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How secure is Citizens Property Insurance?

In less than four years, Citizens Property Insurance went from being a temporary fix for Florida's troubled insurance market to the state's largest insurer of homes, condos and apartments.

Along the way, it has paid out nearly \$5.9 billion in 313,237 claims from eight hurricanes. It ramped up operations to handle catastrophes practically as the storms raged. Its staff has gone from fewer than 100 to more than 1,000. And it took on some 300,000 policies practically overnight when three insurers failed two years ago.

BIG BREAK

Citizens -- and all insurers working in Florida -- got a big break in the past two years because no hurricane made a direct hit on the state.

The question now: Is Citizens, with nearly 1.3 million policyholders, prepared to handle what 2008 may bring?

Bruce Douglas, Citizens' outgoing chairman of its board of governors, and Scott Wallace, its president, say the company is ready to deal with a major storm.

"We're expecting the worst, but we're hoping for the best," says Douglas.

Citizens has established an operations center in Jacksonville to handle storm claims, it has nearly 5,000 adjusters under contract and it has money in the bank -- that's cash and borrowed funds. It has bought private backup insurance to reduce some of its windstorm losses.

Still, some policyholders are wary.

After being dropped by USAA, Richard Francis ended up with Citizens for his home in Anna Maria, near Bradenton. Citizens' rate was lower than what he was offered by the sole private carrier willing to write him a windstorm policy.

"I am presently insured by Citizens, but envision a nightmare in trying to -- God forbid -- ever submit a claim" to the company, Francis says.

No doubt, Citizens has learned from its mistakes. In late 2004 and early 2005, it was bogged down by mismanagement, especially of its claims operations. Allegations of

self-dealing and conflicts of interest plagued the actions of former top officials.

Since then, various task forces and oversight committees have dissected the company's operations. It now has a conflict-of-interest policy in place, and executives and new hires are better screened.

A big factor in handling claims for any insurer is having the cash on hand to cut checks right after a big storm so its policyholders can begin repairs.

Citizens is counting on having at least \$4.1 billion in surplus by year-end to pay claims. That's hard cash.

It also has arranged lines of credit, sold notes and set up agreements with investors to buy bonds totalling another \$4.2 billion that the insurer could tap. Of the total, \$2.5 billion would cover Citizen's riskiest policies -- those in the wind pool area, generally east of Interstate 95 in South Florida.

Citizens also has back-up insurance from the Florida Hurricane Catastrophe Fund. It has \$7.4 billion in reinsurance for its windstorm policies and another \$4.3 billion for its multiperil and commercial policies, which include condo and homeowners associations.

The Florida CAT fund provides 96 percent of Citizens' reinsurance.

SUBPRIME CONNECTION

Citizens itself is managing its borrowed money for now, rather than giving it to Wall Street money managers to invest. The return on these invested funds is greater than the interest Citizens must pay on the debt, so the insurer is in a good position.

However, the meltdown of the sub-prime mortgage market caught the insurer flat-footed last summer and threw off its usual financing and investment strategy.

The State Board of Administration, which had been managing Citizens' money, bought some securities tied to the subprime mortgages that were downgraded shortly after the underlying loans defaulted. Citizens has written down \$88.5 million because of losses on some of these investments. As of early July, it still has \$96.5 million frozen in a fund managed by the SBA.

FIRST IN LINE

The new 2008 insurance bill simplified how Citizens assesses its own policyholders to make up a shortfall, but they're still the first in line to be hit with extra charges. They could see charges of up to 45 percent of their annual premium in one year if there is a shortfall.

If the assessments to its own policyholders don't cover the deficit, Citizens can impose a surcharge of up to 6 percent a year on all the insurance policies in the state.

Although Citizens' has planned carefully and is watching its pennies closely, policyholders might not be able to avoid more surcharges if the insurer faces another shortfall.

"We're talking about being able to handle a very big storm with a small Citizens policyholder assessment," says Sharon Binnun, Citizens' senior vice president for accounting and chief financial officer. She estimates Citizens could weather a hurricane that produced windstorm losses of about \$6.4 billion with only a small assessment.

It's Citizens' reliance on the state CAT fund and its huge exposure -- nearly \$475 billion -- that has many people worried. If the CAT fund can't tap the credit markets for the cash it would need to back up Citizens and all the private insurers working Florida, the state's entire insurance market could collapse.

"Citizens is a disaster waiting to happen," says Barney Bishop, president of Associated Industries of Florida, a lobbying group that represents small and medium-sized businesses around the state. He worries a big storm will wipe out Citizens and the CAT Fund and impose huge assessments on consumers.

LAST RESORT

Bishop would prefer to see Citizens return to being just the insurer of last resort and not be allowed to compete with the private carriers.

Citizens' policy count hasn't grown as quickly as expected in the past two years.

The insurer was required to take on more than 300,000 policies when the three Poe Financial Group companies -- Atlantic Preferred, Florida Preferred and Southern Family -- collapsed in 2006. The additional load required more staff and a processing center in Tampa.

But 12 Florida-based insurers have taken more than 432,000 policies from Citizens in the past 18 months. All of these policies have come from Citizens' personal lines account, where the policies cover properties outside the state's wind-pool region.

Though the number of overall policies is lower, the company's total exposure has continued to climb.

William Murray, president of Nausch, Hogan and Murray, a Miami-based insurance brokerage, says Citizens has become more responsive to agents' needs and the company "is accessible when you need it."

However, Murray worries that Citizens' rates, especially for condo buildings and associations, aren't sufficient given the exposure the insurer has taken on.

Binnun attributes that to rising insured values. Also, the takeouts didn't affect the number of windstorm policies Citizens is carrying.

Several regulatory changes in early 2007 have allowed homeowners to stay with Citizens even if they get a takeout offer from a private carrier. Now, takeout firms must set their rates below Citizens. Also, Citizens can now sell a multiperil policy -- one that includes windstorm as well as fire, theft and liability in the windstorm area -- to bring in extra premiums and help diversify its risk.

Yet, some agents, such as Robert Reynolds with Miami agency Morris & Reynolds, believes the total cost is lower for consumers with a wind-only policy from Citizens.

BLACK EYE IN '04

Undoubtably, what has given Citizens its biggest black eye is how poorly it handled claims after the 2004 storms and initially after Hurricane Wilma hit South Florida the following year. So, the company has spent a lot of time and money in the past two years revamping its claims and catastrophe operations.

To be sure, Citizens was barely a company in the summer of 2004. It had opened its doors in 2002, created by combining the old windstorm pool that had been around for more than 30 years and the Joint Underwriting Association formed after Hurricane Andrew devastated South Florida in 1992. After that storm, many private carriers that had never contended with a hurricane's damage fled the state. To complicate the situation, 11 poorly capitalized companies failed.

Citizens was ill-prepared to deal with the four 2004 hurricanes that hit the state. It had five staffers assigned to its claims operations, working out of a small office suite near the state capitol in Tallahassee. It had planned on having about 500 adjusters at its disposal if needed, but none were on staff. All worked for independent firms hired by the insurer.

By the fall, the insurer was already facing more than \$1.1 billion in insured losses from the storms.

Citizens quickly found out that many of the adjusters it expected to work for the insurer were missing in action, often working for another insurance company that paid more. Worse yet, many adjusters who showed up to work weren't trained or supervised by Citizens. Many claims were delayed, mismanaged and improperly adjusted and gave rise to many claims disputes.

An audit released in early 2006 found claims after the 2005 storms were handled more efficiently than after the 2004 cycle. But problems stemming from inexperienced and

poorly trained adjusters continued to plague the company and its policyholders. A task force set up by the Legislature in 2006 heard from hundreds of consumers. Their No. 1 complaint: Poorly trained adjusters.

Getting a handle on its claims operators and providing adjuster education were key recommendations from this task force, which presented its final report last month.

Citizens' management already had taken some of those recommendations to heart.

ARMY OF ADJUSTERS

It now has about 5,000 independent adjusters under contract via 44 adjusting firms. These adjusters are required to make Citizens' work their first priority, and their work will be closely monitored by 68 supervisors inside Citizens. All the adjusters have to go through a training session covering the company's adjusting practices and Florida's building codes.

Last month, the company ran a hurricane drill, mobilizing adjusters and staffers to see how its procedures would work.

Wallace says the company's claims staff has nearly doubled in the past year.

David Emery, Citizens' vice president for operations, contends Citizens is now set up to do what the large, long-established insurers can do: Quickly deploy large teams of adjusters to do early damage assessments and begin the claims-paying process.

The insurance bill passed this year requires that Citizens, and all insurers in Florida, pay claims quickly. The undisputed portion of a claim must be paid within 90 days, or the firms can be sued under the state's bad-faith trade laws.

Still, says Paul Brawner, director of professional development for Florida Association of Insurance and Financial Advisors and a former independent agent, "the sheer volume of policies it has to handle overloads the staff and you run into delays servicing policies and processing claims."