June 2017 Presidents Report

The legislative session drew to a close without any meaningful legislation related to AOB or the out of control non-weather water litigation that it is occurring. It certainly was not due to the lack of effort by Citizens or lack of consensus among Florida Insurance Companies. We sent over 92,000 emails to tri-county customers educating them on AOB issues, there have been 157 articles on AOB published since January of this year, and 7 editorial board meetings held in every major city with exceptional response. The AOB issue continues to negatively impact the financial results of virtually all Florida Companies, in fact the latest Litigation numbers show that the number of Lawsuits filed against the top 25 Florida Companies has tripled from 335 per company in 2014 to 931 last year validating that this is a growing Industry problem. For the first time companies were solidly behind a common set of potential solutions that were also strongly supported by Governor Scott, CFO Atwater and The Florida House of Representatives. Unfortunately, despite strong Industry support for SB 1038 by Senators Hukill and Passidomo and a solid alternative that passed the House sponsored by Rep. Grant (HB 1421), none of this resulted in a legislative solution and insureds will continue to pay the price for this unresolved problem through increased premiums for their property insurance policies.

While ultimately legislative action will be necessary to stamp out AOB abuse, companies are now looking for non-legislative strategies that could improve their overall financial position and offset the negative impact that increased litigation is having on their bottom lines. Many of the largest Florida Insurance Companies have already filed for substantial rate increases up to Plus 16% overall and significantly higher for the most impacted counties such as Dade, Broward and Palm Beach. In at least three recent cases OIR rejected the rate increase as proposed and approved even higher rates citing the fact that a combination of the proposed increase and the company plans would not meet company profitability forecasts (HCI, Peoples Trust and Federated.) This clearly demonstrates OIR's commitment to the financial viability of Florida Companies, but rate increases to address runaway costs is not a sustainable solution.

Industry results for the first quarter appear to have stabilized with the Florida Specialty companies outperforming the results of the subsidiaries of National Companies. Overall the Industry Capitalization improved by 1.6% and the Combined Ratio improved by 3.6% to 86.18. I would describe this as marginal improvement but definitely better than the first quarter of last year that showed significant deterioration.

Citizen's results for the first quarter were similar in that no significant negative development occurred and surplus also increased slightly to $7.48 Billion however, there was no significant improvement in non-weather water claims activity that would indicate a positive trend. In short a continuation of the negative results reflected for the PLA in the year end 2016 financials will continue through 2017 and 2018. Our combined ratio increased by 4.3 points to 72.9%. The most visible change in our financials is being driven by a change in the makeup of our book of business. At this point it is not the change that we were concerned could occur-a drastic increase in the PLA book, rather it is a steady shift in the overall makeup of our book of business towards the PLA. Through the first quarter the PLA earned premium comprised 51% of our book compared with 44% during the first quarter of 2016. While the premium written in the PLA increased by only 3% premiums written in the CLA and Coastal Accounts, the two accounts with historical profitability, decreased by 50% and 23% respectively. While this reduction in exposure is excellent news, and has taken us to a historical low of $117 Billion in exposure down from a high of $512 Billion, it reinforces our need to find solutions to the net loss projections within the PLA. The overall market has shown amazing resiliency and a continued appetite to write new business and while some companies are declining their writings, especially in Tri-County, others seem to be willing to pick up the slack. Citizens new business policy counts overall this last quarter are almost identical to last year at 16,708.

The Citizens Management team has been working for many months now considering what next steps we can take to get the financial results of the PLA under control. We were hoping for legislative change and a surgical solution. Given that this did not occur in 2017, we cannot wait for the trends to worsen and take no corrective action. It is important that we keep in mind the level of deterioration in the PLA results when we are considering corrective action alternatives. Financial results of the PLA have deteriorated from -$21 million in 2015 to -$35 million in 2016 to a forecast -$124 million in 2017 and a forecast -$182 million in 2018. These results are simply not sustainable and we need to move forward with recommendations regarding changes in policy language and make non-legislative changes that could stabilize and improve these results. Our recommendations fall into three distinct categories. The first is a series of policy language changes, that complement the changes introduced last July, along with changes in our underwriting guidelines that are directed at stabilizing the PLA financial results. The second are changes to our claims management process that can have an impact and finally we have launched a comprehensive analysis to evaluate our loss adjustment and litigation management approach to determine areas where we can strengthen our approach. While each of these have been or will be discussed in far more detail let me provide some high level details in each area:

Policy Language and Administrative Changes:

Implement a $10,000 non-weather water sublimit on all HO3 policies with the option to eliminate the sublimit by using the Managed Repair Program. The limit will not apply to the water mitigation services. Use of Managed Repair will be with agreement by both Citizens and the insured.

A policy form change that provides that “Duties after loss” apply to anyone who files a claim for the benefits under the policy, not just the named insured.

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A change to underwriting eligibility to allow only 1 non-weather water loss in 3 years or 2 non-weather water losses in 5 years unless the insured can demonstrate that the underlying issue has been remediated.

Requiring a signed acknowledgement of these changes on new business and at renewal.

Expanding the use of Industry Loss History Reports including ordering reports on in-force policies to identify repeat claims, particularly water claims.

Expand use of Citizens inspections to determine condition of repair of prior losses on new business and determine whether loss repair has been completed and cause of loss mitigated on renewal.

Claims Management Initiatives:

The claims organization has already implemented numerous changes including dedicated teams of adjusters for Non-Weather Water losses, Utilization of Lynx water mitigation expert review and partnering our SIU with DIF and DFLE. New programs that are being implemented include:

- The Managed Repair Program effective 7/1/17 for H03 and DP3 policies.
- This is a voluntary program for all non-weather water claims where the insured and Citizens both have to agree to enter the program.

2 Phases to the Program:

1. Emergency Water Extraction offered if the loss is reported within 3 days of the actual date of loss. Offered as a service to the policyholder for emergency water extraction and drying without the application of the policy deductible.
2. Contractor Managed Repair completes post loss repairs to return the policyholder to their pre-loss condition for all covered losses. Assignments are made through our agreement with Contractor Connection. Provides for a three year warranty. Enhanced Appraisal process leveraging the contract language to exercise our right to demand appraisal when disputes arise. The use of the Appraisal process does increase administrative costs but substantially reduces Plaintiff Attorney costs.

LAE Study.

The LAE Analysis Project began in mid-April, led by Kelly Booten, with the end goal being comprehensive, detailed look into losses and loss adjustment expenses from the 2014 through 2016 loss years. A cross functional team of subject matter experts has been gathered, including representatives from actuarial, financial, claims ,IT, and Office of Internal Audit. Initial analysis has begun on end-to-end claims processes, decision points and associated costs, as well as indepth review of financial, claim and legal cost data. At this time the team has completed 11 of 17 scheduled process walk-through and we anticipate completion by the end of July. Initial findings clearly show that average LAE costs are increasing because a greater percentage of claims are being litigated. One important question that was answered is that LAE costs for litigated non-sinkhole, non-wind claims have remained around $7,000-$9,000 per claim for almost a decade. Entering litigation adds about $5,200 to a claims ALAE costs. We have also been able to quantify the financial impact for each of the claims management steps that occur for the review period.

Significant analysis must take place to answer the many detailed questions that this initiative is charged with answering. One of the parallel activities being conducted, in conjunction with this study, is an end to end claim process and procedure review that will assess all decision points and of course the drivers for increased claims entering litigation. Trends identified by the study are intended to drive reductions in loss adjusting expenses and manage indemnity costs, and the recommendations will be made at future Board Meetings.