OFFICE OF INSURANCE REGULATION

FILED

FEB 13 2009

Docketed by: ODM

KEVIN M. MCCARTY
COMMISSIONER

IN THE MATTER OF:

CASE NO. 102381-09

In the Matter of
STATE FARM FLORIDA INSURANCE COMPANY,
and its Parent Company STATE FARM MUTUAL
AUTOMOBILE INSURANCE COMPANY
Order on Withdrawal Plan
______________________________________/

ORDER

TO: Edward B. Rust, President
State Farm Mutual Automobile Insurance Company
One State Farm Plaza
Bloomington, Illinois 61710

James Thompson, President
State Farm Florida Insurance Company
7401 Cypress Gardens Boulevard
Winter Haven, Florida 33888

THIS CAUSE came on for consideration as the result of the submission by State Farm Florida Insurance Company (hereinafter referred to as "State Farm Florida") and its parent company State Farm Mutual Automobile Insurance Company (hereinafter referred to collectively as "State Farm") of a Withdrawal Plan (hereinafter referred to as "the Withdrawal Plan") to the Florida Office of Insurance Regulation (hereinafter referred to as the "Office").

Upon consideration of the Withdrawal Plan and being otherwise fully advised in the premises, the Office finds as follows:

1. The Office has jurisdiction over the subject matter of this proceeding and the parties pursuant to the Florida Insurance Code.

2. State Farm, pursuant to Section 624.430, Florida Statutes, submitted a Withdrawal Plan dated January 27, 2009. The Withdrawal Plan states that State Farm Florida is withdrawing from all lines of insurance that it writes in Florida and will surrender its Certificate of Authority by year-end 2011. The Withdrawal Plan filed with the Office is incorporated as "Exhibit A" to this Order.

3. The Withdrawal Plan as submitted contemplates that 470,000 policies covering real property (either residential or non-residential real property) will be non-renewed the first year. The remaining policies will be non-renewed over a two year period after the effective date of the first non-renewal. The Withdrawal Plan also contemplates that State Farm agents will continue to assist non-renewed insureds by applying for coverage in the Citizens Property Insurance Corporation (hereinafter referred to as "Citizens") as the policies are non-renewed. The Withdrawal Plan does not contemplate any placement of these policyholders directly into the private marketplace, but relies entirely on a keep-out or take-out plan through Citizens.

4. According to the Withdrawal Plan, State Farm anticipates that if it begins the non-renewal process based upon the 90-day notice requirement of Section 624.430, Florida Statutes, the last of State Farm's policies would be non-renewed during the Fourth Quarter of 2011. The Withdrawal Plan further states that State Farm will surrender the Certificate of Authority of State Farm Florida after its last policy expires. State Farm has asserted in the Withdrawal Plan that it needs to maintain the Certificate of Authority so it can adjust coverage and add approved endorsements that are requested by the policyholders on the remaining policies.

5. State Farm has suggested that it has a right under Section 624.430, Florida Statutes, to file an additional withdrawal plan cancelling policies rather than proceeding with the non-renewal of policies as presented in this Withdrawal Plan.

6. Section 624.430, Florida Statutes governs the withdrawal of an insurer from the State of Florida. That section provides, in pertinent part:

> (1) Any insurer desiring to surrender its certificate of authority, withdraw from this state, or discontinue the writing of any one or multiple kinds or lines of insurance in this state shall give 90 days' notice in writing to the Office setting forth its reasons for such action. Any insurer who does not write any premiums in a kind or line of insurance within a calendar year shall have that kind or line of insurance removed from its certificate of authority; however, such line of insurance shall be restored to the insurer's certificate upon the insurer demonstrating that it has available the expertise necessary and meets the other requirements of this code to write that line of insurance.
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> (2) If the Office determines, based upon its review of the notice and other required information, that the plan of an insurer withdrawing from this state makes adequate provision for the satisfaction of the insurer's obligations and <u>is not hazardous to policyholders or the public</u>, the Office shall approve the surrender of the insurer's certificate of authority. The Office shall, within 45 days from receipt of a complete notice and all required or requested additional information, <u>approve, disapprove, or approve with conditions</u> the plan submitted by the insurer. Failure to timely take action with respect to the notice shall be deemed an approval of the surrender of the certificate of authority.
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> (4) Any insurer withdrawing from this state or discontinuing the writing of all kinds of insurance in this state shall surrender its certificate of authority.
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> (8) ... Within 90 days after surrendering its certificate of authority, withdrawing from this state, or discontinuing the writing of any one or multiple kinds or lines of insurance in this state, the insurer shall certify to the Director of the Office of Insurance Regulation that the insurer has engaged an independent third party to search for unrealized reinsurance, and that the insurer has made all

> relevant books and records available to such third party. The compensation to such third party may be a percentage of unrealized reinsurance identified and collected. (Emphasis added.)

7. As set forth above, Section 624.430(1), Florida Statutes, requires a withdrawing insurer to set forth in its notice the reasons for its withdrawal. State Farm has asserted in its Withdrawal Plan that this action is being taken in order to avoid what State Farm considers to be "an unacceptable danger of impairment or insolvency, including the inability over time to earn a rate of return that fosters an adequate capital position, which every insurer providing property insurance in this hurricane-prone state needs, and a danger of becoming unable to pay claims and honor other obligations if it does not withdraw."

8. State Farm has stated in the Withdrawal Plan that State Farm Florida's surplus has declined approximately $100 million in the first three quarters of 2008. The Withdrawal Plan states that State Farm Florida's projected decline would render it insolvent in 2011 if it does not non-renew its in-force policies and withdraw from the state.

9. State Farm's cited reasons in the Withdrawal Plan are both disingenuous and misleading to the Office and policyholders they seek to abandon. State Farm created its current "crisis" by failing to pursue the opportunities that were available to reduce its expenses and mitigate its decrease in premium volume. Instead, it chose to attempt to raise rates in order to reduce the savings to its policyholders its mitigation discounts provided and to seek a profit that was excessive and unreasonable in the current economic conditions while certifying that its rate filing reflected all premium savings that resulted from legislative enactments. State Farm's actions raise serious questions regarding the fitness and trustworthiness of its officers and directors to engage in the business of insurance.

10. State Farm's July 16, 2008, rate filing sought an overall average increase of 47.1% for homeowners insurance policies in State Farm Florida. The Office denied the requested rate increase, which denial was challenged and litigated before the Division of Administrative Hearings (hereinafter referred to as "DOAH"). An independent administrative law judge heard the evidence and issued a Recommended Order recommending that State Farm's rate filing be denied.

11. State Farm raised many of the same assertions in the DOAH litigation as it is now raising in its Withdrawal Plan. State Farm represented in its rate filing that application of the windstorm mitigation discounts had created a decrease in premium with no commensurate reduction in its overall exposure. State Farm further asserted, "There was no offset by higher base rates for the premium loss resulting from the doubling of the discounts in the Windstorm Mitigation Discount Program. There was also no offset in the base rates for the unanticipated increase in the number of policies qualifying for that discount."

12. State Farm's assertion is both misleading and troubling. No offset in the base rates was needed if its mitigation discounts accurately reflected a commensurate reduction in its overall exposure as they should. Moreover, charging higher base rates in order to offset premium decreases resulting from mitigation features defeats the purpose of the mitigation discounts which was to reduce the premium paid by policyholders whose homes have mitigation features that reduce the risk of a claim to State Farm.

13. State Farm has asserted that within months of the implementation of its discounts, it realized that the reduction in premium was not commensurate with a reduction in its overall exposure. These are the same discounts that State Farm testified in favor of before the Financial Services Commission prior to the adoption of the rule implementing these discounts. Rather

than change its discounts or properly model the reduction in its exposure, State Farm chose to attempt to raise rates to reduce the savings to its policyholders receiving discounts and to require policyholders not receiving discounts to subsidize policyholders who were. State Farm knew or should have known that its actions were contrary to the Insurance Code when it made its rate filing.

14. State Farm has asserted that it had no alternative but to use the discounts as calculated by the public studies incorporated by reference in the Office's Rule 69O-170.017, Florida Administrative Code. Once again State Farm's assertion is disingenuous and misleading. The rule cited above provides: "These discounts must be used without any modification *unless they are supported by detail[ed] alternate studies where all assumptions are available to the Office for review.*" [Emphasis added]. If State Farm truly believed its discounts provided a reduction in premium that was not commensurate with a reduction in its exposure to loss, it should have immediately provided the information necessary to justify a change in the discounts it offers.

15. The rule requiring insurers to give their insureds windstorm mitigation discounts not only anticipates the very circumstances State Farm asserts has caused a decline in premium, and thus surplus, but also provides a remedy. State Farm had the opportunity to submit its own study to support an alternative amount for the windstorm mitigation discounts but has never availed itself of that opportunity. Instead, in its exceptions to the independent administrative law judge's Recommended Order denying the rate increase, State Farm argued incorrectly that "it is not required to quantify the actual effect of the wind-mitigation discounts; it is only required to project premiums, losses and expenses."

16. On one hand State Farm argues its windstorm mitigation discounts are causing a decline in premium, and thus surplus. On the other hand it argues it is not required to quantify the "actual effect" of those discounts. The importance of the "actual effect" cannot be underestimated.

17. If the discounts do not accurately reflect a commensurate reduction in State Farm's exposure then the discounts need to be reduced appropriately. In order to appropriately reduce the discounts, the "actual effect" of those discounts must be quantified. If the discounts are correct and State Farm has incorrectly modeled the expected reduction in exposure due to the mitigation features, then State Farm Florida has and continues to pay for reinsurance it does not need to its parent, State Farm Mutual. The "actual effect" is necessary to assess any overpayments to State Farm Mutual. In either situation, it is State Farm's failure to address the mitigation issue, along with its continued reduction in policies, that has created the reduction in surplus to State Farm Florida in the amount of hundreds of millions of dollars. State Farm has had ample opportunity to quantify the effects of these discounts and to conduct a study by which to calculate alternative discounts. For reasons only it knows, State Farm has not done so.

18. The factual findings of the Administrative Law Judge may shed some light on why State Farm has failed to quantify the effect of it discounts or to provide for alternative discounts. The judge, in his recommended order, characterized the relationship between State Farm Mutual and State Farm Florida in the following way:

> Transactions between State Farm Mutual and State Farm Florida for reinsurance and credit risk provisions totaling approximately $561.8 million, when viewed in the light of economic reality, Subsection 1.01(3), or Section 624.04, may be transactions which State Farm Mutual engages in with itself and which lack any independent economic significance. Transactions with no independent economic significance would be sham transactions which may distort the economic costs of the reinsurance and credit risk provisions purchased from State Farm Mutual. Such economic

> distortions may enable the group to derive a rate advantage from the legal form in which State Farm Mutual chooses to do business in Florida. (Finding of Fact 42)

19. In any event, State Farm's Withdrawal Plan fails to make any provision to address the mitigation discount issue. It is apparently content to continue losing surplus rather than dealing with the real problem, whether it be that the discounts are too high or the modeling of the exposures is incorrect. This is unacceptable.

20. Furthermore, according to the independent administrative law judge, had the rate filing been approved, the rate would have generated a return to investors of 12.2% based on a profit factor of 16% submitted in the filing. (This is found at page 22 of the Recommended Order.) A 12.2% return to investors in this economic climate is excessive, unreasonable, and cannot be fairly characterized as necessary to save the company from insolvency.

21. Regardless of the fact that the reasons given by State Farm for its withdrawal are disingenuous at best, the Office is without authority to disapprove the Withdrawal Plan solely for that reason.

22. Section 624.430(2), Florida Statutes, clearly provides the factors the Office must consider in order to approve a withdrawal plan. In order to approve the plan it must determine that "the plan makes adequate provision for the satisfaction of the insurer's obligations and is not hazardous to policyholders or the public prior to the approval of the surrender of the insurer's certificate of authority." The Office has reviewed the Withdrawal Plan submitted by State Farm, and has determined in accordance with that statute, that the Withdrawal Plan as submitted cannot be approved. The Withdrawal Plan as submitted would be hazardous not only to the

policyholders of State Farm Florida, but also to existing policyholders of Citizens, and to the citizens of the State of Florida.

23. State Farm states in its Withdrawal Plan that its agents will be able to help policyholders apply to Citizens and obtain coverage from Citizens, or obtain coverage through the Citizens take-out program. The transfer of State Farm's more than 700,000 homeowners policies to Citizens would nearly double the policy load of Citizens, tax its infrastructure beyond its ability to cope, and interfere with its ability to service policyholders. Further, the additional exposure would increase the likelihood and amount of potential assessments to all policyholders in Florida and subject the policyholders of State Farm Florida to an additional Citizens surcharge to which they are not now subject. Therefore, the plan as proposed would be hazardous to State Farm policyholders, Citizens policyholders and the people of the State of Florida.

24. The Office finds that State Farm's Withdrawal Plan fails to make adequate provision for the satisfaction of its obligations because it does not provide for a transfer of policies directly to the private marketplace. State Farm relies upon Citizens as the vehicle by which it sheds these policies. Such reliance is grossly inadequate given the number of property insurers currently licensed and willing to write property insurance in this state. Further compounding the problem, State Farm has informed the Office that it will continue to refuse to allow its captive agents to write policies directly with other insurers, which provides its agents no alternative but to place the policyholders with Citizens. This is unacceptable.

25. State Farm's plan to keep its Florida Certificate of Authority until the last policy is non-renewed is unnecessary to the implementation of the Withdrawal Plan. Section 624.402, Florida Statutes, provides that "A certificate of authority shall not be required of an insurer with respect to: (1) Investigation, settlement, or litigation of claims under its policies lawfully written

in this state, or liquidation of assets and liabilities of the insurer (other than the collection of new premiums), all as resulting from its former authorized operations in this state."

26. Moreover, the Office finds that State Farm Florida's current financial "crisis" was created by State Farm and that the continuation of State Farm Florida's Certificate of Authority is hazardous to its policyholders and the public. The Office further finds that in light of the alleged dire financial condition of State Farm Florida, the addition of new and additional exposure by the adjustment of coverage and the addition of approved endorsements would be hazardous to its policyholders and cannot justify the continuation of State Farm Florida's Certificate of Authority.

27. Finally, the Office finds that State Farm's Withdrawal Plan fails to address its current mitigation discount issue pursuant to the provisions of Rule 69O-170.017, Florida Administrative Code, and as a result is hazardous to its policyholders. As set out above, it is the failure of State Farm to address this issue that has created its current crisis, not the legislature, the Office, or the failure to obtain a rate increase based on a filing made in violation of the Insurance Code.

28. As set out above, Section 624.430, Florida Statutes, provides that the Office may deny, approve or approve with conditions a Withdrawal Plan submitted by an insurer. The Office finds that the Withdrawal Plan as submitted by State Farm Florida cannot be approved because it is hazardous to both the policyholders and to the public.

29. The Office further finds that it can approve the Withdrawal Plan of State Farm subject to certain conditions.

It is therefore Ordered:

State Farm's Withdrawal Plan is hereby approved subject to the following conditions:

A. State Farm Florida shall surrender its Certificate of Authority within thirty (30) days of the issuance of this Order;

B. State Farm shall facilitate the orderly transition of policies from State Farm Florida to the private marketplace in a method directed by the Office and shall not, directly or indirectly, place any of the policies in Citizens. Further, State Farm shall provide notification to its policyholders of their options in a form and manner as directed by the Office.

C. State Farm shall not interfere with the direct placement of its policies by its agents into other private insurance companies;

D. In an effort to minimize the impact of market disruption on policyholders, State Farm and State Farm Fire and Casualty Company shall issue pro-rata refunds of premium to any policyholder seeking to voluntarily cancel or non-renew a policy and will not short-rate the return premium for any policy in any line, whether it be automobile, boat, or property insurance coverage;

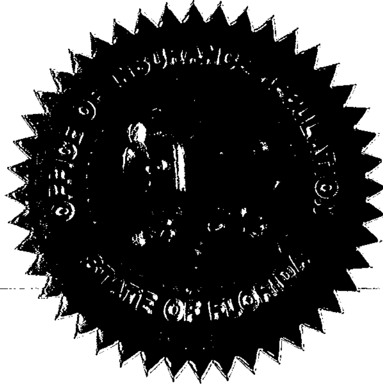
E. State Farm Florida shall remain subject to all taxes and assessments applicable to authorized insurance companies, including but not limited to any Florida Hurricane Catastrophe Fund or Citizen assessment, until one year following its last policy's non-renewal;

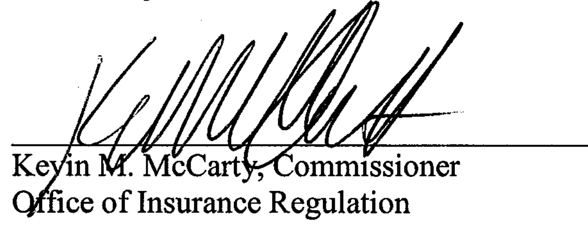
F. State Farm shall consider all offers to buy or assume all or part of its business. A copy of any such offer shall be provided to the Office within forty-eight (48) hours of its receipt;

G. State Farm shall pay the reasonable costs of implementing the Withdrawal Plan including any advertising or written communication that the Office finds necessary to implement a smooth transition of the State Farm Florida insureds; and,

H. The Office retains the jurisdiction to modify the terms of this Order and the Withdrawal Plan in response to changes in the law or changes in conditions that arise.

DONE and ORDERED this 13th day of February, 2009.





Kevin M. McCarty, Commissioner
Office of Insurance Regulation

NOTICE OF RIGHTS

Pursuant to Sections 120.569 and 120.57, Florida Statutes and Rule Chapter 28-106, Florida Administrative Code (F.A.C.), you may have a right to request a proceeding to contest this action by the Office of Insurance Regulation (hereinafter the "Office"). You may request a proceeding by filing a Petition. Your Petition for a proceeding must be in writing and must be filed with the General Counsel acting as the Agency Clerk, Office of Insurance Regulation. If served by U.S. Mail the Petition should be addressed to the Florida Office of Insurance Regulation at 612 Larson Building, Tallahassee, Florida 32399-4206. If Express Mail or hand-delivery is utilized, the Petition should be delivered to 612 Larson Building, 200 East Gaines Street, Tallahassee, Florida 32399-0300. The written Petition must be received by, and filed in the Office no later than 5:00 p.m. on the twenty-first (21) day after your receipt of this notice. Unless your Petition challenging this action is received by the Office within twenty-one (21) days from the date of the receipt of this notice, the right to a proceeding shall be deemed waived. Mailing the response on the twenty-first day will not preserve your right to a hearing.

If a proceeding is requested and there is no dispute of material fact the provisions of Section 120.57(2), Florida Statutes may apply. In this regard you may submit oral or written evidence in opposition to the action taken by this agency or a written statement challenging the grounds upon which the agency has relied. While a hearing is normally not required in the absence of a dispute of fact, if you feel that a hearing is necessary one may be conducted in Tallahassee, Florida or by telephonic conference call upon your request.

If you dispute material facts which are the basis for this agency's action you may request a formal adversarial proceeding pursuant to Sections 120.569 and 120.57(1), Florida Statutes. If you request this type of proceeding, the request must comply with all of the requirements of Rule Chapter 28-106.201, F.A.C., must demonstrate that your substantial interests have been affected by this agency's action, and contain:

A statement of all disputed issues of material fact. If there are none, the petition must so indicate;

A concise statement of the ultimate facts alleged, including the specific facts the petitioner contends warrant reversal or modification of the agency's proposed action;

A statement of the specific rules or statutes the petitioner contends require reversal or modification of the agency's proposed action; and

A statement of the relief sought by the petitioner, stating precisely the action petitioner wishes the agency to take with respect to the agency's proposed action.

These proceedings are held before a State Administrative Law Judge of the Division of Administrative Hearings. Unless the majority of witnesses are located elsewhere, the Office will request that the hearing be conducted in Tallahassee.

In some instances, you may have additional statutory rights than the ones described herein.

Failure to follow the procedure outlined with regard to your response to this notice may result in the request being denied. Any request for administrative proceeding received prior to the date of this notice shall be deemed abandoned unless timely renewed in compliance with the guidelines as set out above.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of this ORDER was sent by Certified Mail to Edward B. Rust, President, State Farm Mutual Automobile Insurance Company, One State Farm Plaza, Bloomington, Illinois 61710 and James Thompson, President, State Farm Florida Insurance Company, 7401 Cypress Gardens Boulevard, Winter Haven, Florida 33888 this 12th day of February, 2009.

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