

July 17, 2008

CFO Alex Sink  
PL 11 Capitol  
400 S. Monroe Street  
Tallahassee, FL 32399-0001

Re: State Farm Florida Insurance Company Rate Filing

Dear CFO Sink:

I am writing to you on behalf of my client, State Farm Florida Insurance Company.

Yesterday, State Farm Florida filed a property insurance rate request with the Office of Insurance Regulation of 47.1 percent on a statewide average basis. This action is necessary to protect State Farm Florida's customers.

State Farm Florida recognizes that this is a large increase, but it is necessary to meet State Farm Florida's primary obligation – TO PAY ITS CUSTOMER CLAIMS WHEN THEY SUFFER A LOSS. State Farm Florida must charge a rate that is necessary to pay all of its claims including those that result from a hurricane.

State Farm Florida's financial position is projected to deteriorate to a deeply concerning level in the next 18 months. Absent immediate action, State Farm Florida is projecting a net underwriting loss exceeding 100% in 2009. This projection assumes no hurricanes make landfall in Florida -- if storms hit, the financial position would deteriorate more quickly and severely.

Providing property insurance in Florida is a challenge for both private and public insurers. Some companies were overwhelmed by the challenge during the 2004 and 2005 hurricane seasons and had to declare insolvency. Others have shed most of their customers. Citizens and the Cat Fund have remained solvent only by adding surcharges to the premiums paid by other policyholders. State Farm Florida has filed the needed rate increase so that it can continue to protect its customers from losses, including those due to catastrophic events.

State Farm Florida intends to work with the Office of Insurance Regulation (OIR) and other state officials in a collaborative fashion to resolve the challenges facing the Company and its customers. State Farm Florida realizes the filing will receive a thorough review by OIR—a review in accordance with the statutory standards established by the Legislature.

State Farm Florida has prepared a backgrounder that provides additional facts and I am available to discuss this filing with you at your convenience.

Cordially,



Mark K. Delegal

Enclosure

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cooperative and collaborative fashion to resolve the business challenges facing State Farm Florida. This backgrounder explains key factors underlying our recent 47.1 percent rate filing and is intended to provide perspective about State Farm Florida's position in the marketplace.

State Farm Florida's objectives are to:

- Charge rates that cover expected costs of loss and operating expenses.
- Stabilize State Farm Florida's financial condition in order to be able to pay our customers' claims, including those due to catastrophic events such as hurricanes.
- Take necessary and timely steps to ensure the risk of insolvency and other marketplace disruptions are minimized
- Ensure that automobile insurance policyholders across the nation, and property insurance policyholders outside the state of Florida, are not required to subsidize the costs of providing property insurance in Florida (and vice versa).

State Farm Florida's financial position is projected to deteriorate to a deeply concerning level during the next 18 months, for reasons explained in this backgrounder. Absent any immediate action, we're projecting that by 2009, State Farm Florida's results will worsen to a net underwriting loss exceeding 100 percent. In other words, in 2009, for every \$1 the company receives in premium income, after reinsurance costs, we expect to pay out more than \$2 in claims and expenses. These projections assume no hurricanes make landfall in the state – were storms to hit, these figures would deteriorate more quickly and severely.

In recent months, State Farm Florida suspended making interest payments on the \$750 million in outstanding surplus notes due to State Farm Mutual, in order to preserve State Farm Florida's capital. State Farm Florida has also limited its writing of new property insurance business in the state. (Presently, we only accommodate in-state transfers of business to eligible locations.) Even with these actions, State Farm Florida's present course is not sustainable.

At current rate levels, State Farm Florida will soon be unable to cover expected costs of loss and operating expenses. State Farm Florida plans to work in cooperation with the OIR to achieve reasonable solutions to these challenges.

We recognize that our customers have a need for reliable property insurance coverage and that our rates must comply with legal requirements. We are also aware of the growing financial burden on Florida property insurance consumers, and that a rate filing of this magnitude could add to that burden. But prompt action is needed.

A significant portion of State Farm Florida's rate need is due to hurricane loss mitigation discounts. In June 2007, State Farm Florida agreed to make a rate filing that essentially doubled the hurricane loss mitigation discounts. The company also agreed to make the increased discounts effective even before the statutory effective date, as an incentive to consumers to pursue mitigation efforts and in recognition of marketplace affordability concerns.

Our experience with these discounts has been anything but as expected. A vastly larger number of properties are receiving the discount than could have been anticipated when the "My Safe Florida Home" program began. To date, more than 260,000 properties have qualified for the discount and we expect the number to grow to more than 300,000. In some cases, the discount exceeds 90 percent of the windstorm portion of the premium. These developments have triggered a significant and unanticipated decrease in State Farm Florida's projected revenue for 2008, 2009 and beyond.

State Farm Florida's financial stability is important to Florida's property insurance marketplace. In Florida's property insurance market, no private insurer has dedicated more capital to stand behind property insurance risks than State Farm. State Farm Florida is now larger than the next four largest private insurers combined.

In the current environment, both private and public property insurers are severely pressed for access to adequate capital. For those companies that were declared insolvent after the 2004/2005 storms, it's too late. Unlike a state-run insurer (Citizens) or re-insurer (Florida Hurricane Catastrophe Fund) that can issue bonds, levy assessments, and impose taxes after an event to fund losses, State Farm Florida cannot charge customers after the fact. It needs adequate capital up front to have the resources necessary to pay claims in a timely manner.

State Farm Florida needs adequate capital to meet its obligations to customers who suffer losses. As with any business, State Farm Florida must have income that covers its expected future costs and allows it to fulfill its obligations.

We understand the difficulty public officials face in responding to the current property insurance crisis. It is vitally important that state officials and private insurers, like State Farm Florida, work cooperatively to solve the challenging issues confronting all Floridians. State Farm Florida is committed to working with state officials to serve our customers.



July 16, 2008

Commissioner of Insurance Regulation  
Florida Department of Financial Services  
Office of Insurance Regulation  
Bureau of Property/Casualty Forms and Rates  
200 East Gaines Street  
Tallahassee, FL 32399-0330

**Corporate Headquarters**  
One State Farm Plaza, D-4  
Bloomington, IL 61710  
Fax 309 766 0225

IN REPLY PLEASE REFER TO: HO-23746

RE: State Farm Florida Insurance Company  
Homeowners Program  
Rate Revision

Submitted on a file and use basis is a revision to the Homeowners Program for the State Farm Florida Insurance Company (hereafter "State Farm Florida"). Proposed changes vary by Form and Zone resulting in an overall average increase of 47.1%. The enclosed documentation supports a statewide indicated rate increase of 67.6%.

The attached exhibits illustrate actual Homeowners experience in Florida and projections of that experience. The details of and support for these changes are outlined in the attached Filing Memorandum and supporting exhibits. This filing is submitted to be effective December 1, 2008 for new business and March 1, 2009 for renewals.

#### BACKGROUND

State Farm Florida is the largest voluntary Homeowners insurance provider in the state. By market share, it is larger than the next four largest private carriers combined. State Farm Florida's financial position is projected to significantly deteriorate as supported by the rate indications for the Homeowners program included in this filing. While State Farm Florida earned approximately \$134 million in 2006 and \$108 million in 2007 in Net Income, the company has lost over \$550 million since inception. State Farm's non-automobile property and casualty lines in Florida have accumulated a net underwriting loss of \$6.2 billion since 1988 and over \$1.2 billion in just the last 10 years. Currently State Farm Florida limits its underwriting of new property insurance business in the state to only accommodate in-state transfers of business to inland locations. The company also announced plans to non-renew and exclude wind coverage (ex-wind) for policies in designated areas beginning with renewal effective dates of March 1, 2008 and continuing for one year. Even with these steps, further action is needed.

At present rate levels, the company soon will not have the financial capital to support the risks it has underwritten. Rates will need to rise and/or risk will need to further decrease in order to operate the company in a responsible manner. State Farm Florida recognizes that its customers have a need for both affordable and reliable property insurance coverage. State Farm Florida is also aware of the growing financial burden on Florida property insurance consumers. There is a need to balance the interests of the marketplace and State Farm Florida customers with the financial situation confronting State Farm Florida.

#### PREMIUM

A significant contributing factor to the indicated rate need is the June 1, 2007 state mandated doubling of the discounts in the Windstorm Mitigation Discount Plan. There has been a dramatic increase in the number of policyholders receiving these discounts caused by increased public awareness, the magnitude of the discounts, and the My Safe Florida Home program providing free inspections. The original analysis of the rate level impact was based on approximately 45,000 policyholders with wind mitigation discounts. As of March 31, 2008, over 250,000 Homeowner policyholders are receiving a discount, with thousands being added monthly, which is continuing to put upward pressure on the rate change indication. The data included in this filing reflects policies that have qualified for the wind mitigation discounts as of March 31, 2008. It is our contention that projecting further premium decline as more policies receive the discount would be appropriate. However, we have not done so based on our understanding of the OIR's position based on F.A.C 690-170.017(3) and the desire to expedite approval and implementation of this filing. The

dramatic increase to date in the number of policyholders receiving the discount, along with the magnitude of the discounts themselves, has resulted in premium levels well below the last approved rate filing.

The last annual base rate filing that was submitted and approved was the Office of Insurance Regulation in Florida (OIR) filing # 06-06279. This filing increased rates 52.7%, resulting in a projected premium per policy of \$2,154. Based on first quarter 2008 data, the projected premium per policy is now \$1,564 (see Exhibit 1), a decline of approximately 27%. Therefore, the 52.7% increase in premium was never fully realized. In total dollars, the projections for the total Homeowners written premium had been \$2.0 billion for 2007 after receiving approval of OIR filing #06-06279. However, the actual written premium for 2007 was \$1.5 billion. The primary cause of the reduction in premium per policy is from the increased magnitude and use of the wind mitigation discounts. The reduction in premium is not corresponding to a matching reduction in losses because most of the potential hurricane loss impacts had already been reflected in our model results. Additionally, State Farm Florida lowered rates by approximately 9% since OIR filing #06-06279 in response to required filings to reflect perceived savings of CS HB 1-A. We estimated the actual savings from CS HB 1-A to be much less than 9%.

#### HURRICANE LOSS COSTS

The calculation of the hurricane provision incorporates WORLDCAT™, RISKLINK™, and CLASIC™ /2 hurricane models that have been approved by the Florida Commission on Hurricane Loss Projection Methodology (Florida Hurricane Commission). Details of the provision are described in Exhibit 5. Additionally, the Catastrophe Model Support responses are included for each model as a trade secret document.

Expected hurricane loss costs are based on State Farm Florida's exposure at year end 2007 and have been adjusted to reflect two factors. First, the increased number of policies receiving Windstorm Mitigation Discount Plan credits (through March 31, 2008) has been contemplated. Further, all policies being non-renewed or ex-winded have been removed from the average annual loss estimates.

#### NET COST OF REINSURANCE

The rate change indication of +67.6% includes the net cost of reinsurance based on the actual costs up to the purchased \$9.25 billion of catastrophe reinsurance coverage (reflects our estimate of State Farm Florida's 1 in 250-year Probable Maximum Loss (PML)). It is our opinion that this level of reinsurance is needed to protect our policyholders in the State of Florida in case of a major hurricane event. Despite this, the cost of reinsurance and expected recoveries included in the submitted rate change is based on a level of reinsurance that is below what was actually purchased for the 2008-2009 contract year.

To meet what we understand to be OIR's rate filing review standards, and because of the urgent need to expedite approval and implementation of the filing, without waiver of our rights to contest OIR processes in the future, the 1 in 250 year PML estimate has been recalculated based on several adjustments. First, all of the planned non-renewals and ex-winded policies have been removed from the PML calculation even though many of those policies are and will still be in force during the 2008 hurricane season. Second, the estimated savings from the additional wind mitigation features for policies through first quarter 2008 have been included. Finally, models that have been approved by the Florida Hurricane Commission were utilized and include the long-term view of hurricane risk in Florida. The resulting PML is \$5.5 billion. We would be willing to amend the proposed change in our filing up to +67.6% as supported by our rate indications if our understanding of the OIR's filing review standards, with respect to any of these issues, is incorrect.

As shown in Exhibit 17, State Farm Mutual Automobile Insurance Company (State Farm Mutual) provides a significant portion of the reinsurance coverage for State Farm Florida, and provides that coverage at a rate significantly lower than the traditional reinsurance market rate. Not only are our State Farm Florida policyholders gaining vital protection, they receive the protection at a substantially lower cost than would be the case if all reinsurance was purchased in the external market. For example, as shown on Exhibit 17 - Page 4, the external market rate for that portion of the reinsurance provided by State Farm Mutual to cover just the \$5.5 billion PML limit is greater than the total amount charged by State Farm Mutual for its entire share of the reinsurance for the \$9.25 billion of coverage purchased by State Farm Florida. Therefore, in estimating the reinsurance costs for the \$5.5 billion of coverage, we have selected the lower of those two amounts in the calculation of the net cost of reinsurance for this filing. Exhibit 17 supports the net cost of reinsurance included in this filing, including detailed descriptions and calculations underlying this summary.

#### PROFIT AND CONTINGENCIES

The Calculation of Indicated Rate Level Adjustment, Exhibit 1, uses a 7.0% provision for Profit and Contingencies as developed in Exhibit 7, Total Financial Needs Analysis. This figure includes 5% for underwriting profit and 2% for contingencies. This profit and contingencies provision is submitted in compliance with Rule 690-170.003.

## RETAINED RISK

In addition to the Profit and Contingencies provision, a Retained Risk Provision of 9.0% has been included in the indicated rate change calculation. This is consistent with State Farm Florida's indicated change calculation included in OIR filing #06-06279. This additional return on the risk that State Farm Florida assumes is included in the rate of return calculation in Exhibit 7, and when combined with the underwriting profit provision of 5%, results in an expected total return on capital that is reasonable and not excessive and is clearly in line with the returns earned in other industries. See Exhibit 7 for detailed calculations.

## OIR RATE LEVEL INDICATIONS WORKBOOK

Accident year experience and indications are provided in Exhibit 9 as required by Florida Rule 69O-170.014. The workbook has been completed as required, and support for the data can be found in Exhibit 9. The indications calculated in the workbook are not aligned with the indications found in Exhibit 1 and Exhibit 10. The primary difference is the workbook uses historical premium levels for five years rather than projecting premium for the time period when these rates will be in effect. That methodology is clearly inappropriate in this case because it does not properly reflect the changing distribution of policies receiving wind mitigation discounts. Additionally, the Retained Risk Provision that is included in the indications from Exhibit 1 and Exhibit 10 is not reflected in the workbook.

## RATE CERTIFICATION

A signed and notarized copy of the Rate Certification Form (OIR B1-1790) is attached, including signatures from State Farm Florida CEO Jim Thompson and Chief Actuary Kathleen Pechan. This is in compliance with Florida Rule 69O-170.0155. It should be noted that the requested rate increase of 47.1% is a step toward rate adequacy, but is not believed to be sufficient to result in adequate rates. Thus neither this filing nor the certification should be construed as a representation or certification that the rates requested are adequate. As stated above, we would be willing to amend the proposed change in our filing up to +67.6% as supported by our rate indications if our understanding of the OIR's filing review standards, with respect to any of these issues, is incorrect.

We submit this filing to be effective December 1, 2008 for new business and March 1, 2009 for renewals.

In an effort to work with you as promptly as possible, please direct any questions to:

Kathy Popejoy	(309) 766-2325	kathy.popejoy.a0gq@statefarm.com
Adam Swope	(309) 766-2471	adam.swope.hdbi@statefarm.com

Please send paper correspondence to the attention of the State Filings Unit at the address shown above.

Sincerely,



Kathy Popejoy, F.C.A.S., MAAA  
Actuary and Assistant Secretary-Treasurer

JG/bl  
Attachment