Executive Summary

Finance and Investment Committee Meeting, June 3, 2020
Board of Governors Meeting, June 24, 2020

2020 Risk Transfer Program

History

Citizens' Board of Governors and staff recognize that the event most likely to trigger assessments would be a catastrophic hurricane or series of hurricanes striking Florida. Transferring risk through the use of catastrophe reinsurance offers an effective means to eliminate the amount and likelihood of assessments after such an event.

Central to Citizens' goal of reducing exposure and, by extension, reducing or eliminating the amount and likelihood of its assessment burden on Florida tax payers, is the transfer of risk through reinsurance mechanisms, traditionally accomplished via participation in the Florida Hurricane Catastrophe Fund (FHCF) reimbursement program, traditional reinsurance markets and in the capital markets. Citizens' participation in the reinsurance markets reduces the potential assessments that result from losses reducing or exhausting Citizens' surplus and FHCF coverage.

Citizens' risk transfer program is structured to provide liquidity by allowing Citizens to obtain reinsurance recoveries in advance of the payment of claims after a triggering event while reducing or eliminating the probabilities of assessments and preserving surplus for multiple events and/or subsequent seasons.

Market Overview

Reinsurance pricing conditions softened from 2015 through 2017, however there was substantial loss development following Hurricanes Irma and Michael, which increased reinsurer's exposure well beyond the initial ultimate loss amounts reported. The insurance industry has incurred approximate $19 billion of losses from Hurricanes Irma and Michael and that number is projected to grow to an ultimate loss of more than $20 billion. Globally there were more than $275 billion of incurred losses during 2017 through 2019.

Reinsurers are operating with an increased cost of capital as a result of increased retrocession costs and higher return expectations from third-party capital providers due to widening spreads in alternative markets such as the corporate bond market, as well as proactively trying to manage their potential risk to COVID-19 claims. Due to these factors, price increases are in the range of 15%-30% on average and 50%-100% in extreme cases.

2020 Risk Transfer Program

As approved by the Board of Governors at the May 14, 2020 board meeting, Citizens sought authorization for $1.3 billion of additional coverage, in addition to the $400 million of 2018 coverage that remains in place for the 2020 storm season. Based on current dislocation in the reinsurance markets and significant price increases, Citizens decided not to chase the market

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and not to lock in the currently elevated rates on a multi-year basis and therefore only placed a cost efficient risk transfer program of $1.02 billion; which includes $620 million of new placement and the $400 million of multi-year coverage from 2018.

Coastal Account

The 2020 risk transfer program for the Coastal Account includes $803 million of coverage with a weighted average gross rate-on-line (ROL) of 7.76% and a net premium of $60.3 million.

The 2020 risk transfer layers for the Coastal Account are as follows:

- Layer 1 of this program is referred to as the sliver layer and sits alongside the FHCF. It provides $95.4 million of annual, per occurrence coverage which covers personal residential and commercial residential losses and works in tandem with the mandatory coverage provided by the FHCF to include the co-payment of the 10% of losses not covered by the FHCF. This layer was placed in the traditional market at a ROL of 14.75%.

- Layer 2 sits above the sliver layer and the FHCF. This single-year, aggregate layer provides $583.8 million of coverage of personal residential and commercial residential losses. This includes the $400 million of renewing coverage placed in 2018. The new placement of $183.8 million was placed in the traditional market at a ROL of 10.0%.

    - The $400 million of renewing coverage placed in 2018 includes $150 million of traditional coverage at a ROL of 6.66%, and $250 million of coverage from the capital markets at a ROL of 4.73%.

- Layer 3 of this program sits above the $583.8 million single-year aggregate layer and covers annual, aggregate personal residential and commercial residential losses. This layer provides $124.2 million of single year coverage and was placed in the traditional market at a ROL of 6.5%.

Personal Lines Account

The 2020 risk transfer program for the Personal Lines Account includes $218 million of coverage with a weighted average gross ROL of 10.58% and net premium of $24.4 million.

The 2020 risk transfer layers for the PLA are as follows:

- Layer 1 of this program is referred to as the wrap layer and sits alongside and above the FHCF. It provides approximately $108.1 million of annual, per occurrence coverage which covers personal residential losses and works in tandem with the mandatory

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coverage provided by the FHCF to include the co-payment of the 10% of losses not covered by the FHCF. This layer was placed in the traditional market at a ROL of 15.0%.

- Layer 2 sits above the wrap layer and the FHCF. This multi-year, aggregate layer provides approximately $110 million of coverage of personal residential losses. This placement provides multi-year, aggregate coverage. This layer was placed in the capital markets at a ROL of 6.25%.

Summary

On a risk-adjusted basis, the 2020 risk transfer program cost is 20% higher than the 2019 program based on the gross ROL. The 2020 gross ROL is 8.36% compared to a risk-adjusted gross ROL of 6.99% for 2019.

- The Coastal Account's 2020 placement is 16% higher than the 2019 placement on a risk-adjusted basis. The total amount of surplus exposed in a 1-100 year event will result in approximately 48%, compared to 28% in 2019.

- The Personal Lines Account's 2020 placement is 25% higher than the 2019 placement on a risk-adjusted basis. The total amount of surplus exposed in a 1-100 year event will result in approximately 62%, compared to 58% in 2019.

The surplus exposed in 2020 is higher than what was exposed in 2019 due to inefficient market conditions and significantly higher pricing. However, we expect reinsurance markets to stabilize as economic conditions and financial markets improve by the end of this year, which will allow us to manage the risk transfer program and surplus exposure effectively and efficiently.

In summary, the total 2020 risk transfer program, including coverage provided by the FHCF, totals $2.9 billion of coverage with a ROL of 7.5%, which is a 7% increase versus the 2019 risk-adjusted pricing.

- FHCF coverage totals $1.9 billion with a gross ROL of 7.0% and the private risk transfer program totals $1.02 billion with a gross ROL of 8.4%.