# Management's Discussion and Analysis

## *Company Background*

This discussion provides an assessment by management of the financial position, results of operations, cash flow and liquidity for Louisiana Citizens Property Insurance Corporation (LCPIC). LCPIC was established in 2003 by the Louisiana legislature as a nonprofit corporation to operate residual market insurance plans effective January 1, 2004. The objective of LCPIC is to provide essential property insurance for residential and commercial property applicants who are unable to procure insurance through the voluntary market. LCPIC is the successor to the program established by Act 424 of the 1992 Regular Legislative Session designated as the "Fair Access to Insurance Requirements Plan" or otherwise known as the Louisiana Joint Reinsurance Plan (FAIR Plan) and the Louisiana Insurance Underwriting Plan (Coastal Plan). Information presented in this discussion supplements the financial statements, schedules, and exhibits in Louisiana Citizens Property Insurance Corporation's 2015 Annual Statement.

Major events occurring in 2015 for LCPIC were:

- LCPIC renewed its reinsurance program in May 2015 for the same storm coverage of $650 million with a $50 million retention that includes a traditional reinsurance program and cat bonds for a savings of $15.7 million compared to 2014.
- LCPIC refinanced its Series 2006B Assessment Revenue Bonds by issuing Series 2015 Refunding Bonds and funds from the Emergency Assessment Stabilization Fund that created total savings of approximately $109.5 million and reduced the average bond life by approximately one year.
- LCPIC completed an ninth round of depopulation effective December 1, 2015 transferring 12,648 policies and approximately $2.5 billion of exposure to the private insurance market.
- There were no significant catastrophes that occurred in 2015.

## *Financial Position*

LCPIC's financial position at December 31 was as follows:

| Balance Sheet (in thousands of dollars - 000) | 2015 | 2014 |
|---|---|---|
| **Assets** | | |
| Operating cash and common stocks | $143,096 | $94,411 |
| Trustee common stocks and short-term investments | 95,937 | 147,776 |
| Total cash and invested assets | 239,033 | 242,187 |
| | | |
| Uncollected and deferred premiums | 16,614 | 19,246 |
| Reinsurance balances | 980 | 5,074 |
| Long-term emergency assessments receivable | 633,202 | 761,907 |
| Other assets | 19,958 | 19,163 |
| Total assets | $909,787 | $1,047,577 |
| **Liabilities and Policyholders' Surplus** | | |
| Unpaid loss and loss adjustment expenses | $66,263 | $70,012 |
| Borrowed money | 639,945 | 745,885 |
| Unearned premiums | 65,495 | 79,824 |
| Excess emergency assessments collected over debt service | 76,234 | 150,552 |
| Other liabilities | 22,668 | 25,002 |
| Total liabilities | 870,605 | 1,071,275 |
| Total policyholders' surplus | 39,182 | (23,698) |
| Total liabilities and policyholders' surplus | $909,787 | $1,047,577 |

## Assets

Total assets decreased by $137.8 million in 2015 compared to 2014 primarily due to:

Operating cash and common stocks in 2015 was $143.1 million compared to $94.4 million in 2014. The $48.7 million increase primarily resulted from a decrease in payments for the Oubre class action suit.

Trustee common stocks and short-term investments decreased $51.8 million in 2015 due to a cash withdrawal in July of $66.4 million used in part to advance refund of LCPIC's Assessment Revenue Bonds, Series 2006B. Offsetting this decrease was a $14.6 million increase in investments of emergency assessment revenue that exceeded bond debt service costs.

# Management's Discussion and Analysis

Long-term emergency assessments receivable reflects the future assessments that will be utilized to repay outstanding bond debt from Hurricane Katrina losses incurred in 2005. The decrease of $128.7 million is due to the following two factors. (1) $82.0 million bond principal reduction from the refinancing of Series 2006B Bonds, and (2) $46.7 million bond principal payment made in 2015.

## Liabilities

Total liabilities decreased $200.7 million in 2015 compared to 2014 primarily due to:

Borrowed money decreased $105.9 million in 2015 compared to 2014 primarily due to the $82.0 million bond principal reduction from the refinancing of the Series 2006B Bonds, and a $46.7 million bond principal payment made in 2015. Offsetting this decrease was $23.3 million received in bond premium from the bond refinancing.

The decrease of $14.3 million in unearned premiums is primarily from LCPIC's depopulation program.

Excess emergency assessments collected over debt service decreased $74.3 million in 2015 primarily due to the following:

| Description (in millions) | Increase (Decrease) |
|---|---|
| Principal and interest paid | ($79.9) |
| Cash used towards refinance of Series 2006B Assessment Revenue Bonds | ($66.4) |
| Emergency assessments collected | $90.9 |
| Interest received on Trustee short-term investments | $3.6 |
| Increase in unamortized premium from refinance of Series 2006B Assessment Revenue Bonds | ($23.3) |
| Net change | ($75.1) |

## Policyholders' Surplus

The increase in total policyholders' surplus of $62.9 million in 2015 compared to 2014 is primarily due to a net income of $50.6 million. In addition to net income, $7.2 million from returned cat bond reserves and $5.0 million tax exempt surcharge collected on LCPIC policies contributed to the increase in policyholders' surplus. Tax exempt surcharge is collected to maintain a federal exempt status and to augment the financial resources of the corporation. It is collected on each policy and represents an amount equal to the premium taxes paid which is 3% of the policy premium.

## *Results of Operations*

LCPIC's operating results and key financial ratios are presented in the following table.

| Statement of Income and Ratios (000) | 2015 | 2014 |
|---|---|---|
| Premiums earned | $101,222 | $115,302 |
| Losses incurred | 19,531 | 106,282 |
| LAE incurred | 9,891 | 10,853 |
| Underwriting expenses | 23,295 | 27,536 |
| Underwriting gain (loss) | 48,505 | (29,369) |
| Net investment loss | (36,669) | (35,566) |
| Other Income | 38,792 | 40,730 |
| Net income | $50,628 | ($24,205) |
| Loss Ratio | 19.3% | 92.2% |
| LAE Ratio | 9.8% | 9.4% |
| Underwriting expense ratio | 26.8% | 26.0% |
| Combined ratio | 55.9% | 127.6% |

# Management's Discussion and Analysis

Net income in 2015 was $74.8 million greater than 2014 due to:

Premiums earned decreased $14.1 million due to LCPIC's depopulation efforts.

Losses incurred – incurred losses were $86.8 million less in 2015 compared to 2014 primarily due to a $92.5 million decline in class action settlements. Offsetting the decrease to losses incurred was the increase of $3.9 million incurred for Hurricane Katrina related claims.

Combined ratio – the combined ratio in 2015 was 55.9% compared to 127.6% in 2014 due to the decrease in premiums earned and losses incurred. The combined ratio expresses the sum of the costs for losses, LAE and underwriting expenses as a percentage of premiums (premiums earned for the loss and LAE ratios and premiums written for the underwriting expense ratio). The ratio is a recognized industry measure of underwriting performance.

## *Cash Flow and Liquidity*

## Cash Flow

Primary sources of cash include cash from premiums collected, miscellaneous income, proceeds from investments sold, matured or repaid; and primary uses of cash include debt service costs, losses and expenses paid, and the cost of investments acquired.

The cash flows of LCPIC are summarized as follows:

| **Cash Flow Statement (000)** | **2015** | **2014** |
|---|---|---|
| **Operations** | | |
| Premiums collected | $99,248 | $107,029 |
| Net investment income received (paid) | (36,669) | (35,566) |
| Miscellaneous income | 38,792 | 40,730 |
| Losses paid | (22,847) | (102,779) |
| Expenses paid | (33,757) | (38,585) |
| Net cash from operations | $44,767 | ($29,171) |
| **Investment Activities** | | |
| Proceeds from investments sold, matured or repaid | $236,073 | $355,594 |
| Cost of deficit long-term investments acquired | (212,634) | (349,208) |
| Net cash from investments | 23,439 | 6,386 |
| **Financing Activities** | | |
| Other cash provided (applied) | (47,921) | (13,772) |
| Net cash from financing activities and miscellaneous sources | (47,921) | (13,772) |
| **Change in Cash and Short-Term Investments** | | |
| Net change in cash, cash equivalents and short-term investments | $20,285 | ($36,557) |

Cash and short-term investments increased $20.3 million in 2015 compared to 2014 due to:

Net cash from operations was $44.8 million in 2015 compared to ($29.2) million in 2014 for a net change of $74.0 million that was due to the following:

| **Description (in millions)** | **Cash Provided (Cash Applied)** |
|---|---|
| Change in premiums collected related to LCPIC'S depopulation efforts | (7.8) |
| Losses paid decreased primarily due to class action suit settlements ($7.8 million paid in 2015 versus $83.0 million paid in 2014) | 75.2 |
| Commission paid decreased related to LCPIC'S depopulation efforts | 2.9 |
| All other cash movements related to cash from operations | 3.7 |
| Net cash provided from items listed above impacting cash from operations | $74.0 |

Net cash from investments in 2015 was $23.4 million compared to $6.4 million in 2014. The change in investment activity relates to the cash inflows and outflows of the assessment revenue bond obligations as well as investments of operating cash. The increase in net cash from investments was primarily due to the investment activity related to LCPIC's bond obligations.

# Management's Discussion and Analysis

## Cash Flow (continued)

Cash provided from financing activities and miscellaneous sources decreased $34.1 million in 2015 compared to 2014. Sources of cash applied are displayed below:

| **Description (in millions)** | **Increase (Decrease)** |
|---|---|
| Change in borrowed money as described in the Liabilities section on Page 350.1 | (58.7) |
| Change in accrued liability for excess emergency assessments collected over debt service as described in the Liabilities section on Page 350.1 | ($66.6) |
| Change in accrued liability for takeout premium payable related to depopulation. | 9.3 |
| Change in accrued liability for non-claim related litigation expense liability | 18.0 |
| Change in receivable for emergency assessments as described in the assets section on Page 350.1 | 65.7 |
| All other cash movements related to financing activities and miscellaneous sources | (1.8) |
| Net change | ($34.1) |

## Liquidity

All liquid funds held by LCPIC are kept in commercial bank accounts that are FDIC insured or 100% collateralized.

In addition to policyholder premiums, LCPIC has a much broader range of resources available to pay losses and repay debt obligations than does a typical insurer. LCPIC can institute a regular assessment on the state insurance industry of up to 10% of their written premium for deficits each year, and an emergency assessment of up to 10% of the premium written on property policyholders of the State of Louisiana for each calendar year of a storm to pay debt incurred in previous years.

In 2015, LCPIC secured a $100.0 million line of credit with Regions Bank that matures in June 2017. The line of credit provides additional liquidity to the corporation.

In 2010, LCPIC instituted lockbox processing to reduce cash flow interruption in the event of a temporary closure of its office for a catastrophic event.

In 2005, LCPIC did not have sufficient funds to pay 80,000 claims resulting from Hurricanes Katrina and Rita. In 2006, LCPIC issued $978.0 million of fixed rate assessment revenue bonds. On December 31, 2015, LCPIC had approximately $600.4 million of fixed rate assessment revenue bonds outstanding. The debt service of these bonds is paid through emergency assessments on property insurance policies written in the State of Louisiana. The emergency assessments are remitted quarterly to the bond trustee.

## *Pending Litigation*

As of December 31, 2015 there were 663 open litigation matters against LCPIC. The majority of these lawsuits are first-party suits related to Hurricanes Katrina, Rita, and Isaac. Unpaid loss and loss adjustment expenses are included on the balance sheet of approximately $9.7 million, excluding the Oubre class action suit described below. The balance of the litigated matters are related to first party losses, third-party bodily injury claims, subrogation or claims where the issue of coverage is in dispute.

*Oubre v. Louisiana Citizens Property Insurance Corporation*. The plaintiffs in this suit allege that LCPIC failed to timely initiate loss adjustment as required by Louisiana statutory law exposing LCPIC to penalties up to a mandatory limit of $5,000.00. On July 23, 2012 LCPIC settled the first phase of this class action suit with a payment of $104.7 million to the plaintiff counsel for distribution to the class members. LCPIC entered into a settlement with the class for the remaining Oubre claims. LCPIC has paid $97.1 million towards the final settlement as of December 31, 2015 and has a reserve of $47.1 million for the remaining settlement (included in unpaid losses on the balance sheet). LCPIC will continually review the reserve to ensure that it meets the anticipated settlement costs.

# Management's Discussion and Analysis

## ***Future Plans***

LCPIC had $650 million in total reinsurance and cat bonds in place for the 2015 storm season. The cat bonds include a $140.0 million four year catastrophe bond and a $100.0 million three year catastrophe bond. In addition to the reinsurance program and cat bonds, LCPIC has reinstatement premium protection and second event catastrophe coverage. The amount of reinsurance purchased by LCPIC is determined by many factors that include, losses projected by catastrophe models, insured values of the company, reinsurance market prices, and availability of cash. The reinsurance coverage, excluding cat bonds, described above expires on May 31, 2016. LCPIC is in the process of negotiating a new reinsurance program for the 2016 storm season.

To the extent that the above comments about future plans constitute forward-looking statements, these statements are not guaranties of future performance. Forward-looking statements are based on current expectations and projections about future events and are subject to risks, uncertainties and assumptions about LCPIC, economic and market factors, judicial rulings and the insurance industry, among other things. Actual events may differ materially from those expressed in forward-looking statements.