

**Florida's storm insurer could face shortfall Fund official disputes concerns by rating agency, underwriter October 20, 2008 By JUDY GREENWALD**

**TALLAHASSEE, FL** The Florida Hurricane Catastrophe Fund could be short more than \$14 billion should a severe hurricane strike this year given the difficulty of raising funds in today's constricted municipal bond market, according to the fund.

The 2008 hurricane season is drawing to a close, but a severe storm with losses could present serious difficulties for primary insurers that are relying on the fund for their catastrophe coverage of Florida risks, and could possibly lead to ratings downgrades, observers say. The fund has a total potential liquidity of \$10.29 billion. However, a fund official said such a problem is highly unlikely. Rating agency A.M. Best Co. Inc. last week said it is concerned about the fund's ability to pay claims in the event of a severe hurricane. The Oldwick, N.J.-based rating agency said it has started to assess the effect on rated entities' risk-adjusted capitalization "based on the reduction in the potential coverage available from the FHCF. According to data released last week, the FHCF's single-season maximum loss reimbursement obligation is now about \$27.8 billion. The fund projects, however, that it can raise only an estimated \$3 billion over a 12 month-period under current municipal bond market conditions. Taking into account a projected fund balance of \$2.79 billion and pre-event and other liquidity resources of \$7.5 billion, this gives the fund a 12-month loss reimbursement capacity of only \$13.29 billion, leaving a potential shortfall of \$14.49 billion.

The resources take into account the \$4 billion in bonds that Berkshire Hathaway Group Inc. agreed to buy under a put option deal announced earlier this year that is triggered if the FHCF has more than \$16 billion in losses.

This is a catastrophe waiting to happen, E. Graham Clark, managing director, financial institutions group at Citigroup Global Corporate Bank in New York, one of the fund's senior managing underwriters, said in a speech earlier this month. He warned that if there is a severe storm, the fund would not be able to raise the necessary amount of capital because of the current market environment. He said some of the fund's largest investors, primarily European investors, have already required a bailout by their own governments. This capital structure is insolvent, he said.

Citigroup later issued a statement that said, "Mr. Clark's remarks about the Florida Hurricane Catastrophe Fund were regretfully taken out of context. The FHCF is a valued client of Citi's and we continue to believe strongly in their stability and will continue to support them as an adviser and underwriter. In its comment last week, Best said it had previously indicated concerns about the FHCF's ability to fund all obligations should a severe hurricane hit the state.

These concerns were largely based on the contingent capital nature of the FHCF and capital market acceptance of what would likely be one of the largest public debt offerings, Best said. "In addition, the potential liquidity and cash flow issues that might arise from such an event created an additional level of uncertainty. Based on current market conditions, it is only prudent to re-evaluate these expectations in the assignment of ratings, despite the near-completion of the 2008 hurricane season. As a result of its review, Best said,

Companies with significant potential gaps in reinsurance coverage and correspondingly inadequate risk-adjusted capitalization will be placed under review with negative implications pending additional discussions with company management regarding improving this key metric. Best Analyst Richard Attanasio said insurers would not necessarily face a downgrade, "but we need to evaluate each one; and if the potential exists, we could put them under review. There might not be an issue because of structures around the cat fund that provide additional protections, for instance. "Those are the things we need to figure out now. Mr. Attanasio said the fund's current problems were caused by the Florida Legislature's decision last year to expand the fund, which roughly doubled it to more than \$30 billion, plus the current credit crisis.

Jack Nicholson, the fund's chief operating officer, expressed confidence about the fund's financial condition. "I don't have any doubt that we'd be able to fund losses one way or the other. Time will help us out, the markets will improve or the event will be small enough so that we can easily fund it", he said.

Mr. Nicholson said the fund could pay the hurricane losses of 2004 and 2005 plus have "a billion left over with our current resources. In the vast majority of scenarios I can think of, we would not have any problems, and it would have to be, certainly, an unprecedented hurricane to create any, Mr. Nicholson said.

Certainly, we are discussing the situation around the cat fund with our clients, and that includes the reaction and comments made by A.M. Best, said Lara Mowery, Minneapolis-based managing director for reinsurance intermediary Guy Carpenter & Co. Inc. "I think certainly we anticipated that A.M. Best would react in some way to this situation, because the mechanics of what has happened do, in fact, produce gaps in companies' coverage that have significant involvement in the Florida market, Ms. Mowery said. She noted that under Florida law, insurers may not recoup reinsurance costs that duplicate coverage provided by the FHC. This means insurers are, in effect, prohibited from obtaining coverage "that would help them fill in the gap if, in fact, the cat fund wasn't there, said Ms. Mowery.

We have to take very seriously the implications that there has to be another way to fill those gaps in coverage, she said. Guy Carpenter does not want its clients "to be in a situation where a late-season storm happens and it is not known whether the fund has the resources to pay its claims, she said.

One potential solution to help the cat fund is the possibility of the federal government purchasing bonds from the fund. Mr. Nicholson said he believes the federal government would do so "if push comes to shove. Meanwhile, the question also remains of what happens next year.

This is largely a function of where the credit markets stand in terms of level of funds and what might be needed to raise funds, said Mr. Attanasio. There also is the possibility that the fund's structure might be changed, he said.

Sam Miller, executive vp of the Tallahassee, Fla.-based Florida Insurance Council, said the legislature should lower the fund's capacity to a level where "the cat fund can always deliver, even in economic crises like this. Insurers should then be able to purchase additional coverage in the private market, he said. Richard Miller contributed to this story.