Demotech, Inc.

Florida Property Insurers – Financial Stability Ratings® Update

Columbus, Ohio, March 28, 2018 – "*Stare decisis*" translates to "stand by that which is decided." This guiding principal of the judiciary is critical to the construction of policy coverage, forms, and endorsements within the insurance industry. Moreover, claims procedures, practices, and protocols are developed based upon the implicit and explicit assumption that precedent decisions are to be followed by the courts.

Whether an insurance company is reviewing its policies, forms, and endorsements or its claims procedures, protocols, and practices, the insurer and other interested parties (i.e., producers, reinsurers, policyholders, regulators, actuaries, auditors, rating agencies, and other stakeholders) assume that precedent decisions by the courts will be followed by the courts when they decide the cases in front of them. The expectation is that today's court will abide by or adhere to decided cases.

According to the American Tort Reform Association, which since its establishment in 1986 has been the only national organization exclusively dedicated to reforming the civil justice system, Florida is the number one Judicial Hellhole in the United States for 2017-2018. Although we are not lawyers or attorneys, in large part the Florida Supreme Court's unwillingness to adhere to the guiding principal of *stare decisis* was the tipping point that moved Florida from being a top five contender for the title to being crowned number one Judicial Hellhole for 2017-2018.

According to the publication, Judicial Hellholes 2017-2018, "The Florida Supreme Court's liability-expanding decisions and barely contained contempt for the lawmaking authority of the legislators and the governor has repeatedly led to its inclusion in this report. And though the high court's plaintiff-friendly majority this year shrunk from 5-2 to 4-3, a hushed discussion between two majority justices recently caught by an open microphone suggests that this majority is as partisan as ever and brazenly determined to influence the judicial selection process as three like-minded colleagues facing retirement in early 2019."

Some of the court cases that have kept Florida in contention include but are not limited to:

1. Continental Casualty, Supreme Court of Florida, January 24, 2008 – an assignee "stands in the shoes of the insured."

2. Magnetic Imaging v. Prudential, 3rd District Court of Appeals (DCA), March 12, 2003 – "Where an insurer makes payment of a claim after suit is filed, but before a judgment is rendered, such payment operates as a confession of judgment, entitling the insured to an attorney's fee award."

3. Shaw v. State Farm, 5th District Court of Appeals, June 27, 2013 - "The assignment of a contract right does not entail the transfer of any duty to the assignee, unless the assignee assents to assume the duty."

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4. Accident Cleaners v. Universal, 5th District Court of Appeals, April 10, 2015 – eliminated the statutory requirement of holding an insurable interest prior to a loss in order to enforce a property insurance policy. Although Florida statute 627.405, 2 provides: (1) No contract of insurance of property … shall be enforceable ….except for the benefit of persons having an insurable interest in the things insured at the time of the loss.

   The 5th DCA in Accident Cleaners ruled that a contractor that performed cleanup and construction services and received an assignment of the insured's rights after a loss was not required to have insurable interest at time of loss in order to sue the homeowner's insurer.

   Here, the court ruled the statutory requirement to hold an insurable interest to enforce an insurance contract is not applicable to an assignee thereby allowing both the insurable interest requirement and free assignability of post-loss claims to coexist.

5. One Call Property Services v. Security First, 4th District Court of Appeals, May 20, 2015 - "All contractual rights are assignable unless the contract prohibits assignment, the contract involves obligations of a personal nature, or public policy dictates against assignment."

   A seminal case in that it held an insured's rights and benefits are freely assignable unless the policy had a prohibition. Although the 4th DCA upheld the assignment, they did so only because there was no policy provision prohibiting it. This case inferred that the carrier could have put in such a provision if they wanted to address an assignment of benefits.

   Subsequently, Security First Insurance Company filed policy language requiring insurer consent for an assignment. The Office of Insurance Regulation denied Security First's language as violating Florida common law based on their interpretation of various cases, including the One Call Property Services decision.

6. Security First v. OIR, 1st District Court of Appeals, June 22, 2015 – this action challenged OIR's denial of Security First's proposed anti-assignment policy language based upon an OIR interpretation of case law because Florida statutes allow OIR to deny policy language only where the language violates statute (common law is not mentioned) or the language is misleading.

   This decision expanded the OIR's authority to deny policy language, as its authority is no longer limited to policy language violating statute but now allows OIR to interpret case law, a judiciary function, and deny policy language as "misleading" if they deem it violative of common law.

7. United Water v. State Farm, 1st District Court of Appeals, July 8, 2015 - An "assignee 'stands in the shoes' of the assignor [insured] and is able to maintain suit in its own name as the real party in interest, that is, the person in whom rests by substantive law the claim

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to be enforced. This case solidified the assignee "standing in the shoes of the insured" for purposes of entitlement and enforcement.

The principle of the assignee "standing in the shoes of the insured" has yet to be applied to the duties of the insured where duties are a condition precedent to coverage. An assignee can sue to enforce payment of benefits where an insured that has not met its duties cannot.

8. Bioscience West v. Gulfstream, 2nd District Court of Appeals, February 5, 2016 - the insurer argued that the assignee, a water mitigation company, in setting the cost of the cleanup services and the scope of services constituted unlicensed adjusting. The 2nd DCA disagreed. The ruling indicted that the water mitigation company did not violate the public adjuster statute in Florida, 626.854(16), prohibiting unlicensed public adjusting.

9. Restoration One v. State Farm, 5th District court of Appeals, April 22, 2016 – the 5th DCA ruled that evidence indicating the insured never intended to legally assign its rights and benefits does not invalidate an unambiguous assignment. This means that testimony from the insured that they never intended to transfer their rights and benefits and did not understand that the AOB contract transferred their rights and interests is not admissible if the AOB was unambiguous. The fact that the insured did not know what they were doing and did not intend to make an assignment does not invalidate an unambiguous assignment.

10. Start To Finish Restoration v. Homeowners Choice Property & Casualty Insurance Company, Inc., 2nd District Court of Appeals, June 10, 2016 – indicated that an otherwise invalid partial assignment under Space Coast was likely not applicable to an assignment of post loss benefits under an insurance policy. This case opens the door for valid "partial" assignments allowing an insured to parse out its benefits to multiple assignees thereby allowing each of them standing to sue the insurer and avail themselves of legal fees.

11. Johnson v. Omega, Florida Supreme Court, September 29, 2016 – a payment after initiation of a lawsuit constitutes both an erroneous denial of benefits and a confession of judgement triggering plaintiff's entitlement to legal fees under Florida statute 627.428. There is no requirement that the err was wrongful or known prior to the initiation of a lawsuit.

12. Sebo v. American Home, Florida Supreme Court, December 1, 2016 – when multiple perils converge to create a loss and one of the perils is covered and one is not, there are two competing theories of coverage:

    Concurrent Causation Doctrine – whereby a jury can find coverage where an insured risk, i.e. peril/cause of loss, constitutes a concurrent cause of the loss even where the insured risk is not the primary or efficient cause of the loss.

    Efficient Proximate Cause Doctrine – whereby the jury determines which involved peril was the most substantial or responsible factor in the loss. If the policy insures against that peril, coverage is provided. If the policy excludes that peril, there is no coverage.

This case was an appeal from the 2nd DCA's decision, which held that the concurrent causation doctrine should never be applied with the reasoning that "under the concurrent causation doctrine because a covered peril can usually be found somewhere in the chain of causation…to apply the concurrent causation analysis would effectively nullify all exclusions in an all-risk policy."

The Florida Supreme Court reversed the Second District Court of Appeal's decision holding that when independent perils converge and no single cause can be considered the sole or proximate cause, it is appropriate to apply the Concurrent Causation Doctrine.

Cases involving the Concurrent Causation Doctrine are far more favorable to insureds seeking coverage because the insured need only to prove that a covered peril contributed to a loss rather than proving that it was the proximate (i.e. sole/primary) cause.

Concurrent Causation Doctrine cases are also more likely to be resolved by way of summary judgment. Cases involving the Efficient Proximate Cause Doctrine require placing the burden on the insurance carrier to prove that the proximate cause of a loss falls within an exclusion.

The law in Florida is now Concurrent Causation unless the policy has language expressly stated the loss is not covered even if it is a concurrent cause.

Why does the analysis of the financial stability of an insurance company include a synopsis of the principle of *stare decisis* and commentary on several recent decisions by the Florida judiciary? The answer is that although there are myriad facets to the financial stability of an insurance company, four of the more critical aspects of the financial stability of insurance carriers are directly and adversely impacted when *stare decisis* is no longer a guiding principle of the judiciary. The four critical aspects of financial stability that are impacted include:

1. When courts expand the liability of insurers beyond that contemplated in the coverage document, not only are existing claims procedures, practices, and protocols tested, the relative adequacy of the premium charged to insureds is diminished. This impacts all policies, new and renewal, until the coverage document that has been expanded by a judicial decision has been amended to revert to its anticipated coverage, or rates have been revised to reflect the change in policy terms and conditions.
2. Claim costs and the cost of adjusting claims, whether those open now or to be reported in the future, escalate beyond the estimate of claims personnel or actuaries. In fact, closed claims might be re-opened to avail those who have already settled claims with similar characteristics to have another bite at the apple.
3. The cost of reinsurance, a significant expenditure for carriers, especially those writing in catastrophe prone geographical areas, rises with uncertainty and unfavorable rulings from the judiciary branch of government. With the cost of current reinsurance programs based on the expectation that today's court will abide by or adhere to decided cases, the cost of future reinsurance programs will be revised upward.

4. Investors view *stare decisis* favorably. *Stare decisis* permits investors to create pro forma financial statements and make projections to evaluate numerous investment opportunities. With respect to investments in the insurance industry, jurisdictions that exhibit *stare decisis* are more attractive than those that do not. States with a judiciary that has developed a reputation for activism versus *stare decisis*, i.e., are described as judicial hellholes, will find it difficult to retain or attract investment capital. In a state that depends on the investment community to fund catastrophe on a post-loss basis through the Florida Hurricane Catastrophe Fund, the impact of a dearth of investors in the insurance industry can adversely impact the innovation of primary carriers, re-capitalization of primary carriers, as well as the reinsurance community.

Demotech's review and analysis process focuses on the ability of carriers to meet or exceed our metrics by implementing and executing their business plan through a business model that meets the expectations of policyholders, claimants, regulators, third parties, and Demotech.

Although a rigorous review of the sufficiency of premiums, adequacy of loss and loss adjustment expense reserves, and the quality and quantity of reinsurance are key components of our analysis, the ability of carriers to implement and execute business plans is heavily dependent on the environment in which they operate. Claims procedures, processes, and protocols utilized in the past must be applicable in the future if loss and loss adjustment expense experience is to be predictable and claims handling processes scalable.

The assignment of benefits (AOB) situation in Florida is unlike any other in the United States and other recent court decisions have revised claims procedures, practices, and protocols from the industry standards that previously existed to a Florida-only standard.

More than a year ago, Demotech advised each of the Florida-focused carriers that we review to focus on addressing the impact of AOB on its internal claims handling. We believe that it was at least implicit, perhaps even explicit, that carriers needed to have a claims function that was prepared and adept at implementing changes in claims procedures and processes every time that Florida's judiciary moved away from *stare decisis*. Available marketplace solutions provide carriers enhanced predictability and efficiency as the AOB issue evolves. We are aware that proven tools such as CaseGlide are available. We reemphasize previous guidance that carriers must adapt to the changing judicial landscape by embracing proven technology and analytics-driven processes.

It is our belief that management's success is measurable by the results reported in its year-end 2017 financial statement and related supporting documents. It is our belief that the ultimate measure of management's understanding of the operating environment in Florida is revealed by its reported operating results, loss and loss adjustment expense adequacy, and similar quantifiable financial metrics.

In other words, even though carriers have addressed weather events through rigorous vertical and horizontal catastrophe reinsurance programs, given the Florida judiciary's limited adherence to *stare decisis*, the operating environment requires a claim function that is prepared to identify and

respond to changes in claims procedures and processes. In an operating environment such as Florida's, today's balance sheet, acceptable reinsurance program, and favorable operating results may not be indicative of tomorrow.

Based upon our review of year-end 2017 financial information including, yet not limited to, our measurement of the capability of an insurer's claim function to recognize, react, and respond to the Florida judiciary's diminution of adherence to *stare decisis*, we believe that carrier claims functions have demonstrated that they can address the influences in the operating environment in Florida. In sum, as of March 27, 2018, this group of insurers has met applicable financial metrics and have adapted to changes created by Florida's judicial environment. We affirm the Financial Stability Ratings® (FSR) assigned below:

	Name of insurer	FSR applicable
12968	American Coastal Insurance Company	A′
13563	American Platinum Property & Casualty Insurance Company	A
10872	American Strategic Insurance Corp.	A″
12359	American Traditions Insurance Company	A
12196	ASI Assurance Corporation	A″
11072	ASI Home Insurance Corporation	A″
13142	ASI Preferred Insurance Corp.	A″
14042	ASI Select Insurance Corp.	A″
12813	Auto Club Insurance Company of Florida	A
10908	Capitol Preferred Insurance Company	A
10835	Castle Key Indemnity Company	A′
30511	Castle Key Insurance Company	A′
12482	Edison Insurance Company	A
10790	Federated National Insurance Company	A
10897	First Protective Insurance Company	A
10688	Florida Family Insurance Company	A′
10132	Florida Peninsula Insurance Company	A
10074	Frontline Insurance Unlimited Company	A
12237	Gulfstream Property and Casualty Insurance Company	A
14407	Heritage P&C Insurance Company	A
12944	Homeowners Choice Property & Casualty Insurance Company	A
13648	Lakeview Insurance Company	A′
12957	Modern USA Insurance Company	A
15715	Monarch National Insurance Company	A
12954	Olympus Insurance Company	A
13038	Progressive Property Insurance Company	A″
12563	Safe Harbor Insurance Company	A′
10117	Security First Insurance Company	A

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36560	Service Insurance Company	A
10136	Southern Fidelity Insurance Company	A
14166	Southern Fidelity Property & Casualty, Inc.	A
12247	Southern Oak Insurance Company	A
11844	St. Johns Insurance Company, Inc.	A
15885	TypTap Insurance Company	A
10969	United Property & Casualty Insurance Company	A
11986	Universal Insurance Company of North America	A
10861	Universal Property & Casualty Insurance Company	A
15900	US Coastal P&C Insurance Company	A
14930	Weston Insurance Company	A

Based upon our review of year-end financial information including, yet not limited to, our measurement of the capability of an insurer's claim function to recognize, react, and respond to the diminution of the Florida judiciary's adherence to *stare decisis*, we believe that the claims functions of these carriers are effectively developing the capability to address influences in the operating environment in Florida. As of March 27, 2018, these insurers meet applicable financial metrics and are focused on developing the capability to adapt to changes imposed by Florida's judicial environment. Accordingly, we affirm the Financial Stability Ratings® (FSR) assigned below:

	Name of insurer	FSR applicable
12841	American Integrity Insurance Company of Florida, Inc.	A
33162	Bankers Insurance Company	A
13990	First Community Insurance Company	A
38644	Omega Insurance Company	A
13125	People's Trust Insurance Company	A
15341	Safepoint Insurance Company	A
29050	Tower Hill Preferred Insurance Company	A
11027	Tower Hill Prime Insurance Company	A
12011	Tower Hill Select Insurance Company	A
12538	Tower Hill Signature Insurance Company	A

Based upon our review of year-end financial information including, but not limited to, our evaluation of the capability of the insurer's current claim function to respond to the Florida judiciary's diminution of adherence to *stare decisis*, the claims functions of these carriers are addressing the influences in the changing operating environment in Florida. The following insurers have adapted their business models to meet applicable financial metrics. Concurrently, these carriers are enhancing their capability to adapt to changes imposed by Florida's judicial environment. Accordingly, as of March 27, 2018, we affirm the Financial Stability Ratings® (FSR) assigned below:

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	Name of insurer	FSR applicable
15617	Anchor Property and Casualty Insurance Company	A
13139	Avatar Property & Casualty Insurance Company	A
29734	Conifer Insurance Company	A
10953	Cypress Property & Casualty Insurance Company	A
13687	Prepared Insurance Company	A
11932	White Pine Insurance Company	A

We believe that the reported year-end 2017 financial position of Florida Specialty Insurance Company facilitates the protection of policyholders and claimants. Cash and invested assets were 828% of loss and loss adjustment expense reserves, with more safeguards for consumers being actively negotiated with third parties. The State of Florida Office of Insurance Regulation and Demotech reviewed the business plan that could further benefit consumers. Accordingly, we leave in place the FSR of A assigned to the Company during their final deliberations and negotiations with third parties. Our expectation is that their effort will be completed by March 31, 2018.

Communication with carriers and monitoring of their information is performed on an as-needed basis. The following schedule enumerates anticipated milestones for the balance of 2018:

Preliminary analysis related to catastrophe reinsurance programs	April 2018
Preliminary analysis related to catastrophe response plan	April 2018
Preliminary analysis related to disaster recovery plan	April 2018
Preliminary review of reinsurers providing catastrophe reinsurance	April 2018
First quarter 2018 financial statement review	May 2018
Review and acceptance of finalized catastrophe reinsurance programs	June 2018
Final review of reinsurers providing catastrophe reinsurance programs	July 2018
Second quarter 2018 financial statement review	August 2018
Third quarter 2018 financial statement review	November 2018

This schedule is subject to revision in the event of a named catastrophe event. Similarly, the schedule as well as the FSRs currently assigned are subject to revision at any point based upon events other than natural disasters. These situations include but are not limited to:

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- Communications with management related to their ability to address judicial decisions that restate and revise the claims practices, procedures, and protocols underlying the legacy processing procedures of insurance carriers.
- Indications that the existing rate levels of a carrier are inadequate based upon actuarial assumptions that we believe to be reasonable.
- Legislative or administrative decisions related to the anticipated or potential impact of legislative or administrative revisions implemented to address the status quo of the assignment of benefits situation. In other words, unless and until the Florida judiciary has affirmed revisions, it is Demotech's position that downward revisions in premium levels are premature and will result in inadequate rate levels.

In summary, analyzing year-end financial information including the discussion of establishing loss and loss adjustment expense reserves in an operating environment plagued by judicial revisions that disrupt claims procedures, protocols, and practices is a time-consuming, intense process. Given our review of year-end results and the resultant communications with management, we expect Demotech's response and affirmation timeframes with respect to anticipated milestones to be equally rigorous.

Questions on this summarization of Demotech's position should be directed to Barry Koestler, CFA, Chief Ratings Officer, Robert Warren, CPA, CPCU, Client Services Manager, or Joseph Petrelli, ACAS, ASA, FCA, MAAA, President. They can be reached at (614) 761-8602.

About Demotech, Inc.
Demotech, Inc. is a financial analysis firm specializing in evaluating the financial stability of regional and specialty insurers. Since 1985, Demotech has served the insurance industry by assigning accurate, reliable and proven Financial Stability Ratings® (FSRs) for Property & Casualty insurers and Title underwriters. FSRs are a leading indicator of financial stability, providing an objective baseline of the future solvency of an insurer. Demotech's philosophy is to review and evaluate insurers based on their area of focus and execution of their business model rather than solely on financial size. Visit www.demotech.com for more information.

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