STATEMENT OF JIM THOMPSON

PRESIDENT, STATE FARM FLORIDA

August 12, 2008

Introduction:

Good morning. My name is Jim Thompson. I have called Florida my home for almost 10 years during my career with State Farm, and currently serve as President of the State Farm Florida Insurance Company (State Farm Florida).

By Florida Law, one of my duties is to review certain rate filings and certify as to certain matters. I have done both of those things as to the filing we are discussing today.
The letter setting this hearing requires that the company produce persons who are able to answer questions that may be posed by representatives of the Office of Insurance Regulation (OIR) that are related to the filing.

We have done that, and in addition to myself, we have produced three other people who have more detailed knowledge of the filing. First to my right is Kathy Popejoy, who is the Assistant Vice President and Actuary, and Pricing Director with responsibility for homeowners insurance rate filings for Florida. Next to Kathy is Adam Swope, who is the pricing manager who directed preparation of the filing under Kathy's supervision. We also have Jeff McCarty who is Assistant Vice President and Actuary, and most knowledgeable as to the reinsurance costs that went into the filing.

It is our intention that I or these witnesses will be capable of answering questions from the OIR that are related to the rate filing before you. With your permission we would like to direct any questions to the person with the most knowledge, and others may contribute additional information.

We have all learned the sobering realities of how difficult it is to provide homeowners insurance in this beautiful state we call home. Mother Nature has made all of our lives difficult, and we cannot control the number or intensity of hurricanes that could make landfall this year or next year. It is our obligation as a private insurer to do all we can responsibly to provide for our policyholders.

The preservation of the financial strength of State Farm Florida relies heavily on reinsurance it purchases from three sources: the Florida Hurricane Catastrophe Fund (FHCF), the outside reinsurance market, and its parent company, State Farm Mutual. Through this combination of sources and surplus, State Farm Florida has over $9.2 billion of claims-paying capacity to cover policyholder losses should a major hurricane make landfall. No other private insurer in Florida provides protection anywhere near this level. The reinsurance purchased by State Farm Florida from its parent constitutes half, over $4.6 billion, of the $9.2 billion of claims-paying capacity. And as is typical in private reinsurance contracts, State Farm Mutual has committed to provide an additional $4.6 billion of reinsurance protection should the original limit be exhausted by a catastrophe during the 2008 hurricane season. The willingness of State Farm to expose this level of capital confirms the commitment State Farm Florida has to the Florida property insurance market. All of us here today understand the challenge facing Florida to attract the capital so vitally necessary to cover the hurricane exposure. The State's recent agreement with Berkshire Hathaway underscores the difficulty in bringing new risk capital to support this market.

The filing generally

I would like to start by describing the filing generally, and the reasons for it. As indicated in the filing letter, this filing proposes an average rate increase of 47.1%, to enhance our ability to pay claims, including claims when a catastrophe strikes. The filing will raise our rates to a level that is closer to covering our expected costs, and also help stem the severe decline in revenue. This decline is already causing underwriting losses, even without a hurricane, and undermining the financial strength of the Company.

We have seen our revenue fall dramatically in recent months due to inadequate premiums. Looking at the first six months of 2008, written premiums have fallen by 33% compared to the first six months of 2007. As a result, State Farm's average written premium per policy has fallen by over 21% since January 2007. This is exceedingly concerning and has caused an underwriting loss for the 2nd Quarter of 2008. In times of no catastrophic events, such as this past quarter, the Company should be setting funds aside to cover the losses from the inevitable catastrophes.

Though we have proposed 47.1%, an increase of over 60% is justified as the information provided in the filing demonstrates.

We seek your approval of the lesser amount even though we do not expect this to be adequate to cover all of our costs. We did this for two reasons: First, we need to increase our rates as soon as possible, something we cannot do without prior approval. Absent timely action on this filing, we're projecting that by next year, State Farm Florida's results will worsen to a net underwriting loss exceeding 100 percent—losses that will seriously compromise our company's financial condition. This projection is actually optimistic. It assumes no hurricanes—if storms hit, the financial condition of the Company will deteriorate more quickly and severely. Second, we regard this filing as a significant step toward rate adequacy.

Major Factors in our Rate need

State Farm Florida is, in many important respects, like any other business. It cannot continue to sell a product at below expected costs. Unfortunately, our current pricing is far below expected costs. More importantly, we need to be able to pay for hurricane losses when the winds blow. We can't let our net worth deteriorate to a point where our obligations to our policyholders cannot be met.

We also pledge to OIR and to our policyholders that any profits that might be earned by State Farm Florida will stay in Florida Company surplus, until used for future claims, expenses, or reinsurance, or as otherwise approved by the OIR. State Farm supported a law to that effect when it was enacted, and State Farm Florida has never paid any stockholder dividend to its parent.

There are many factors that contribute to our premium deficiency and need, but I want to highlight some of the biggest.

The first factor is the revenue loss we are experiencing when very large wind mitigation discounts are applied, without commensurate reduction of our actual exposure. This occurs because many wind mitigation features had already been considered in our prior loss cost projections, and in our prior average premiums. If necessary, Ms. Popejoy can provide more information about how this has occurred, and how it will continue to occur if not addressed by increasing our average rates.

The wind mitigation discounts, along with the mandated rate decreases we filed in 2007, had a significant impact on the amount we realized from our 2006 rate filing. While we received approval for a 52% increase, we actually realized less than half of that amount.

We needed the rate increase in 2006; our need is demonstrably greater now to help stabilize State Farm Florida's financial condition.

The second factor is the cost of reinsurance. State Farm Florida purchases the amount of reinsurance necessary to protect our policyholders. This reinsurance, together with the Florida Company's surplus, enables us to cover policyholder losses up to 9.2 BILLION dollars, equal to our 250 year Probable Maximum Loss (PML) from a single storm. Some may wonder why State Farm Florida needs to reinsure to a 1 in 250 year event. As I said, Jeff McCarty, who is responsible for reinsurance issues at State Farm, is here to answer questions about our reinsurance program, but I want to provide a brief, but very important, introduction to the issue here. The Company needs to be able to pay claims in the event of a large hurricane, or a series of large hurricanes in a single year. Past experience has made it clear that catastrophic hurricanes and multiple hurricanes in a single year can happen, and they must be planned for. In 1992, Hurricane Andrew struck our state as a class 5 hurricane causing over $ 15 billion in insured damage. In today's dollars, that's over $33 billion.

State Farm Fire and Casualty Company paid nearly $4 billion to its Florida customers for their property damages arising from Andrew. At the time, that exceeded the Fire and Casualty Company's entire net worth, which had been accumulated since its inception in 1935 from its earnings throughout the United States and Canada. Stated differently, in addition to causing the insolvency of several insurers that never recovered, in one day Hurricane Andrew depleted all of the earnings that had been accumulated for the protection of policyholders by the largest property insurer in the U.S. Without the financial support provided at that time by State Farm Mutual, the Fire & Casualty Company would have had to discontinue offering property insurance coverage to its customers not only in Florida, but also throughout the rest of the country, leaving millions of homeowners without coverage.

In 2004 and 2005, eight hurricanes caused property damage in Florida. State Farm Florida paid its customers over $4.2 billion because of the damage caused by these storms. While the Company had purchased reinsurance to help protect its customers, the losses in 2004 completely exhausted the Florida Company's surplus, and it had to seek support again from State Farm Mutual, in the form of a loan, so that it could continue to provide coverage for its customers. If the hurricanes of 2004 were repeated this year, State Farm Florida would have more than half of its current surplus wiped out, even with the reinsurance we have in place today. While in all likelihood State Farm Florida would still be able to pay claims, the company would need to secure additional capital to continue operations. As President of State Farm Florida, I cannot assure you that additional capital could be forthcoming from the parent company or any other source.

The Legislature correctly recognized the need for companies to adequately protect their customers through building sufficient capital and the purchase of reinsurance up to a 1 in 250 year event. This is wise public policy, reflected in both the rating law and the excess profits law. Florida property owners deserve this level of assurance.

In light of the fact that our present policyholder surplus is less than one tenth of our probable maximum loss, we must buy reinsurance in the amount we did to protect our policyholders. State Farm Florida cannot assess its policyholders after a catastrophe, which means it must have the capital immediately available to pay for a large hurricane, either in surplus or through reinsurance.

To secure adequate reinsurance, we bought all of the low cost reinsurance that we could from the Florida Hurricane Catastrophe Fund. All benefits of this lower rate and lower cost for this reinsurance are passed on to Florida Company policyholders in our filing. The remainder of State Farm Florida's reinsurance needs are met by purchasing some coverage from reliable reinsurers in the traditional worldwide reinsurance market, with the balance from its parent, State Farm Mutual. State Farm Mutual is the largest provider of reinsurance protection to its property affiliates, including State Farm Florida. It does this at a substantially lower price than what could be obtained from the external reinsurance market.

If State Farm Florida had sought to place this balance w/other reinsurers it would cost State Farm Florida <u>**in excess of a half a billion dollars, about $500 per policyholder, more**</u> than the purchase price from State Farm Mutual

In summary, we believe that the 47.1% that we have requested is needed if we are going to be able to stand behind our promises and to provide a market for homeowners insurance in Florida. It is fully substantiated by the information in the rate filing. State Farm Florida's mission is to meet its obligations to its property policyholders. This increase is critical to carrying out that mission.

I or other members of our panel will be happy to answer your questions about this filing. Thank you for your attention.