

October 2008

FHCF Bonding Capacity Update

The Florida Hurricane Catastrophe Fund (FHCF) has announced changes in bonding capacity. The new estimates, voted on and approved by the Advisory Council, reflect the changes in the economic climate and emphasize the heavy dependence of the FHCF on post-event financing to meet its obligations.

FHCF Updates

The FHCF held an Advisory Council meeting on October 14, 2008 to announce the latest capacity estimate for the 2008 Member Company coverage calculation. Due to the extreme shift in financial market conditions, the FHCF's financial advisor, Raymond James, presented two views of the capacity available for 2008 claims paying:

1. A theoretical capacity (the method that has been used in the past): this involves a mathematical calculation of how much capacity the FHCF has, considering the current interest rate environment and the assessment base of the FHCF to support a bond issue
2. A market-based estimate of what the FHCF could secure realistically in the next 12 months: this estimate was developed with the FHCF's three lead bond underwriters – Citi, Goldman Sachs, and Morgan Stanley.

Under the theoretical calculation, there is a slight shortfall in the bonding capacity because of the unprecedented movement in the municipal credit market over the last few months. The market-based estimate, however, shows a substantial reduction from those in May 2008—from USD25.5 billion of bonding and total capacity of USD29.1 billion (in May) to USD1.5 billion to USD3 billion of bonding and USD13.29 billion of total capacity (at present).

The Advisory Council voted to accept the Estimated Loss Reimbursement Capacity as the official October bonding estimate. This change in capacity will result in a recalculation of the member companies' payout multiples, consequently modifying the amount of coverage provided to each company.

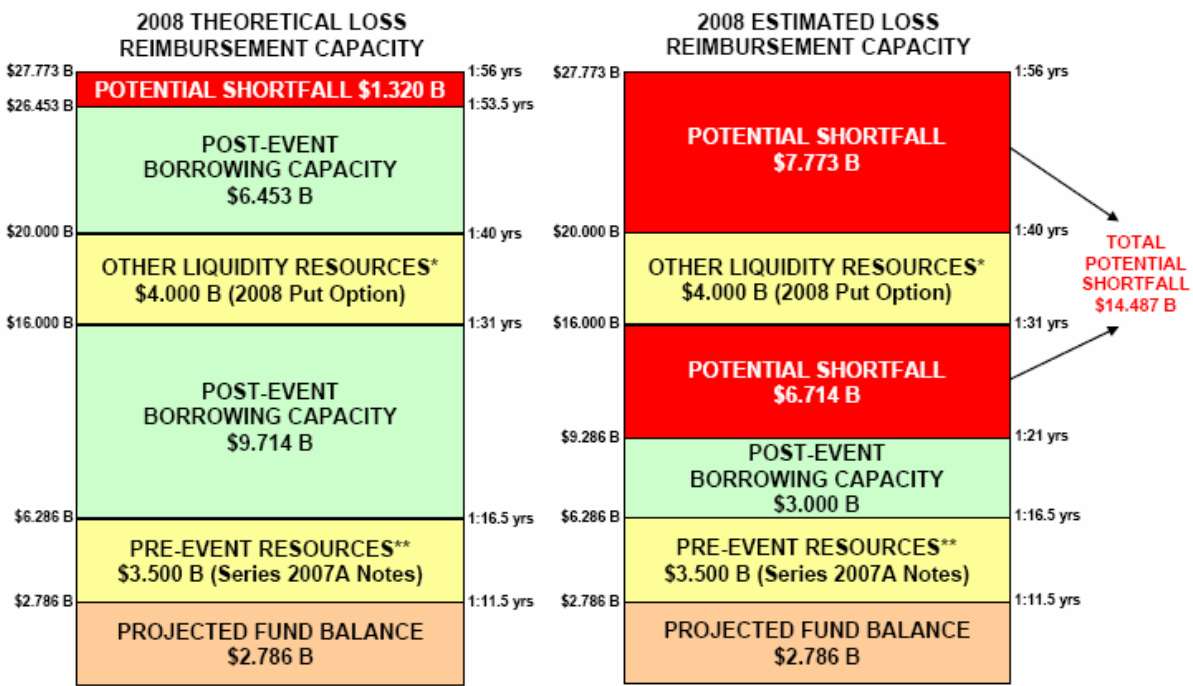
While the estimated loss reimbursement is the maximum amount the FHCF believes it can raise over the next 12 months, it does not use the full 6 percent assessment available to the FHCF for an annual period. The USD3 billion estimate only requires a 2.7 percent assessment, leaving 3.3 percent available for additional bonding over a longer timeframe.

	Projected Fund Balance	Pre-Event & Other Liquidity Resources*	Post-Event Borrowing Capacity	Total Loss Reimbursement Capacity	Annual Assessment %
Initial Season	\$2.786 B	\$7.500 B	\$1.500 B (6-mo) \$3.000 B (12-mo)	\$11.786 B \$13.286 B	2.3% (6-mo) 2.7% (12-mo)

Source: Raymond James

Since the FHCF does not guarantee payment within a certain timeframe and will continue to issue bonds (if possible) for as long as they have assessment capacity available, companies must consider coverage for the timing of reimbursements. The Advisory Council stressed at the meeting that companies should expect to provide for their own liquidity, either during the 12 months following an event or further into the future.

The chart below illustrates the capacity available under both the theoretical approach and the actual estimated amount based on market conditions. Note that the total capacity needed in the October estimates differs from the May numbers due to the actual coverage selections by Member Companies that were made in June. Also, the projected cash balance has decreased, due in part to losses in the investment portfolio.



* The 2008 Put Option is designed not to trigger until FHCF reported losses reach the TICL layer (approximately \$16 billion in FHCF losses).
 ** Does not include Series 2006B Extendible Notes as 95% of these Notes will be defeased by March 2009 and are therefore not available to pay claims.

Source: Raymond James

The impact of the reduction in companies' FHCF reinsurance layers both now and into 2009 will depend on several factors.

- Favorable conditions for late-season storm activity may encourage some companies to address any gaps in reinsurance coverage immediately
- The Florida Office of Insurance Regulation's response regarding coverage requirements and the amounts of additional reinsurance expense allowed in rate filings will impact purchases
- Rating agency reactions will influence company responses
- An FHCF decision to enter into other financing mechanisms will reduce the gap for insurers in their programs

A.M. Best has started its assessment of the FHCF announcement's impact on rated carriers. Currently, companies found to have substantial gaps in coverage will be placed under review with negative implications, pending additional discussions with senior management.

Each company with potential exposure to gaps in coverage should undertake a careful review of the current treatment of the FHCF within their reinsurance contracts, as well as any other financing options available. Solutions for companies should be tailored based on a particular company's current risk management tolerance and coverage in force. Markets have indicated there is capacity available to address shortfalls for 2008, should a company choose to pursue solutions now.

While any coverage purchased now by member companies or by the FHCF is likely to expire prior to January 1, 2009, reinsurers still will need to evaluate their capacity allocations for the new year in relation to an increased need for Florida exposure, especially planning for June 1, 2009 renewals.

This will be a fluid situation over the coming months. We will be monitoring developments closely and will provide updates as new information becomes available.

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