



CHIEF FINANCIAL OFFICER
JIMMY PATRONIS
STATE OF FLORIDA

July 21, 2022

Ms. Sandra L. Thompson, Director
Federal Housing Finance Agency
400 7th Street SW
Washington, D C 20219

Dear Director Thompson:

I am writing out of concern that underwriting guidelines at Fannie Mae/Freddie Mac (GSEs) have inadvertently empowered a rogue ratings agency, Demotech, Inc. (Demotech) to play havoc with the financial lives of millions of Floridians. Florida's Office of Insurance Regulation (OIR) is charged with regulating Florida's Property Insurance Market. Recently, the OIR has been contacted by a number of insurers who have been advised that Demotech intends to downgrade their Financial Stability Ratings to a level that is not recognized as sufficient for insuring properties that you underwrite. The purpose of this letter is to urge you to reconsider your reliance on Demotech as the primary ratings agency for rating the strength of Florida's domestic insurance market, and to give Florida leaders time to identify a suitable alternative ratings body to evaluate the financial strength of Florida insurers.

If GSEs de-authorized a sizeable percentage of Florida's insurers based on the dubious ratings of one company, it would create financial chaos for millions of Floridians. Not only could Florida families end up being required to accept expensive and inadequate forced-placed coverage from their lender, but a "rug-pull" of this magnitude would expose over 115,000 Florida insurance agents to litigation risks. Such extreme outcomes are not necessary given the fact that all Florida insurance companies being downgraded were able to obtain reinsurance and are not presently "impaired" or "insolvent" as those terms are defined in the Florida Insurance Code.

As detailed below, Florida is a very unique state and there are three primary reasons why your underwriters may want to reserve judgment on the ability of Florida's property insurance market to weather storms that may come our way:

1. By their own admission, Demotech's ratings are based on Demotech's own conjectures of public policy outcomes, not pure actuarial science.
2. In a May 2022 Special Legislative Session, The Florida Legislature completed what Demotech acknowledges is likely a "once in a generation" overhaul to the Florida Insurance Code, and more time is required for companies to realize the benefit of these significant reforms.

3. Florida learned hard lessons from Hurricane Andrew and subsequently put a number of very unique apparatuses in place to stabilize our insurance market, including the Florida Hurricane Catastrophe Fund (Cat Fund).

Demotech ratings rely heavily on conjecture as to the impact of hypothetical policy outcomes.

Demotech utilizes Financial Stability Ratings to evaluate the relative financial strength of Florida insurance companies on behalf of GSEs. Demotech describes its ratings process as: “[A]n objective baseline for assessing solvency based on changes in financial stability, as presented in an insurer’s balance sheet over time.” In reality, much of Demotech’s ratings are based on conjecture that the Florida Legislature will modify the insurance code in ways that Demotech deems favorable for the market as a whole. For instance, in a letter dated March 23, 2022, Demotech explained that its prior ratings of Florida insurance companies were based, in part, “*on the expectation of meaningful legislative reform in the next session*”¹ (emphasis added). GSEs should ask themselves: How can a company assign financial strength ratings based on *the expectation* of legislative reform?

After learning that the Securities & Exchange Commission (SEC) approved Demotech as a Nationally Recognized Statistical Rating Organization, we obtained and reviewed Demotech’s filings with the SEC. Those documents indicate that all rating actions are subject to an appeal process, as provided in a referenced exhibit. However, the referenced exhibit does not provide any appeal procedures. The omission of appeal procedures should be a cause of concern for the GSEs and the SEC.

The Florida Legislature significantly reformed Florida’s Insurance Code in May of 2022 to improve the operating environment for Florida insureds, and it is far too early to denounce those reforms as “too little, too late.”

Setting aside Demotech’s dubious ratings methodology, it is far too early for the GSEs to “pull the rug out” from under Florida families given the significant property insurance reforms contained in Florida Senate Bill 2D that were signed into law on May 26, 2022. These reforms included the bold step of prohibiting the assignment of one-way attorney fees via an assignment of benefits, a new reinsurance program at the Cat Fund, which is being made available to companies into the 2023 storm season, and significant reforms relating to bad faith litigation, insurer liability for multipliers on attorney fees, and a \$150 million dollar home hardening program that will offer free wind mitigation inspections to all Floridians and home-hardening grants to Floridians who live in coastal areas. In a communication obtained by my office, even Demotech acknowledges that the reforms implemented during the May special session are likely “the most significant reforms to Florida’s Homeowners insurance market in a generation.”² Accordingly, I would urge the GSEs to allow these reforms to take root instead of accepting Demotech’s sour-grapes analysis of “too little, too late” as the litmus test for determining the viability of Florida’s insurance market³.

The backstops for Florida’s property insurance market remain strong.

¹ Demotech Letter to Florida Leaders dated March 23, 2022, p. 2.

² See Draft Demotech Press Release dated July 26, 2022.

³ *Id.*

Ms. Thompson
July 21, 2022
Page 3

The State of Florida endured some hard lessons in the wake of Hurricane Andrew, and that experience gave rise to several significant, stabilizing entities in Florida's property insurance market, namely: The Florida Hurricane Catastrophe Fund (CAT Fund), the Florida Insurance Guaranty Association (FIGA), and the state's insurer of last resort—Citizens Property Insurance (Citizens). Each of these entities plays an important role in limiting the liability faced by Florida policyholders and lenders in the event a property insurance company becomes insolvent.

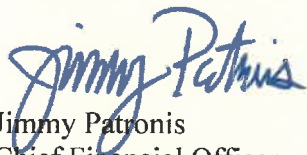
Under Florida law, all policyholders in Florida's admitted property insurance market benefit from safeguards at FIGA. In the event an insurer becomes insolvent, FIGA steps in to provide coverage to the affected policyholders and may raise capital by borrowing funds, issuing bonds, and levying assessments. In this fashion, FIGA significantly reduces risks for both policyholders and GSEs.

Further, Florida is very unique in that it maintains its own reinsurance pool, known as the CAT Fund. The CAT Fund is essentially a non-profit reinsurance provider. Like FIGA, in times of need, the CAT Fund enjoys the ability to raise funds by issuing bonds and levying assessments. Finally, Florida's insurer of last resort, Citizens, enjoys a healthy balance sheet, and it too can raise capital in times of need by issuing bonds and levying assessments.

Taken together, state-backed entities like the CAT Fund, FIGA, and Citizens produce a significant, stabilizing effect for Florida policyholders and GSEs. For these reasons, I believe GSEs should carefully consider the benefits these entities provide before writing off Florida's property insurance carriers as unsalvageable for purposes of insuring properties encumbered with a federally-backed mortgage based on a dubious rating methodology, two months into hurricane season.

In conclusion, it is far too early for the GSEs to declare Florida's property insurance market as a lost cause as Demotech suggests, especially when Demotech's ratings look "beyond the balance sheet" and make conjectures based on hypothetical policy outcomes. Moreover, it is far too early to declare the reforms Florida adopted less than 60 days ago as "too little, too late," as described in the draft press release Demotech distributed to insurers who received notice of an impending downgrade. The GSEs would be wise to reserve judgment about the soundness of Florida's insurance market until Florida leaders are able to provide the GSEs with a suitable alternative to Demotech for evaluating the financial strength of Florida insurance companies.

Sincerely,



Jimmy Patronis
Chief Financial Officer

c: Mr. Michael DeVito, Chief Executive Officer
Florida Congressional Delegation
Barry Gilway, Citizens Property Insurance
Kyle Ulrich, FAIA
Lamar Taylor, CAT Fund
Joe Petrelli, Demotech, Inc.



CHIEF FINANCIAL OFFICER
JIMMY PATRONIS
STATE OF FLORIDA

July 21, 2022

Mr. Mike Hutchins, President
Freddie Mac
8200 Jones Branch Drive
McLean, VA 22102-3110

Dear President Hutchins:

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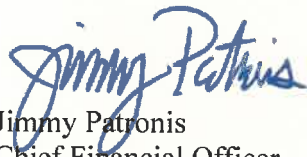
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CHIEF FINANCIAL OFFICER
JIMMY PATRONIS
STATE OF FLORIDA

July 21, 2022

Mr. David Benson, President
and Interim Chief Executive Officer
Fannie Mae
1100 15th Street, NW
Washington, D C 20005

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