# Insuring the Uninsurable:

# How to Do It!

Presentation to:

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# Introduction

## **John Forney**, CFA

Managing Director, Public Finance

**Raymond James & Associates, Inc.**

**-- Financial Advisor, Florida Hurricane Catastrophe Fund**

**-- Financial Advisor, Citizens Property Insurance Corporation**

**-- Financial Advisor, Florida Insurance Guaranty Association**

# Insuring the Uninsurable:

## Private Insurance Markets and Government Intervention in Cases of Extreme Risk

By Sophie M. Korczyk, Ph.D.

A Public Policy Paper of the National Association of Mutual Insurance Companies

June 2005

# The Problem:

- Catastrophic Risks "are uninsurable through conventional markets…."

- "Because they defy the conditions private markets require for operation."

# The Proof:

Conditions for a Functioning Insurance Market:

- Large # of exposures ✓
- Losses are accidental ✓
- ~~Individual exposures independent~~
- ~~Losses are predictable~~
- ~~Events are relatively small & relatively frequent~~

# The Results:

- Over $100 billion appropriated for Hurricane Katrina

- Florida Citizens has over 1.3 million policies and $485 billion in exposure

- Only 13% of Californians have earthquake insurance

# Options:

- Allow current dysfunctional markets to continue

- Deregulate insurance and/or let rates rise

- Capital markets to the rescue!

# Should the Government Intervene?

- Market failure is a necessary, but not sufficient, condition for such intervention

- There must also be a public policy interest……………….

**IS THERE?**

# *The Solution*

- A layered, integrated, comprehensive partnership between the private and public sectors at the local, state and federal levels



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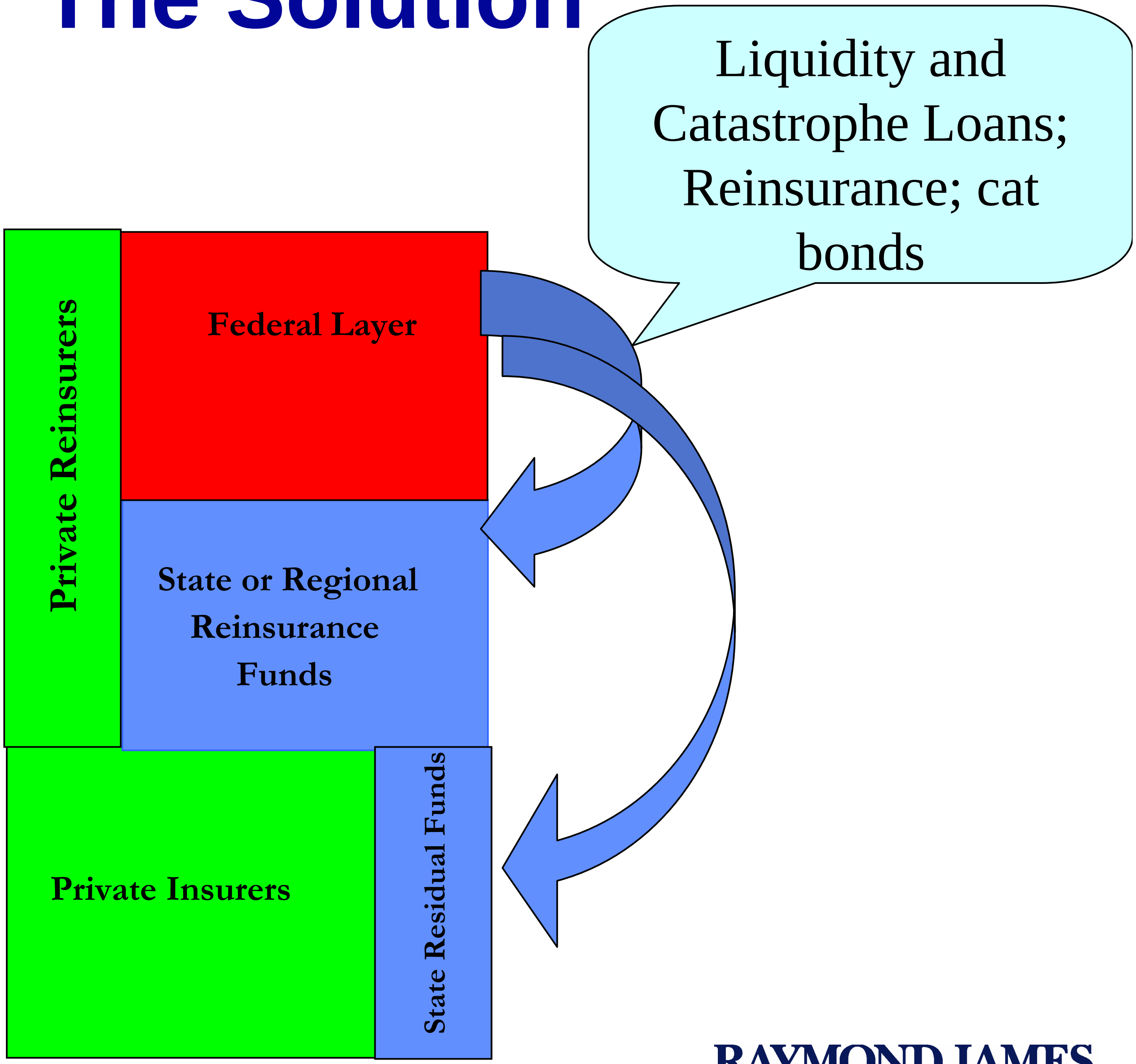
# The Solution



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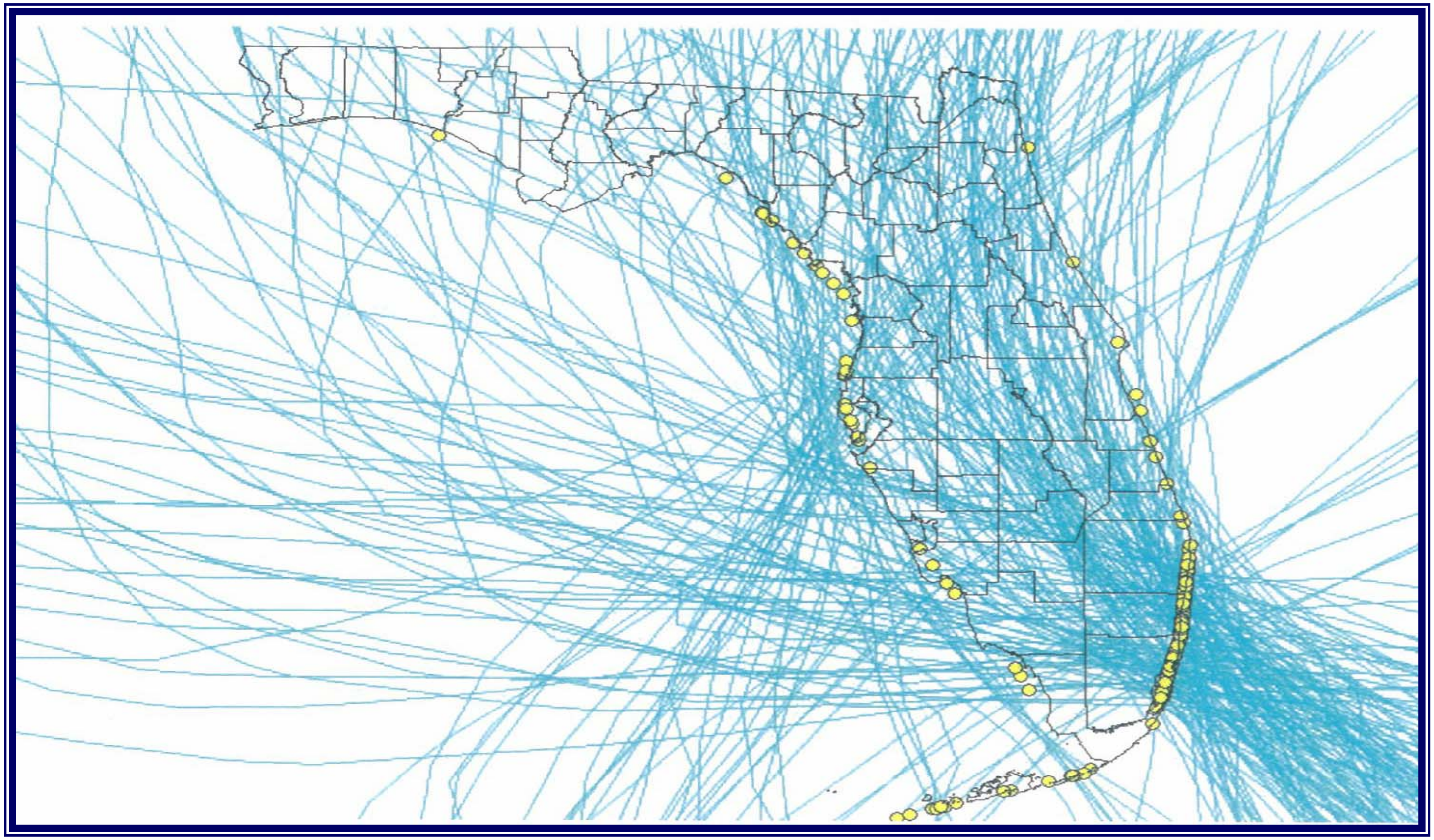
## *Characteristics of the Solution*

- **Stronger financial protection for consumers – integrated state and national financial backstop**
  - **Pre-funded**
  - **Actuarially sound**
  - **Subsidization not a necessary component**
  - **Augments rather than replaces private markets**

# A Real-Life Example:  Florida

## Availability!

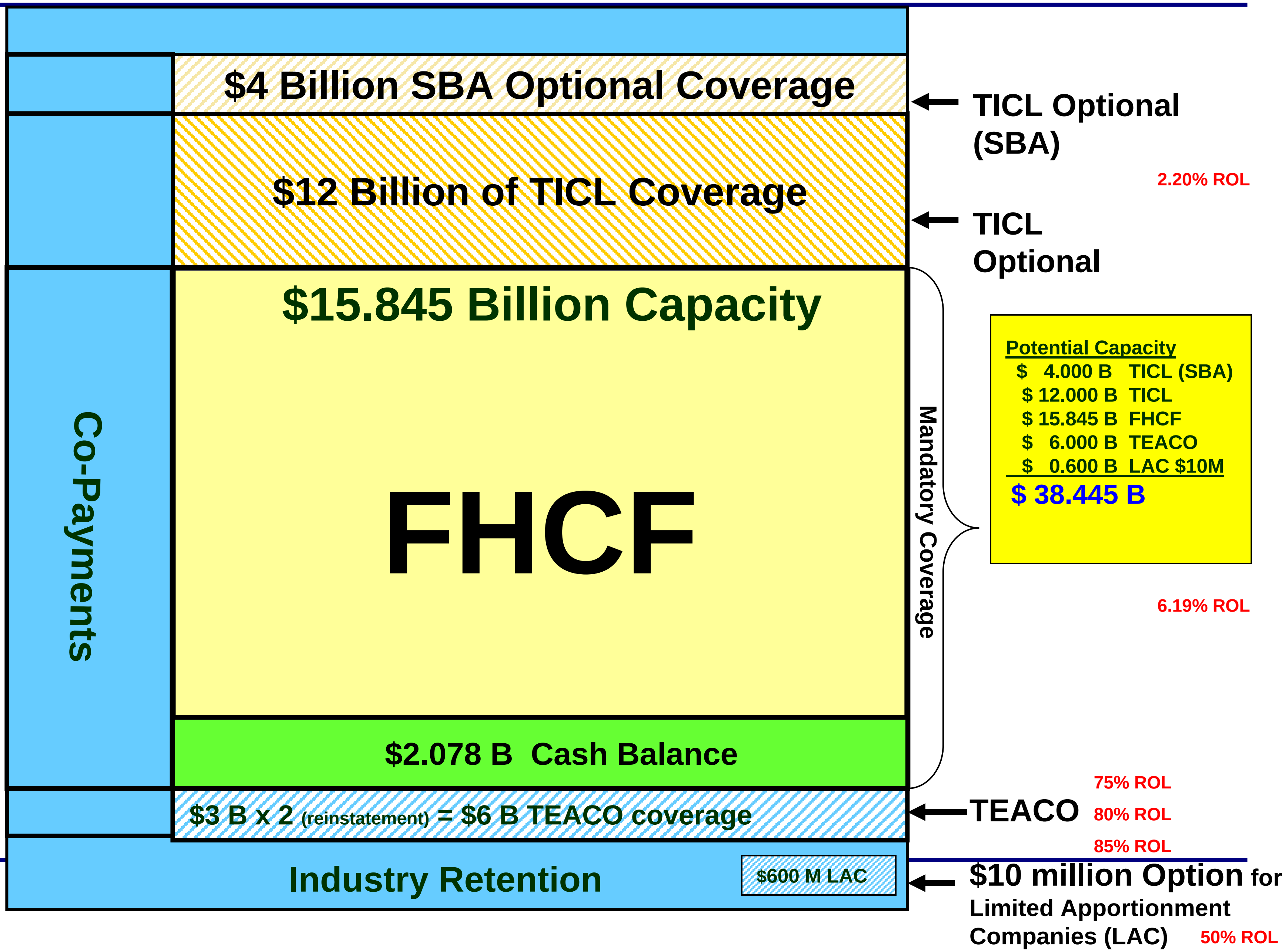


# Florida:  Affordability!

# The Florida Hurricane Catastrophe Fund (FHCF)

- A State Tax-Exempt Trust Fund created in November 1993 by the Florida Legislature for the purpose of providing a stable and ongoing source of reimbursement to insurers for a portion of their catastrophic hurricane losses in order to provide additional insurance capacity for the state.
- Serves as a catastrophe reinsurer for residential property insurers.
- Mandatory for insurers writing residential property insurance in Florida.
- Provides over $50 billion of reinsurance capacity on a multi-year basis.
- Acts as a low cost, efficiently managed, state controlled entity.
- **Provides reinsurance at one-fourth to one-third the cost of private reinsurance.**
- Helps keep residential insurance rates down, thereby savings Florida policyholders billions of dollars.

# FHCF Coverages



# Funding the FHCF – How it Works

- The FHCF receives annual reimbursement premiums from participating insurers; these premiums are actuarially set to be equal to the average annual expected loss for the FHCF
  - **Annual premiums approximately $1 billion**

- If losses occur, and accumulated reimbursement premiums are insufficient to pay claims, the FHCF can issue tax-exempt bonds secured by emergency assessments for up to 30 years on a broad range of property and casualty insurance premiums in the State
  - This liability for losses is limited to the lesser of the statutory maximum or what the FHCF can raise in the capital markets
  - **Current assessment base over $37 billion**
  - **Maximum capacity could theoretically be achieved with a bond issue supported by annual assessments of less than 5%**

- The FHCF can uses the bank or capital markets to secure liquidity funding to ensure that it has enough liquid resources to pay claims in the period immediately following an event, but before it can access the markets for “post-event” funding
  - These taxable “pre-event” financings can be retired from the issuance of tax-exempt debt after a hurricane, or simply paid through maturity from a combination of the unspent proceeds, interest earnings on those proceeds, reimbursement premiums, and, if necessary, emergency assessments

# The FHCF – Has it Worked?

| Year | Premium Revenue ($ in millions) | Savings to Florida Policyholders ($ in millions)[1] | Hurricane Losses ($ in millions) | Assessments Levied ($ in millions) |
|---|---|---|---|---|
| 2000 | 438 | 657 | - | - |
| 2001 | 439 | 659 | - | - |
| 2002 | 478 | 717 | - | - |
| 2003 | 498 | 747 | - | - |
| 2004 | 488 | 732 | - | - |
| 2005 | 617 | 926 | 3,750 | - |
| 2006 | 735 | 1,103 | 4,700 | 1,350 |
| Total | 3,693 | 5,540 | 8,450 | 1,350 |

| | |
|---|---|
| **Return on Investment for Florida Policyholders** | **370%** |

[1] Assumes FHCF cost is 1/3 of private reinsurance cost and 50% of premiums are ceded to reinsurers

- **The FHCF has provided Florida policyholders with billions of dollars in savings and a significant "return on investment."**

# What They Are Saying

"I am quite happy to see this business under government control."

--Jürgen Gräber, Executive Board Member, Hannover Re

“Which credit risk would you rather bear…….. the state of Florida………. or that of an A- rated reinsurer domiciled outside the U.S.?”

----- William Wilt, Morgan Stanley Insurance Analyst

“I am writing to let you know that recent legislative and regulatory actions in Florida have created an untenable property insurance market in your state.”

---Robert G. Davis, Chairman and CEO, USAA in a letter to policyholders

“Money for Nothing and your Chicks for Free”

----- Florida Insurance Lobbyist

## The Best Answer

Contact Information for Questions/Comments:


**John Forney, CFA**
**Managing Director/Public Finance**
**Raymond James & Associates, Inc.**
**john.forney@raymondjames.com**
**727-567-7825**

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