Executive Summary

Board of Governors Teleconference, May 8, 2018

2018 Risk Transfer Program

History

Citizens' enabling statute requires us to make the best effort to procure catastrophe reinsurance in the private market at reasonable rates. The analysis and decision to purchase catastrophe reinsurance coverage is evaluated by staff each year and a recommendation is made to the Board of Governors.

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. For reinsurance purposes, the PLA and CLA are evaluated together while the Coastal Account is evaluated separately. After eleven years of no significant hurricanes and after Hurricane Irma losses and loss adjustment expenses of approximately $1.8 billion, substantial surplus has been accumulated in all accounts to pay for future claims. The PLA and CLA continue to be financially stronger than the Coastal Account with respect to claims paying ability; as such Citizens' risk transfer programs are focused on the Coastal Account.

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 delivers a dollar-for-dollar reduction of potential assessments that result from losses reducing or exhausting Citizens' surplus and FHCF coverage. Citizens' strategic plan to transfer hurricane risk for the Coastal Account to the global reinsurance markets includes both traditional risk transfer and capital markets risk transfer. The proposed 2018 Risk Transfer Program incorporates all strategic elements from prior risk transfer programs, which includes: coverage for the mandatory layer of the FHCF, a single and multi-year traditional reinsurance program, and a multi-year capital markets risk transfer program. It is noteworthy that support by the Board of Governors for consistent and aggressive pursuit of risk transfer, coupled with the significant amount of depopulation over the last six years, has eliminated any probable assessment for a 1-100 year event for the 2018 season.

Citizens plans to transfer exposure in the amount of approximately $1.42 billion to the global reinsurance and capital markets in 2018, which includes $480 million of risk transfer from the 2017 season that remains in place for the 2018 season - $180 million of multi-year traditional reinsurance and $300 million of capital markets risk transfer through Everglades Re. Citizens' strategy for 2018 is to transfer risk alongside the FHCF, transfer commercial non-residential (CNR) risk, and transfer aggregate annual risk in order to protect a portion of surplus for most catastrophic events and thereby further reducing the amount and likelihood of assessments

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beyond the 1-100 year event to the citizens of Florida. This in turn also provides for additional claims paying resources in the event that multiple hurricanes strike Florida. Citizens' private reinsurance programs are structured to also provide liquidity to Citizens by allowing Citizens to obtain reinsurance recoveries in advance of the payment of claims after a triggering event.

Staff has considered an approach to transfer meaningful amounts of exposure to the private market at competitive rates. Citizens is best poised to transfer risk to the private reinsurance market as a consistent buyer.

2018 Risk Transfer Program – Traditional Reinsurance

Staff has worked extensively with Citizens' co-brokers and its financial advisor to evaluate available options relating to the structure, terms, pricing, and other relevant matters in structuring the 2018 Traditional Risk Transfer Program. Citizens and its co-brokers, Willis Re and Guy Carpenter, convened with a number of global traditional reinsurance markets over the last four months to market Citizens' risk transfer programs. This marketing effort included demonstration of Citizens' management expertise and capabilities, high data quality which can help to better predict catastrophic losses, Citizens' financial capabilities, and Citizens' claims deployment and adjusting capabilities. The marketing efforts culminated in efficient pricing and continued future opportunities for Citizens to further reduce its exposure.

The traditional reinsurance program provides coverage for personal residential, commercial residential, and commercial non-residential covered losses. It is important to note that Citizens' co-brokers also perform reinsurer market credit analyses to evaluate the financial strength of reinsurers seeking placement on Citizens' program. The purpose of this process is to ensure Citizens' placement is with reinsurance partners that are financially stable, solvent, and properly managed in order to pay valid claims when due. This analysis includes reviews of various qualitative and quantitative factors, including, but not limited to, a review of credit ratings and reports, review of financial statements, key financial ratios, review of management, and claims settlement history.

2018 Risk Transfer Program – Capital Markets

Citizens has been a participant in capital markets risk transfer in prior years, and has on several occasions used a collateralized structure to mitigate counterparty risk. Fiscal year 2012 marked the first time that Citizens used the capital markets for a portion of its risk transfer program. Over the last six years, Citizens executed a total of $3.1 billion of multi-year, collateralized reinsurance placements in the capital markets with Everglades Re. These placements not only provided an overall reduction in the pricing of reinsurance programs but also enabled Citizens to expand the diversity of reinsurance sources and reach new market participants.

In 2018, the capital markets transaction team is expected to obtain efficient pricing based upon market conditions and the continued evolution of the capital markets risk transfer space. The 2018 transaction provides aggregate cover to protect Citizens' surplus, and by extension reduce its reliance on assessments, in the event of multiple smaller storms or a large event.

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This serves as a reflection of both current market conditions and Citizens' continued and expanded efforts in the capital markets.

The 2018 transaction is almost identical to the 2017 capital markets transaction and is placed just above the exhaustion of the FHCF and alongside the traditional aggregate layer and the 2017 capital markets transactions. The 2018 transaction, like the 2015 and 2017 transactions, is callable after two years in the event of a significant change in Citizens' exposure, primarily due to depopulation, which provides flexibility.

The Everglades Re II transaction represents an important continuation of the risk transfer strategy for Citizens. Primary benefits of the capital markets segment of the 2018 Risk Transfer Program include the following:

- Provides beneficial diversification to Citizens' risk transfer counterparties by introducing new participants and continuation of the previous year's participants to Citizens' program;
- Reduces counterparty risk through full collateralization; and
- Provides collateralized, multi-year aggregate protection at a fixed cost; among other advantages, this can improve Citizens' financial posture in years following hurricane events.

Recommendation

Staff recommends that the Board of Governors take the following actions:

1) Approve the recommendation to purchase traditional and capital markets risk transfer in the Coastal Account at a cost not to exceed the amount of $92 million; and
2) Authorize Staff to take any appropriate or necessary action consistent with this Action Item.