The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Committee on Banking and Insurance

BILL: SB 482

INTRODUCER: Senator Hays

SUBJECT: Florida Hurricane Catastrophe Fund

DATE: March 24, 2014 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Stearns	Yeatman	CA	**Favorable**
2.	Matiyow	Knudson	BI	**Pre-meeting**
3.			AP	

I. Summary:

SB 482 reduces the Florida Hurricane Catastrophe Fund (Cat Fund) coverage limits and allows insurers to recoup through their property insurance premiums specified reinsurance premiums paid by insurers to the Cat Fund. The bill is designed to reduce the overall financial obligations of the fund, reducing the likelihood and amount of bonding and emergency assessments needed to fund deficits in the event the fund experiences a shortfall after a major hurricane.

The bill amends s. 215.555(4)(c)1, F.S., to phase in decreases of $1 billion per year to the $17 billion Cat Fund mandatory coverage limit beginning in the 2015-2016 contract year until the 2017-2018 contract year, when the limit will have been reduced to $14 billion. Thereafter, the bill provides a mechanism for the board to determine if the claims-paying capacity of the fund will exceed $14 billion.

The bill also amends s. 627.062(5), F.S., to allow insurers to recoup reinsurance premiums paid to the Cat Fund and purchased solely to cover a potential gap between the maximum statutory obligation of the fund as specified in s. 215.555(4)(c), F.S., and the fund's claims-paying capacity estimate. The bill also deletes a prohibition against insurers recouping reinsurance costs that duplicate coverage provided by the Cat Fund.

II. Present Situation:

The Florida Hurricane Catastrophe Fund (Cat Fund)

The Cat Fund is a tax-exempt fund created in 1993 after Hurricane Andrew as a form of mandatory reinsurance for residential property insurers. The Cat Fund is administered by the State Board of Administration (SBA) and is a tax-exempt source of reimbursement to property insurers for a selected percentage (45, 75, or 90 percent) of hurricane losses above the insurer's retention (deductible). The Cat Fund provides insurers an additional source of reinsurance that is significantly less expensive than what is available in the private market, enabling insurers to generally write more residential property insurance in the state than would otherwise be written. Because of the low cost of coverage from the Cat Fund, the fund acts to lower residential property insurance premiums for consumers. The Cat Fund must charge insurers the actuarially indicated premium for the coverage provided, based on hurricane loss projection models found acceptable by the Florida Commission on Hurricane Loss Projection Methodology.

Cat Fund Mandatory Coverage

All insurers that write residential property insurance in Florida are required to buy reimbursement coverage (reinsurance) on their residential property exposure through the Cat Fund. The Cat Fund is authorized by statute to sell $17 billion of mandatory layer coverage. Each insurer that purchases coverage may receive up to its proportional share of the $17 billion mandatory layer of coverage based upon the insurer's share of the actual premium paid for the contract year, multiplied by the claims paying capacity of the fund. For example, if an insurer paid 10 percent of the total premium paid in a contract-year, then that insurer would be eligible to receive up to 10 percent of the mandatory layer of coverage ($1.7 billion of the $17 billion mandatory layer).

To access the Cat Fund an insurer must have incurred losses above the retention levels calculated and set by statute. Insurers that experience multiple hurricanes causing losses during the contract year may receive reimbursement from the Cat Fund for losses that exceed the applicable retention. The insurer's full retention is applied to each hurricane causing the two largest losses for that insurer. For each other covered event resulting in losses, the insurer's retention is only one-third of the full retention. . Citizens Property Insurance Corporation is the largest purchaser of Cat Fund coverage.

Cat Fund Premiums

The Cat Fund must charge insurers the "actuarially indicated" premium for the coverage provided, based on hurricane loss projection models found acceptable by the Florida Commission on Hurricane Loss Projection Methodology. The "actuarially indicated" premium is an amount that is adequate to pay current and future obligations and expenses of the fund. In practice, each insurer pays the Cat Fund annual reimbursement premiums that are proportionate to each insurer's share of the Cat Fund's risk exposure. The cost of Cat Fund coverage is significantly lower than the cost of private reinsurance due to the fact that the fund is a tax-exempt non-profit corporation and does not charge a "risk load."

Cat Fund Claims-Paying Resources

The Cat Fund cash balance at year-end 2014 is estimated to be $11.010 billion.[1] The proceeds from the 2013 $2 billion pre-event bond issue provide additional liquidity.[2] Obligations exceeding the cash balance of the Cat Fund would require bonding of up to $5.236 billion.[3] The assessment base for the Cat Fund is approximately $36.185 billion for premiums written at year end 2012,[4] enabling the Cat Fund to levy annual assessments of as much as $2.171 billion for one contract year and $3.619 billion for multiple contract years.[5]

Cat Fund Bonding and Assessment Authority

Reimbursements to insurers for losses above the current cash balance of the fund are financed through bonding. When the cash balance of the Cat Fund is insufficient to cover losses, the law authorizes the Cat Fund to issue revenue bonds, which are funded by emergency assessments on property and casualty policyholders. If a large storm triggered the full capacity of the Cat Fund, this season bond issues totaling over $5 billion could be necessary for the fund to meet its maximum obligations.

Bonds would be funded by an emergency assessment of up to 6 percent of premium on most lines of property and casualty insurance for funding losses from a single year, and up to 10 percent of premium for funding losses from multiple years. All lines of property and casualty insurance, including surplus lines insurance, are subject to emergency assessment except for workers' compensation and medical malpractice liability insurance. The Cat Fund's broad-based assessment authority is one of the reasons the Cat Fund was able to obtain an exemption from federal taxation from the Internal Revenue Service as an integral part of state government.

Cat Fund Claims-Paying Capacity Estimates

In May and October of each contract year, the SBA is required to publish in the Florida Administrative Weekly a statement of the fund's estimated borrowing capacity, the fund's estimated claims-paying capacity, and the projected balance of the fund as of December 31, 2013.[6] After the end of each calendar year, the board is required to notify insurers of the estimated borrowing capacity, estimated claims-paying capacity, and the balance of the fund as of December 31 to provide insurers with data necessary to assist them in determining their retention and projected payout from the fund for loss reimbursement purposes.

The October 15, 2013, Claims-Paying Capacity Estimate (Estimate) is the most recent such report to be issued.[7] The report, prepared by Raymond James, evaluated the Cat Fund's bonding

---

[1] Florida Hurricane Catastrophe Fund, Annual Report of Aggregate Net Probable Maximum Losses, Financing Options, and Potential assessments, (February 2014).
[2] State Board of Administration, Florida Hurricane Catastrophe Fund, *FHCF Claims-Paying Capacity Estimates*, 2 (October 15, 2013), *available at* http://www.sbafla.com/fhcf/LinkClick.aspx?fileticket=gFTzX4lQxpA%3d&tabid=1412&mid=4266 (last visited Jan. 14, 2014).*Id.*
[3] *Id.*
[4] *Id.* at 4.
[5] *Id.*
[6] Section 215.555(4)(c)(2), F.S.
[7] The first Claims Paying Capacity Estimate for the 2014-2015 hurricane season is due to be published in May 2014.

capacity by analyzing the current financial markets and obtaining written feedback from a senior managing underwriter from four large financial services firms (Barclay's, Citi, Goldman Sachs, and J.P. Morgan).

Bonding capacity (the estimated dollar amount of bonds that could be successfully issued) for a 12-month period is estimated to be $6.1 billion, with an additional $5.7 billion of capacity estimated for months 13-24.[8] These amounts are in excess of the maximum amount of bonding that could have been needed for the 2013-2014 contract year. Claims-paying resources for the 2014-2015 contract year will include these amounts plus additional reimbursement premium revenues of approximately $1.3 billion.[9]

III. Effect of Proposed Changes:

Section 1 amends s. 215.555(4)(c)1, F.S., by reducing the Florida Hurricane Catastrophe Fund coverage limits. The bill phases in annual decreases of the $17 billion Cat Fund mandatory coverage limit beginning in the 2015-2016 contract year as follows:

- For the 2015-2016 contract year, $16 billion;
- For the 2016-2017 contract year, $15 billion;
- For the 2017-2018 contract year, $14 billion; and
- For the contract years after the 2017-2018 contract year, $14 billion. However if the board determines the estimated claims-paying capacity of the fund will exceed $14 billion for the current contract year and an additional $14 billion for the following year, the claims-paying capacity for the current year is to be determined by adding to the $14 billion one-half of the fund's estimated claims-paying capacity in excess of $28 billion for the current year and the subsequent year.

Section 2 amends s. 627.062(5), F.S., to allow insurers to recoup reinsurance premiums paid to the Cat Fund and purchased solely to cover a potential gap between the maximum statutory obligation of the fund as specified in s. 215.555(4)(c), F.S., and the fund's claims-paying capacity estimate. The bill also deletes a prohibition against insurers recouping reinsurance costs that duplicate coverage provided by the Cat Fund.

Section 3 provides an effective date of July 1, 2014.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

---

[8] *Claims-Paying Capacity Estimates* at 11.

[9] The precise amount of reimbursement premium will not be determined until after the FHCF premium formula is adopted by the SBA Trustees under s. 215.555(5), F.S., and 2014 exposure reports are received from insurers.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

According to the analysis performed by the staff of the Florida Hurricane Catastrophe Fund (FHCF), by lowering coverage limits, the bill will reduce the fund's potential reliance on bonding backed by assessments, which will, among other things, reduce the fund's potential impact on non-residential-property policyholders. This action will also reduce the impact of volatile bond market conditions on the ability of the FHCF to fully fund its maximum obligation, thereby providing additional stability in the insurance marketplace. In addition, the reduction in the limit will improve the FHCF's ability to provide coverage for subsequent storm seasons after a major event.

The bill will reduce the coverage provided by the fund, and the premiums collected by the fund will be reduced to reflect the reduction in coverage limits. It is presumed that most insurers will procure additional reinsurance to offset the reduction in FHCF limits, and that private insurers will seek to recoup their additional reinsurance costs in the premiums they charge consumers, but not necessarily Citizens Property Insurance Corporation. Citizens is not required to purchase reinsurance that guarantees the corporation's ability to pay all claims stemming from a 1 in 100 year probable maximum loss storm, a benchmark that most private market insurers meet in their reinsurance programs. Representatives of some insurers and consumer advocates have asserted that reductions in Cat Fund size resulting in private market premium increases may hinder the depopulation of Citizens by increasing the disparity between rates charged by Citizens and private market insurers. However, property catastrophe reinsurance pricing for Florida risks has declined significantly in the last several years, and current reports indicate that this trend is expected to continue with respect to the 2014 hurricane season.

Representatives of some business groups have voiced support in the past for reducing the Cat Fund's capacity because this change will reduce the likelihood that the Cat Fund will be required to levy assessments on all property and casualty lines of business (except workers' compensation and medical malpractice liability insurance). Many of these business groups view these assessments as a "tax" on other lines of insurance (such as motor vehicle insurance) that subsidizes the residential property insurance market.

C. Government Sector Impact:

The bill reduces the assessment liability of the Cat Fund, which decreases the probability that the fund will be required to issue bonds to meet its financial obligations. Supporters of similar legislation in the past noted that the Cat Fund is not the only insurance-related state entity granted assessment authority. Citizens and the Florida Insurance Guaranty Association (FIGA) each have statutory authority to issue bond debt to meet obligations incurred in the event a major hurricane exhausts the financial resources of each entity. Reducing the likelihood of Cat Fund bonding and assessments will assist Citizens and FIGA in being able to raise funds from bond issues because Cat Fund bonds will be less likely to be in competition for investors in the event of a storm.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Statutes Affected:

This bill substantially amends the following sections of the Florida Statutes: 215.555, 627.062.

IX. Additional Information:

A. Committee Substitute – Statement of Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

B. Amendments:

None.