ACTUARIAL & UNDERWRITING COMMITTEE
ANNUAL RECOMMENDED RATE FILINGS – EFFECTIVE FEBRUARY 1, 2017 EXECUTIVE SUMMARY

As required by statute, Citizens has completed the annual analysis of recommended rates for 2017. The Office of Insurance Regulation uses this information as it establishes Citizens rates to be implemented for policy effective dates beginning February 2017. The analysis developed rate indications that:

- Comply with the requirement in Florida law that Citizens recommend actuarially sound rates. The indications developed are designed to generate the premium needed to cover Citizens' projected losses and expenses during the effective period of the rates.
- Are not excessive, inadequate or unfairly discriminatory, and meet the requirements of U.S. Actuarial Standards of Practice except where Florida law supersedes such standards.
- Comply with the statutory "glide path" that limits Citizens annual rate increases to no more than 10% for any single policy issued. This is an exception to the requirement for actuarially sound rates. It applies to non-sinkhole perils, and excludes coverage changes and surcharges.
- Considers the Florida Public Hurricane Model (FPM) results in wind rate recommendations, as required by law. Law changes this year removed the requirement that the FPM results be the "minimum benchmark" for those rates.
- Include an appropriate charge to pass through the Florida Hurricane Catastrophe Fund (FHCF) Rapid Cash Build-Up Factor, as required by law.

Major cost factors in the rate analysis include:

i) Non-catastrophic losses and loss adjustment expenses (LAE)
ii) Modeled catastrophic hurricane losses and estimated LAE
iii) Administrative expenses
iv) Risk transfer costs
v) Pre-event liquidity costs

The average statewide indicated rate change over all personal lines of business is +64.7%. The premium impact after the application of the glide path cap is 6.8%. Note that each Citizens policyholder pays a premium for an individual policy line that is based on their risk classification; nobody pays exactly the average. The indications vary greatly by account and by product line. See Exhibit 1 for more detail.

The average statewide indicated rate change over all commercial lines of business is +46.8%. The premium impact after the application of the glide path cap is +9.0%. These results also vary widely by product line. See Exhibit 1 for more detail.

When underlying costs are rising rapidly, the difference between indicated revenue need and actual premium impact may be significant. Due to the glide path, cost trends may outstrip the ability of Citizens to obtain sound premiums, even if base rates are sound.

Determination of Overall Rate Indications by Line of Business

Water Peril

Last year Citizens' rate indication for Personal Lines averaged 25.5%. As noted above, this year the Personal Lines rate indication is 64.7%. The spike in the rate need is driven by skyrocketing water damage losses. Statewide, for Homeowners policies (HO-3), the average annual cost of water damage ("loss cost") per policy for water more than doubled from $551 in 2013 to $1,156 in 2015. Importantly, the loss cost is averaged over all policies, including the vast majority that did not file claims and therefore contribute zero to the loss costs. In the South East region of the state (Miami-Dade, Broward, and Palm Beach counties), the analogous cost per policy increased from $1,443 (already almost triple the statewide average) to $1,955. The result is a water-only rate indication of well over 300%. Said differently, Citizens projects paying out over $3 for every $1 earned in premium earmarked for water damage. This severe water rate inadequacy is the driver of the statewide HO-3 rate need of 72.6%.

The water peril indication has been adjusted for the coming policy language changes effective July 1, 2016. Both the historical water losses and prospective water loss trend used in the calculations were tempered to reflect the expected short term savings. Without these adjustments, the water peril indication would be over 400%. The policy language changes are part of a long-term enterprise-wide solution to encourage policyholders to Call Citizens First and avoid losing control of their claims to intermediaries that often inflate costs – costs that, as shown here, drive rate hikes. Citizens hopes that in the longer term, cost trends can be reversed and non-wind rates stabilized or reduced using this strategy.

Hurricane Peril

Hurricane peril rates drive the overall Citizens premium for many policyholders, particularly in coastal territories. As Florida law requires, projected hurricane losses from accepted scientific simulation models were considered. Citizens used four models accepted by the Florida Commission on Hurricane Loss Projection Methodology: AIR (v15.0.1,Touchstone v3.1.0), RMS (Risklink v15.0), EQE (RQE v16.0), and the FPM (v6.1). No model results were modified or adjusted. The four distinct models underpinned a range of rate indications for each line of business. These ranges varied by line of business, as models may disagree widely in some territories and products.

When determining the selected statewide indication, greatest consideration was given to the "middle" two models. This statistically sound approach minimized the effect of outliers while providing a result that captures the overall information from the models for each product line.

Exhibit 1- **Summary of Statewide Rate Indications** displays results for each product line. The **Uncapped Indication** is the selected statewide indication adjusted for the FHCF pass-through. The **Proposed Change** columns represent the actual premium impact to consumers after the application of the glide path cap to each single policy. At the policy level, all premium changes are limited to +/- 10% (except for HO-4 which is limited to +10%/-15%, in accordance with previous OIR guidance). After the application of the cap, the impact of the FHCF pass-through is added.

Impact of Private Reinsurance Costs

Due to significant depopulation and continued low "rates-on-line" (unit costs) for private reinsurance, Citizens was, once again, able to transfer the majority of its hurricane risk away from Florida policyholders (including non-Citizens policyholders, who would pay emergency assessments if storms caused significant deficits). For the second year in a row, Citizens can sustain a so-called “1-in-100 year” storm, meaning a storm with a 1% chance of occurring in any given year, in the Coastal Account without triggering assessments. Because Citizens is only exposing 60% of its Coastal surplus to such a storm, it can also sustain a 1-in-16 year storm following a 1-in-100 year event.

Last year, Citizens transferred $3.91 billion of Coastal Account risk to private reinsurers at a net cost of $200 million. This year, Citizens transferred $2.46 billion of Coastal Account risk to the private sector at an estimated net cost of $149 million. “Net cost” refers to the gross expenditure on risk transfer less the expected hurricane losses that would be subject to the agreements. The lower net cost of reinsurance is reflected in the rate indication. Last year’s Homeowners indication included a provision of 15.9% for the cost of private reinsurance. This year the provision is 12.0%, meaning that 12 cents of the premium dollar is devoted to reinsurance.

Private reinsurance covers policies in the Coastal account only, but it does lower the probability that policyholders in the Personal Lines Account (PLA) and Commercial Lines Account (CLA) will face a surcharge due to deficits in the Coastal Account. Consequently, a small portion of private reinsurance costs are allocated to the policies in the PLA and CLA. The rate indications allocate 90% of the private reinsurance costs to the Coastal Account and 10% to the PLA/CLA.

Note that public reinsurance from the mandatory participation in the FHCF is divided into a PLA+CLA contract and a separate Coastal contract, the net costs of which are allocated to policies in the respective accounts.

Due to the severe water peril rate indications, private reinsurance costs for many policyholders, such as Homeowners in the South East region, do not significantly affect the charged rates in 2017 after the glide path is applied. The maximum 10% impact applies prior to consideration of these costs.

Impact of Pre-Event Liquidity

Pre-event liquidity (debt financing) provides a funding bridge to the point in time and loss levels at which the FHCF begins to pay hurricane reimbursements. It also ensures quick claims-paying capacity for subsequent storms in a season and augments other Citizens claims-paying resources that are not readily available in cash after a storm. This allows for timely payment of claims as well as flexibility in the timing and cost of issuance of post-event debt.

Pre-event debt does impact the cost structure of Citizens, and therefore the rate indications. The impact in Homeowners to the statewide uncapped rate indication is around +3.8%. As with private reinsurance costs, the impact is not significant to most customers who would “max out” at a 10% increase due solely to water peril indications and the glide path.

Impact of Policy Level Capping

Due to the interaction of all actuarial considerations, rate indications vary greatly from policy to policy within Citizens. Large increases as well as large decreases are indicated for various consumers. The glide path established in 2010 requires Citizens to ensure no single policyholder shall be subject to a (non-sinkhole) rate increase greater than 10%. In order to balance the statutory requirements of actuarial soundness and the glide path, it is recommended that all rate increases be capped at +10%, and all rate decreases at -10%, except for HO-4 forms as noted above.

Impact of FHCF Buildup Premium

The FHCF is required by law to include a "rapid cash buildup factor" of 25% in its premium. Citizens, in turn, is required by law to pass this cost to the policyholder, outside the 10% glide path cap. This results in higher rate indications and affects the statewide premium impacts as well, raising some lines slightly above 10%.

Sinkhole Indications

The number of reported sinkhole claims to Citizens has been steadily declining since the end of 2011. In 2011, over 4,500 claims were reported. By 2013 the number was reduced to around 1,200 and has declined further since then, attributable largely to the impact of Senate Bill 408, the major sinkhole claims reform enacted in 2011. While all signs at this point are that SB408 has successfully addressed sinkhole trends, there does remain uncertainty about the final outcome of many pending claims, some litigated. Staff recommends that for a third straight year, sinkhole rates remain unchanged. As the ultimate effect of law changes emerges in the claims experience, there is no guarantee that future sinkhole rate increases will not be necessary.

Rate Analysis Exhibits

Several Exhibits are included with this item. Note that scale differs on some maps, so review the legends carefully when comparing maps. Also, all premium totals are based on policies in-force as of 12/31/2015.

Exhibit 1: Summary of Statewide Indications

- Columns (1) through (3) display the statewide uncapped indication and the proposed capped rate impact for multi-peril lines of business in the Personal Lines Account.
- Columns (4) through (6) display the statewide uncapped indication and the proposed capped rate impact for multi-peril lines of business in the Coastal Account.
- Columns (7) through (9) display the statewide uncapped indication and the proposed capped rate impact for wind-only lines of business (written only in the Coastal Account).
- Columns (10) through (12) display the statewide uncapped indication and the proposed capped rate impact for combined multi-peril and wind-only lines of business.

Exhibit 2 – Multi-Peril HO-3 (Homeowners) County Average Premium Impacts Map

- Displays the average proposed premium impact after capping for each county
- Note that the numbers in this exhibit show the average premium impact for the county
- The actual premium impact can vary between -10% and +10% for individual policyholders within each county

Exhibit 3 – Wind-Only HW-2 (Homeowners) County Average Premium Impacts Map

- Displays the average proposed premium impact after capping for each county
- Note that the numbers in this exhibit show the <u>average</u> premium impact for the county
- The actual premium impact can vary between -10% and +10% for individual policyholders within each county

Exhibit 4 – Multi-Peril HO-6 (Condo Unit-Owners) County Average Premium Impacts Map

- Displays the average proposed premium impact after capping for each county
- Note that the numbers in this exhibit show the <u>average</u> premium impact for the county
- The actual premium impact can vary between -10% and +10% for individual policyholders within each county

Exhibit 5 – Wind-Only HW-6 (Condo Unit-Owners) County Average Premium Impacts Map

- Displays the average proposed premium impact after capping for each county
- Note that the numbers in this exhibit show the <u>average</u> premium impact for the county
- The actual premium impact can vary between -10% and +10% for individual policyholders within each county

Exhibit 6 – Multi-Peril DP-1 and DP-3 (Dwelling Fire) County Average Premium Impacts Map

- Displays the average proposed premium impact after capping for each county
- Note that the numbers in this exhibit show the <u>average</u> premium impact for the county
- The actual premium impact can vary between -10% and +10% for individual policyholders within each county

Exhibit 7 – Wind-Only DW-2 (Dwelling Fire) County Average Premium Impacts Map

- Displays the average proposed premium impact after capping for each county
- Note that the numbers in this exhibit show the <u>average</u> premium impact for the county
- The actual premium impact can vary between -10% and +10% for individual policyholders within each county

Exhibit 8 – Multi-Peril MHO-3 and MDP-1 (Mobile Homeowners and Dwelling Fire) County Average Premium Impacts Map

- Displays the average proposed premium impact after capping for each county

- Note that the numbers in this exhibit show the average premium impact for the county
- The actual premium impact can vary between -10% and +10% for individual policyholders within each county

Exhibit 9 – Wind-Only MW-2 and MD-1 (Mobile Homeowners and Dwelling Fire) County Average Premium Impacts Map

- Displays the average proposed premium impact after capping for each county
- Note that the numbers in this exhibit show the average premium impact for the county
- The actual premium impact can vary between -10% and +10% for individual policyholders within each county

Exhibit 10 - Multi-Peril Commercial Residential County Average Premium Impacts Map

- Displays the average proposed premium impact after capping for each of the "Group 2" perils territories (some of which cross several counties)
- Note that the numbers in this exhibit show the average premium impact for the territory.
- The actual premium impact can vary between -10% and +10% for individual policyholders within each county

Exhibit 11 - Wind-Only Commercial Residential County Average Premium Impacts Map

- Displays the average proposed premium impact after capping for each county
- Essentially all policyholders in each territory will receive a +9% increase
- The reason why it is not a +10% increase is due to the FHCF pass through. The FHCF actually has a negative allocated cost in this line.
- The territory showing 0% impact has no policies

Exhibit 12 - Multi-Peril Commercial Non-Residential County Average Premium Impacts Map

- Displays the proposed premium impact after capping for each Group 2 territory
- The numbers display the expected premium impact for each policyholder within a territory.

Exhibit 13 - Wind-Only Commercial Non-Residential County Average Premium Impacts Map

- Displays the average proposed premium impact after capping for each county
- Every policyholder will receive a +10% increase

Exhibit 14 - Distribution of Recommended Rate Impacts by Policy in PLA

- Tabulates the proposed capped premium impacts for personal lines into a histogram showing number and proportion of policyholders in each impact range
- Includes all personal lines combined
- Range exceeds +/- 10% slightly, due to the impact of the FHCF pass through

Exhibit 15 - Distribution of Recommended Rate Impacts by Policy in Coastal Account

- Tabulates the proposed capped premium impact for personal lines into a histogram showing number and proportion of policyholders in each impact range
- Includes all personal lines combined
- Range exceeds +/- 10% slightly, due to the impact of the FHCF pass through

Exhibit 16 – Average Premium by County – HO-3

- Current and proposed average premium by county for multi-peril Homeowners policies
- Based on in-force policies as of 12-31-2015

Exhibit 17 – Average Premium by County – HW-2

- Current and proposed average premium by county for wind-only Homeowners policies
- Based on in-force policies as of 12-31-2015

Exhibit 18 – Average Premium by County – HO-6

- Current and proposed average premium by county for multi-peril Condo Unit policies
- Based on in-force policies as of 12-31-2015

Exhibit 19 – Average Premium by County – HW-6

- Current and proposed average premium by county for multi-peril Condo Unit policies
- Based on in-force policies as of 12-31-2015