INSURANCE INFORMATION INSTITUTE

RESIDUAL MARKET PROPERTY PLANS: FROM MARKETS OF LAST RESORT TO MARKETS OF FIRST CHOICE

SEPTEMBER 2014

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I. The Changing Residual Property Market

INTRODUCTION

Major forecasters continue to expect a below-average 2014 Atlantic hurricane season, but it only takes one storm for insurers' loss experience to change, as proven by 2012's Hurricane Sandy or by Hurricane Andrew in 1992—the event that caused the first explosion in residual market growth beginning 20 years ago. Hurricane Arthur and Tropical Storm Bertha, the first two storms of 2014, could easily have caused significant damage along the U.S. East Coast had they taken a more westerly track.

This year's report by the Insurance Information Institute (I.I.I.) reveals that the exposure value of the residual property market in hurricane-exposed states has declined significantly from the peak levels seen in 2011. In fact between 2011 and 2013, total exposure to loss in the plans fell by almost 30 percent.

At $639 billion, the 2013 exposure to loss of the residual market property insurers is also down from $772 billion at year-end 2007, two years after Hurricane Katrina.

Meanwhile policy counts in 2013—at around 3.2 million—are also down from their 2011 highs.

However, while attempts by certain states to reduce the size of their plans appear to be paying off, the fact of the matter is that this market of last resort remains the market of first choice for many vulnerable, high-risk coastal properties.

The fact that many of the plans charge rates that are not actuarially sound and do not accurately reflect the risk of loss means that a major hurricane could expose residents in certain states to billions of dollars in post-storm assessments.

Increased appetite for these risks from the capital markets—highlighted by Florida Citizens Property Insurance Corp's record-setting $1.5 billion catastrophe bond issued in 2014 (the largest single catastrophe bond issuance in history)—should not detract from the core concerns that this concentration of risk represents.[1]

I.I.I.'s latest analysis adds to what is now a well-documented body of research among industry experts and government agencies demonstrating that many state-run residual property insurers have morphed from markets of last resort to become major insurance providers in their states. [2]

[1] http://www.artemis.bm/blog/2014/05/02/everglades-re-2014-completes-officially-the-largest-catastrophe-bond-ever/.
[2] *State Beach and Windstorm Plans*, Insurance Research Council, October, 2010; GAO 10-568R, Natural Catastrophe Insurance Coverage, Government Accountability Office (GAO), October, 2010.

Annual growth in U.S. residual market exposures averaged close to 18 percent between 1990 and 2007, according to the Insurance Research Council (IRC).[3] It is important to recognize that because most of these plans do not charge rates that reflect the true cost of risk, demand for the subsidized coverage they provide remains high.

As long as the plans continue to grow and their coverage remains underpriced, state finances will remain under threat, while policyholders and ultimately taxpayers, many of whom live nowhere near the coast, will continue to face the prospect of increased assessments in the years ahead.

OVERVIEW

A myriad of different programs in place across the United States provide insurance to high-risk policyholders who may have difficulty obtaining coverage from the standard market. So called residual, shared or involuntary market programs make basic insurance coverage more readily available.

Today, property insurance from the residual market is provided by Fair Access to Insurance Requirements (FAIR) Plans, Beach and Windstorm Plans and two state-run insurance companies in Florida and Louisiana: Florida Citizens Property Insurance Company (CPIC) and Louisiana Citizens Property Insurance Corporation (Louisiana Citizens). Established in the late 1960s to ensure the continued provision of insurance in urban areas, FAIR Plans often provide property insurance in both urban and coastal areas, while Beach and Windstorm Plans cover predominantly wind-only risks in designated coastal areas. Hybrid plans like Florida and Louisiana's CPIC, provide property insurance throughout those states. It is important to note that in addition to windstorm risk, these plans routinely cover a range of other exposures, such as vandalism and fire. In addition to these residual property plans, a number of federal legislative proposals regarding the financing of natural catastrophes are under consideration. A detailed analysis is beyond the scope of this paper, but a summary of the various proposals is available in Appendix 1.

In the course of the last four decades these FAIR and Beach Plans have experienced explosive growth both in terms of policy count and exposure value. However, latest data shows that between 2011 and 2013, total exposure to loss in the plans fell by almost 30 percent. The most recent decline in the residual market exposure belies a period of more than 20 years between 1990 and 2011—a period characterized by major catastrophes such as Hurricane Andrew and Hurricane Katrina—when total exposure to loss in the plans surged by 1,517 percent from $54.7 billion in 1990 to a peak of $884.7 billion in 2011. Total policies in-force (both habitational and commercial) in the nation's FAIR and Beach and Windstorm Plans combined more than tripled from 931,550 in 1990 to peak at 3.31 million in 2011. In 2013, total policy counts for the residual property plans remain just below those record levels at 3.22 million (Fig. 1 and 2).

[3] Ibid.

Fig. 1

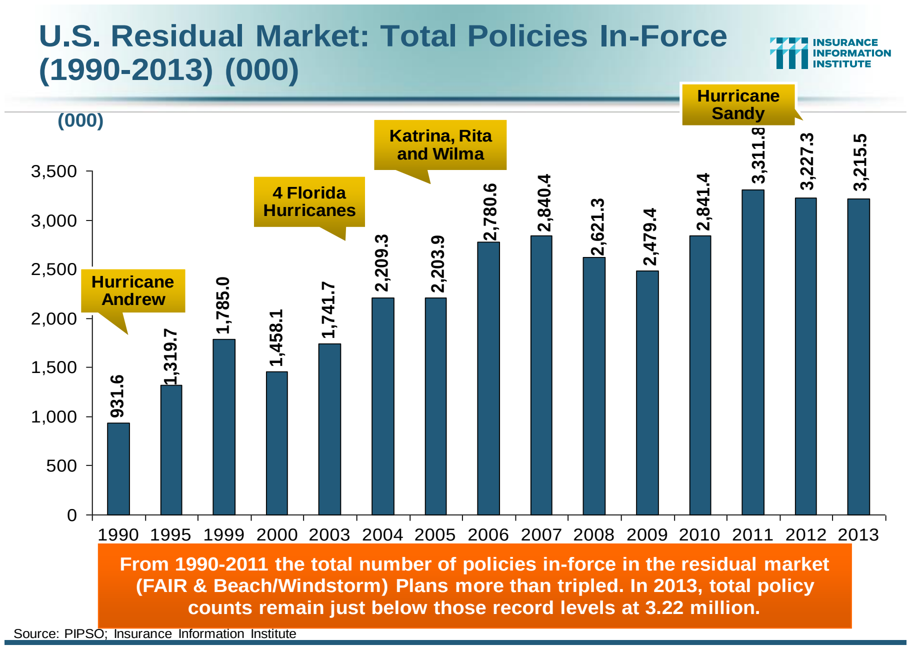
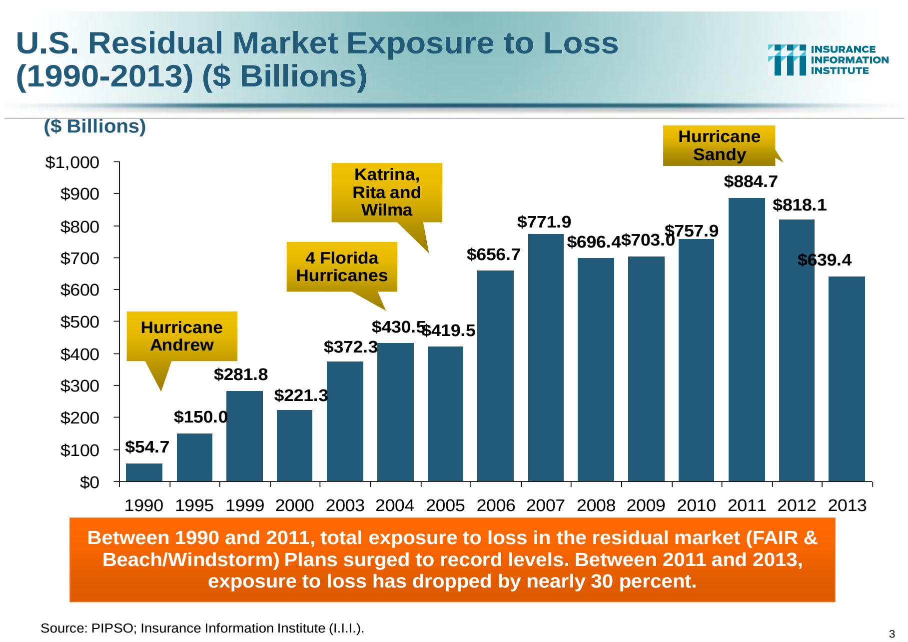
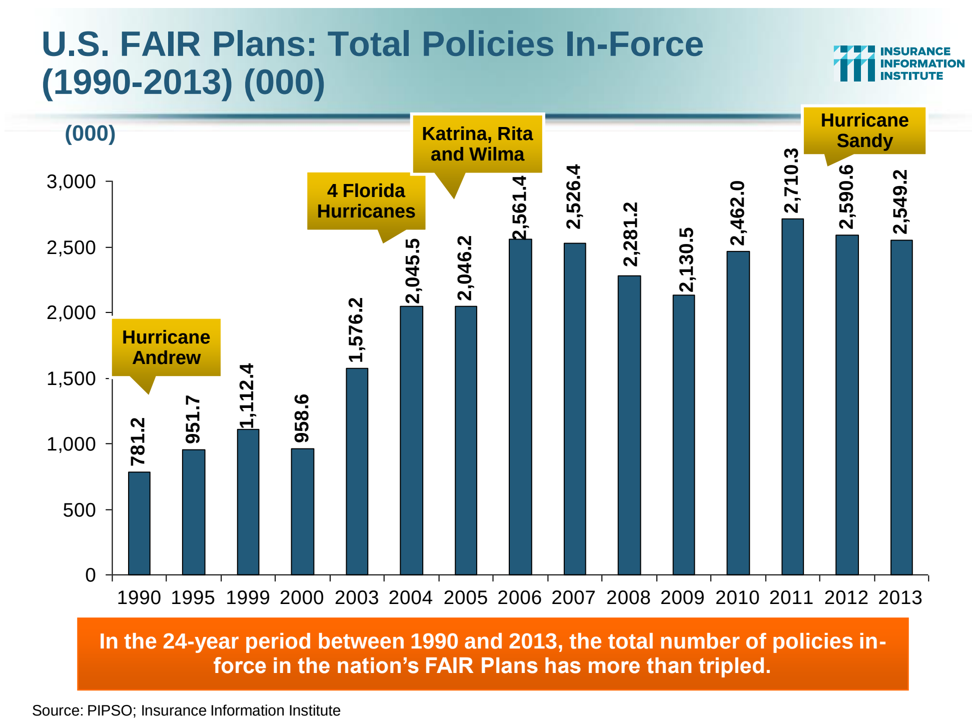

U.S. Residual Market: Total Policies In-Force (1990-2013) (000)
INSURANCE INFORMATION INSTITUTE
(000)
Hurricane Andrew
4 Florida Hurricanes
Katrina, Rita and Wilma
Hurricane Sandy
3,500
3,000
2,500
2,000
1,500
1,000
500
0
931.6
1,319.7
1,785.0
1,458.1
1,741.7
2,209.3
2,203.9
2,780.6
2,840.4
2,621.3
2,479.4
2,841.4
3,311.8
3,227.3
3,215.5
1990 1995 1999 2000 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013
From 1990-2011 the total number of policies in-force in the residual market (FAIR & Beach/Windstorm) Plans more than tripled. In 2013, total policy counts remain just below those record levels at 3.22 million.
Source: PIPSO; Insurance Information Institute

Fig. 2


U.S. Residual Market Exposure to Loss (1990-2013) ($ Billions)
INSURANCE INFORMATION INSTITUTE
($ Billions)
Hurricane Andrew
4 Florida Hurricanes
Katrina, Rita and Wilma
Hurricane Sandy
$1,000
$900
$800
$700
$600
$500
$400
$300
$200
$100
$0
$54.7
$150.0
$281.8
$221.3
$372.3
$430.5
$419.5
$656.7
$771.9
$696.4
$703.0
$757.9
$884.7
$818.1
$639.4
1990 1995 1999 2000 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013
Between 1990 and 2011, total exposure to loss in the residual market (FAIR & Beach/Windstorm) Plans surged to record levels. Between 2011 and 2013, exposure to loss has dropped by nearly 30 percent.
Source: PIPSO; Insurance Information Institute (I.I.I.).
3

The nation's FAIR Plans account for by far the majority of policies and exposure in the overall residual property market. For example, total policies in-force (both habitational and commercial) in the FAIR Plans more than tripled from 781,188 in 1990 to 2.5 million in 2013 (Fig.3).

Fig. 3



While total exposure to loss in the FAIR Plans declined by 38 percent from $715.3 billion in 2011 to $445.6 billion in 2013, total exposure to loss in the Beach and Windstorm Plans continued to grow, increasing by 14 percent during that period (Fig. 4 and 5). Since 2010, the Beach and Windstorm Plans have seen their exposure more than double from $95.2 billion to $193.7 billion in 2013.

Fig. 4

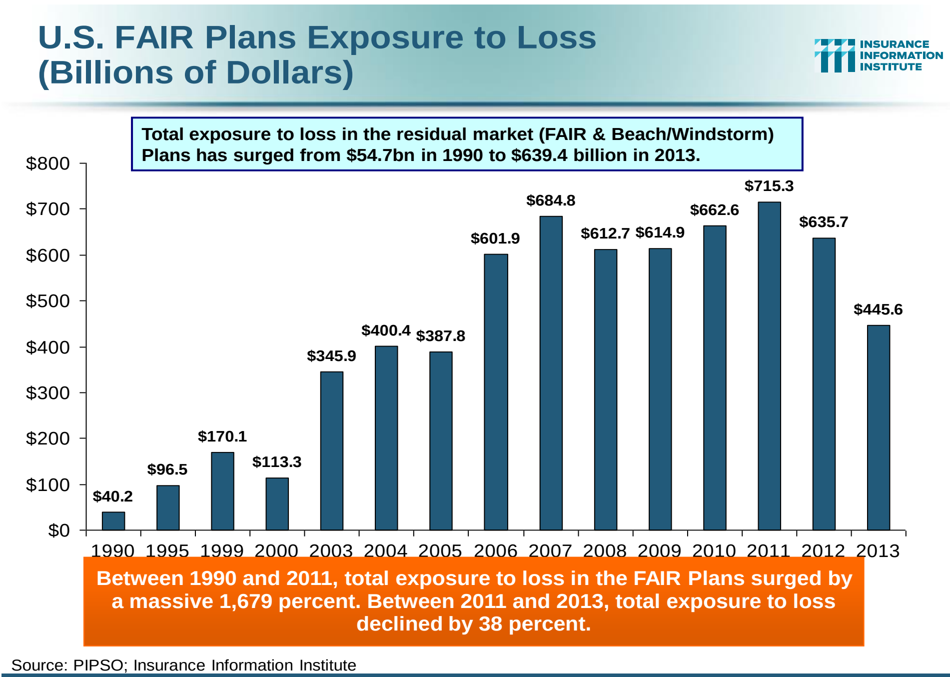
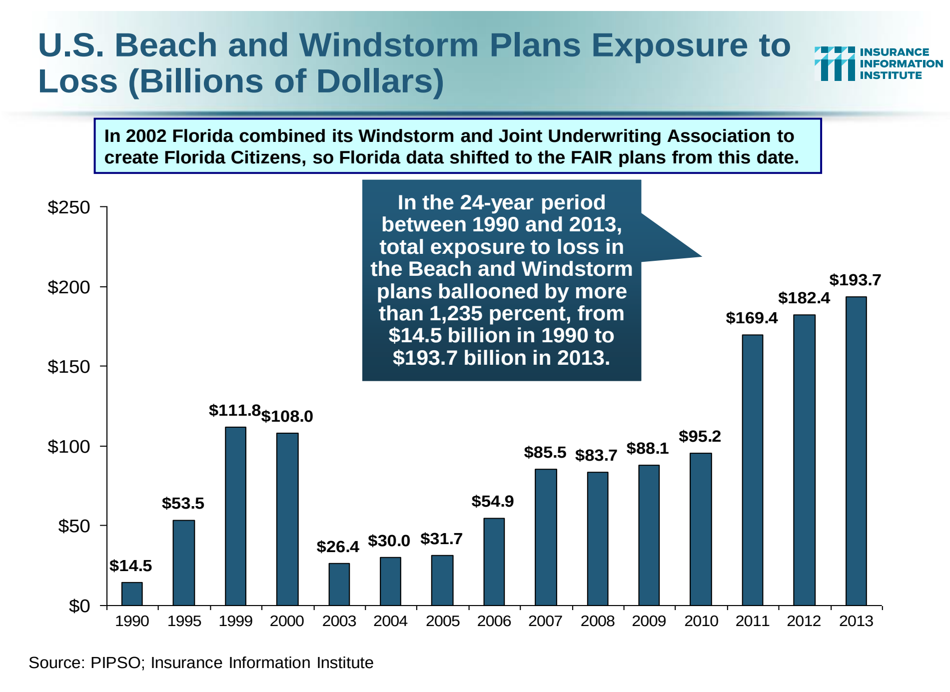

U.S. FAIR Plans Exposure to Loss (Billions of Dollars)
INSURANCE INFORMATION INSTITUTE
Total exposure to loss in the residual market (FAIR & Beach/Windstorm) Plans has surged from $54.7bn in 1990 to $639.4 billion in 2013.
$800
$700
$600
$500
$400
$300
$200
$100
$0
$40.2
$96.5
$170.1
$113.3
$345.9
$400.4
$387.8
$601.9
$684.8
$612.7
$614.9
$662.6
$715.3
$635.7
$445.6
1990
1995
1999
2000
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
Between 1990 and 2011, total exposure to loss in the FAIR Plans surged by a massive 1,679 percent. Between 2011 and 2013, total exposure to loss declined by 38 percent.
Source: PIPSO; Insurance Information Institute

Fig. 5


U.S. Beach and Windstorm Plans Exposure to Loss (Billions of Dollars)
INSURANCE INFORMATION INSTITUTE
In 2002 Florida combined its Windstorm and Joint Underwriting Association to create Florida Citizens, so Florida data shifted to the FAIR plans from this date.
In the 24-year period between 1990 and 2013, total exposure to loss in the Beach and Windstorm plans ballooned by more than 1,235 percent, from $14.5 billion in 1990 to $193.7 billion in 2013.
$250
$200
$150
$100
$50
$0
$14.5
$53.5
$111.8
$108.0
$26.4
$30.0
$31.7
$54.9
$85.5
$83.7
$88.1
$95.2
$169.4
$182.4
$193.7
1990
1995
1999
2000
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
Source: PIPSO; Insurance Information Institute

Despite recent fluctuations in the exposure levels of the residual property market, over the course of several decades it is clear that in some states these plans shifted away from their original purpose as predominantly urban property insurers. As a result, many evolved from their traditional role as markets of last resort into much larger insurance providers, in some cases even becoming the largest property insurer in a state.

After the record hurricane seasons of 2004 and 2005, and amid predictions of increased storm activity over the next 15 to 20 years, this shift of high-risk exposure away from the private insurance market placed an enormous burden on these plans. Arguably, many of the plans became home for the most highly exposed, wind-only risks—in other words the least attractive types of business. In some cases, this left plans with huge concentrations of risk.

Consequently, it is not surprising that many of the plans have experienced severe financial difficulties in certain years (see section on financial results). Of the 31 FAIR Plans for which data are available, 28 have incurred at least one operating deficit since 1999. Of the six Beach and Windstorm Plans for which data are available, all have sustained at least one underwriting loss since 1999.

GROWTH IN SIZE AND POPULATION

The FAIR and Beach and Windstorm Plans have experienced explosive growth in the course of the last two decades. However, the number of policies in-force and exposure to loss in each plan can rise or fall from one year to the next due to legislative and regulatory developments—in addition to actual catastrophic loss activity.

A July 2010 study by the Government Accountability Office (GAO) found that between 2005 and 2009 the plans in Mississippi, Texas and Florida showed the largest percentage growth in terms of exposure and number of policyholders.

According to the Property Insurance Plans Service Office (PIPSO), total exposure to loss in the residual market (FAIR and Beach/Windstorm Plans) rose from $419.5 billion in 2005 to a record $884.7 billion in 2011—an increase of 1,109 percent—and between 1990 and 2011, exposure to loss in the plans surged by 1,517 percent.

In 2013 total exposure to loss in the FAIR Plans was $445.6 billion, a 38 percent decline from the 2011 peak of $715.3 billion in exposure. Meanwhile the FAIR Plans had a total policy count of 2.55 million in 2013, comprising some 2.48 million habitational policies and 64,359 commercial policies (Table 1).

Table 1

INSURANCE PROVIDED BY FAIR PLANS, FISCAL YEARS 2004-2013 (1)

	Number of			
Year	Habitational policies	Commercial policies	Exposure (2) ($000)	Direct written premiums ($000)
2004	1,907,337	138,163	400,413,034	2,164,546
2005	1,928,292	117,942	387,780,124	2,234,493
2006	2,389,299	172,070	601,859,916	4,063,324
2007	2,412,252	114,053	684,829,667	4,431,381
2008	2,190,189	90,876	612,749,753	3,727,311
2009	2,043,969	86,575	614,905,551	3,038,712
2010	2,378,736	83,243	662,633,180	3,448,576
2011	2,658,662	51,657	715,289,876	3,942,021
2012	2,518,808	71,776	635,705,150	4,059,446
2013	2,484,816	64,359	445,635,335	3,685,283

(1) Includes the Texas FAIR Plan; Florida's Citizens Property Insurance Corporation, which includes FAIR and Beach Plans; the Louisiana Citizens Property Insurance Corporation, which includes FAIR and Beach Plans for 2004, 2005 and premiums written after 2007; and North Carolina after 2010.

(2) Exposure is the estimate of the aggregate value of all insurance in-force in all FAIR Plans in all lines (except liability, where applicable, and crime) for 12 months ending September through December.

Source: Property Insurance Plans Service Office (PIPSO).

Florida Citizens, a plan that accounts for more than half (51 percent) of the total FAIR Plans' exposure to loss, saw its exposure to loss drop by nearly 50 percent from $429.4 billion in 2012 to $228.9 billion in 2013, as Citizens' took much-needed steps to reduce its size. This accounted for the overall reduction in total exposure under the FAIR Plans.

The drop in exposure came after Florida Citizens exposure to loss had hit a new peak of $510.7 billion in 2011, surpassing its prior peak of $485.1 billion in 2007. Florida Citizens' exposure to loss had also risen to $460.7 billion in 2010, after two Florida insurers were declared insolvent and as a number of national companies reduced their exposure to Florida windstorm risk, leaving some high-risk policyholders looking for coverage (see later section).

Florida Citizens also accounts for 57 percent of the total FAIR Plans policy count. Of the 2.5 million total policies (habitational and commercial) insured by the FAIR Plans in 2013, some 1.5 million were in Florida Citizens. In 2014, Florida Citizens saw its total policy count drop to below the one million mark for the first time since 2006. Florida Citizens attributes this success to eight storm-free years that have enabled Florida's private insurance market to begin to rebound as new investors and companies look to increase their market share in the state.

Meanwhile, premiums written by Florida Citizens in 2013 also declined. Direct premiums written totaled $2.7 billion in 2013, down from $3.2 billion in 2012. Between 2007 and 2008, direct premiums written by Florida Citizens had declined by nearly $1 billion (from $3.7 billion in 2007 to $2.8 billion in 2008). The collapse in home and condominium construction throughout the state due to the subprime mortgage and credit crisis and ensuing recession had been a significant factor in the decline in new business.

After Florida, Massachusetts has the next largest number of policies, with 215,579 or 8 percent of total FAIR Plan policies (Table 3). The Texas Beach and Windstorm Plan (Texas Windstorm Insurance Association) insured 289,530 total policies in 2013, making it the largest Beach and Windstorm Plan.

In the Beach and Windstorm Plans, as in the FAIR Plans, the policy count varies significantly from year to year due to the shifting size and nature of some of the plans, described below. In 2002 Florida combined its Windstorm and Joint Underwriting Association to create Florida Citizens, so these policies were counted under the FAIR Plans from that date.

PIPSO data show that between 2005 and 2013, the number of policies in the Beach and Windstorm Plans as a whole more than tripled from 157,708 in 2005 to 666,282 in 2013 as the plans continued to experience burgeoning growth. It is important to note that PIPSO's figures include the North Carolina Beach Plan, one of the largest Beach and Windstorm Plans, and a PIPSO member as of June 2012 (see later section on North and South Carolina's property insurers of last resort).

Total exposure to loss under the Beach and Windstorm Plans, as under the FAIR Plans, has ballooned by 1,236 percent from $14.5 billion in 1990 to $193.7 billion in 2013, demonstrating the values at stake (Fig. 6) (Table 2).

Between 2005 and 2013 some of the Beach and Windstorm Plans reporting results to PIPSO have seen accelerating exposure growth rates. During this period, for example, total exposure to loss in the Texas Beach Plan increased by 230 percent.

Table 2

INSURANCE PROVIDED BY BEACH AND WINDSTORM PLANS, FISCAL YEAR 2013 (1)

	Number of			
State	Habitational policies	Commercial policies	Exposure (2) ($000)	Direct written premiums ($000)
Alabama	29,520	96	$5,061,538	$45,393
Mississippi	42,351	1,331	6,891,208	76,509
North Carolina	247,797	12,179	90,074,990	385,460
South Carolina	42,617	861	14,772,689	92,648
Texas	273,097	16,433	76,921,369	472,740
Total	**635,382**	**30,900**	**$193,721,794**	**$1,072,750**

(1)The Florida and Louisiana Beach Plans merged with their FAIR Plans.
(2) Exposure is the estimate of the aggregate value of all insurance in-force in each state's Beach and Windstorm Plan in all lines (except liability, where applicable, and crime) for 12 months ending September through December.

Source: Property Insurance Plans Service Office (PIPSO).

While certain coastal states have shown particularly rapid growth in terms of policy count over the years, more recently policy counts have declined in some states such as Florida and Louisiana, as depopulation plans have taken effect. Under these plans state-run insurers can transfer policies back to private insurers, subject to regulatory approval.

For example, in 2007 Louisiana Citizens set out to reduce its policy count to below its pre-Hurricane Katrina policy total of 125,000. Louisiana Citizens' policy count had spiked to 174,000 in September 2008 in the wake of hurricanes Katrina and Rita. After completing another successful round of depopulation, Louisiana Citizens was reported to have reduced its personal lines policy count to below 90,000 in December 2013. According to the Louisiana Department of Insurance this brought Citizens to an all-time low homeowners market share of 2.7 percent from a high of 174,000 policies and 9.8 percent market share in 2008.

The depopulation of Louisiana Citizens is the result of an incentive program created by the legislature in 2007 to increase the availability of property insurance and to decrease the business written through Louisiana Citizens.

Table 3

INSURANCE PROVIDED BY FAIR PLANS BY STATE, FISCAL YEAR, 2013 (1)

	Number of			
State	Habitational policies	Commercial policies	Exposure (2) ($000)	Direct written premiums ($000)
California	123,287	5,327	$41,708,503	$69,103
Connecticut	2,829	116	540,843	3,687
Delaware	1,947	73	306,440	629
D.C.	368	63	115,687	393
Florida (3)	1,418,877	40,467	228,887,485	2,761,638
Georgia	33,793	1,792	4,731,530	25,431
Illinois	6,406	94	686,372	7,132
Indiana	2,232	52	243,382	2,190
Iowa	1,133	42	73,477	800
Kansas	11,648	163	623,217	5,540
Kentucky	11,596	589	589,679	7,633
Louisiana (3)	126,708	5,022	17,831,008	179,003
Maryland	2,225	89	421,309	1,408
Massachusetts	215,201	378	77,176,753	275,455
Michigan	24,109	439	3,011,975	26,581
Minnesota	5,465	37	1,259,687	4,257
Mississippi	12,847	(4)	751,425	8,829
Missouri	4,088	179	234,464	2,209
New Jersey	18,098	529	2,601,010	10,865
New Mexico	10,612	223	70,119	4,038
New York	52,312	3,584	14,449,237	36,996
North Carolina	139,642	2,226	11,204,596	52,429
Ohio	30,727	547	7,116,116	25,857
Oregon	2,332	80	189,989	947
Pennsylvania	20,706	1,463	1,731,758	8,272
Rhode Island	16,643	134	3,997,695	20,933
Texas	155,469	(4)	20,594,317	122,683
Virginia	32,871	557	4,429,507	19,798
Washington	54	23	21,109	175
West Virginia	591	71	36,646	372
Total	**2,484,816**	**64,359**	**$445,635,335**	**$3,685,283**

(1) Does not include the FAIR Plans of Arkansas, Hawaii and Wisconsin.
(2) Exposure is the estimate of the aggregate value of all insurance in-force in all FAIR Plans in all lines (except liability, where applicable, and crime) for 12 months ending September through December.
(3) Citizens Property Insurance Corporation, which combined the FAIR and Beach Plans.
(4) The Mississippi and Texas FAIR Plans do not offer a commercial policy.

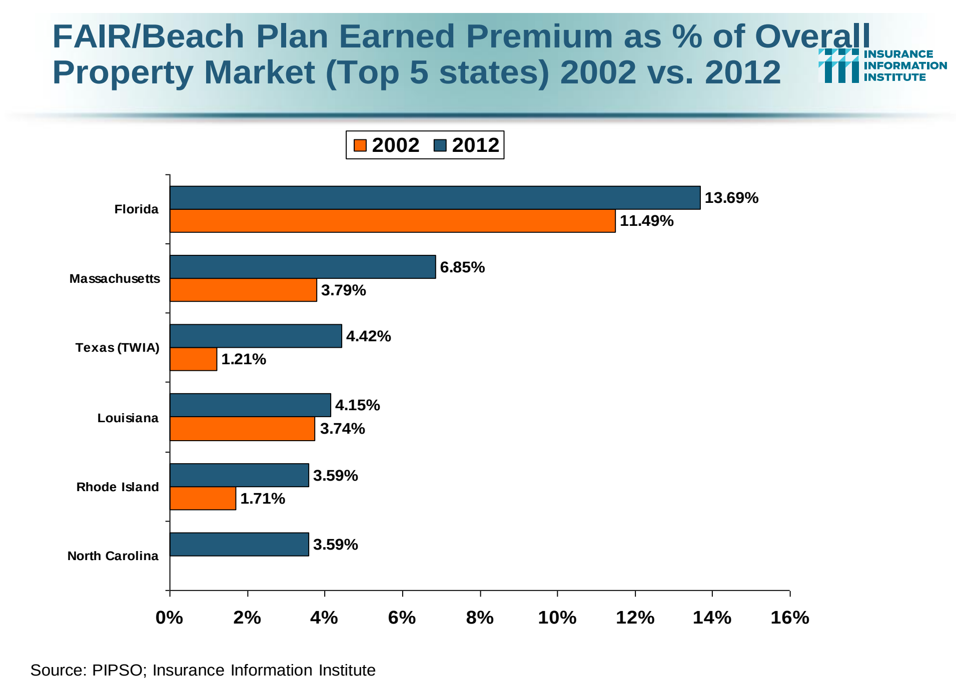
NA=Data not available.

Source: Property Insurance Plans Service Office (PIPSO).

It should be noted that in terms of the percentage of premium in the residual market, there are few states where the involuntary market represents more than 1 percent of total property premium. However, for several states, a significant percentage of the property insurance market is in the involuntary market (Fig. 6).

Florida and Massachusetts are two notable examples. For example, in Florida around 13.7 percent of property premium was in the involuntary market in 2012, while in Massachusetts 6.9 percent of the market was in the involuntary market in 2012. Texas is another state that has experienced rapid growth in its residual market, with 4.4 percent of property premium in the involuntary market in 2012, compared with just 1.2 percent in 2002. Rhode Island's residual market also accounts for 3.6 percent of its property market.

Fig. 6



Reasons Behind Explosive Growth

There are a number of factors that have contributed to such rapid growth in the plans. One key factor is the changing shape and size of the various residual market mechanisms in a number of states. While in the past there was a clear delineation between coastal and urban plans with coastal properties insured under Beach and Windstorm Plans, and urban properties under FAIR Plans, increasingly these distinctions are blurring. FAIR Plans are acting as an insurer of last resort for residents who live in shoreline communities in states that do not have a Beach and Windstorm Plan, such as New York State. Beach and Windstorm Plans in some states are being merged with FAIR Plans or joint underwriting associations as in Florida and Louisiana, or are administering new FAIR Plans as in Texas. As a result, it is difficult to make a direct comparison of the number of properties insured under any plan with numbers from earlier years. What is clear, however, is that the rapid growth in the FAIR Plans is due in part to these mergers.

Another factor fueling the increase is the rise in coastal properties. According to the U.S. Census Bureau, the population in coastline counties has grown steadily in recent decades (Table 4). The Atlantic coast, the Gulf of Mexico and the Hawaiian Islands are home to the U.S. counties most vulnerable to hurricanes. These counties account for nearly two-thirds of the nation's coastal population.

Table 4.

TOP TEN STATES, BY POPULATION CHANGE IN COASTAL COUNTIES, 1960-2010

	Total change			Percent change	
Rank	State	By change in number	Rank	State	By percent change
1	California	13,130,000	1	Florida	270.1%
2	Florida	10,360,000	2	Alaska	239.8
3	Texas	3,732,000	3	New Hampshire	198.0
4	Washington	2,578,000	4	Texas	161.9
5	Virginia	1,903,000	5	Virginia	150.8
6	New York	1,400,000	6	Washington	144.4
7	New Jersey	1,275,000	7	South Carolina	125.1
8	Maryland	938,000	8	Hawaii	115.2
9	Massachusetts	826,000	9	North Carolina	114.4
10	Hawaii	728,000	10	California	107.2

Source: U.S. Department of Commerce, Census Bureau.
http://www.census.gov/dataviz/visualizations/039/508.php

According to the latest National Oceanic and Atmospheric Administration (NOAA) *State of the Coast* report, in 2010, 52 percent of the nation's total population—some 163.8 million people—were living in coastal counties (including those that abut the Great Lakes).[4] In 2010 coastal population density was 319 persons per square mile, compared to just 61 persons per square mile in inland areas. Between 1970 and 2010, the population of U.S. coastal counties grew by 50.9 million people, or 45 percent.

Of the 11 most hurricane-prone counties, five are in Louisiana, three are in Florida and three are in North Carolina, according to the U.S. Bureau of the Census. Some 75.7 percent of the Florida population resides in coastal counties, compared with 32.3 percent in Louisiana, 9.9 percent in North Carolina and 47.7 percent for the total United States (Fig. 7).

Fig. 7

Top Coastal Counties Most Frequently Hit By Hurricanes: 1960 to 2008

County	State	Coastline Region	Number of Hurricanes	Percent Change in Population 1960 to 2008
Monroe County	Florida	Gulf of Mexico	15	50.8%
Lafourche Parish	Louisiana	Gulf of Mexico	14	67.2%
Carteret County	North Carolina	Atlantic	14	104.3%
Dare County	North Carolina	Atlantic	13	465.9%
Hyde County	North Carolina	Atlantic	13	-10.1%
Jefferson Parish	Louisiana	Gulf of Mexico	12	108.9%
Palm Beach County	Florida	Atlantic	12	454.7%
Miami-Dade County	Florida	Atlantic	11	156.5%
St. Bernard Parish	Louisiana	Gulf of Mexico	11	17.2%
Cameron Parish	Louisiana	Gulf of Mexico	11	4.8%
Terrebonne Parish	Louisiana	Gulf of Mexico	11	78.7%

Source: U.S. Census Bureau, Decennial Census of Population and Housing: 1960 to 2000; Population Estimates Program: 2008.

Exposure to windstorms and high property values combine to make Florida the state with the highest potential for losses and New York City and Long Island the second highest. An updated study by AIR Worldwide puts the value of insured coastal property in hurricane prone states—states bordering on the Atlantic Ocean and Gulf of Mexico—at $10.6 trillion in 2012, up 19 percent from $8.9 trillion in 2007 and up 47 percent from $7.2 trillion in 2004.[5] In Florida alone the value of residential and

[4] National Oceanic and Atmospheric Administration (NOAA), *State of the Coast*, Woods & Poole and NOAA 2011, http://stateofthecoast.noaa.gov/population/welcome.html

[5] AIR Worldwide, The Coastline at Risk, 2013 Update to the Estimated Insured Value of U.S. Coastal Properties.

commercial coastal property is $2.86 trillion (Fig. 8). This represents 79 percent of the state's total insured property values (Fig. 9). In New York it is even higher, at $2.92 trillion, but New York has a smaller proportion of its value in coastal counties, at 62 percent. In terms of insured residential coastal exposures, Florida, New York and Texas are the top three states on the list (Fig. 10). However, the value of New York's commercial coastal property, at $2.1 trillion, is higher than that of any other state on the list (Fig. 11). Other states where insured coastal property values exceed 50 percent of the state's total are Connecticut, Maine and Massachusetts.

Fig. 8

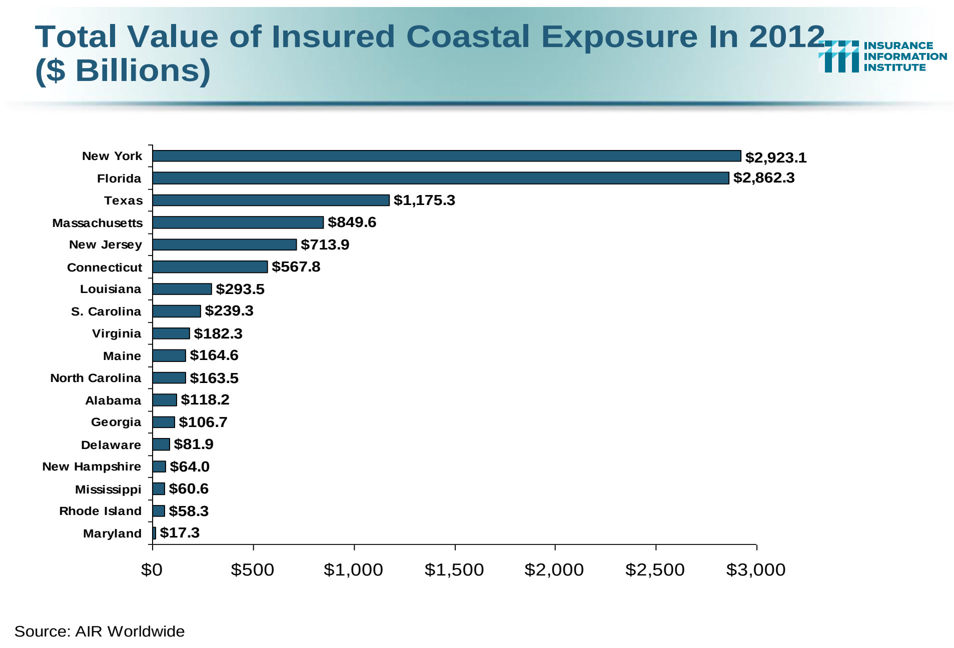
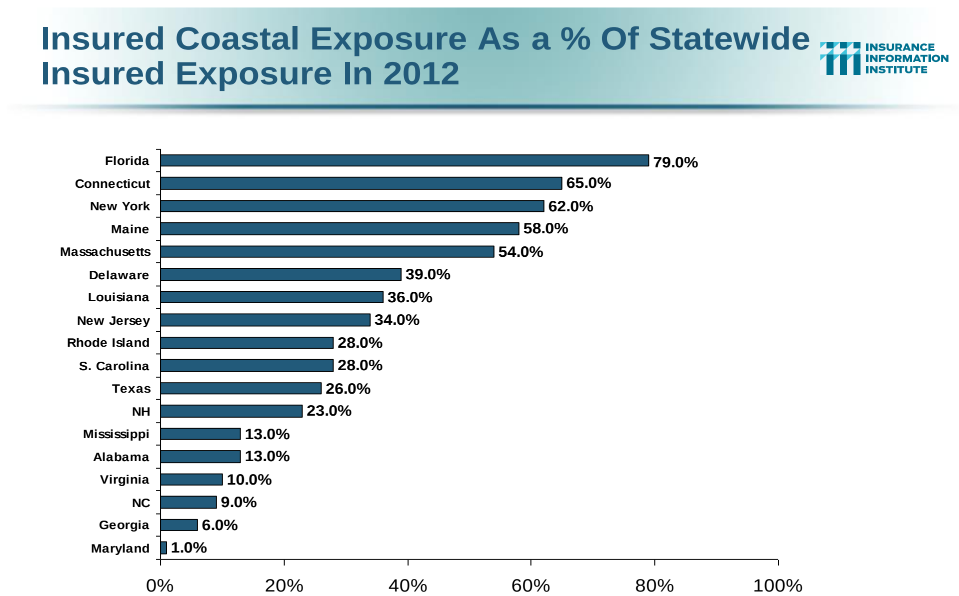
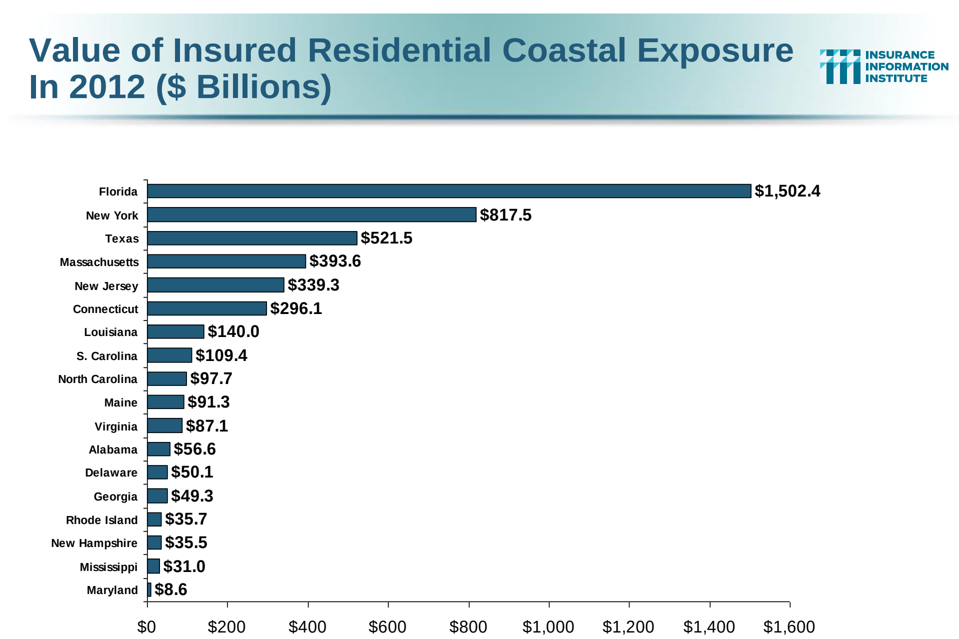


Fig. 9



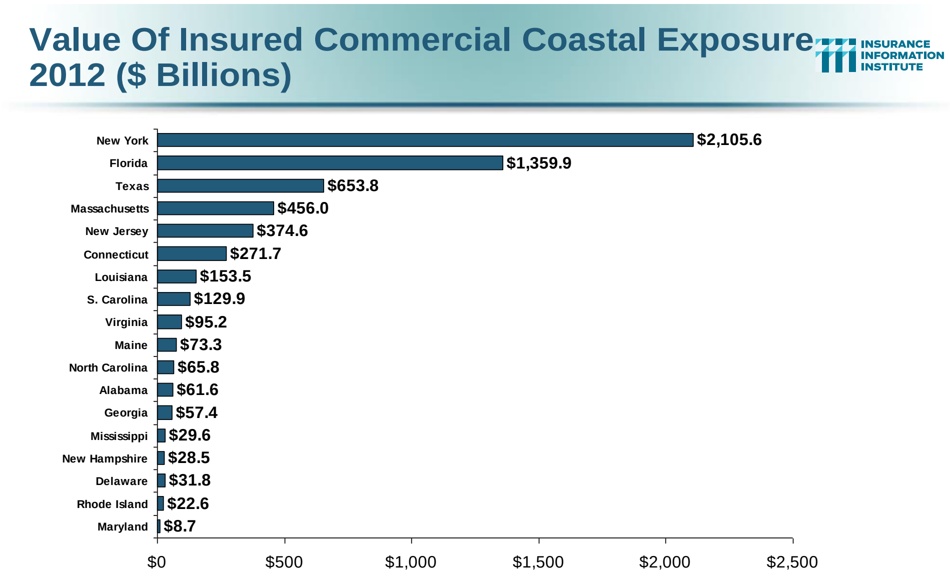
Source: AIR Worldwide

Fig. 10



Source: AIR Worldwide

Fig. 11



Source: AIR Worldwide

Even in states where the value of insured coastal property values represents a relatively small percentage of total insured property values it does not mean that the residual markets are not experiencing rapid growth. For example, North Carolina ranks 11th on AIR's list, with $163.5 billion in insured coastal exposure, representing just 9 percent of the state's total insured values. Yet as of year-end 2012, North Carolina's Beach and Windstorm Plan, the North Carolina Insurance Underwriting Association, reported a total of 233,403 policies, up from 119,810 policies reported at the end of 2005. Total exposure to loss under the plan also increased, from $43.3 billion in 2005 to $81.0 billion at year-end 2012—an increase of 87 percent.

PUBLIC ATTITUDES TOWARD SUBSIDIZED INSURANCE FOR COASTAL DWELLERS

Evidence shows that the growth in residual market mechanisms may be due in part to the implicit support of residents of coastal communities. According to the Insurance Research Council (IRC), geographic proximity to the coast plays a major role in influencing opinions about the fairness of policyholder and taxpayer property insurance subsidies for natural disasters.[6] The IRC found that those living in non-coastal areas are more likely to disapprove of taxpayer and policyholder subsidies of insurance costs for those living in high-risk areas. Some 63 percent of those from interior counties and non-coastal states believe policyholder subsidies for wind damage coverage in coastal areas are unfair, compared with half of those from coastal counties (Fig. 12). Similarly, when asked about taxpayer subsidized

[6] Insurance Research Council (IRC), Public Attitude Monitor (PAM) 2006, Issue 2, October 2006.

insurance for natural disasters such as the National Flood Insurance Program, 59 percent of those from interior counties and 61 percent from non-coastal states found these to be unfair, compared with just 51 percent of those in coastal counties (Fig. 13).

Fig. 12

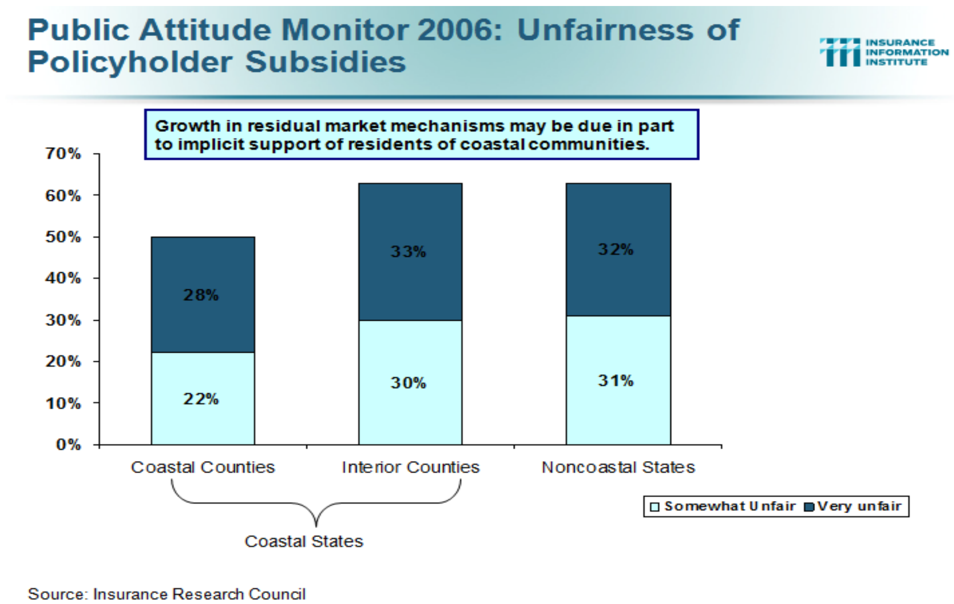
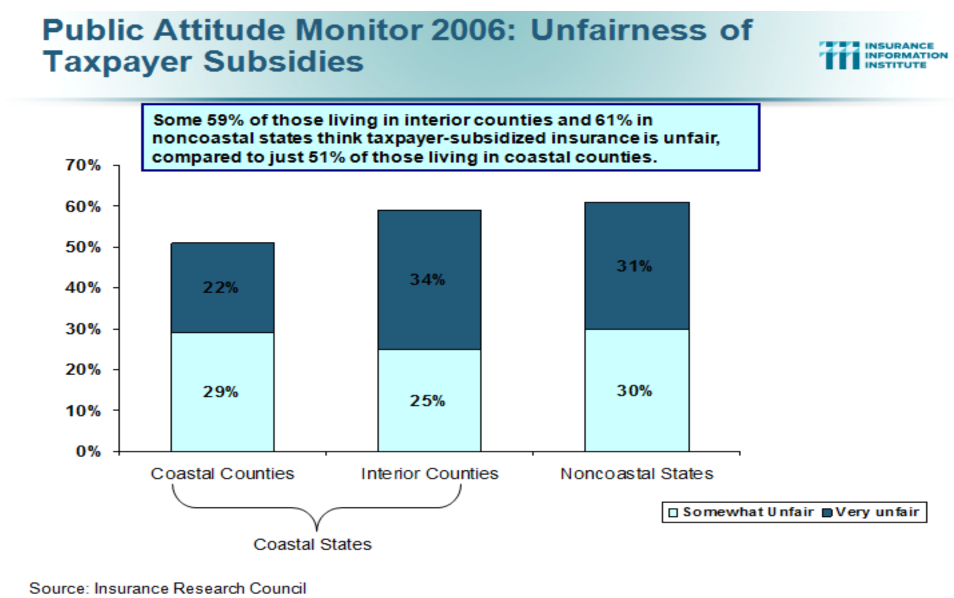


Fig. 13



Availability and affordability of property insurance in the voluntary market also has an impact on the rate of growth of the FAIR and Beach and Windstorm Plans. Applicants rejected by the voluntary market may apply to the residual market, where acceptance is usually contingent upon proof of inability to obtain coverage in the voluntary market, with some pools requiring evidence of rejection from two or three companies. Therefore, the inability of insurers to charge a rate commensurate with the risk to be assumed (due to regulatory suppression of rates) is a major factor in their decision to reject an applicant in the voluntary market. In addition, the concentration of property risks in coastal areas means insurers are unable to diversify and spread their portfolio, and that can lead to a reduction or even withdrawal of voluntary capacity in certain markets. For example, in early 2009 a leading Florida property insurer announced plans to withdraw from that state. Such a situation inevitably will increase the volume of property policies being written by the residual market mechanisms.

FINANCIAL RESULTS

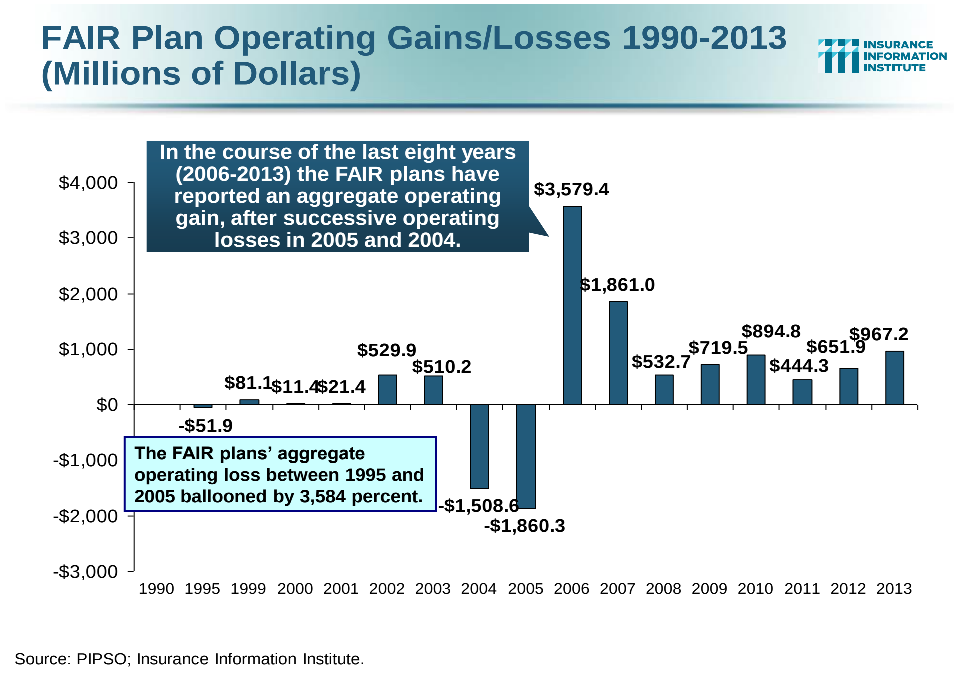
Today, many residual property market plans have shifted away from their original mission as insurers of urban properties into major providers of insurance in high-risk coastal areas. It is important to recognize that many operate at deficits, or from slim positions of surplus, even in years with little or no catastrophe losses. A variety of factors are at play here, including the fact that state plans may be prohibited from charging a rate that is commensurate with the risk being assumed.

Such frequent volatility in the financial results of the plans raises key questions not just about heightened risk in coastal areas and coastal development, but about rate adequacy. The funding that underpins the plans is in many cases not adequate to offset the rising coastal exposures. Benign hurricane seasons, while welcome reprieves, do not provide a solution for this situation as experts predict that hurricane losses will only continue to grow in the long term. The large volume of insurance being provided under the plans also has serious implications for the private property insurance market and state fiscal policy.

Rates charged by state plans are controlled by state regulators and legislators and are therefore vulnerable to political manipulation. The tendency of regulators and/or legislatures to suppress rates in the private sector is a major contributing factor to a pull-back by private insurers in many coastal areas, which leads directly to more property owners seeking coverage through the state's residual market facility, often at rates that are inadequate.

In 2013, the latest year for which complete data is available, the FAIR Plans reported an aggregate operating gain of $967.2 million, a 48 percent increase from the $651.9 million reported in 2012. Eight consecutive years of gains between 2006 and 2013 followed successive operating losses of $1.9 billion in 2005 and $1.5 billion in 2004 (Fig. 14). The turnaround in fortunes in recent years can be attributed to the less active hurricane seasons that followed the record hurricane losses experienced in 2005 and 2004.

Fig. 14



It is important to note that the figures for 2005-2007 exclude the results of Louisiana Citizens Property Insurance Corporation, a plan severely impacted by losses arising from Hurricane Katrina in 2005 and the third largest of all the FAIR/Beach plans by number of policies in 2004. In 2013 Louisiana Citizens reported an operating gain of $22.9 million after two consecutive years of operating losses in 2012 and 2011.

In the decade from 1995 to 2005, the FAIR Plans saw a more than 30-fold ballooning of their aggregate operating loss. If Louisiana Citizens' reported 2005 operating deficit of $954 million is included, the FAIR Plans' 2005 deficit rises to a staggering $2.8 billion—a more than 50-fold increase in the aggregate deficit over the course of the decade.

In 2005 by far the largest deficit—$1.77 billion—was reported by Florida's FAIR Plan, Citizens Property Insurance Corporation. Both Florida and Louisiana's 2005 deficits resulted in the levying of assessments on virtually all residential property owners in their states.[7] Insufficient rates, inadequate cash reserves and insufficient or nonexistent reinsurance have contributed to the problems in Florida, Louisiana and other states.

[7] Florida's Citizens can assess even property owners that are not its own insureds; people who live on the coast and people who have filed no claims.

The financial results of the Beach and Windstorm Plans show a similar trend. The results of these plans are illustrative of the fact that in years of low hurricane activity operating margins are slim, and in years of high hurricane activity, losses mount. The Insurance Research Council (IRC) reports that as rate inadequacy has continued to increase, the demand for coverage from Beach and Windstorm Plans has grown relative to the total statewide property insurance market. As a result, some plans face increasing risk of insolvency and the potential for large assessments on insurance in non-coastal areas is increased.[8]

If their claims-paying capacity is exhausted in a particular year, FAIR and Beach and Windstorm Plans have a number of capital-raising options available to them:

- ***Levy of assessments*:** When losses exceed claims-paying capacity in a given year, FAIR and Beach and Windstorm plans are required by state law to assess participating insurers. Assessments typically are based on an individual insurer's market share in the state. In many states insurers are allowed to recoup these assessments by imposing a rate surcharge on policyholders. In some states like Florida, the assessment is a percentage of premium and is passed through directly to consumers.
- ***Issuance of bonds*:** Plans also have the ability to finance losses and raise additional capacity via the issuance of bonds. In the wake of the 2004 and 2005 hurricane seasons, a number of plans went ahead with post-event bond issues. Pre-event bond issues may also be completed by some plans for funding future hurricane seasons. The cost of issuing bonds may be passed onto policyholders via assessments and surcharges. In recent years, plans have become increasingly dependent on the issuance of debt.
- ***Reinsurance and capital markets*:** Many plans also buy reinsurance or access the capital markets, providing them with additional layers of catastrophic coverage and ability to fund losses. While costs can be high, reinsurance is playing an increasingly important role in the financing of mega-catastrophes. For example, private reinsurers paid an estimated 45 percent of 2005 hurricane losses. More recently, certain plans have chosen to reduce or eliminate the coverage they purchase from private reinsurers, effectively "rolling the dice" when it comes to bearing these catastrophic risks.[9]

A number of plans are also accessing the capital markets to provide extra protection. In April 2014 Florida Citizens accessed the capital markets for the third time, significantly increasing its reinsurance protection via the issuance of a $1.5 billion catastrophe bond—the largest single catastrophe bond issuance in history.

The 2014 transaction is the third capital market risk transfer secured by Florida Citizens in the past three years. (A $750 million catastrophe bond was issued in 2012 and a second $250 million catastrophe bond was issued in March 2013.)

[8] *State Beach and Windstorm Plans*, Insurance Research Council, October, 2010.
[9] *States Shed Reinsurance and 'Run Naked' Through Storm Risks*, by Evan Lehmann of ClimateWire, New York Times, August 17, 2009.

The Texas Windstorm Insurance Association also accessed the capital markets for the first time in 2014 via the issuance of a $400 million catastrophe bond. Meanwhile, in 2013 Louisiana Citizens accessed the capital markets for the second consecutive year, joining a growing list that in previous years has included North Carolina's Beach and Windstorm Plan and the Massachusetts' Fair Plan.

In addition to assessments and debt, increasingly plans are being bailed out by a diversion of tax revenues from state coffers. Certain plan funding mechanisms may also expose state funds to excess hurricane losses. For example, losses from hurricanes Dolly and Ike in 2008 left the Texas general revenue fund exposed after the Texas Windstorm Insurance Association's funds were depleted (see later section on Texas). In an effort to offset the 2005 deficit of Florida Citizens Property Insurance Corporation, state legislators provided for a $715 million appropriation of state general revenue dollars to the fund. Similarly, in December 2006 the Louisiana legislature passed a law creating a state income tax credit for policyholders facing assessments from Louisiana Citizens. Diversion of state and federal funds to the Mississippi Windstorm Underwriting Association also followed the passage of reforms by the state legislature in 2009 and 2007 (see later section on Mississippi).

These subsidies effectively shift the cost of assessments from the plan's policyholders to policyholders and taxpayers across the state or country.[10] Such temporary political salves for policyholders in coastal areas are hardly a long-term solution to the financial distress in which some of the residual market plans find themselves. At the same time, they dilute the message of risk that actuarially sound premiums send to coastal dwellers. The effect is to encourage and enable even more vulnerable coastal development, further increasing residual market exposure and increasing the burden on taxpayers.

PRICING TO RISK

All insurers must file rates and forms with the state insurance regulator and residual market plans are not exempt from this requirement. However, each state has different rate-setting rules and individual plans write different types of risks, so the exact parameters vary from state to state. In general, residual market mechanisms have been designed to work as a complement to, rather than in competition with, the private market. Therefore, historically the rates charged by the residual plans have been higher than those in the voluntary market. The idea has been to charge a risk-based premium that is commensurate with the specific type of business being written.

Today, a number of state legislatures have eliminated the requirement for the rates charged by residual market plans to be noncompetitive with the private market. This means that private insurers face an uphill battle when trying to compete on price. A July 2010 report by the Government Accountability Office (GAO) found that most state-run natural catastrophe plans charge rates that are not actuarially sound and

[10] *Surcharges Help State Insurance Plans Control Rates*, by Thomas Frank, USA Today, September 22, 2010.

do not accurately reflect the risk of loss.[11] State natural catastrophe programs in Alabama, California, Florida, Louisiana, Mississippi, North Carolina, New Jersey, South Carolina and Texas were reviewed for the report. According to GAO, six of the 10 plans studied charged rates that did not fully reflect the risk of loss, potentially discouraging private market involvement and mitigation efforts by property owners.

As noted earlier, the availability and affordability of property insurance in the voluntary market has a direct impact on the rate of growth of the FAIR and Beach and Windstorm Plans. Post-2004 and 2005, property insurance market conditions changed rapidly, and a number of private insurers and residual market plans in hurricane zones came under considerable financial strain. Record catastrophe years may have amplified the problems, but even before 2004 and 2005, it was clear that many of the residual market plans had not lived up to their original objectives.

Today, overall exposures in the residual property market appear to have stabilized somewhat and many of the plans are underwriting profitably. Legislative reform passed in some of the most at-risk markets, for example the state of Florida, has also contributed to an improvement in the overall financial position of the plans. Diminished hurricane activity in recent years in areas like Florida has been another positive factor. But, while hurricane activity in the most exposed states may have been lower in recent years, there is no question that over the long-term major hurricanes will cause extensive damage in future. This highlights how important it is for the rates charged by these plans to be actuarially sound.

IMPACT ON THE VOLUNTARY INSURANCE MARKET

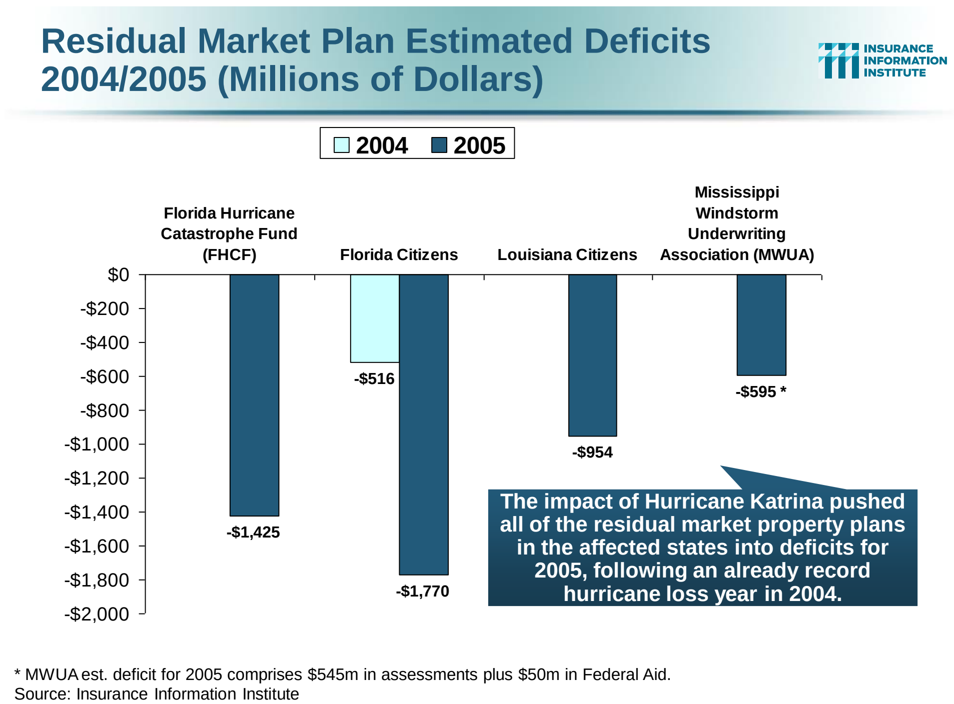
When the losses of FAIR Plans and Beach and Windstorm Plans exceed their claims-paying capacity in a given year, the plans impose an assessment on every participating insurer, typically based on their homeowners or property insurance market share in a state. In many states, insurers may then recoup this amount from policyholders when their homeowners policies come up for renewal. The plans may also buy reinsurance. This means that people far away from the coast and property owners who may have never filed a claim are called upon to subsidize coastal insurance rates.

In 2005 the extent of losses from Hurricane Katrina pushed all the residual market plans in the affected states into deficit (Fig. 15). This followed the record hurricane losses of 2004, when Florida Citizens also reported a deficit. As a result, the plans were required to assess participating insurers in order to remain solvent. While the assessment formulas vary from state to state, the record losses created substantial financial strains on private insurance companies in some Gulf coast states. This led a number of companies to file a class-action lawsuit against the Mississippi Windstorm Underwriting Association board of directors, claiming that the pool did not buy adequate and reasonable reinsurance, which led to the excessive

[11] GAO-10-568R – Natural Catastrophe Insurance Coverage, July 2010.

assessments.[12] Over time it is likely that private insurers operating in high-risk states will have to make additional adjustments to account for their increasing exposure to the residual market. Going forward, it will be critical for private insurers to better understand their risks to the residual market.

Fig. 15



Another important consideration is that as private insurers pull back from writing business in coastal areas, a significant share of premium is being ceded to the residual market. This means that private insurers, while reducing their exposure to catastrophic loss, are missing out on significant growth opportunities in certain states.

The leakage of premium to residual market mechanisms also has the ultimate effect of reducing options in the private marketplace, another negative for insurance buyers.

[12] Case 1:06-cv-00954-LTS-RHW; United States District Court for the Southern District of Mississippi Southern Division; Filed 09/15/06.

CONCLUSION

While residual market property plans fulfill a key role by ensuring that policyholders can obtain insurance coverage, their exponential growth in the course of the last two decades has key implications for insurers and insurance buyers going forward.

In particular, there are a number of public policy considerations that will need to be addressed as insurers, regulators and legislators seek a long-term solution to managing and funding catastrophic risks in future. Some of those public policy impacts are as follows:

- As residual market plans migrated from markets of last resort to markets of first, or only, choice in certain states, a significant amount of property insurance premium has exited the private marketplace (both the admitted and non-admitted insurance market). This reduced growth opportunities for carriers and choice for policyholders.

- When premiums charged are not commensurate with the risks assumed in highly vulnerable coastal and other areas, it can lead to increased development, unwise land-use policies and buildings that are not sufficiently well-constructed to withstand the exposures.

- When, due to political and/or regulatory constraints, insurers are unable to charge a premium commensurate with the risk they assume in coastal areas, this distorts the true cost of insurance coverage. This has two key public policy implications:

    1. Firstly, rate and underwriting restrictions on property insurers can result in a situation where high-risk property owners actually pay lower premiums, while low-risk property owners pay artificially higher premiums. This leads to unfair cross-subsidization among risk classes and discourages mitigation.

    2. Ultimately policyholders in both coastal and non-coastal areas pay the price of inadequate premiums in the form of additional payments, such as assessments and taxes following federal/state bailouts, which are passed on to them. Even policyholders of unrelated risks, such as auto and liability, have to pay assessments.

- In contrast to the private market, state-run insurers concentrate risks on the state itself—on its property owners, business owners and even its drivers—and, ultimately, the state's taxpayers. While private insurance transfers and spreads risk, ensuring that sufficient funds will be available in the event of a loss, state-run schemes act rather as a conduit to pass along their cost to other insurance buyers, even those who have never filed a claim, live nowhere near the coast and in some cases have no property exposure at all.

II. How Fair and Beach and Windstorm Plans Operate

FAIR Plans and Beach and Windstorm Plans are run by state insurance regulators in conjunction with private insurers and basically operate as pools (an association of organizations or individuals that combine resources to economically finance recovery from accidental losses). The pool acts as a single insuring entity, and premiums, losses and expenses are shared among pool members (i.e. insurers) in agreed-upon amounts.

Each state has enacted its own legislation in response to local market needs, so there is considerable variation in the types of coverage provided and the methods of operation among the 35 jurisdictions with FAIR Plans. The state government does not typically provide financial support for these plans though exceptions do occur. Plans may also float debt and benefit from the state's credit rating, which is ultimately linked to its authority to tax. In addition, each state has a guaranty fund in place to pay the claims of failed insurers. Guaranty funds are supported by assessments on solvent insurers doing business in the state. Some FAIR Plans employ their own staff to handle underwriting, processing and even claim adjustment, while others contract with specific insurers to act as servicing carriers. These insurers, for a percentage of premium, perform underwriting, policyholder service and claim settlement functions.

Underwriting Criteria

A property owner unable to obtain property insurance in the voluntary insurance market may apply to the state's FAIR Plan through a licensed agent or broker. To be eligible for FAIR Plan coverage, the insured must have the property inspected.

Only property that meets the FAIR Plan's inspection criteria will be insured in the program. Owners of properties failing to meet basic levels of safety, typically older houses and commercial establishments, may be required to make improvements as a condition for obtaining insurance.

Such improvements may include upgrading the electrical wiring, heating and plumbing, and ensuring that the roof is sound, for example. Where deficiencies are not remedied, FAIR Plan administrators may deny insurance as long as hazards are unrelated to the neighborhood location or to hazardous environmental conditions beyond the applicant's control, such as being located adjacent to a fireworks factory.

Under most FAIR Plans, the following types of exposures are considered uninsurable:

- Vacant property.
- Property poorly maintained.
- Property subject to unacceptable physical hazards, such as storage of flammable materials.
- Property in violation of law or public policy, such as a "condemned building" (one that is considered unfit for human habitation).
- In some states, property not built in accordance with building and safety codes.

III. Eight Individual State Plans

1. FLORIDA CITIZENS PROPERTY INSURANCE CORPORATION (CPIC)

Overview

Since its establishment in 2002, after the state passed legislation combining two separate high-risk insurance pools, known as the Florida Windstorm Underwriting Association and the Florida Residential Property & Casualty Joint Underwriting Association, Citizens Property Insurance Corporation (CPIC) has experienced exponential growth. As a result, Florida Citizens has evolved from a market of last resort, becoming the state's largest property insurer in 2006.

Citizens is a state-regulated association and historically has provided property insurance where it is not available from the regular market. It has tax-exempt status and provides insurance to homeowners, commercial residential properties and a limited number of commercial businesses in coastal high-risk areas and others who are unable to obtain coverage in the private insurance market.

According to PIPSO data, of the 2.5 million total policies (habitational and commercial) insured by the FAIR Plans across the U.S. in 2013, 1.5 million or 57 percent were in Florida Citizens. This compares with the 658,085 policies or 44 percent insured by Florida Citizens in 2002.

In 2014, Florida Citizens saw its total policy count drop to below the one million mark for the first time since 2006. Florida Citizens attributes this success to eight storm-free years that have enabled Florida's private insurance market to begin to rebound as new investors and companies look to increase their market share in the state. Depopulation efforts in recent years have led to nearly 500,000 policies being shifted from Citizens to the private market. Meanwhile, improving reinsurance market conditions have also allowed Citizens to transfer more risk to the private market. However, others maintain that coverage sold by Citizens remains dramatically underpriced and warn that a major storm could still cause both Citizens and the Florida Hurricane Catastrophe Fund to levy billions in post-hurricane assessments on nearly every policy in the state.

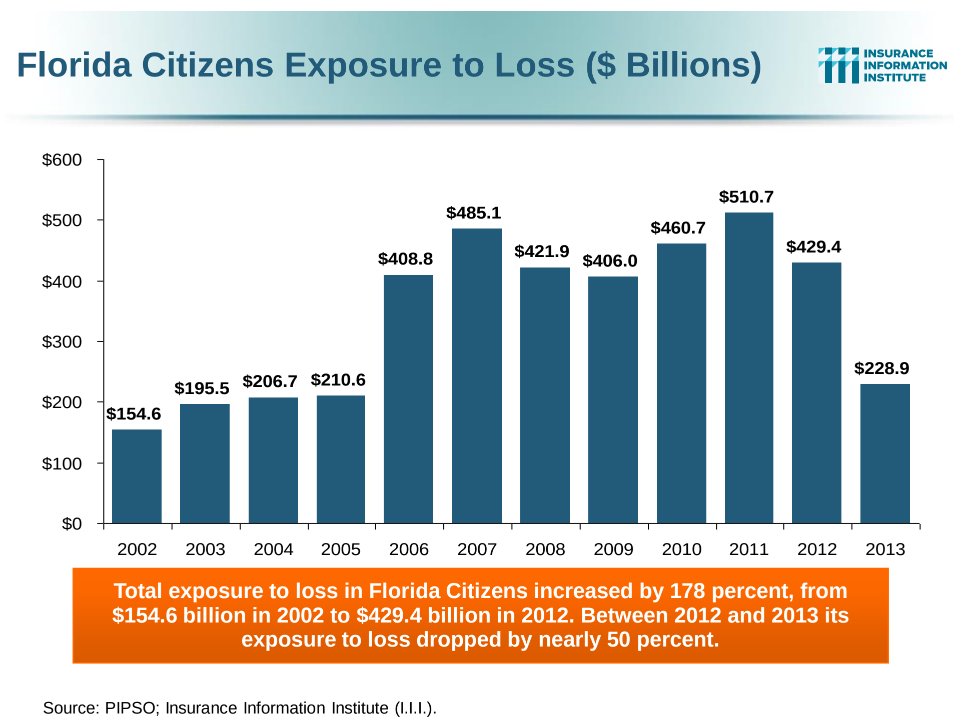
As of June 30, 2014, Citizens had 238,354 coastal (high-risk) account policies in-force (those that were in the old windstorm pool). The CPIC also had about 554,533 personal/residential policies in-force, and about 5,743 commercial/residential policies. Total policies in-force in Florida Citizens had dropped to 933,422 at June 30, 2014.

Meanwhile, Florida Citizens also accounted for slightly more than half (51 percent) of the total FAIR Plans' exposure to loss. Florida Citizens' exposure to loss dropped by nearly 50 percent from $429.4 billion in 2012 to $228.9 billion in 2013 after Citizens took much-needed steps to reduce its size (Fig. 16).

The success is due in part to Citizens charging more competitive rates and offering more restrictive coverage; efforts to recruit small local insurers to take over some Citizens' policies; and the creation of a computerized clearinghouse which allows Citizens policyholders to find alternatives to purchasing insurance through the pool and allows private insurers to decide whether they want to take on pool policies that are up for renewal and new applications before they are accepted by Citizens.

The drop in exposure in 2012 and 2013 came after Florida Citizens exposure to loss hit a new peak of $510.7 billion in 2011, surpassing its prior peak of $485.1 billion in 2007. Florida Citizens' exposure to loss had also risen to $460.7 billion in 2010, after two Florida insurers were declared insolvent and as a number of national companies reduced their exposure to Florida windstorm risk, leaving some high-risk policyholders looking for coverage.

Fig. 16



Meanwhile, premiums written by Florida Citizens in 2013 also declined. Direct premiums written totaled $2.7 billion in 2013, down from $3.2 billion in 2012.

Between 2007 and 2008 direct premiums written by Florida Citizens had declined by nearly $1 billion (from $3.7 billion in 2007 to $2.8 billion in 2008). The collapse in home and condominium construction throughout the state due to the subprime mortgage and credit crisis and ensuing recession was a significant factor in the decline in new business.

Between 2003 and 2006 Citizens reduced its exposure by $100 billion and approximately 500,000 policyholders were returned to the private market. However, the insolvency of major insurance group, the Poe Insurance Companies, after the hurricanes of 2004 and 2005, added thousands of policies to Citizens at a time when many other insurers were cutting back on policy renewals in coastal areas.

Legislative Developments

Legislation (SB 1770), signed into law at the end of May 2013, was designed to return Florida Citizens to its original purpose as the state's insurer of last resort. The law created a clearinghouse that would allow private insurers to decide whether they want to take on pool policies that are up for renewal and new applications before they are accepted by Citizens.

Other provisions of the legislation barred Citizens from insuring new construction in high-risk coastal areas after July 1, 2014 and would cap policies issued to cover homes valued at $1 million to $700,000 in 2017. The legislation also required the appointment of an inspector general to restore public confidence in the entity after the discovery of some questionable expenditures.

Earlier in April 2012 legislation (HB 1127) was signed into law. The law changed how Florida Citizens imposes post-disaster assessments (taxes) on policyholders, effectively reducing the tax burden on non-Citizens policyholders after a catastrophic storm.

Under previous law, if Citizens exhausted its claims-paying capacity in any of its three accounts (personal lines, commercial and high-risk coastal) and ran a deficit, its policyholders were assessed 15 percent of their premium for each account, up to 45 percent. After exhausting that amount, Citizens could levy a 6 percent regular assessment on virtually all property/casualty lines policies in the state (see section on claims-paying capacity below).

From July 1, 2012 the new law reduced the regular assessment on non-Citizens policyholders from 6 percent to 2 percent for the coastal account and eliminated the existing 6 percent regular assessments on the other accounts. Emergency assessments that would kick in after the regular assessments are exhausted remain in place, however.

Insurance regulators granted Citizens a higher rate increase than requested for 2011, due to the huge rise in sinkhole claims. A comprehensive property insurance reform measure (SB 408), enacted in May 2011, was designed to reduce the cost of sinkhole claims and included the following:

- Increases the minimum surplus requirements for residential property insurers to $15 million.

- Requires windstorm and hurricane claims to be brought within three years and sinkhole loss claims to be brought within two years.
- Revises what constitutes a sinkhole loss.

Major legislative reforms enacted in 2009 (HB 1495) were widely regarded as a step in the right direction for the state's property insurance market after legislation passed in 2007 and 2008 had significantly expanded the overall role of the state as an insurer and reinsurer of Florida homes.

Among other things, the 2009 reforms allowed Citizens to increase rates by up to 10 percent per year until rates are actuarially sound.

Claims-Paying Capacity

When Citizens losses exceed its claims-paying capacity, it is required to impose assessments on insurers doing business in the state that are then passed on to their policyholders in the form of a surcharge. Following the legislative reforms enacted in 2007 the base for assessments to pay for Citizens deficits expanded from property insurance to auto, liability and other lines of insurance, with the exception of medical malpractice and workers compensation, thus placing the burden of paying for the next big storm on all Floridians, even those with no exposure at all to hurricane losses.

Citizens also has the ability to finance loss payments by issuing tax-exempt bonds that carry low interest rates, piggy-backing on the state of Florida's strong credit rating. The credit crisis that began in mid-2007 raised serious concerns about Citizens' ability to raise significant sums in the bond markets should a major hurricane strike. However, since then there has been a gradual improvement in credit markets and bonding capacity.

In April 2014 Florida Citizens accessed the capital markets to significantly increase its reinsurance protection via the issuance of a $1.5 billion catastrophe bond—the largest single catastrophe bond issuance in history. The 2014 transaction is the third capital market risk transfer secured by Florida Citizens in the past three years (a $750 million catastrophe bond was issued in 2012 and a second $250 million catastrophe bond was issued in March 2013).

Unlike previous capital market transactions which were structured for single events only, the 2014 deal provides coverage on an annual aggregate basis over the next three years, protecting the insurer of last resort from multiple smaller storms.

Citizens has also bolstered its participation in the traditional reinsurance market with the expected purchase of approximately $1.3 billion in coverage for the 2014 hurricane season, including approximately $750 million that covers aggregate losses in the event of multiple storms.

Citizens' ability to pay claims is partly dependent on the state-run reinsurance fund—the Florida Hurricane Catastrophe Fund (the Cat Fund)—which reimburses Citizens a stated percentage of hurricane losses once a retention level is reached. However, in the event of a major storm, the Cat Fund's ability to pay claims may also be impacted.

Citizens was hit hard by the hurricane seasons of 2005 and 2004, suffering record hurricane damage claims and incurring a deficit in both years. As a result of losses related to Hurricanes Dennis, Katrina and Wilma, Citizens reported an operating deficit of just over $2 billion in 2005. This followed an operating deficit of $1.6 billion in 2004, after Citizens incurred around $2.4 billion in losses from nearly 120,000 hurricane damage claims, of which $1.8 billion came from its high-risk windstorm account.

To offset Citizens' 2005 deficit legislation (SB 1980), passed in May 2006, provided for a $715 million appropriation of state general revenue dollars to the fund. This reduced the regular assessment on policyholders from 11 percent to 2 percent. A further 10 percent emergency assessment to pay off the remainder of the deficit was spread over a 10-year period (1.4 percent annually until 2017).

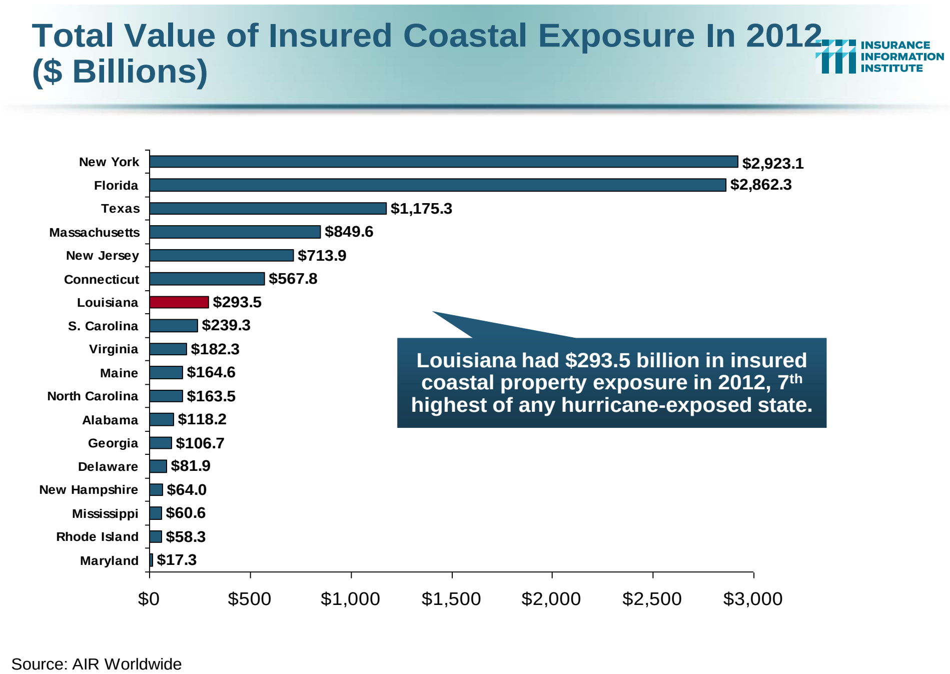
2. LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION

Overview

Louisiana Citizens Property Insurance Corporation (Louisiana Citizens, LA Citizens) was created by the legislature in 2003 to oversee the state's Coastal and FAIR Plans. This state-run entity acts as a market of last resort for residential and commercial property insurance in Louisiana. For coverage purposes, the Louisiana Citizens FAIR Plan and the Louisiana Citizens Coastal Plan operate as separate programs under Louisiana Citizens.

Louisiana ranks seventh highest on the AIR Worldwide coastal exposure list, with $293.5 billion in insured coastal exposure in 2012, representing 36 percent of the state's total insured values (Fig. 17).

Fig. 17



Due to a lack of available data in the years post-Hurricane Katrina, Louisiana Citizens exposure growth was difficult to establish. However, based on PIPSO data, Citizens exposure went from $22.7 billion in 2004, to $28.4 billion in 2009—an increase of 25 percent. However, from 2009 to 2013, Citizens exposure to loss declined by 37 percent to $17.8 billion.

By law, Citizens rates are non-competitive with private insurers and must be at least 10 percent above the private market. A new law (SB 130), which took effect August 2009, revised LA Citizens rate structure and ensured that the plan remains the insurer of last resort by requiring the 10 percent surcharge be added to the highest rates charged by private insurers that write at least 2 percent of policies in a given parish. New companies that have not reached the 2 percent market threshold must have sold at least 25 homeowners policies in the previous year to be included in the rate structure.

In 2007 Louisiana Citizens set out to reduce its policy count to below its pre-Hurricane Katrina policy total of 125,000. Louisiana Citizens' policy count had spiked to 174,000 in September 2008 in the wake of hurricanes Katrina and Rita. After completing another successful round of depopulation, Louisiana Citizens was reported to have reduced its personal lines policy count to below 90,000 in December 2013. According to the Louisiana Department of Insurance this brought Citizens to an all-time low homeowners market share of 2.7 percent from a high of 174,000 policies and 9.8 percent market share in 2008.

The depopulation of LA Citizens is the result of an incentive program created by the legislature in 2007 to increase the availability of property insurance and to decrease the business written through LA Citizens (see below).

Despite the success of its depopulation program, Louisiana Citizens has to pay out nearly $106 million in a judgment that stemmed from whether it began adjusting claims from 2005 hurricanes Katrina and Rita within the 30-day time limit. The class action involves some 18,500 policyholders. LA Citizens will also be called upon to pay many property claims result from Hurricane Isaac, which hit the state on August 28, 2012.

Hurricane Katrina produced severe losses for Louisiana Citizens, when the Category 4 storm struck the state in late August 2005. The FAIR Plan was left with a $954 million deficit for 2005, after incurring estimated hurricane losses of up to $850 million. Louisiana Citizens issued $978 million in revenue bonds to help fund the shortfall. Emergency assessments to pay off those bonds began in 2007 and will continue into 2025.

The Coastal Plan offers coverage in Zone 5, south of the Intercoastal Waterway, the most hurricane-vulnerable area. The Fair Plan offers coverage in the rest of the state. Louisiana Citizens provides coverage statewide. It offers coverage up to $750,000 for residential properties.

Legislative Developments

New legislation (HB 952) passed in June 2010 relaxed take-out policy rules under which an insurer assumes policies from LA Citizens. Under HB 952, insurers participating in the depopulation program can remove fewer policies than in the original program and select the ones they want.

The original takeout program had required insurers to assume bundles of 500 policies to eliminate cherry-picking. In addition, the program now requires companies to prove that they have the capacity to take on new policies. The state insurance department is required to create at least one round of take-out offers each year.

Major legislation passed in 2009 revised Citizens' rate structure and limits the exposure of policyholders to one named storm deductible per hurricane season:

- SB 130 revised Citizens rate structure and ensures that the plan remains non-competitive with the private market by requiring its rates to be 10 percent higher than either: the actuarially sound rate; or the highest rates charged by private insurers with at least a 2 percent market share in a parish; or the rates of companies that have sold at least 25 homeowners policies in the previous year. The bill also required Citizens to charge rates by zip code, rather than by parish.

- HB 333 applied a single named storm deductible per hurricane season. If multiple named storms occur in one year, the full amount of the named storm, hurricane, wind and hail deductible can be applied only once.

Legislation passed in 2007 was designed to make the state of Louisiana more attractive to insurers and to help property owners deal with increased insurance cost by allowing Louisiana Citizens to solicit bids from private insurers to take over its policies. The state also provided financial incentives to new insurers entering the homeowners market on the condition that 25 percent or more of their new business consists of policies taken over from Citizens.

In a special session in December 2006, state legislators passed a law taking $56 million from a state emergency fund to reimburse policyholders who had been assessed to pay for Citizens' losses. At the same time, a law was approved that created a state income tax credit for policyholders facing assessments from Louisiana Citizens.

Claims-Paying Capacity

In the normal course of business, Louisiana Citizens utilizes its cash to pay claims, liquidating investments as necessary to meet demands. The plan also buys reinsurance to supplement its claims-paying capacity in the event of a catastrophe. The amount of reinsurance purchased and the structure of the program may vary year to year.

Louisiana Citizens has a reinsurance structure that is a combination of traditional reinsurance and two catastrophe bonds, making it one of a growing number of state-run residual market plans to have accessed the capital markets to extend its catastrophe protection.

In 2013 Louisiana Citizens accessed the capital markets for the second year running to protect it from hurricane losses via a $140 million catastrophe bond issuance. The deal followed Louisiana Citizens' $125 million catastrophe bond issuance in 2012.

The Louisiana Citizens traditional reinsurance program was up for renewal on June 1, 2014, while the first catastrophe bond Pelican I will expire in April 2015 and Pelican II expires in May 2017.

Together, the 2013/2014 traditional reinsurance and catastrophe bond structure provided first event coverage of $650 million, including a $50 million retention, and second event coverage up to $375 million, assuming the first event coverage was exhausted.

In August 2013 the Louisiana Bond Commission approved a $50 million increase in its bank line of credit for Louisiana Citizens. The increase from the existing credit line of $75 million to $125 million will give the state's property insurer of last resort a financial cushion as it enters peak hurricane season. The line of credit serves as a short-term loan for Louisiana Citizens, which, in the event of a hurricane or strong storm, would allow it to tap into the loan to pay claims and expenses as needed. Any money used from the line of credit would have to be paid back with 6 percent interest.[13]

In the event of a deficit in either the FAIR or Coastal Plan, Louisiana Citizens has the ability to assess its member insurers to an amount up to 10 percent of industry premium for the assessable lines of business. Insurers may then choose to recoup that amount from their policyholders over the course of the next year. Policyholders may, in turn, claim that amount as a credit against their Louisiana state income taxes.

If the plan year deficit exceeds the amount that can be recovered via regular assessments, Louisiana Citizens may fund the remainder by issuing revenue assessment bonds in the capital markets. It then declares emergency assessments each year to provide debt service on the bonds until they are retired. Insurers writing assessable lines must surcharge their policyholders in the percentage established annually by Louisiana Citizens. As in the case of regular assessments, policyholders may claim amounts paid as a credit against state income taxes.

3. MISSISSIPPI FAIR PLANS

Overview

Mississippi has two residual market plans that act as a market of last resort for residential and commercial property insurance in the state. The Mississippi Windstorm Underwriting Association (MWUA) was established by the legislature in 1987 to provide an adequate market for windstorm and hail insurance in the coastal areas of Mississippi. The Mississippi Residential Property Insurance Underwriting Association (MRPIUA) was established by the legislature in 2003 to provide an adequate market for residential property insurance in both rural and other areas of the state. It was formed by expanding the state's former Mississippi Rural Risk Underwriting Association to offer coverage across the entire state. All insurers writing property insurance on a direct basis in Mississippi are required to be members of the associations.

MWUA and MRPIUA are funded by the premiums from the insurance issued by the plans and assessments made against the member companies to cover any shortfall between revenues and exposure. The member companies are assessed based on a percentage of their total written property premiums. Insurers doing business in Mississippi are now able to recoup the assessment amount by surcharging their policyholders, following legislative reform approved by the state legislature in March 2007.

The plans may also buy reinsurance. MWUA purchased $955 million of reinsurance protection for the 2014 hurricane season.

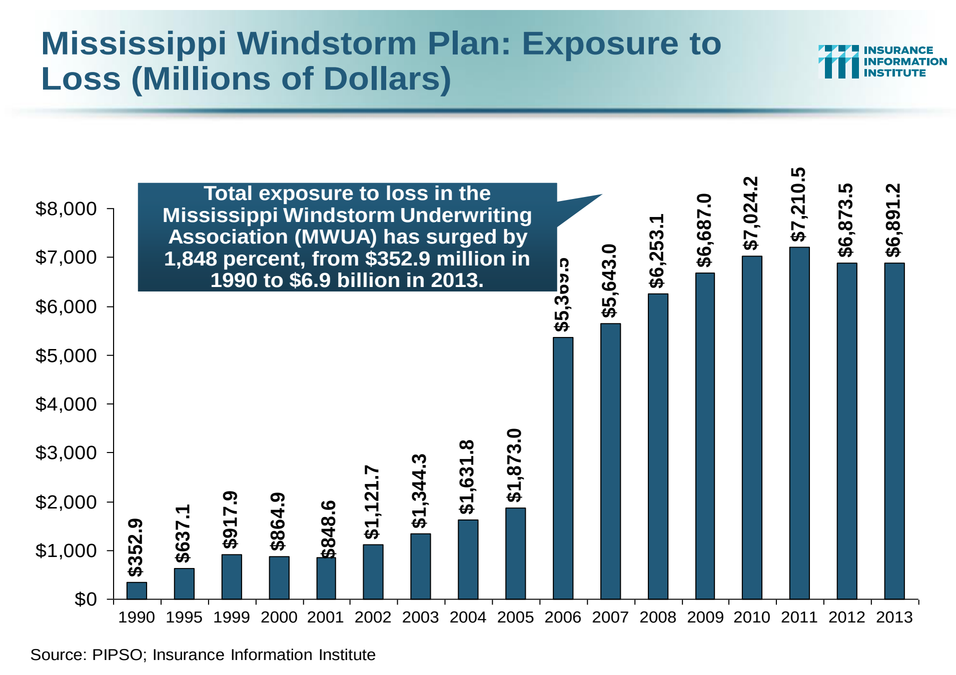
[13] *Bond Commission approves $125M line of credit for insurer of last resort*, by Lauren McGaughy, The Times-Picayune, August 15, 2013.

MWUA provides windstorm and hail coverage only in the coastal counties of George, Hancock, Harrison, Jackson, Pearl River and Stone. Coverage is available up to $1,000,000 for one- to four-family dwellings and $250,000 for contents. MWUA policies contain a hurricane deductible of 2 percent of the insured value of the home. The hurricane deductible is triggered by windstorm losses resulting from a named storm as declared by the National Hurricane Center of the National Weather Service and remains in effect until a tropical storm warning is over.

Mississippi ranks 16th on AIR Worldwide's coastal exposure list, with $60.6 billion in insured coastal exposure, about 50 percent of which is residential and 50 percent commercial. Mississippi's insured coastal exposure represents just 13 percent of the state's total insured values.

At year-end 2013 MWUA had a total of 43,682 policies in-force for a total exposure value of $6.9 billion. Total exposure to loss has surged by 1,848 percent from $352.9 million in 1990 to $6.9 billion as of December 31, 2013. (Fig. 18).

Fig. 18



MRPIUA provides fire and extended coverage throughout the state. However, properties located in the three lower coastal counties of Mississippi (Hancock, Harrison and Jackson counties) cannot obtain wind and hail coverage through MRPIUA. Coverage for these perils is available through MWUA. Coverage limits under MRPIUA are up to $200,000 for buildings and $75,000 for contents. MRPIUA policies contain a standard deductible of $500 for all perils. At the end of

2013 MRPIUA had a total of 12,847 policies in-force for a total exposure value of $751.4 million.

Insurers that write new wind and hail insurance policies in coastal areas in Mississippi may now be granted credits against the payment of state insurance premium taxes following passage of the 2007 legislative package.

In addition, policyholders statewide can be surcharged directly if MWUA has to issue bonds or repay loans or assess insurers for pool deficits. MWUA assessed its member companies around $545 million for Hurricane Katrina claims, after reinsurance.

Since July 2009 MWUA has been offering discounts of up to 25 percent to policyholders who improve the hurricane resistance of their homes. This is another step toward the state's goal of encouraging development along the coast.

Legislative Developments

In May 2010 Mississippi Governor Haley Barbour vetoed a portion of HB 1642 that would have allocated an additional $20 million from the state's hurricane disaster contingency fund to MWUA to subsidize the purchase of reinsurance for another year. The contingency fund exists to repay the federal government for spending $400 million in hazard mitigation expenses in southern Mississippi.

Legislation in 2007 (HB 1500) created the Mississippi Windstorm Underwriting Association Reinsurance Assistance Fund, whereby the state provides a portion of the revenue received from state insurance premium taxes (up to $20 million a year) over a four-year period to help MWUA pay its reinsurance premiums. It also allowed a one-time $80 million diversion of federal and state funds to MWUA to boost the pool's reserves for windstorm damage claims. The infusion of funds is designed to protect policyholders against rate increases.

4. TEXAS WINDSTORM INSURANCE ASSOCIATION (TWIA)

Overview

Hurricane Celia, which struck the Texas coast on August 3, 1970, was one of the most damaging hurricanes in the state's history, causing an estimated $310 million in insured losses in 1970 dollars ($1.55 billion in 2005 dollars). Following the extensive damage caused by the hurricane, many insurers decided to stop writing business in the state's exposed coastal communities. As a result, the state stepped in and created the Texas Catastrophe Property Insurance Association (now called the Texas Windstorm Insurance Association) in 1971.

The Texas Windstorm Insurance Association (TWIA) provides wind and hail coverage for Texas Gulf coast property owners in the event of catastrophic loss. It is the state's insurer of last resort for wind and hail coverage in 14 coastal counties and parts of Harris County, as follows: Aransas, Brazoria, Calhoun, Cameron, Chambers, Galveston, Harris County (partial), Jefferson, Kennedy, Kleberg, Matagorda, Nueces, Refugio, San Patricio and Willacy.[14]

How It Operates

All companies licensed to write property insurance in Texas are required to be members of TWIA. Their percentage participation is based on their company's statewide sales versus sales within TWIA's territory. TWIA is governed by a nine-member board of directors comprised of five insurance company representatives, two agent representatives and two consumer representatives. The board meets on a quarterly basis.

Coverage for both residential and commercial property owners is available under TWIA. In addition, the association provides coverage for miscellaneous items such as signs, fences, swimming pools and flagpoles.

Effective January 1, 2014 residential and commercial policyholders can purchase TWIA coverage up to the following statutory limits:

- Residential—Dwelling Building and Contents: $1.77 million
- Apartment, Condo, Townhouse—Contents Only: $374,000
- Commercial—Commercial Building and Contents: $4.42 million

TWIA Growth in Policies and Exposure

Increasing development together with a reduction by some insurers of the number of coastal policies they will issue has led to dramatic growth in TWIA's exposure to loss and policy count in the course of the last decade, even as the number of structures insured by TWIA decreased significantly after Hurricane Ike.

Between 2005 and 2012, TWIA's loss exposures increased by approximately 319 percent from $23.26 billion to $74.17 billion, while its total policies in-force grew by 243 percent from 109,693 to 266,726, according to the Texas Windstorm Insurance Association Clearinghouse Feasibility Study released in May 2014.[15]

More recently, TWIA's exposure and policy growth have flattened. According to TWIA figures, as of March 31, 2014 TWIA insured 270,503 residential and commercial policyholders, up 1.7 percent from 266,050 policies in-force at March 31, 2013.

TWIA's exposure to loss for buildings and contents was up just 0.4 percent at $77.2 billion by March 31, 2014, from $76.9 billion at December 31, 2013 (Fig. 19). TWIA total exposure had reached $84.9 billion (including additional living expense (ALE) and business interruption) by March 31, 2014 (Fig. 20).

[14] Part of Harris County—when located inside Houston city limits and east of highway 146, the following portions of Harris County are also included: LaPorte, Morgan's Point, Pasadena, Seabrook, Shore Acres.

[15] TWIA Clearinghouse Feasibility Study, December 2013.

Under state law, insurance rate increases are capped at 10 percent each year unless the insurance department determines that a higher increase is necessary due to catastrophic events.

Fig. 19

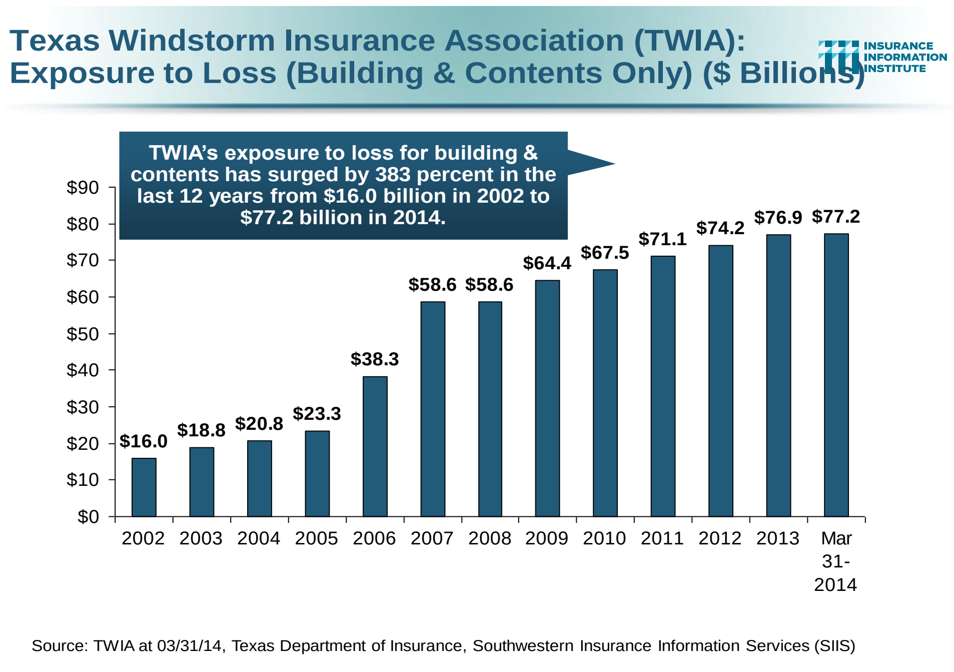
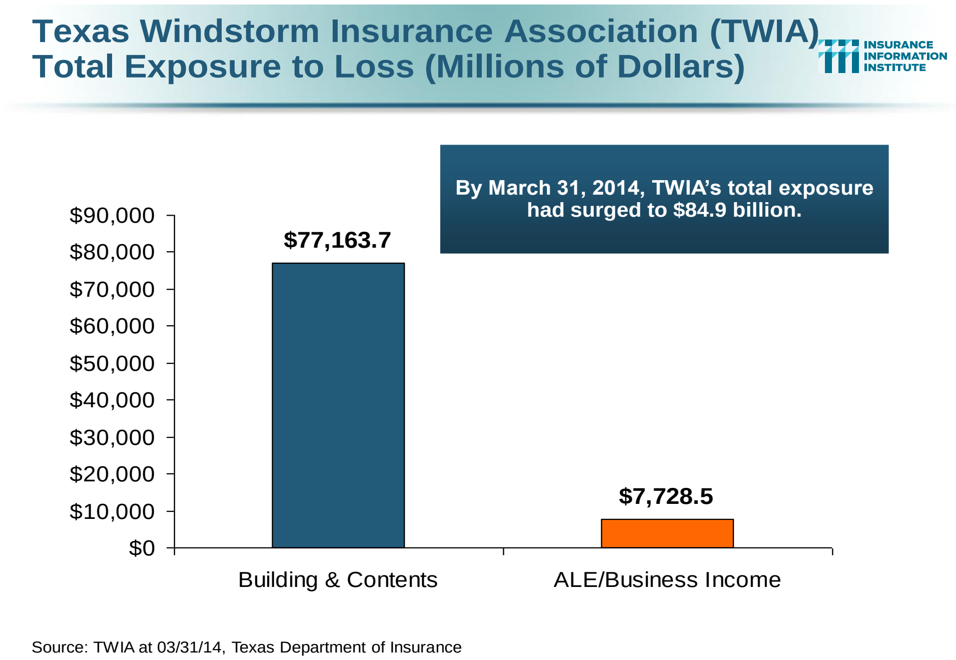


Fig. 20



Claims-Paying Capacity

TWIA's ability to cover future claim-related costs as well as its long-term financial viability have been topics of ongoing concern. Different proposals have been considered to restructure TWIA and its funding mechanism to avoid compromising the state's general revenue fund in the event of another major hurricane making landfall in Texas.

One such proposal would create a clearinghouse or portal that would give private insurers access to policies written by the pool and assist in depopulation of TWIA's book of business. Insurers say the underlying problem with TWIA is that funds that should have been accumulating as surplus in the past three relatively storm-free years have been used instead to pay ongoing claims from 2008 Hurricane Ike, leaving TWIA without a viable financial base to pay future claims.

In 2008, TWIA funds were depleted after paying an estimated $3 billion in losses resulting from Hurricanes Ike and Dolly. Concerns over claims handling led to TWIA being placed under administrative oversight by the state department of insurance in 2011 and its management was replaced. The state's insurance commissioner determined that TWIA's structure was unsustainable.

Reform legislation (HB 3) was passed in a special legislative session in 2011. HB 3 allows TWIA to issue pre-event bonds only once a year, improves its administrative operations and claims-paying processes, and places limits on lawsuits against TWIA.

Under HB 3, if TWIA does not purchase reinsurance it has to submit an actuarial plan to the state insurance department detailing how it will pay losses in the event of a catastrophe with estimated damages of $2.5 billion or more.

In 2014 TWIA obtained $950 million in traditional reinsurance and accessed the capital markets for the first time via the issuance of a $400 million catastrophe bond. Insurers can also purchase reinsurance to cover their individual exposures.

Earlier in 2009 new legislation (HB 4409), made major reforms to TWIA funding and claims-paying structure, making up to $2.5 billion available to fund hurricane losses.

HB 4409 clarified that TWIA is intended to serve as a residual market insurer of last resort. It established a more rational plan for the growth of TWIA reserves and premiums and eliminated the unlimited assessments on insurers. The legislation also moved TWIA towards a more actuarially sound rating system.

Claims-Paying Capacity

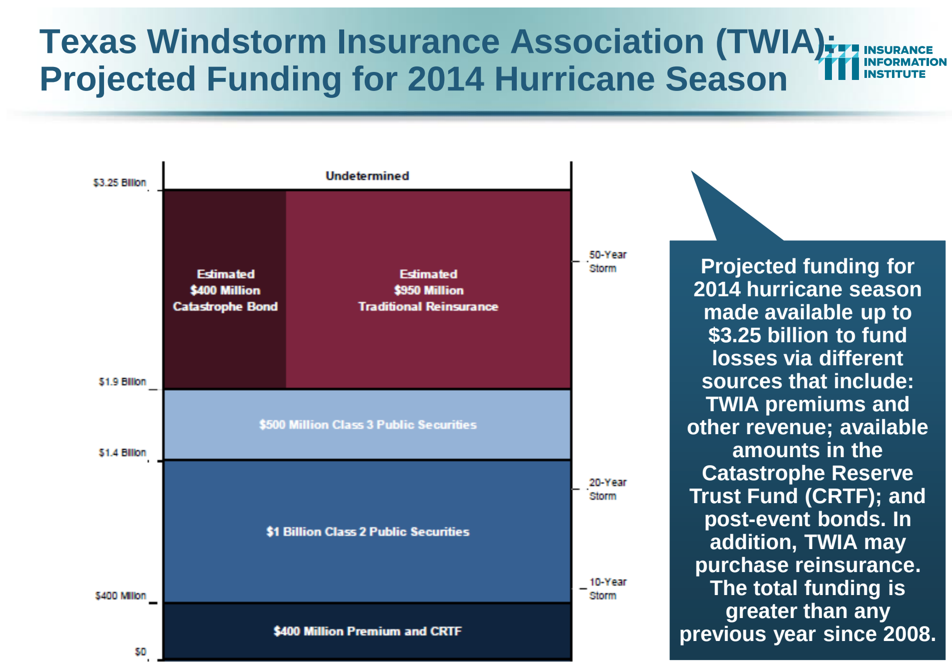
Under the financial structure established in 2009, TWIA losses in excess of premiums and other revenue are funded by available reserves and amounts in the Catastrophe Reserve Trust Fund ($188 million as of April 30, 2014), up to $1.5 billion via the issuance of post-event bonds, and the possible issuance of pre-event bonds (Fig. 21).

The pre-event bonding layer would utilize up to $1 billion in Class One public securities or other financial instruments, to be repaid from TWIA premium. The next post-event layer would tap up to $1 billion in Class Two public securities, to be repaid in no more than 10 years. Some 70 percent of these costs will be funded by a premium surcharge on all property/casualty insurance policies (except federal flood, workers compensation and medical malpractice) in the 14 coastal counties. TWIA member insurers would be assessed 30 percent without a recoupment provision or premium tax credit. There is then another bonding layer where up to $500 million in public securities could be utilized that would be repaid via non-recoupable assessments on TWIA member insurers.

A 2014 proposal for the issue of pre-event Class One bonds is currently being evaluated by the Texas Department of Insurance (TDI). A 2013 application TWIA submitted to the TDI for approval to issue $500 million in pre-event Class One public securities in the form of a Bond Anticipation Note (BAN) was denied approval by former Insurance Commissioner Kitzman. A similar BAN was issued in 2012 and fully paid off.

In addition, TWIA may purchase reinsurance coverage. In 2014 TWIA obtained $950 million in traditional reinsurance and accessed the capital markets for the first time via the issuance of a $400 million catastrophe bond.

Fig. 21



Source: Texas Windstorm Insurance Association (TWIA) Annual Report Card, May 30, 2014.

TWIA Assessment History (Prior to Enactment of HB 4409)

Prior to the 2009 legislative reforms, a substantial component of TWIA funding was its ability to assess its member insurers for losses. Assessments for losses were based on an individual insurer's share of the overall Texas market. In the event of a major storm, an unlimited assessment of member insurers would be utilized after initial TWIA assessment layers, reserves, surplus and reinsurance were exhausted. These unlimited assessments were recoverable through premium tax credits, potentially compromising the state's general revenue fund.

A $100 million assessment of member insurers was made after Hurricane Dolly hit in July 2008, causing major damage in Cameron and Willacy counties. Member insurers were then assessed $430 million to pay for excess losses resulting from Hurricane Ike, which struck the Texas coast in September 2008 causing major damage in Brazoria, Chambers, Galveston, Harris, Jefferson and Matagorda counties. Some $230 million of this assessment was subject to premium tax credits based on the previous statutory funding structure.

A $100 million assessment of member insurers was also made in 2005, after Hurricane Rita struck the upper Texas coast causing major damage in Jefferson, Chambers and Galveston counties. Hurricane Alicia, which struck Galveston Island in 1983, also led to a $157 million assessment, of which some $57 million was subject to premium tax credits based on the funding structure at the time.

5. MASSACHUSETTS PROPERTY INSURANCE UNDERWRITING ASSOCIATION (MPIUA)

Overview

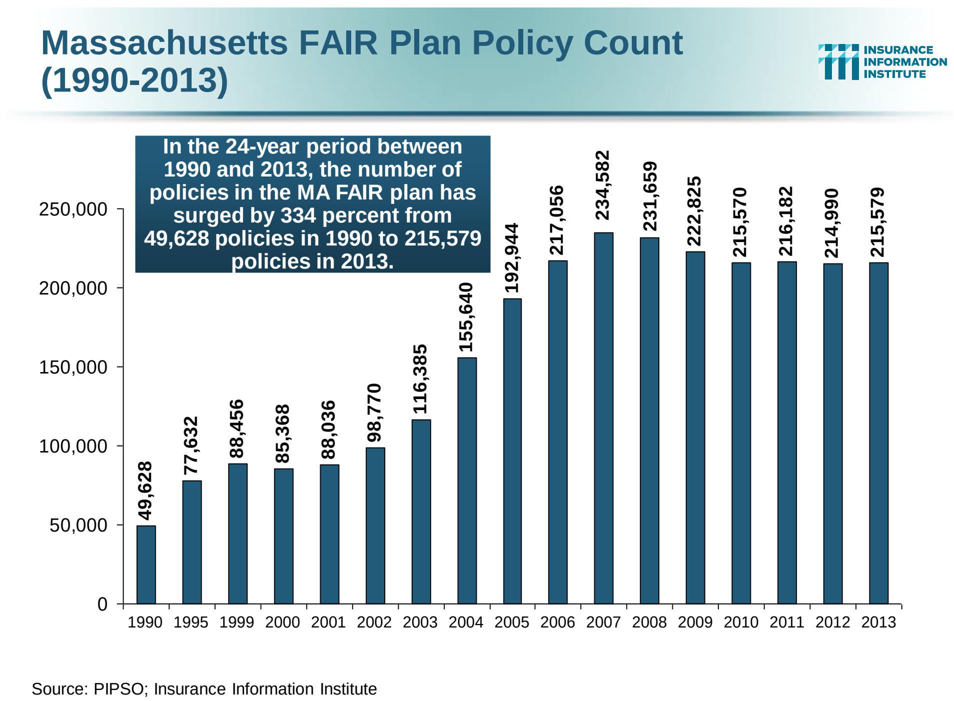
The Massachusetts Property Insurance Underwriting Association (MPIUA) was formed by the Massachusetts legislature after passage by Congress of the Housing and Urban Development Act of 1968. This legislation made federal riot reinsurance available to those states that instituted such property insurance pools.

All companies writing basic property insurance in Massachusetts are required to participate in the plan, with losses shared among member companies on a premium volume basis. The plan uses a windstorm/hail deductible for any type of wind damage. Coverage for both residential and commercial property owners is available under MPIUA. The plan offers policies under the homeowners, dwelling fire and commercial property forms. The maximum limits of liability under each program are $1 million for a single building at any one location and $1.5 million for multiple interests/building and contents coverage.

Like other Eastern seaboard states, Massachusetts is experiencing rapid coastal growth. The combination of its exposure to windstorms and high property values makes it a state with significant potential for losses. An updated 2013 study by AIR Worldwide puts the value of insured coastal property (residential and commercial) in Massachusetts at $849.6 billion, ranking it fourth behind New York, Florida and Texas. This represents 54 percent of the state's total insured property values. AIR estimates that Massachusetts faces a 15 percent chance of a catastrophic storm within the next decade that would cost insurers $5 billion or more.

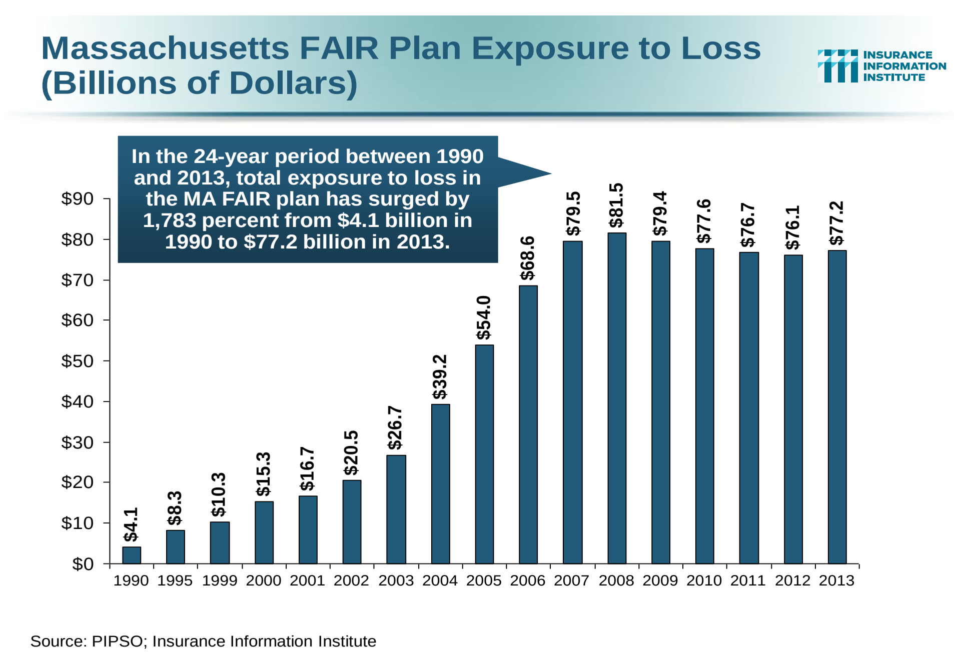
The FAIR Plan grew rapidly in the course of the last decade, mirroring rapid growth on Cape Cod, Martha's Vineyard, Nantucket and other coastal areas. MPIUA's policy count surged by 334 percent from 49,628 total policies (habitational and commercial) in 1990 to 215,579 policies in 2013, although the number of policies has declined by 8.1 percent since 2007 (Fig. 22). The FAIR Plan continues to dominate the homeowners market on Cape Cod and the islands of Martha's Vineyard and Nantucket, where it accounts for about 46 percent of all homeowners insurance policies. Exposure to loss under the plan has also skyrocketed, from $4.1 billion in 1990 to $77.2 billion in 2013 (Fig. 23). MPIUA has been operating profitably for the last 10 years. In the 14-year period from 2000 to 2013, it reported an operating gain in 11 years (2000 and 2004-2013) and an operating deficit in three years (2001, 2002 and 2003) and (Fig. 24).

Fig. 22



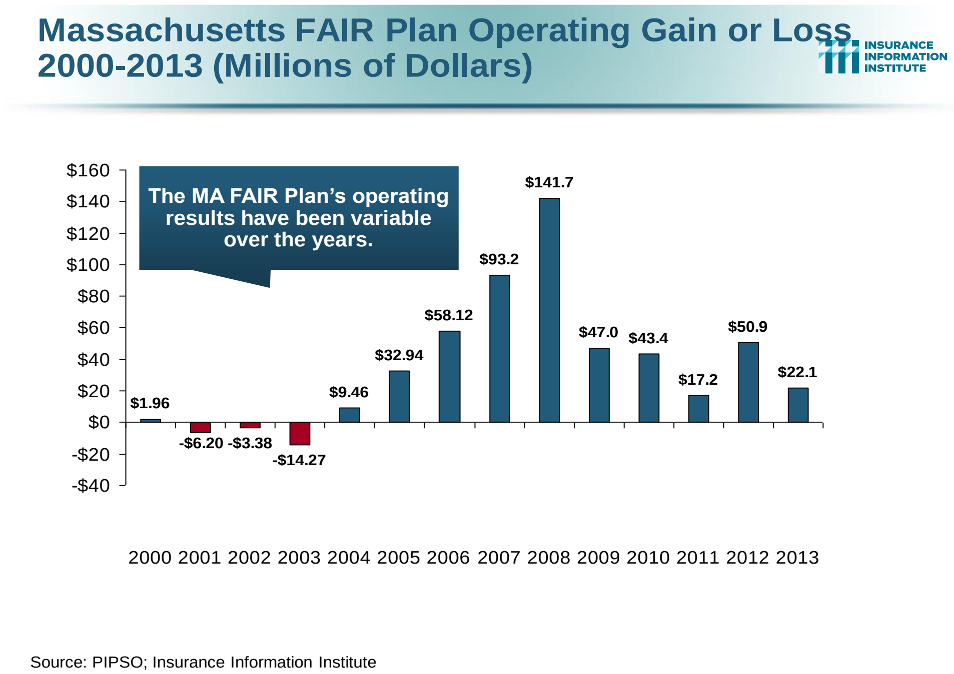
Massachusetts FAIR Plan Policy Count (1990-2013)
In the 24-year period between 1990 and 2013, the number of policies in the MA FAIR plan has surged by 334 percent from 49,628 policies in 1990 to 215,579 policies in 2013.
250,000
200,000
150,000
100,000
50,000
0
49,628
77,632
88,456
85,368
88,036
98,770
116,385
155,640
192,944
217,056
234,582
231,659
222,825
215,570
216,182
214,990
215,579
1990
1995
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
Source: PIPSO; Insurance Information Institute

Fig. 23



Massachusetts FAIR Plan Exposure to Loss (Billions of Dollars)
In the 24-year period between 1990 and 2013, total exposure to loss in the MA FAIR plan has surged by 1,783 percent from $4.1 billion in 1990 to $77.2 billion in 2013.
$90
$80
$70
$60
$50
$40
$30
$20
$10
$0
$4.1
$8.3
$10.3
$15.3
$16.7
$20.5
$26.7
$39.2
$54.0
$68.6
$79.5
$81.5
$79.4
$77.6
$76.7
$76.1
$77.2
1990
1995
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
Source: PIPSO; Insurance Information Institute

Fig. 24



Prior to 2004 homeowners' rate changes under MPIUA were restricted by statute. In territories where its market share was extensive, the plan was permitted to increase pricing only by the statewide average of the top 10 companies. As a result, in the eight-year period from 1997 to 2004, the annual average price increase was capped at 1 percent. However, a bill passed in December 2004 allowed the insurance commissioner to consider predicted hurricane losses and cost of reinsurance when reviewing the pricing of the plan. As a result, starting from 2006, the rates could be adjusted upward, thereby giving the FAIR Plan an actuarially sound pricing basis going forward.

MPIUA is one of the few plans that offer coverage almost comparable to a homeowners policy. The plan also offers a form of guaranteed replacement cost coverage, which pays up to $1 million to rebuild a home. Legislation that would have revised the plan's coverage and allowed the plan to stop offering unlimited replacement cost coverage failed to pass the Massachusetts legislature in 2008.

The MPIUA purchased $1.2 billion of reinsurance coverage for the 2014 season, effective July 1. The reinsurance attachment point in 2014 is $120 million. The plan first purchased reinsurance in 2006. Any loss in excess of reinsurance is funded by company assessments. Assessments for losses are based on an individual insurer's market share. Insurers doing business in Massachusetts may recoup the assessment amount by surcharging their policyholders.

In 2010 MPIUA had also accessed the capital markets to provide it with an additional layer of catastrophe protection via a $96 million catastrophe bond issuance. The bond provided MPIUA with protection against the effects of Massachusetts hurricane risk through June 30, 2013.

In 2013 the FAIR Plan requested a rate increase of 9.9 percent for homeowners on Cape Cod and the Islands. The rate increase was denied by the state's insurance commissioner Joseph Murphy in June 2014 after a lengthy hearing process.

This is the second time the MPIUA's request for a rate increase has been denied by commissioner Murphy. In 2011, the plan had requested an overall statewide average rate increase of 7.4 percent. Homeowners on Cape Cod would have faced a 6.7 percent rate increase under the proposal, while areas including New Bedford, Fall River and parts of Boston would have faced an increase of 10 percent. The commissioner found this requested increase was unjustified and based on unexplained hurricane models.

Another request by the FAIR Plan for a rate increase was also denied in 2008. At that time, the insurance commissioner found the FAIR Plan failed to use reasonable, accurate and timely data to support its call for a rate increase. The plan had requested an overall statewide rate increase of 13.2 percent in 2007, but many coastal residents on the cape would have faced rate increases of 25 percent. State attorney general Martha Coakley appealed the rate hike to the insurance commissioner.

In 2006 the insurance commissioner granted the FAIR Plan an average rate increase of 12.4 percent and a rate increase of about 25 percent in certain coastal areas.

6. NORTH CAROLINA AND SOUTH CAROLINA PROPERTY MARKETS OF LAST RESORT

Overview: The North Carolina Joint Underwriters Association (NCJUA) and North Carolina Insurance Underwriting Association (NCIUA)

North Carolina has two residual market plans that act as a market of last resort for residential and commercial property insurance in the state. The North Carolina Joint Underwriters Association (NCJUA) was created in 1969 to make basic and broad property insurance available to those unable to buy coverage through the standard insurance market. The FAIR Plan covers the entire state except those barrier islands adjacent to the Atlantic Ocean. The North Carolina Insurance Underwriting Association (Beach Plan), also created in 1969, provides windstorm and hail coverage as well as homeowners policies for properties located in the state's beach and coastal area (18 coastal counties).

North Carolina ranks 11th on AIR Worldwide's coastal exposure list with $163.5 billion in insured coastal exposure, of which about 60 percent is residential and 40 percent is commercial. North Carolina's insured coastal exposure represents just 9 percent of the state's total insured values.

Yet as of year-end 2013, North Carolina's Beach and Windstorm Plan, the North Carolina Insurance Underwriting Association, reported a total of 259,976 policies, up from 119,810 policies reported at the end of 2005. Total exposure to loss under the plan more than doubled from $43.3 billion in 2005 to $90.1 billion at year-end 2013. As of March 31, 2014, growth appears to be slowing with NCIUA reporting $90.3 billion in exposure and 235,533 total policies.

The North Carolina JUA/IUA plans have optimized the use of both traditional reinsurance and capital markets in an effort to achieve a robust risk financing program. The plans have accessed the capital markets four times (2009-2011 and 2013) to provide them with additional reinsurance protection in the event of a hurricane. As a result, the plans were covered by $500 million in catastrophe bond protection as well as $1.7 billion in traditional reinsurance to manage hurricane risk for the 2014 season.[16]

Legislative Developments

In August 2009 legislation (HB 1305) aimed at reforming the beach plan was passed by the state Senate and subsequently signed into law by North Carolina Governor Bev Perdue. The legislation caps insurers' assessments for losses incurred in one year at $1 billion; allows insurers to assess a 10 percent surcharge on every property insurance policy statewide after a major storm if the plan hits the $1 billion deficit threshold; and reduces coverage limits for residential property to $750,000 from $1.5 million.

The bill was based on recommendations made in January 2009 by a Joint Select Study Committee to restore the beach plan to its intended role as a market of last resort.

In addition to these legislative recommendations, in December 2008 changes were made by the beach plan and the department of insurance without the need for legislation. These changes, which included increasing homeowners policy deductibles, raising rates and allowing the plan to retain more capital, were intended to increase the plan's surplus and decrease its exposure to loss.

An October 2008 study by Milliman, an actuarial consulting firm, for the Property Casualty Insurers Association of America warned that the North Carolina beach plan was financially unprepared to weather a severe storm. It noted that the beach plan's exposure to liability is increasing but its ability to pay claims from a storm and the timing of those payments is dependent upon assessments from member companies. In a season with a large storm (1-in-250 year scenario), the plan would likely face a $6.2 billion deficit. This could result in assessments which may significantly impact the financial conditions of some insurers, according to Milliman. Even a small storm (1-in-50 year scenario) would leave the plan some $1.4 billion in the red.

[16] http://www.ncjua-nciua.org/DocLib/mbr_co/RiskFinanceStructureFile2014.pdf.

Overview: The South Carolina Wind and Hail Underwriting Association

The South Carolina Wind and Hail Underwriting Association (SCWHUA), known as the Beach Plan or Wind Pool, provides wind and hail coverage for residential and commercial properties in the coastal area of the state.

As of December 31, 2013 the South Carolina Beach Plan had a total of 43,478 policies in-force, down 5 percent from 45,855 policies in-force at the end of 2012, but up 97 percent from 22,068 total policies in-force at the end of 2005. The South Carolina Beach Plan's total in-force liability increased by 124 percent from $6.6 billion in 2005 to $14.8 billion at the end of 2013.

South Carolina ranks eighth on AIR Worldwide's coastal exposure list with $239.3 billion in insured coastal exposure, representing 28 percent of the state's total insured values. The state is also experiencing accelerating coastal population growth. Between 1980 and 2003, its coastal population grew by 33 percent, ranking it 10th among leading states in terms of coastal population growth.

From January 1, 2008 the state insurance department has required Wind Pool policyholders choosing replacement cost coverage to purchase flood insurance. Around 70 percent of Wind Pool policyholders already had flood coverage and several thousand additional policyholders are now covered for flood damage.

Legislation expanding the Beach Plan's coverage territory was approved in June 2007. Residents who make their homes more resistant to wind damage would also be given tax breaks. In addition, insurers would receive tax-credits for writing coastal policies that did not exclude windstorm losses.

7. ALABAMA INSURANCE UNDERWRITING ASSOCIATION (AIUA)

Overview

The Alabama Insurance Underwriting Association (AIUA) was voluntarily formed in the early 1970s by insurance industry leaders in co-operation with the Alabama Department of Insurance. In 2008 the Alabama legislature codified the AIUA along with its articles of agreement, plan of operation, and rules and procedures.[17]

The purpose of the AIUA is to provide a market where owners of eligible property located in coastal areas of Baldwin and Mobile counties may obtain essential insurance when they are unable to obtain coverage in the private insurance market.

The Alabama Beach Plan provides two types of polices: a fire and extended coverage policy (provides no liability coverage); and a wind and hail only policy. Only home and businesses located in the Gulf front, beach and seacoast territories of Baldwin and Mobile counties are eligible for coverage under the beach plan.

[17] http://www.aiua.org/

Residential and commercial policyholders can purchase AIUA coverage up to the following limits:

- Residential—Dwelling Building and Contents: $500,000
- Commercial—Commercial Building and Contents: $1 million

Since July 1, 2008 the plan has offered discounts on policies covering residential dwellings built or retrofitted to fortified wind resistive standards, as certified by the Insurance Institute for Business and Home Safety (IBHS).

The Alabama Beach Plan has grown rapidly in the course of the past two decades. PIPSO data show a total of 29,616 habitational and commercial policies in-force at year-end 2013, an increase of 835 percent from 3,169 policies in 2004. Exposure to loss in the plan reached $5.1 billion in 2013, up 1,494 percent from $317.6 million in 2004. (PIPSO exposure data for the AIUA in 2005 and 2006 are unavailable.)

In 2014, that growth continues. As of May 2014, the plan had 31,279 total policies in-force and total exposure to loss was more than $5.4 billion.

Latest data from the AIUA website show the plan continues to grow in 2014, with 31,279 total policies in-force and total exposure reaching $5.4 billion as of May, 2014.

Alabama ranks 12th on AIR Worldwide's coastal exposure list, with $118.2 billion in insured coastal exposure, about 50 percent of which is residential and 50 percent commercial. Alabama's insured coastal exposure represents 13 percent of the state's total insured values.

The Alabama Beach Plan had a $500 million reinsurance program in place for the 2014 hurricane season. The attachment point was $70 million, with an optional buy down for individual members of $30 million excess of $40 million. Individual members could also purchase a further $100 million of reinsurance coverage excess of the $500 million layer, bringing total coverage up to $600 million.

Once the Beach Plan's total claims-paying capacity is exhausted, members assume outstanding liabilities and are liable for assessments. No specific provisions exist for recouping assessments.[18]

A series of severe tornadoes hit parts of Alabama in April 2011. Availability and affordability of homeowners insurance is a rising concern given Alabama's exposure to tornadoes and hurricanes.[19]

[18] *State Beach and Windstorm Plans*, Insurance Research Council, October, 2010.
[19] *Gov. Robert Bentley takes lead on tornado recovery, says buck stops with him*, Associated Press interview via AL.com, June 19, 2011.

8. NEW YORK PROPERTY INSURANCE UNDERWRITING ASSOCIATION (NYPIUA)

Overview

The New York Property Insurance Underwriting Association (NYPIUA) was established in 1968 following passage by Congress of the Housing and Urban Development Act of 1968. This legislation made federal riot reinsurance available to those states that instituted such property insurance pools.

The plan insures residential and commercial properties in the state where the homeowner cannot find coverage elsewhere. Extended coverage includes windstorm coverage.

Exposure to loss under the NYPIUA more than doubled from $5.6 billion in 1990 to $14.4 billion in 2013, even as the plan's policy count went down. The plan's total policy count (habitational and commercial) was 55,896 in 2013, compared with 58,197 policies in 2012, and 73,805 total policies in 1990.

For New York coastal residents trying to obtain homeowners coverage, there is also a Coastal Market Assistance Plan (C-MAP), which was developed by the New York State Insurance Department and is administered by the NYPIUA. C-MAP began operations in 1996.

C-MAP assists policyholders living on the South shore of Long Island, Brooklyn, Queens, Staten Island and Long Island's forks that are within one mile of the shore and property on the north shore of Long Island, in the Bronx and Westchester within 2,500 feet of the shore locate an insurer willing to provide homeowners coverage.

To increase availability, insurance companies voluntarily participate in C-MAP by offering to insure property that they might otherwise reject due to proximity to the coast.

The insured value of coastal properties in New York totaled $2.9 trillion in 2012—the highest among all coastal states—according to an analysis by AIR Worldwide. New York's coastal exposure represents 62 percent of the state's total insured values.

New York was one of a dozen states impacted by superstorm Sandy in October 2012. Sandy caused $18.75 billion in insured property losses, excluding flood insurance claims covered by the National Flood Insurance Program (NFIP), according to estimates from ISO's PCS unit, as of January 18, 2013. New York and New Jersey had suffered the largest private insurance losses from Sandy. Sandy was the largest natural disaster in terms of insured losses in the state's history.

New York was also among those states that felt the impact of Hurricane Irene in August 2011. Irene affected a total of 14 states, causing some $4.3 billion in insured property damage, not including flood losses covered under the NFIP, according to ISO.

Three of the costliest hurricanes to hit the U.S., based on insured property losses, caused damage in New York: Hurricane Ivan and Hurricane Frances, both in 2004, and Hurricane Sandy in 2012.

Hurricane Sandy has prompted a re-evaluation of how the New York metropolitan area prepares for and deals with major disasters, just as Hurricane Katrina did in 2005. While Katrina was a stronger storm and caused more damage ($48.75 billion in current dollars), Hurricane Sandy hit a more populous area, with up to 15 percent of the total U.S. population feeling its impact.

Legislative Developments

In June 2013 the New York State Assembly approved a comprehensive post-Sandy insurance reform package, comprising 14 pieces of legislation.[20]

The approved bills ranged from establishing a Homeowner's Bill of Rights to creating measures that proponents say would increase claims efficiency and fairness to enhancing consumer protection.

The approved bills are being considered by the NY State Senate.

[20] *N.Y. Assembly Approves a Flurry of Post-Sandy Insurance Reform Bills*, Insurance Journal, June 5, 2013.

Appendix 1

Summary of Major Natural Catastrophe Legislative Proposals
Source: I.I.I. research and Property Casualty Insurance Association of America (www.pciaa.net), as of August 2014.

Homeowner Catastrophe Protection Act of 2013 (HR 549)
Summary: Provides tax incentives for homeowners and insurers to allow them to better prepare for natural disasters. Amends the Internal Revenue Code to: 1. allow insurers to establish tax-deferred reserves to cover natural disasters; 2. allow homeowners to create tax-exempt catastrophe savings accounts to help pay for losses resulting from a federally declared natural disaster; and 3. provide tax credits for homeowners who upgrade their homes to mitigate damage due to hurricanes and earthquakes.

Homeowners' Defense Act of 2013 (HR 737)
Summary: Establishes the National Catastrophe Risk Consortium to: 1. maintain an inventory of catastrophe risk obligations held by state reinsurance funds, state residual market entities, and state-sponsored providers of natural catastrophe insurance; 2. facilitate the issuance of catastrophe bonds; 3. coordinate reinsurance contracts; 4. act as a centralized repository of state risk information; and 5. establish a database to perform research and analysis of the risk-linked securities market.

Homeowners' Insurance Protection Act of 2013 (HR 240)
Summary: Establishes a federal reinsurance program under the oversight of a National Commission on Catastrophe Preparation and Protection. Allows insurers that participate in state programs to establish Catastrophe Capital Reserve Funds.