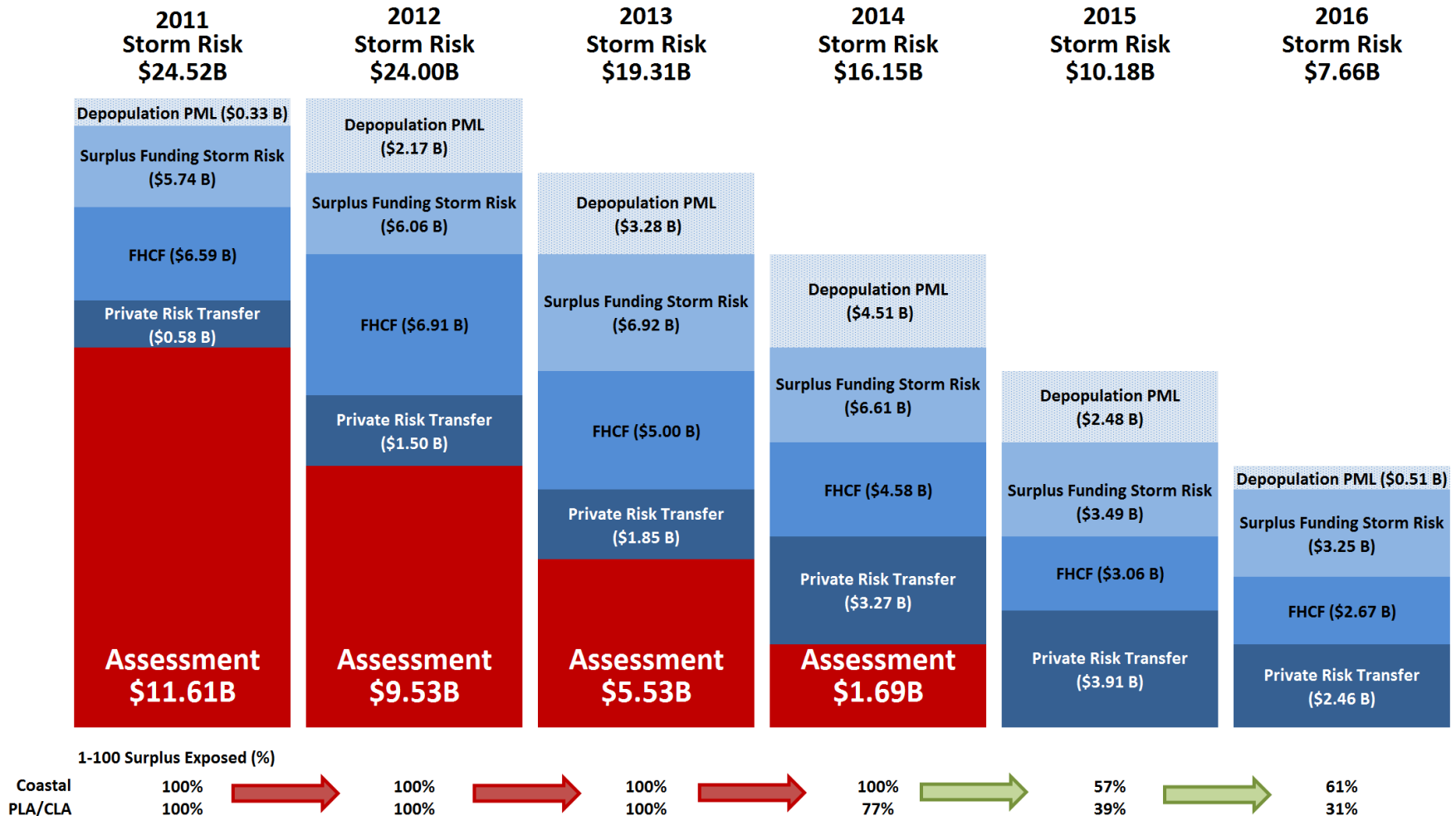
- Price must be lower in private market to make renewals ineligible. New business must be <15% higher in private market. Number of deterred renewals would double if threshold was the same as new business.

Rate Progress Activates Depop and Clearinghouse as Takeout and Entry Decisions Hinge on Relative Price



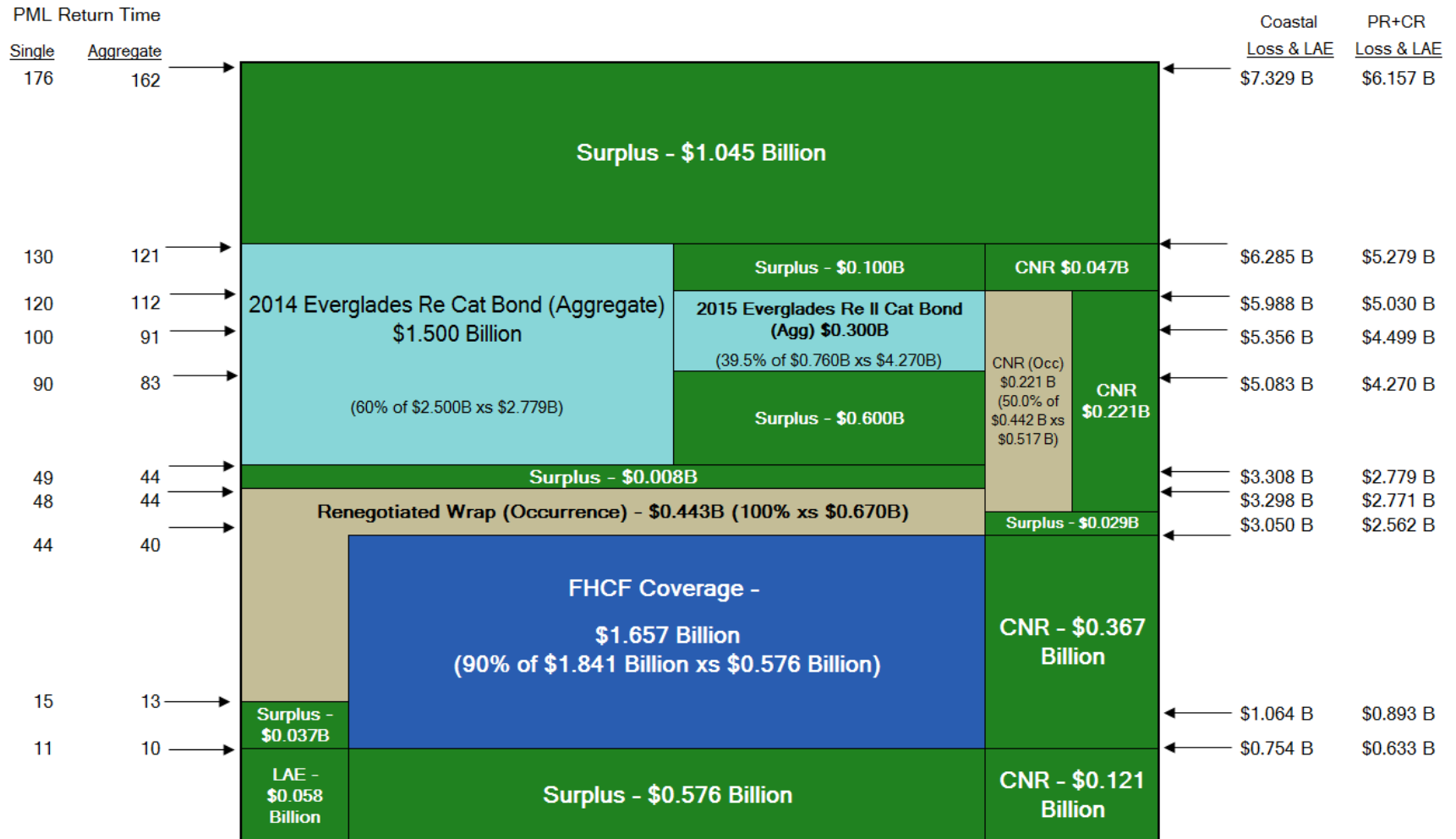
- Progress has been steady, with some setbacks in multiperil due to rising nonweather claims.
- Glide path is asymptotic in wind-only. As adequately priced policies leave, the remaining book consists increasingly of underpriced policies, resulting in the need for continued rate hikes to a smaller customer base.

Reinsurance Strategy Ensures Storm Risk is Prefunded



- First phase – Eliminate assessment risk.
- Second phase – Protect exposed surplus.

Reinsurance Detail Illustrates Strategic Concepts



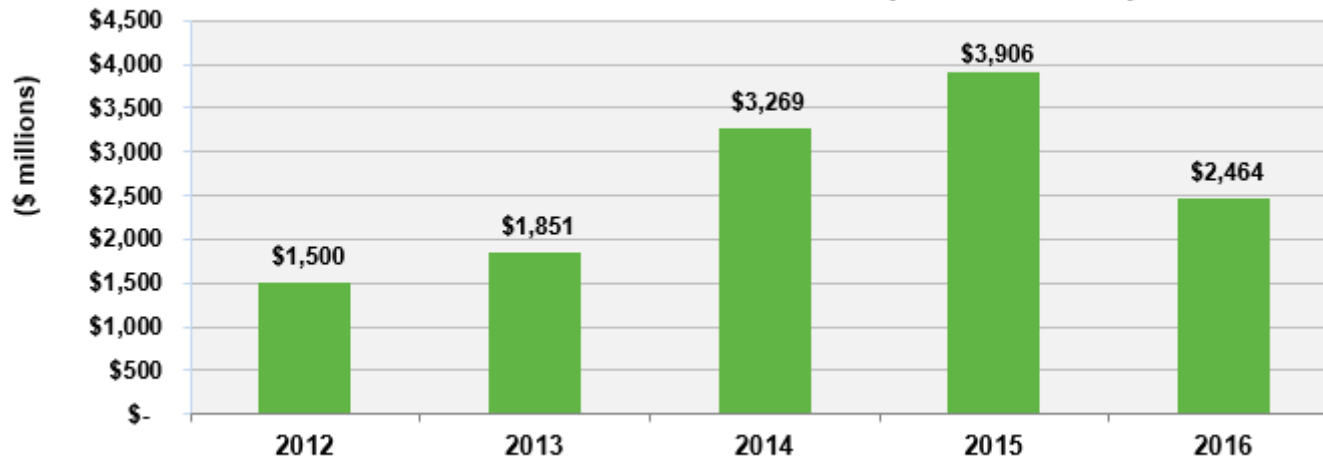
- ILS and traditional reinsurance
- Single and multiyear

- Aggregates
- Commercial nonresidential (CNR)



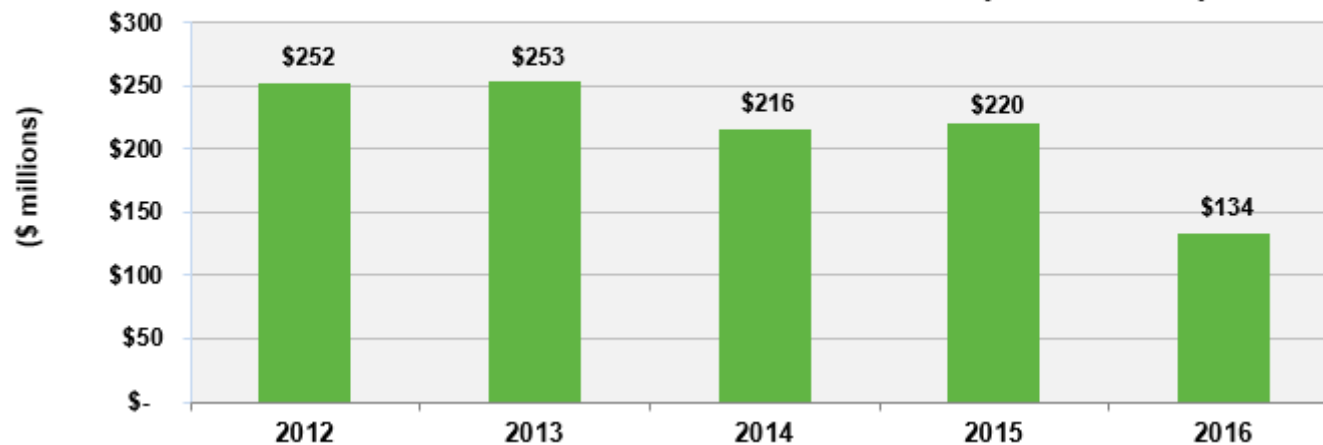
Reinsurance Expansion is Not on Consumer Backs

Total Private Risk Transfer (2012 - 2016)



- Favorable price trends have allowed more bang for the buck in reinsurance program, so fewer costs enter the rate base.

Net Cost of Private Risk Transfer (2012-2016)



Sustainable Progress for a Public Risk Pool: How Did Citizens Do It? Is our Success Exportable?

Political capital precedes risk capital

- New governor and cabinet prioritized Citizens risk reduction in 2011
- Public education and interest group campaign highlighted hidden assessment risk
- Legislative and regulatory prongs were designed with consumer stability in mind

Analytical compass and talent enables strategy and tactics

- Having a licensed AIR catastrophe model and GIS tools in-house led to less reliance on outside services
- Built tools to analyze risk and reward of potential initiatives, pro-forma forecast financials
- Drove better ground truth on risk through re-underwriting with modern valuation and classification tools
- Invested in actuarial, big data and geographic systems staff expertise

Multiyear strategy and market relationships

- Used ILS to lock in multiyear coverage before traditional reinsurance equivalent was available
- Developed broker and market relationships toward steady build-out of coverage

Other state and federal pools are noticing and emulating over time

- TWIA, NCIUA, LA Citizens, CEA have all sponsored cat bonds and expanded reinsurance.
- TWIA and LA Citizens have set up depop facilities.
- NFIP has studied its PML and brokered reinsurance for the first time.

Questions and Discussion

