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December 6, 2006

THE HONORABLE DONALD HINES,
PRESIDENT OF THE SENATE
THE HONORABLE JOE R. SALTER,
SPEAKER OF THE HOUSE OF REPRESENTATIVES

Dear Senator Hines and Representative Salter:

This report provides the results of our examination of the regular and emergency assessments recently levied by the Louisiana Citizens Property Insurance Corporation. Citizens levied the assessments in response to deficits created by hurricanes Katrina and Rita in the insurance plans it operates.

I hope this report will benefit you in your legislative decision-making process.

Sincerely,

Steve J. Theriot, CPA
Legislative Auditor

SJT/ss

[LCPIC06]

Office of Legislative Auditor

Louisiana Citizens Property Insurance Corporation - Assessments

Information Report (First in a Series of Reports on Citizens) December 2006

HOW MUCH MONEY HAS CITIZENS ASSESSED AND COLLECTED IN CONNECTION WITH THE REGULAR AND EMERGENCY ASSESSMENTS IT LEVIED AFTER HURRICANES KATRINA AND RITA?

HOW MUCH MONEY HAS BEEN CHARGED TO AND COLLECTED FROM INSUREDS IN CONNECTION WITH THE ASSESSMENTS?

Conclusion

Regular Assessment and Citizens Surcharge. After the hurricanes, Citizens levied a total of $192,966,339 in regular assessments on private insurers to help cover deficits created in the FAIR and Coastal Plans. This amount was derived from a 10 percent assessment for the FAIR Plan and a 5 percent assessment for the Coastal Plan. Because of errors made by the Department of Insurance (DOI) in data it provided to Citizens on September 26, 2005, to calculate the assessments, over $4.8 million was not assessed for 26 insurers that were erroneously omitted from the assessment data. DOI recognized its error and sent Citizens corrected DWP data on November 16, 2005. According to a Citizens official, however, Citizens has taken no corrective action because its priority since the hurricanes has been processing claims. As of September 30, 2006, Citizens had collected from insurers a total of $188,660,693 of the $192,966,339 that was assessed.

In addition, Citizens is levying a 15 percent charge on its customers to help cover the deficits. This charge will result in approximately $30,375,000 in collections from people insured by Citizens. Exhibit 1 provides a summary of the regular assessments and the Citizens charge.

Exhibit 1
Regular Assessments and Collections
As of September 30, 2006
and Citizens Charge

	FAIR Plan	Coastal Plan	Total
Amount Assessed Private Insurers (% of Aggregate Statewide Direct Written Premium)	$128,644,233 (10%)	$64,322,106 (5%)	$192,966,339 (15%)
Amount of Assessment Collected	$127,165,118	$61,495,575	$188,660,693
CITIZENS Charge on its Customers	$ 28,350,000	$2,025,000	$30,375,000

Source: Created by legislative auditor's staff using documents and data provided by Citizens.

The amount of regular assessments collected by Citizens from private insurers is less than the amount assessed because:

(1) three companies have not fully paid assessments and still owe $157,842;

(2) four companies were assessed a total of $2,696,233, but they do not sell the types of insurance covered by the assessments and therefore should not have been assessed; and

(3) two companies' assessments were not reduced by Coastal Plan credits totaling $1,451,545 because of errors in the data Citizens used to calculate the credits.

Insurance companies are allowed to recoup all or part of their regular assessments from their policyholders. Insurers' recoupment plans that have been filed with DOI show that most insurers plan to recoup the FAIR assessment by charging policyholders 10 percent of their current annual premium. For the Coastal Plan, insurers plan to recoup anywhere from 8.3 to 0 percent of their policyholders' current annual premium. Some of the percentages to be recouped for the Coastal Plan are higher than the 5 percent overall assessment because of the Coastal Plan credit program, which is discussed on page 5 of the report.

It should be noted that because the regular assessments were based on 2004 direct written premium (DWP) and the recoupments are based on subsequent years' DWP (which is probably higher than 2004), the total amount ultimately recouped may exceed the total amount assessed. Any excess recoupments are required by law to be remitted to Citizens. Insurers are required to report recoupment amounts to Citizens at the completion of their recoupment process. However, no insurers have reported to Citizens the recoupments they have collected from their policyholders yet because the recoupment process has not been completed. Thus, the total amount of recoupments that have been collected thus far is not known.

Emergency Assessment. The regular assessment was sufficient to cover the deficit in the Coastal Plan, thus no emergency assessment was needed for that plan. However, in April 2006, Citizens borrowed $978,205,000 by selling bonds to help cover the deficit in the FAIR Plan. The estimated annual debt service to repay the bonds is $50 million to $83 million. As currently structured, it will take Citizens 20 years to repay the bonds.

Citizens pledged the proceeds of future emergency assessments to repay the bondholders. Citizens' board of directors has decided that for 2007, the emergency assessment levied on all applicable policyholders will be 3.6 percent of their annual premium. This percentage, which is estimated to total approximately $61 million, will be charged on all policies written or renewed for the applicable types of insurance starting January 1, 2007. The board will make similar determinations of amounts to charge policyholders each year the bonds are outstanding. Thus, policyholders can expect to pay a percentage of their premiums for another 19 years to service the debt.

Introduction

Louisiana Citizens Property Insurance Corporation

The Louisiana Citizens Property Insurance Corporation (Citizens) was created as a nonprofit corporation by Act 1133 of the 2003 Regular Legislative Session, which enacted Louisiana Revised Statute (R.S.) 22:1430. The corporation was formed to operate two residual market insurance programs previously established by the legislature and known as the Louisiana Insurance Underwriting Plan and the Louisiana Joint Reinsurance Plan. The legislation renames the old plans the Coastal Plan and the FAIR Plan, respectively, and designates the newly named plans as successors to the old plans. All insurers authorized[1] to write and engaged in writing property insurance in the state are required to participate in the Coastal and FAIR plans. Under state law, Citizens and the two plans are subject to examination by the Legislative Auditor.

According to the enabling legislation, Citizens was created to provide fire, extended coverage, vandalism, malicious mischief, and homeowners insurance in the coastal and other areas of Louisiana to applicants who are entitled to, but are unable to, procure coverage through the voluntary (i.e., private) market. Citizens is to operate insurance plans functioning exclusively as residual market mechanisms. That is, Citizens was designed to be an insurer of last resort. Any person with an insurable interest in insurable property is entitled to apply to Citizens either directly or through a representative for coverage through the Coastal or FAIR Plan.

R.S. 22:1430.3(A) establishes a 15-member board of directors for Citizens. The board is responsible for adopting a plan of operation. The House and Senate Insurance Committees must approve Citizens' plan of operation, as well as all revisions to the plan. The plan must be filed with the Office of Property and Casualty of the Department of Insurance (DOI).

Rates charged by Citizens on residential policies must be at least 10 percent higher than the rates charged among the 10 insurers with the greatest total direct written premium (DWP) in each parish for that line of business in the preceding year. State law says that the Citizens' insurance plans are not intended to offer competitive rates, but its rates must be actuarially justified and must be adjusted annually. This statute was amended in the 2005 Regular Legislative Session to say that the rates charged in a particular parish must exceed by at least 10 percent the rates of any insurer that has a minimum of 3 percent of the total premium for the parish. The statute was further amended in the 2006 Regular Session to exclude, until January 1, 2009, wind and hail coverage from the 10 percent provision.

Citizens may purchase reinsurance on risks insured by the corporation and the plans. Citizens is required to develop and annually reassess a reasonable and prudent reinsurance program. The reinsurance is to enhance the capability of the corporation to timely and efficiently handle claims from hurricanes or other natural disasters. An amendment to state law passed

[1] An authorized insurer is defined in state law as an insurer with a certificate of authority or license issued under provisions of the state insurance code.

during the 2006 Regular Legislative Session requires Citizens to purchase sufficient reinsurance so as to minimize the likelihood of an assessment being levied.

The Citizens legislation provides for the depopulation of the Coastal and FAIR plans. It requires Citizens' board of directors to effectuate a plan of dissolution of the corporation when less than 1,000 policies are written in a plan year and the board declares that the plans no longer need to be operated to fulfill the purposes set forth in law. The plan of dissolution must be approved by the House and Senate Insurance Committees and the Commissioner of Insurance. No dissolution can take effect as long as the corporation has bonds or other financial obligations outstanding unless adequate provision has been made for the payment of the obligations, according to state law.

Overview of Regular Assessment Process

State law authorizes Citizens to levy regular assessments against assessable insurers in certain cases and allows recoupment of these fees from assessable insureds. Assessable insurers ("insurers") are defined as those who are authorized to write property insurance in Louisiana. Assessable insureds are the policyholders of the assessable insurers.

Citizens may levy regular assessments when its board of directors determines that the corporation faces a deficit in either the Coastal or FAIR Plan. The assessments are to be used to remedy the deficit. The assessments are as follows:

- When Citizens' deficit is less than or equal to 10 percent of aggregate statewide DWP for the subject lines of business[2] for prior calendar year, the entire deficit amount is recovered through regular assessments.

- When Citizens' deficit exceeds 10 percent of aggregate statewide DWP for the subject lines of business for the prior calendar year, Citizens shall levy regular assessments in an amount equal to the greater of 10 percent of the deficit or 10 percent of the aggregate statewide DWP. Any remaining deficit is covered through emergency assessments.

The Department of Insurance (DOI) issued Directive 191 on December 22, 2005.[3] The directive provides that when Citizens determines that a regular assessment is necessary, it must notify each insurer of the assessment, the amount that the insurer owes, and the percentage of subject premium used to calculate the amount. After issuing invoices to the insurers, Citizens must file the assessment amounts and percentages with the Louisiana Insurance Rating Commission to be verified. Insurers must pay the specified amount to Citizens within 30 days of the notification date stated on their invoice.

[2] Subject lines of business are defined in R.S. 22:1430.1(12) as fire, allied lines, homeowners' multiperil, and the property insurance portion of commercial multiperil policies. According to DOI, the subject lines of business include all mobile home policies.

[3] The directive was amended on September 28, 2006. The amendments have no impact on the contents of this report.

Coastal Plan Credit Program. To encourage insurance companies to sell property insurance in the coastal area of the state, state law allows the Citizens board of directors to adopt a credit schedule for insurance voluntarily written in the coastal areas. Under this credit schedule plan, insurers who sell insurance policies in the coastal area of the state can have their regular assessments reduced proportionately. According to Citizens' records, 15 companies received credits that reduced or eliminated their regular assessments.

The Citizens board of directors is also allowed to adopt a credit plan for insurance voluntarily written in the FAIR Plan. However, the board has not chosen to do so.

Overview of Regular Assessment Recoupment Process

State law allows insurers to add a surcharge to their policyholders' bills to recoup either the full amount they paid to Citizens or a portion thereof after they pay Citizens the regular assessment. The surcharge must be a uniform percentage of premium but must not be considered a premium. This recoupment of regular assessments is optional. That is, insurers are not required to recoup the costs of regular assessments they incur.

Surcharge Percentage. Directive 191 provides that, to recoup a regular assessment, an insurer must establish a uniform recoupment surcharge percentage that is equal to or less than the percentage underlying the regular assessment amount. This percentage must be applied to each premium and added as a surcharge. The surcharge may be applied to all of the insurer's written premiums for fire and allied lines (including mobile homes), homeowners multiperil insurance, and the property insurance portion of a commercial multiperil policy. In addition, if one or more of the stated subject lines is a part of an inseparable package premium, the insurer must estimate how much of that package is attributed to the line(s) and then apply the surcharge percentage to that portion.

Directive 191 also says that the surcharge should be uniform throughout the state and among the various subject lines. Therefore, if the insurer implements a surcharge, it must implement the charge for all policyholders in the affected lines. That is, insurers may not exempt specific policyholders in affected lines from the surcharge. Policies with a term longer than a year should be charged at a rate modified to reflect the length of the policy so that the total charge is equivalent to a similar 12-month policy. In addition, insurers should not consider these charges part of premiums and or use them when calculating premium taxes, commissions, service fees, and other charges. The surcharge must remain in effect, without interruption, during the entire 12-month recoupment collection period and may not be changed by the insurer.

Recoupment Plans. According to Directive 191, each insurer that decides to recoup some or all of its regular assessment must inform DOI in writing of the surcharge percentage that it will apply to policies, how the insurer calculated the percentage, the starting date for the recoupment process, and an outline of its plan to notify policyholders of the surcharge percentage and amounts. DOI must receive this information 30 days prior to implementation.

Market Equalization Charge. State law says that when Citizens implements a regular assessment for either plan, it must charge its own customers a market equalization charge. This charge must be a uniform percentage of premium that is equally applied to all policyholders. The market equalization charge percentage must be the ratio of the total regular assessment to the aggregate statewide DWP.

Other Provisions. Directive 191 also includes provisions related to the following:

- Notices to Policyholders
- Excess Recoupment
- Reporting of Recoupment Collections
- Partial Recoupment
- Extended Recoupment Plans
- Disputes
- Affiliated Groups

Overview of Emergency Assessment Process

State law also allows Citizens to levy an emergency assessment on all assessable insureds when its board of directors determines that the corporation faces a deficit in either the Coastal or FAIR Plan. Emergency assessments can be levied for as many years as necessary to cover the plan deficits. Directive 191 allows Citizens to levy an annual emergency assessment when plan losses are higher than plan profits, excess reserves, reinsurance proceeds, and regular assessments. Citizens levies emergency assessments directly on all policyholders in the state (in the subject lines of business), but insurers collect the assessments from their policyholders and remit them to Citizens.

The amount of an emergency assessment collected in a particular year must be a uniform percentage of that year's DWP for subject lines of business (excluding National Flood Insurance Program premiums) for all private insurers and all Citizens plan accounts, according to state law. The aggregate amount of emergency assessments levied in any calendar year shall not exceed the greater of:

(1) 10 percent of the amount needed to cover the original deficit plus interest, fees, commissions, required reserves, and other costs associated with the financing of the original deficit or

(2) 10 percent of the aggregate statewide DWP for subject lines of business and for all Citizens' plan accounts for the prior year plus interest, fees, commissions, required reserves, and other costs associated with financing the original deficit.

Directive 191 requires Citizens to establish a statewide percentage to be added to policyholders' bills, both new and renewed, and then notify insurers of this percentage. The insurers must inform Citizens of the amount of premiums written and emergency assessments collected in a quarterly report. The directive also provides for dispute resolution.

Results of Examination

Regular Assessments and Market Equalization Charge

In September 2005, Citizens officials projected a $516 million deficit in the FAIR Plan and a $56 million deficit in the Coastal Plan. According to data provided to Citizens by DOI, aggregate statewide assessable DWP for the subject lines of business for the 2004 calendar year was $1,286,442,210. Therefore, in accordance with R.S. 22:1430.16, the Citizens board of directors levied a $128,644,233[4] FAIR Plan regular assessment (or 10 percent of DWP) and a $64,322,106[4] Coastal Plan regular assessment (or 5 percent of DWP) on all assessable insurers in the state.

In addition, Citizens levied a 15 percent market equalization charge on its policyholders. Based on premium projections from Citizens, this charge will approximate $30,375,000 overall.

FAIR Plan Assessment. Each assessable insurance company's share of the FAIR Plan regular assessment is 10 percent of the company's net DWP for the subject lines of business for the 2004 calendar year. However, DOI omitted 26 assessable insurers from the DWP data it provided to Citizens on September 26, 2005, to calculate the regular assessment. Therefore, Citizens did not assess these 26 companies, and the companies did not pay any percentage of DWP to Citizens. DOI recognized its error and sent Citizens corrected DWP data on November 16, 2005. According to a Citizens official, however, Citizens has taken no corrective action because its priority since the hurricanes has been processing claims. The FAIR assessment for these 26 companies would have been over $3.2 million. Over 200 other companies were assessed 10 percent of DWP.

Coastal Plan Assessment. The Coastal Plan regular assessment of $64,322,106[4] was designed to levy an overall assessment of 5 percent of aggregate statewide DWP for the subject lines of business for the 2004 calendar year. The Coastal Plan's credit program eliminated the regular assessments of six insurers and reduced the regular assessments of nine others. Therefore, to collect the full 5 percent of DWP, Citizens reallocated the assessment amounts among the approximately 200 insurers that did not have credits. As a result of the reallocation, Citizens levied an assessment of 8.27 percent of DWP on insurers that had no credits. In the 15 cases where insurers received credits, the assessments ranged from 8.06 percent to 0 percent of DWP, depending on how much of their individual assessments were offset by the credits. In addition, Citizens did not levy assessments on the 26 companies that DOI omitted from the DWP data it provided to Citizens. The Coastal assessment for these 26 companies would have been over $1.6 million.

[4] Minor mathematical differences are due to rounding.

Collection of Amounts Due. According to Citizens officials, as of September 30 2006, they had collected a total of $188,660,693 of the regular assessments ($127,165,118 for the FAIR Plan and $61,495,575 for the Coastal Plan). This amount is $4,305,646 less than the amount assessed. The net difference is due, in part, to various mistakes made by DOI and Citizens. We identified the following problems that resulted in lower collections than assessments.

- Citizens assessed four insurance companies that sell insurance lines that are exempt from regular assessments. This mistake occurred because DOI erroneously included these companies in the DWP data Citizens used to calculate the assessments. These uncollected assessments totaled $2,696,233.

- Errors in the data Citizens used to calculate the credits for the Coastal Plan resulted in two companies not receiving their full credit amounts. After the errors were discovered, Citizens officials lowered the assessments for the two companies by a total of $1,451,545.

- Citizens did not enforce the payment due date for the assessments, resulting in some insurance companies only partially paying their assessments or not paying at all. Directive 191 requires insurers to pay regular assessments within 30 days of the notification date on the assessment invoices. Citizens sent the invoices to insurance companies on October 20, 2005. As of September 30, 2006, a total of $157,842 was outstanding from three companies. According to the Citizens plan of operation, Citizens should apply a penalty or late charge to all regular assessments paid after 30 days. However, according to a Citizens official, Citizens did not charge any late fees because paying claims has been its top priority since the hurricanes.

Recoupment of Assessment Amounts From Policyholders. According to a DOI official, the first company choosing to recoup its assessment from policyholders began recouping on December 12, 2005, and will finish on December 11, 2006. The last company began its recoupment on October 1, 2006, and will complete it by September 30, 2007. Thus, all companies planning to recoup their assessments have begun the process, and some have almost completed it.

Because the regular assessments were based on 2004 DWP and the recoupments are based on future years' DWP (which are probably higher than 2004), the total amount ultimately recouped may exceed the total assessment. Any excess recoupments are required by law to be remitted to Citizens. The total amount of recoupments that insurers have collected from their policyholders has not yet been reported to Citizens. Therefore, the assessable insurers are the only ones who have this information at the current time. The recoupment for each plan is explained in the following paragraphs.

FAIR Plan Recoupment. About 150 of the 200 recoupment plans filed by insurance companies with DOI show that the companies are recouping the FAIR assessment by charging policyholders the maximum 10 percent of DWP. The remaining plans show that companies are charging amounts ranging from 9.9 percent to 0 percent of DWP. Companies not planning to recoup the assessments were not required to file plans with DOI.

***Coastal Plan Recoupment**.* As previously explained, the Coastal Plan assessments ranged from 8.27 to 0 percent of DWP. For various reasons, the recoupment percentages varied as well, from 8.3 to 0 percent of DWP. Reasons for the varied recoupment percentages are as follows:

- The credits earned by some companies partially offset their assessments, and the credits earned by other companies totally eliminated their assessments. In addition, some of the companies with credits were grouped together with other affiliated companies that did not receive credits, resulting in the entire group paying less than 8.27 percent of DWP.

- Some insurers chose to recoup only part of their assessments, and others chose not to recoup any of their assessments.

- Some insurers were erroneously not assessed anything because DOI left their names off the data list provided to Citizens on September 26, 2005, to calculate the assessments. DOI recognized the error and sent corrected data to Citizens on November 16, 2005. However, a Citizens official said that Citizens has not taken any corrective action because its priority since the hurricanes has been processing claims.

- Some companies erroneously recouped 10 percent of their DWP because Citizens sent letters to all assessable insurers stating that they could recoup their assessments by applying a 10 percent surcharge to applicable policies. However, Directive 191 says that the maximum recoupment percentage is each company's assessment percentage. In most cases, this amount would be 8.27 percent of DWP. (It should be noted that DOI has sent letters to all of these companies instructing them to refund their policyholders any overcharges.)

- According to DOI, some companies rounded their recoupment percent to 8.3 percent of DWP instead of 8.27 percent of DWP because of limitations of their computer systems.

Market Equalization Charge. On July 1 2006, Citizens began levying a 15 percent market equalization charge on its policyholders. As explained in the Introductory section, Citizens must levy a market equalization charge on its own customers when it implements a regular assessment on non-Citizens customers to cover deficits in the FAIR and/or Coastal plans. The 15 percent charge will continue to be charged until June 30, 2007. Based on Citizens' premium projections, it is estimated that this charge will result in approximately $30,375,000 in collections from Citizens' policyholders to help cover the deficits resulting from the hurricanes.

Emergency Assessments

The Coastal Plan regular assessment was sufficient to cover the deficit it incurred as a result of paying hurricane-related claims. Thus, no emergency assessment was needed for that plan. However, in addition to the revenue derived from the regular assessment, Citizens had to borrow $978,205,000 by issuing bonds to help cover the deficit in the FAIR Plan. As a part of the bond agreement, Citizens pledged the proceeds of future emergency assessments to repay the bondholders.

According to the bond agreement, estimated annual debt service for the bonds ranges from $50 million to $83 million over the next 20 years. For 2007, Citizens' board of directors has set the emergency assessment to be levied on all policyholders (including Citizens' policyholders) in the subject lines of business at 3.6 percent of a policyholder's premium. The private insurance companies and Citizens are to collect these charges from their policyholders. DOI estimates that policyholders will pay approximately $61 million in 2007 for this purpose. The bond agreement further estimates that debt service in subsequent years will require an emergency assessment of at least 5.51 percent of premium.

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Need more information?

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A copy of this report is available on our Web site at www.lla.state.la.us.

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