

Good morning Mr. Chairman and Board of Governors. In January Citizens achieved an unprecedented milestone, its lowest recorded count of policies in force since its inception in August of 2002 – 484,788 policies. Over the past three years since our peak of 1.5 million policies in late 2012 we have been hard at work introducing a comprehensive set of initiatives that produced this result.

A highly successful depopulation program working closely with 26 Insurance companies resulted in 277,000 policies assumed in 2012, 365,000 in 2013, 416,000 in 2014 and another 273,000 last year. The launch of the Clearinghouse in 2013 also had an impact reducing new business writings from 359,000 in 2012 (30,000 a month) to 125,600 in 2015 (10,000 per month) by creating increased competition for Citizens business in the private market. There are other factors of course that impacted this success. The effectiveness of the glide path in moving us closer to rate adequacy, new capital entering the market supporting the formation of new successful companies now competing for business, significant reductions in reinsurance costs allowing private companies to be more competitive and of course a decade free from major catastrophe's.

The focus of my remarks today, however, is not to highlight our successes but raise awareness that this success is being challenged. Although consolidated financial results for calendar year 2016 are near break-even (we

show a net income of just \$5.7 million compared with a 2014 Net Income of \$351 million and an initial budget for the period of \$177 million) there are two major negative surprises, both driven by a deteriorating legal environment for non-weather water claims on multi-peril policies. The unfortunate impact on Citizens policyholders will be premium increases in affected regions in 2017 & beyond and potentially fewer private market options for Insurance as private carriers reduce their exposure in critical areas.

The first issue is that 18 more cents of every premium dollar in the PLA are going to non-weather claims, compared to last year the vast majority (over 80%) of which are water damage claims, than in the previous year. The direct Loss + LAE has worsened from 56% to about 74% over the last quarter of 2015. When this recent experience is incorporated into the projected HO-3 AOP Rate indications you get some staggering numbers.

Miami Dade 189% indication

Broward 186% indication

Palm Beach 165% indication

And while the rest of the state is currently showing a -10% Indication the increased frequency of water losses from 3% to 9% over the past two years cannot help but reverse this positive trend. This experience is being exacerbated by “out of control litigation” that despite the huge drop in policy count continues unabated with 620 new suits opened every month.

Depopulation has amplified the effect as expected as our concentration of business in the Tri-County area increases.

I do want to emphasize there is no private reinsurance placed in the PLA so the picture of loss trends is relatively pure and despite the 10th year with no major storms the PLA will show a net loss of \$21 million you can only imagine the impact in the event of a major storm.

Sinkhole losses are also a factor also a factor in the PLA results contributing about one fifth of the 74% loss ratio, almost all due to higher settlements costs for pre-SB 408 claims driven primarily by reopened claims. Fortunately we now believe that this deterioration is behind us having settled over 2,700 claims through the global settlement. **The second issue** is that the coastal account swung to a \$54 million loss and about half of that was also due to non-wind losses on Coastal Multi-Peril increasing from 12.3% to 16.5%.

All private reinsurance applies to the coastal account and protects both multi-peril and wind. The reinsurance was absolutely appropriate for the risk level during 2015 wind season but significant depopulation after wind-season took a small budgeted operating income and turned it into a net loss due to significantly reduced revenue. In short we were a victim of our own over-performance in reducing the size of Citizens.

Without a reversal of water loss trends, the financial and actuarial results have three major consequences.

- 1) It is almost certain Citizens will require significant rate increases for most multi-peril products in 2017 and continuing into the foreseeable future. As I indicated in a recent press release these projected increases could easily increase the average premium in Miami Dade from \$2,800 to \$4,000 over the next five years and increases would be substantially higher without the glide path that caps individual policy increases to plus 10%.
- 2) The lack of operating income will over time put pressure on our ability to fund reinsurance programs to defray the possibility of post-hurricane assessments and even more challenging to buy appropriate levels of reinsurance without impacting surplus.
- 3) If the poor loss trends are market wide, and we are clearly seeing that this is the case, Citizens limited by the glide path, cannot keep pace with private insurer rate increases, we will become even more price-competitive and less able to provide consumers with comprehensive market alternatives using the Clearinghouse.

A market intelligence report created by Steve Bitar, Carl Rockman, and our field team indicates the market restrictions are already happening. One market is attempting to cancel 9,000 policies mid-term and paying bonuses to

move the business. Another is requiring consent to rate forms, upwards of +40%, in order to renew their policy, several companies are restricting new & renewal business particularly in the Tri-County area and others are already filing and receiving approval for rate increases. Recent earnings reports from major companies speak to restrictions in Tri-County writings until the environment improves. Last week the Quasar or Industry results became available. Our analytics team conducted a high level review of the year 2015 results for the top 10 market share leaders in Florida and any insurance company that depopulated at least 10,000 policies in 2014 and 2015. I do not intend to provide specifics today on those results but it's worth noting that of the 15 companies reviewed only 3 showed improved combined ratio's while 4 indicated a deterioration in excess of 50%. Utilizing our actuarial methodology as a base for our analysis we estimate that these companies were likely targeting a combined ratio between 75% and 85% after a year with no major storms and assuming rates were adequate. The composite Combined Ratio for the companies reviewed was 91.9% compared with a 2014 equivalent of 76.02%, almost a 16 point deterioration. While I am not attributing all of this deterioration to increased water damage activity and the AOB Crisis this clearly indicates that these companies will be taking a more restrictive position regarding take-out activity especially in the Tri-County area where results have been historically worse than rest of State.

We are of course responding to this challenge as aggressively as we can while still attempting to keep pricing affordable for consumers.

- We took a leadership role during this recent legislative session to attempt to get meaningful reform to address the AOB Crisis. I want to personally thank all of the Board members who were actively involved on the behalf of Citizens but unfortunately no effective legislation passed this session.

- As you are aware, we have also been negotiating with OIR to get reasonable policy coverage changes to address the issue of 1 Late reported claims (currently averaging 33 days after the event), 2. Restrictions on permanent repairs until Citizens has a chance to assess the loss and 3. Limitations on the scope of damage when collapse occurs. We are optimistic that we will reach appropriate compromise with OIR on this language.

- On the claims front we will be launching a Contractor Repair Program that is being presented for your approval today, having the ability to very quickly getting a professional certified contractor in front of our insured who provides a warranty for his services is ultimately the best way to reduce litigation.
- In the Consumer Affairs Committee we outlined the “Call Citizens First” program that will be piloted.
- In the Claims Committee Jay Adams outlined the steps his organization has taken to address the increased litigation that is occurring and we will

be incorporating recommendations received by Committee members regarding enhanced medial visibility to the AOB issues.

In summary we are taking aggressive action on all areas under our control to effectively address the AOB issue. We are considering future options that include mandatory managed repair, water exclusion language with a limited buy back, already approved for some companies, and further policy restrictions should our proposed, recommended language not be accepted by OIR. At all times we are focusing on getting non-weather claims and litigation under control while providing legitimate claimants with a fair and prompt settlement of their losses.