PRESIDENT BARRY GILWAY'S REPORT - MARCH 29, 2017

The impact of AOB Losses and Increased Litigation is beginning to impact Citizens Financials in a dramatic way. Jennifer Montero will be providing a detailed analysis in her financial presentation but in 2016 Citizens posted its first net loss since 2005 despite limited impact from Hurricanes Mathew and Hermine, a net loss of $27.1 million compared with net income of $5.7 million in 2015. The primary driver behind the deterioration in results was the net LAE ratio of 26.7% for the year, an increase of 16 percentage points over prior year. This despite the fact that the average incurred loss for non-wind water claims has almost doubled over the past five years ($10,301 to $19,968) in the Tri-County area, the source of 96% of the Litigation. This increased Litigation moving from 12% of our claims to just under 50% of our claims last year was responsible for $70 million in adverse development in the overall last year ($60 Million in PLA and $11 Million in Coastal) adding 15 percentage points to the L&LAE. Jennifer has requested Brian Donovan, Chief Actuary, to provide you with a more detailed evaluation of Citizens Reserving and Reserve Development in the Financial Section of the Board Report.

Citizen's results were reflective of what is occurring across the Florida Marketplace and the Florida Homeowners market loss ratio was also the highest result seen since 2005 moving to 42.4% up 10.6 percentage points from 2015. Following Industry results in the 3rd quarter of 2016 that had deteriorated significantly from the prior year, and the fact that those results did not include the impact of Mathew or Hermine, there has been a considerable number of actions taken by Florida Domestic Companies to shore up their financials to avoid a possible downgrade by Demotech.

The actions were fueled by a decision made by Demotech, Florida's primary rating agency responsible for providing a rating for 57 Florida Domestic Companies, in early February to suspend the written guidance for all property insurers writing in Florida citing the negative impact of AOB losses on results along with recent court decisions(Johnson Sept 16 and Sebo Dec 16) that revised the rules regarding claims practices- all relating to the potential impact of Plaintiff Attorney fees on Industry results. The same notice referenced Statutory Accounting Principles that provided an opportunity for these companies to strengthen their balance sheets prior to the 2/28 filing deadline for statutory year end statements.

This was a key issue for Citizens given that 257,000 of the 1.4 million policies assumed by the private market in the past four years were assumed by a number of the 26 companies cited by Demotech as being problematic. Over the past two months this combined list of companies added $155 Million to Policyholders Surplus and added approximately $200 Million to Loss and Loss Adjustment reserves. As a result of these and other consolidation actions on March 16th Demotech issued a follow up release indicating downgrades were "largely avoided." It was noted that transactions such as the sale of Mount Beacon to Florida Specialty, Prepared to PLW investments and Elements to Avatar impacted their more positive assessment of the market. There were warnings included, however, that if the overall climate did not change, for example positive AOB Legislation, that this was a short term delay in potential downgrades.

However the Industry results for Florida Property Insurers, announced last week, clearly showed the significant deterioration from 2015 that Demotech had expected. The combined ratio for 2015 moved from 85.65% and a net income of $680 Million to a combined ratio of 100.86% with net income of $76 Million in 2016. This does not tell the whole story, however, as 21 companies posted Combined Ratio's over 110% and 11 of these companies were over 125%. If you exclude the impact of the National Companies, Nationwide and Allstate for example, the Industry had negative net income of $44 Million.

While the direct impact of Downgrades has been avoided in the short term the earnings calls of the major publically owned companies all focused on the ongoing issues of AOB and the impact it was having on their financials, and the actions that would need to be taken to either reduce their presence in the Tri-County area or discontinue writing new business in these territories and the increased need for higher rate increases.

The impact on Citizens is obvious. While we continue to see some reductions in our commercial and wind only business, hitting an all-time low of 449,000 policies and exposure of $120 Billion, due to a strong E&S market for commercial business and continued low Reinsurance pricing impacting the private market appetite for wind only business, we still anticipate an increase in the multi-peril business that will continue to be influenced by the increase in Litigation. We cannot increase rates at the same pace as the private market which over time will impact our growth, especially in the Tri-County area where rates are inadequate today. Bottom line is that we are anticipating overall growth, primarily in the Multi-Peril lines, in line with our original 2017 expectations and budget. However assuming budgeted reinsurance spend necessary to maintain our current level of surplus protection our interim forecasts show a further deterioration in consolidate net income from $4.5 million to a $8.3 million net loss for 2017 and a net loss of approx. $100 million on a consolidated basis for 2018.

While we are focused today on potential progress from a legislative perspective we are already evaluating other alternatives to address AOB that we will be prepared to discuss in more detail in the June Board Meeting.