



650 California Street, 17<sup>th</sup> Floor  
San Francisco, California 94108

Tel +1 415 403-1333  
Fax +1 415 403-1334

[www.milliman.com](http://www.milliman.com)

December 3, 2010

Mr. Stephen Korducki  
President and Chief Executive Officer  
Sunshine State Insurance Company  
475 West Town Place, Suite 210  
St. Augustine, Florida 32092

Dr. Jack E. Nicholson  
Chief Operating Officer  
Florida Hurricane Catastrophe Fund  
State Board of Administration  
1801 Hermitage Boulevard, Suite 100  
Tallahassee, Florida 32308

**Re: Decision Regarding 2004 Commutation Between Sunshine State Insurance Company and Florida Hurricane Catastrophe Fund**

Dear Sirs:

This letter is in reference to an engagement in which Milliman, Inc. (Milliman) is serving on a panel appointed to conduct the resolution of a dispute between Sunshine State Insurance Company (SSIC) and the Florida State Board of Administration (SBA). The Florida Hurricane Catastrophe Fund (the "FHCF"), which is administered by the SBA, provided reimbursement to SSIC for a portion of its catastrophic losses pursuant to a contract effective June 1, 2004 ("the Reimbursement Contract"). The dispute arose in regards to the commutation of the Reimbursement Contract.

I have reviewed the documents provided by the SSIC, the SBA and the other two actuaries on the panel. Additionally, the panel met via conference call on December 2 with representatives of the SBA and SSIC to discuss some follow-up questions on the materials provided. The purpose of this letter is to provide my final decision to SSIC and the SBA.

**DECISION**

Based on the evidence presented and the specific circumstances in this matter, I concur with the position of SSIC that they are entitled to full reimbursement of the disputed amount with respect to policyholder attorney fees (PHAFs) on four claims (#280000003877, #280000002804, #280000003464, and #280000003504) disputed by the SBA. It appears that the total PHAFs stated at 100% are equal to \$94,268.40, and SBA reduced the proposed commutation amount by

Mr. Korducki and Dr. Nicholson  
December 3, 2010  
Page 2 of 5

\$89,083.64, being 90% times 105% of the disputed amount<sup>1</sup>. Added to the uncontested amount of \$726,747.15<sup>2</sup>, this implies a final commutation amount of \$815,830.79.

This decision was based solely on the specific nature of the dispute between SSIC and the SBA, and the support provided in the context of that dispute. Because this decision is specific to the circumstances in this case, it does not consider any other disputes or entities and should not be cited, construed or relied upon as a precedent or decision in any other context, particularly in any future proceeding.

## **BASIS OF DECISION**

The remainder of this section contains a high-level summary of the basis of my decision.

In general, my opinion was guided by the language in the Reimbursement Contract to the extent that it is explicit and clear. To the extent that the language is not explicit and clear, my opinion was guided by other relevant sources, such as Florida regulatory requirements, Florida statutory requirements, statutory accounting requirements, industry claims settlement practices, industry reinsurance practices, and Actuarial Standards of Practice. While all of these sources are relevant to my opinion, I am not neither an accountant nor an attorney, and thus I do not express any professional opinion about legal or accounting matters.

*Loss Adjustment Expense.* The SBA contends that PHAFs could be characterized as a type of loss adjustment expenses (LAE) and therefore would be excluded as a portion of reimbursable losses under the terms of the Reimbursement Contract.

I believe that PHAFs should be characterized as loss and not LAE. The basis of my opinion is that both parties agreed that insurers routinely account for such expenses as loss, insurers routinely cede such expenses as loss to private reinsurers, and neither party identified any basis within statutory accounting standards to treat PHAFs as LAE. Further, the Reimbursement Contract does not include a definition of LAE that specifies or indicates that it is meant to include PHAFs.

*Extra-Contractual Obligations.* The SBA contends that PHAFs could be characterized as a type of extra-contractual obligations (ECO). They also argued that PHAFs are a voluntary choice of SSIC to cover costs outside the terms of their policies (similar to waiving a deductible). Under either interpretation, PHAFs would be excluded as a portion of reimbursable losses under the terms of the Reimbursement Contract.

The Reimbursement Contract does not include a definition of ECO that specifies or indicates that it is meant to include PHAFs. Further, PHAFs do not fall under the common business and

---

<sup>1</sup> From a one-page exhibit provided by SBA as a submission to the panel titled "Sunshine State Insurance Company; 2004 Commutation; Summary of Commutation Amounts August 9, 2010."

<sup>2</sup> From Exhibit B of the SSIC submission to the panel, a letter dated August 13, 2010 from Mr. Nicholson to Mr. Vanderpool of SSIC.

Mr. Korducki and Dr. Nicholson  
December 3, 2010  
Page 3 of 5

reinsurance usage of the term ECO. Therefore I do not believe that PHAFs should be characterized as ECO.

The support provided by SSIC demonstrated to my satisfaction that the PHAFs arise from a statutory obligation of SSIC to protect the attorneys for their policyholders. I understand that SSIC's insurance policies do not list "attorney fees" as a covered item alongside "damage to property," but I believe that SSIC's contractual coverage is based on the sum of the policy language and the insurance statutes and regulations in the state, not solely on the policy language.

I asked SSIC what would happen if the sum of PHAFs and other losses paid to the policyholder were to exceed the limits under the policy. In that instance, SSIC indicated that they would cap the sum of PHAFs and other losses at the policy limits, and any amounts in excess of the policy limits would be excluded from the losses reported to the FHCF.

Based on all these considerations, I do not consider PHAFs to be extra-contractual or a voluntary decision to provide coverage outside the terms of their policies.

*Direct vs. Indirect Losses.* The SBA contends that PHAFs could be characterized as a type of indirect loss and therefore would be excluded as a portion of reimbursable losses under the terms of the Reimbursement Contract. The contract language specifies that it covers "direct incurred losses under covered policies" with limits on losses for additional living expenses and exclusions for fair rental value, loss of use and business interruption.

The SBA interprets the term "direct" to mean that the loss focuses on the reduction in property value or loss of property as a measure of the loss to the policyholder, and contends that PHAFs are by nature "indirect" and therefore excluded from coverage. The SBA cites a CPCU textbook and other insurance textbooks, plus the "plain clear meaning" of the word, as sources of this definition. However, the Reimbursement Contract does not include a definition of "direct." There is one mention of "indirect" loss, but it applies only to losses caused by or resulting from nuclear reaction, nuclear radiation, or radioactive contamination, which do not apply in this case.

The 2004 FHCF statute (215.555) cited by the SBA as being in effect at the time of the Reimbursement Contract contains the same reference to "direct incurred losses", also without a definition. However, that statute also contains a reference to "direct premiums" in a later section. I asked the SBA about this and my understanding of their answer was that their interpretation of term "direct" as applied to losses would not translate to the same interpretation as applied to premium.

In my experience, the term "direct" in the insurance and reinsurance context typically implies "written directly by the company" as opposed to being assumed from another company, or ceded to another company. This is how companies categorize their premiums and losses in statutory financial statements. Interpreted with this definition, the usage of the term "direct" in the 2004 FHCF statute and the Reimbursement Contract would be consistent when applied to premiums and losses. Using this definition, I believe that the PHAFs in this dispute arose from policies

written directly by SSIC and therefore should be considered “direct incurred losses” for purposes of coverage.

*Follow the Fortunes.* There is a clause in Article VII of the Reimbursement Contract that specifies “The Company shall investigate and settle or defend all claims and losses. All payments of claims or losses by the Company within the terms and limits of the appropriate coverage parts of Covered Policies shall be binding on the SBA, subject to the terms of this Contract, including the provisions in Article XIII relating to inspection of records and examinations.”

SSIC considers this to be a “follow the fortunes” clause, and the SBA does not. Both parties gave me example wording from private reinsurance contracts, and the wording was not consistent between the two examples.

In my experience, reinsurance contracts have a very wide array of wording, and I do not express any legal opinions regarding the reinsurance concept of “follow the fortunes.” However, the wording of Article VII in the Reimbursement does appear to give SSIC the duty of settling or defending its claims, and bind the SBA to go along with these settlements as long as they do not fall outside the terms of the Reimbursement Contract.

*Individual Claim Circumstances.* During our December 2 meeting, SBA claims personnel presented some additional information regarding the four disputed claims in answer to my questions. There were some other circumstances unique to these claims, such as a question as to whether they related to 2004 hurricanes or were from pre-existing damage, and a question as to whether a portion of a global settlement related to a storm in which SSIC had not exceeded the retention under the Reimbursement Contract.

I concur that the SBA has the authority to refuse to cover a claim if it did not arise from a hurricane in which SSIC has exceeded its retention. However, the claim adjustments, arguments and support presented by both parties in this dispute have all focused on the fact that PHAFs were reported by SSIC as covered losses, and the SBA does not believe that PHAFs should be covered. The SBA did not emphasize or carve out separate adjustments beyond the central dispute regarding PHAFs, and I was not asked to comment on other issues. Therefore I did not attempt to do so.

## **RELIANCES AND LIMITATIONS**

*Use of Report.* The information in this report is provided to support the conclusions contained herein, limited to the scope of work specified by SSIC and SBA, and may not be suitable for other purposes. Milliman is available to answer any questions regarding this report or any other aspect of our review. The undersigned is neither an accountant nor a legal expert, so none of the information or concepts in the report should be construed as accounting or legal guidance or advice.

Mr. Korducki and Dr. Nicholson  
December 3, 2010  
Page 5 of 5

*Distribution.* This report was prepared solely for the use and benefit of SSIC and SBA, and is only to be relied upon by SSIC and SBA. Although we have agreed to allow distribution of this report to outside parties, Milliman does not intend to benefit or create a legal duty to any third party recipient of its work. Milliman's work may not be filed with the SEC or other securities regulatory bodies. In the event this report is distributed to third parties, the report must be provided in its entirety. We recommend that any such party have its own actuary review this report to ensure that the party understands the assumptions and uncertainties inherent in our estimates. This report may not be filed with the SEC or other securities regulatory bodies.

*Data Reliances.* In performing this analysis we relied upon data and other information provided to us by the SBA and SSIC. We have not audited or verified this data and information. If the underlying data or information is inaccurate or incomplete, the results of our analysis may likewise be inaccurate or incomplete.

We performed a limited review of the data used directly in our analysis for reasonableness and consistency. We did not find material defects in the data. If there are material defects in the data, it is possible that they would be uncovered by a detailed, systematic review and comparison of the data to search for data values that are questionable or relationships that are materially inconsistent. Such a detailed review was beyond the scope of our assignment.

*Qualifications.* This letter may be considered a statement of actuarial opinion under guidelines promulgated by the American Academy of Actuaries. The undersigned professional is a member of the American Academy of Actuaries and meets the Qualification Standards of the American Academy of Actuaries to render the opinion contained herein.

## CLOSING

I appreciate the opportunity to participate in this engagement. Please feel free to contact me if you have any questions about this letter.

Sincerely,



Nancy P. Watkins, FCAS, MAAA  
Principal and Consulting Actuary

Cc: Mr. Martin Simons, ACAS, MAAA, MCA  
Mr. Peter Scourtis, FCAS, MAAA