



June 2010

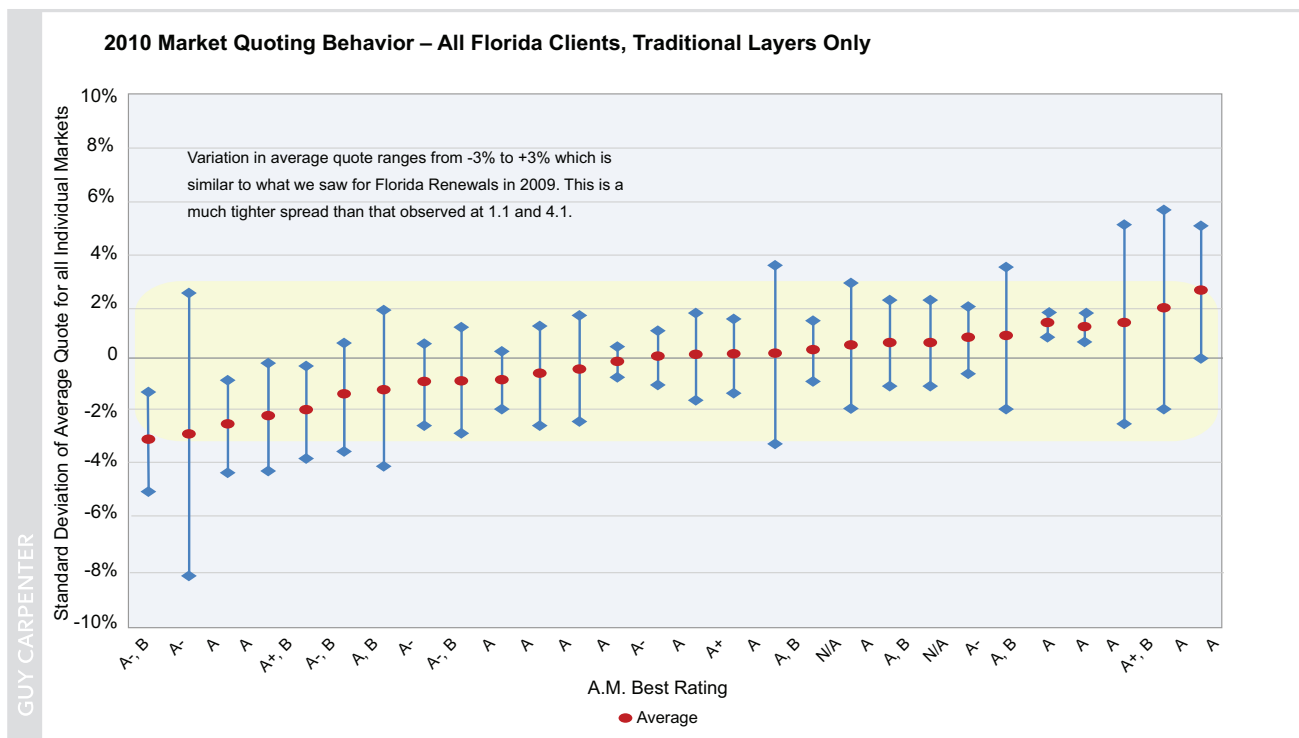
## June 1 Reinsurance Rate Decreases are one Positive Development for Florida Companies

At each Florida renewal season there are many challenges companies face in designing and placing their reinsurance programs. This year was no exception. While companies deal with navigating the challenges of the Florida Hurricane Catastrophe Fund (FHCF) integration each year, 2010 also included heightened commentary by rating agencies regarding acceptable risk transfer approaches, the Florida Office of Insurance Regulation's (OIR's) own views on risk transfer and an environment of continuing economic turmoil specific to the Florida insurance environment.

In a positive development for these companies, reinsurance pricing continued its 2010 trend of price declines and dropped year over year on a risk adjusted basis by 10 percent to 12 percent on average. This drop returns pricing to a level close to that seen in 2008, particularly in upper layers.

### Florida Pricing Decreases Reflect Abundant Reinsurer Capital

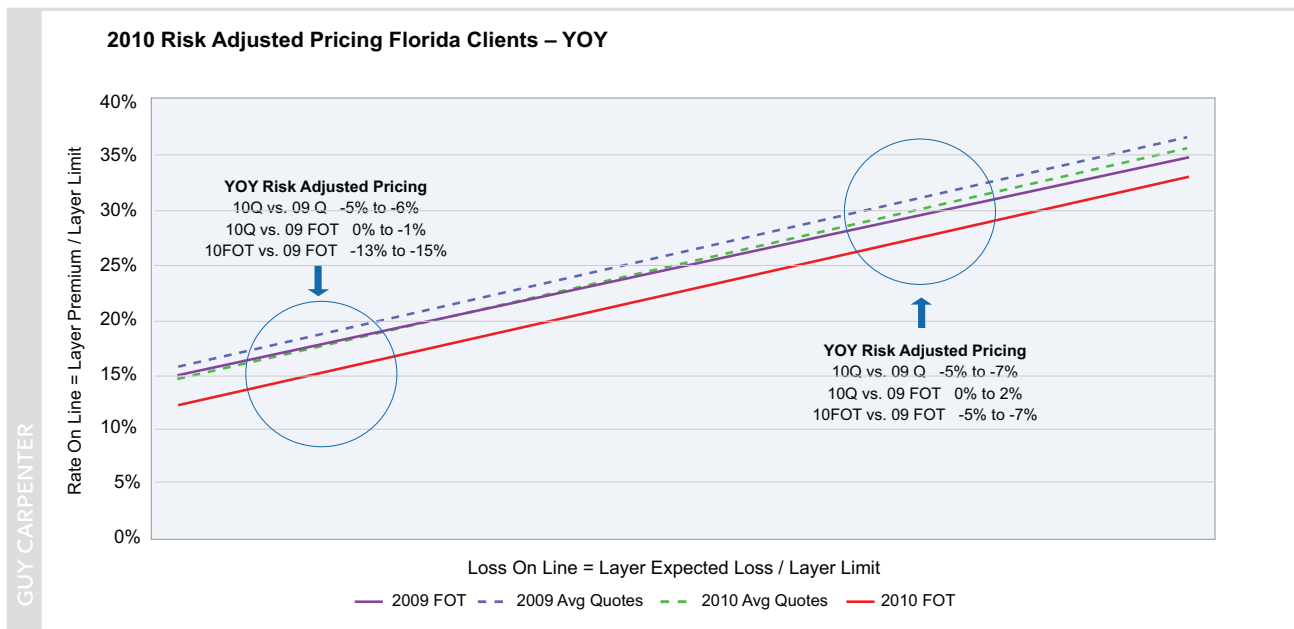
Consistently in 2010, capacity has returned in abundance, counterbalancing the direct impact last year's scarce capital had on pricing. In addition, reinsurers writing Florida business tend to view metrics for this exposure within a very narrow band, much more so than other catastrophe exposed regions. Variation in average quotes ranged from declines of 3 percent to increases of 3 percent, which is similar to what we saw for Florida Renewals in 2009. This is a much tighter spread than that observed at both January 1 and April 1, 2010.



Source: Guy Carpenter & Company, LLC

The abundance of capital currently on insurers' balance sheets is demonstrated by the volume of share buybacks initiated this year. To date in 2010, 21 companies that underwrite reinsurance have returned capital totaling USD8.8 billion to shareholders compared to USD1.8 billion in the whole of 2009. The 2010 amount represents 7.7 percent of their aggregate shareholders' funds at the end of 2009. The 2009 buy-backs were equivalent to 2.0 percent of 2008's closing shareholders' funds.

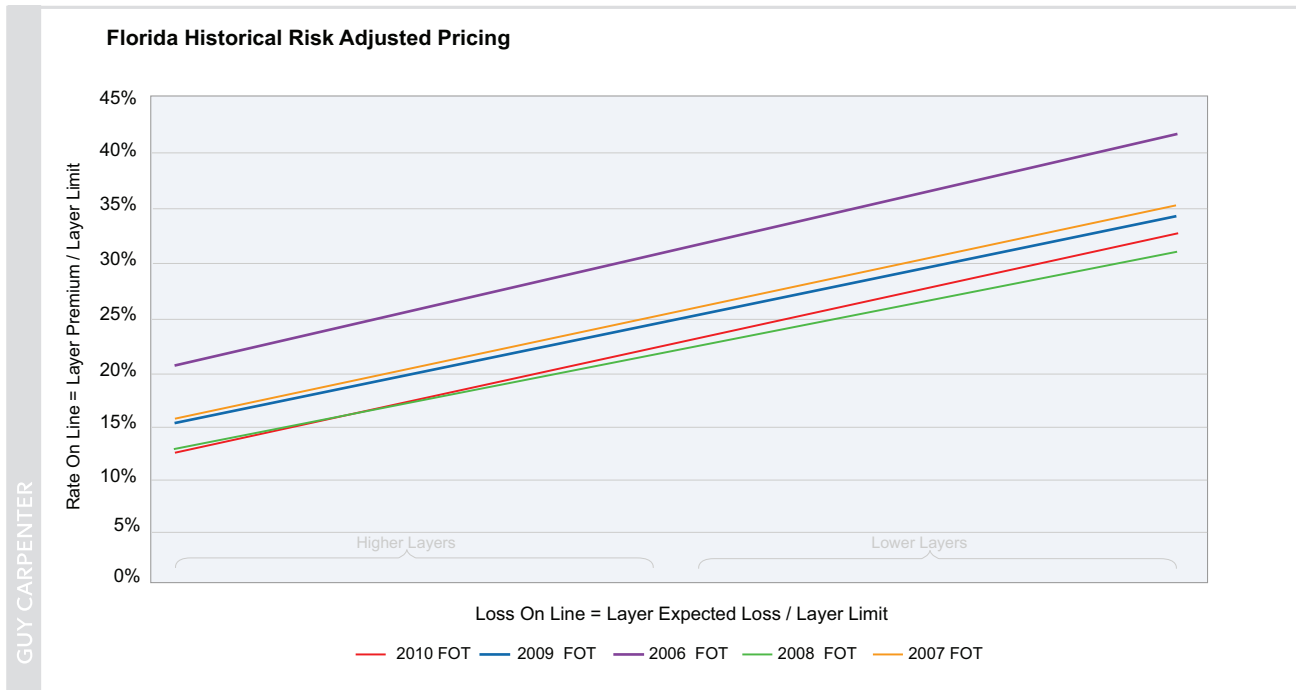
While average quotes dropped 5 percent to 7 percent from 2009 quotes, reinsurers overall were very consistent in providing indicated pricing this year that was almost flat as compared to 2009 firm order terms. These indications were surprising given the general expectation following the January and April renewals that decreasing pricing trends would continue. Following significant discussion with clients and markets, 2010 firm order terms averaged a decrease of 5 percent to 7 percent in the lower layers, where capacity isn't as abundant and a decrease of 13 percent to 15 percent in the upper layers.



Source: Guy Carpenter & Company, LLC

Programs were placed at 86.85 percent of average quotes received for the program and at 102.61 percent of the lowest quote received.

The overall effect of this year's renewal process was a shift in pricing back to roughly 2008 levels. The layers exhausting at the highest return periods ended slightly better than in 2008. As indicated in the chart below, pricing since 2007 has remained in a very stable band. Even with the significant global economic turmoil of 2009, enough capacity was available to keep pricing within an expected range, unlike the pricing implications of 2006 coming off of multiple unprecedented hurricane losses in 2004 and 2005.



Source: Guy Carpenter & Company, LLC

### Renewal Challenges

One of the critical components in the majority of Florida contracts renewing at June 1 is the structure of the FHCF. While factors influencing the FHCF structure overall were dealt with earlier in the year than in prior years, there remained questions regarding the viability of the TICL layer and rating agencies' treatment of TICL within the reinsurance structure. In 2009, with the impact of the financial crisis on the municipal bond market, which the FHCF utilizes to pay post event claims above their available cash on hand, there was considerable concern regarding the viability of this upper layer of coverage. Statutorily, the legislature reduced coverage offered by USD2 billion to USD10 billion last year. Due in part to companies' concerns regarding the timing of payments received from TICL, only USD5.56 billion was taken up. Of this, approximately 65 percent was selected by Citizens Property Insurance Corporation (Citizens).

This year, the FHCF TICL layer was further reduced to USD8 billion and in light of last year's take up rate and Citizens' decision not to purchase coverage, the FHCF is estimating a take up of USD2.72 billion of TICL coverage. In addition to companies' own concerns regarding the timing of payments from TICL, Demotech specifically provided criteria in 2010 that companies would have to meet in order to utilize the TICL layer within their reinsurance structure and maintain an A rating or better. These criteria include a liquidity ratio greater than 1.0, ratio of total liabilities to policyholders' surplus of 3.0 or less and favorable one and two year reported loss development.

The FHCF has recently released their May bonding estimates and as expected the financial markets' continued improvement has had a positive impact on the FHCF, as well. Total possible FHCF obligations in 2010 assuming USD8 billion of TICL coverage are USD25.461 billion. The new capacity estimates cover the full USD25.461 billion at an estimated 5 percent post-event assessment, assuming current financial market conditions. This includes the projected Fund balance of USD6.02 billion, USD3.50 billion of pre-event notes and just under USD16 billion of bonding.

Beyond FHCF considerations, both OIR and Demotech contributed specific views on appropriate risk transfer approaches. In addition to the comments on TICL, Demotech's guidance document included commentary on the criteria and ratios they use to evaluate companies. OIR released a memorandum stating that companies should not necessarily focus on purchasing to the 1 in 100 year event as this would not be an OIR requirement, but should also evaluate giving equal weight to protecting surplus from multiple storms of smaller magnitude. This did have an impact on some companies that chose to purchase less limit on top in order to place other coverages providing protection such as second or third event structures.

The continued economic issues facing Florida insurers also weighed heavily on companies as they considered final reinsurance structure criteria. Factors including increasing attritional loss ratios and decreasing premium volumes due in part to the way in which the wind mitigation credits have been applied, continue to put substantial pressure on companies' financial health. While many companies have recently seen rate increases approved, it will take a significant amount of time before this will impact the continued erosion of capital.

## Guy Carpenter Briefing

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