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Risk Transfer Success Leads to Ratings Upgrades for Florida Citizens.

It’s an exceedingly rare thing that I’d ever point to anything my adoptive state of Florida does in the area of insurance markets as an example that others might want to copy. But in at least one important respect, recent moves by the state-run Citizens Property Insurance Corp. offer a model not only for other residual markets, but also for the National Flood Insurance Program and, perhaps most importantly, for Citizens’ sister agency, the Florida Hurricane Catastrophe Fund.

Citizens’ efforts to slim down its portfolio and shift more risk to private reinsurance markets already are paying off in a big way. Late last week, the rating agencies Moody’s and Fitch both upgraded Citizens’ debt credit rating ahead of a planned $1 billion municipal bond issuance, Citizens’ first in three years.

Moody’s upgraded both Citizens’ personal lines and commercial lines accounts from A2 to A1, and assigned an A1 rating to the pending $750 million of tax-exempt senior secured bonds and $250 million of floating-rate notes.

> *The upgrade to A1 on all the Accounts notes CPIC’s track record and expertise with administering the assessment mechanism, during and after heavy storm seasons, as well as the state’s robust economy and* ***the corporation’s successful efforts to transfer risk and reduce the necessity for post-event bonding in coming years.***

Fitch upgraded more than $2.6 billion of Citizens’ outstanding senior secured debt from AA- to A+. Those bonds include $746.6 million issued in 2009, $1.24 billion issued in 2010 and $645 million issued in 2011. For the forthcoming issues, Fitch again assigned an AA- rating.

> *The upgrade to ‘AA-‘ from ‘A+’ on the senior secured bonds reflects Citizens’* ***successful efforts to lower and transfer risk****, reducing its exposure to claims and reducing the magnitude of potential future borrowing.*

How these changes, particularly the Moody’s upgrade, ultimately affect Citizens’ cost of borrowing will be seen more definitively when the issues come to market May 18. The last time Citizens did a bond issuance, in 2012, its 10-year bonds were priced at 3.77 percent, about 180 basis points above the benchmark.

As seen in the ratings guidance, credit goes to Citizens management for embarking on a bold plan to leverage soft pricing conditions in the private reinsurance markets. Citizens previously only received reinsurance from the Cat Fund, thus multiplying the solvency risk should the state be hit by a major storm. In addition to purchasing billions in traditional reinsurance in recent seasons, Citizens also followed the lead of entities like North Carolina’s Beach Plan, Massachusetts’ FAIR plan and Louisiana’s own all-purpose Citizens by jumping into the catastrophe bond market in a major way.

Between them, Citizens’ Everglades Re and Everglades Re II entities have issued catastrophe bonds for $750 million in April 2012, $250 million in March 2013, $1.5 billion in May 2014 and, most recently, a $250 million issuance this coming month. The $1.5 billion 2014 cat bond remains the largest single issuance in history, and Citizens' combined $2.75 billion in cat bonds represents about 12 percent of the $23 billion global market.

Credit also belongs to Citizens' successful depopulation program, as its policy count has fallen by more than half in the past three years (from 1.5 million to about 600,000) and their total insured value has over the past four years fallen from $518 billion to less than $200 billion.

Of course, these improvements have only been made possible by an unprecedented nearly decade-long drought of major storms hitting the Sunshine State. Citizens ended 2005, following the strike of Hurricane Wilma, with a deficit of $1.8 billion. Were it a private company without the ability to assess "hurricane taxes" on other privately sold policies, that would have been the end of the line for Citizens. Instead, policyholders across Florida were forced to pick up the slack and, thanks to the lucky streak, Citizens was able to end 2014 with a surplus of $7.4 billion.

Now, the next step is to import that same success to the Cat Fund. Earlier this month, the Florida Cabinet approved a plan by the fund to buy $1 billion of retrocessional reinsurance cover, which would mark its first ever private reinsurance deal. The Citizens upgrades suggest similar improvements are possible for the Cat Fund should it follow through with these risk-transfer plans.

Not only would transferring more risk back to the private market better protect Florida taxpayers and policyholders from future hurricane taxes (and given current pricing, with no or close to no impact on rates) but it would mean cheaper borrowing costs in the long term. Approving the final deal should be a no brainer for the State Board of Administration.

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