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HOUSE OF REPRESENTATIVES
COMMITTEE ON
INSURANCE
ANALYSIS

BILL #: HB 1133

RELATING TO: Collateral Protection Insurance

SPONSOR(S): Representative(s) Mealor

TIED BILL(S): None

ORIGINATING COMMITTEE(S)/COUNCIL(S)/COMMITTEE(S) OF REFERENCE:

(1) INSURANCE YEAS 12 NAYS 0
(2) COUNCIL FOR COMPETITIVE COMMERCE
(3) FISCAL RESPONSIBILITY COUNCIL
(4)
(5)

I. SUMMARY:

In 1993, the Legislature created the Florida Hurricane Catastrophe Fund (Cat Fund). It is administered by the State Board of Administration.

The Cat Fund provides the equivalent of reinsurance to Florida insurers transacting residential property insurance. All insurers writing residential property insurance in Florida must enter into reimbursement contracts with the Cat Fund as a condition of doing business in this state. Under these contracts, insurers pay a premium to the Cat Fund and are reimbursed based on their reimbursement percentage when losses exceed the insurer's retention.

Until 1999, those insurers writing collateral protection insurance were required to participate in the Cat Fund. Collateral protection insurance covers the interest of a creditor arising out of a credit transaction secured by real or personal property.

In 1999, the Legislature enacted legislation stating that collateral protection insurance is not "residential" coverage. As a result, the Cat Fund is not required to enter into reimbursement contracts to cover collateral protection insurance policies and insurers have not been required to purchase coverage for these policies.

This bill would require the Cat Fund to enter into reimbursement contracts with insurers to cover collateral protection insurance policies and require insurers writing these policies to purchase Cat Fund coverage as a condition of doing business in Florida. It would remain classified as not being residential coverage, except for purposes of securing Cat Fund coverage.

On February 25, 2002, the Committee on Insurance adopted two amendments. The first amendment qualified the type of collateral protection plan that would be required to participate in the Cat Fund, and the second amendment removed redundant language from the bill. These amendments are traveling with the bill. See section VI, Amendments or Committee Substitute Changes.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

1. Less Government Yes [] No [X] N/A []

The Cat Fund would be required to enter into reimbursement contracts with insurers writing collateral protection insurance and require collateral protection insurers to participate in the Catastrophe Fund as a condition of doing business in this state.

2. Lower Taxes Yes [] No [] N/A [X]

3. Individual Freedom Yes [] No [] N/A [X]

4. Personal Responsibility Yes [] No [] N/A [X]

5. Family Empowerment Yes [] No [] N/A [X]

B. PRESENT SITUATION:

The Florida Hurricane Catastrophe Fund

In 1993, the Legislature created the Florida Hurricane Catastrophe Fund (Cat Fund).[1] It was established to create additional reinsurance capacity, safeguard the public against insufficient catastrophic protection, and protect the state's residents and economy from the dangers of a shrinking private sector reinsurance market. The Cat Fund provides the equivalent of reinsurance to personal and commercial residential insurers in Florida. The State Board of Administration (the board) administers the Cat Fund.

All insurers writing "covered policies" in Florida are required to enter into reimbursement contracts with the Cat Fund. Covered policies include:

> any insurance policy covering residential property in this state, *including, but not limited to*, any homeowner's, mobile home owner's, farm owner's condominium association, condominium unit owner's, tenant's, or apartment building policy, or any other policy covering a residential structure or its contents issued by any authorized insurer, including any joint underwriting association or similar entity created pursuant to law.[2]

According to the Cat Fund, the cost of reinsurance through the Fund generally has been less than one-half of the cost of private reinsurance for similar coverage.[3]

Data from the Cat Fund indicates that 259 insurers have contracts with the Cat Fund, representing and estimated $900 billion in total exposure. In exchange for payment of an actuarially indicated premium, the Cat Fund reimburses insurers for a selected percentage (45, 75, or 90 percent) of

[1] Section 215.555, F.S.
[2] Section 215.555(2)(c), F.S. Emphasis added.
[3] This statistic is contingent on the layer of reinsurance referenced. The private reinsurance market usually has several levels of costs.

hurricane losses in excess of a specified amount, known as the insurer's retention. Retention is defined as the amount of an insurer's losses for which the insurer is solely responsible.[4]

Collateral Protection Insurance

Collateral protection insurance is sold to lending institutions for the purposes of insuring the lending institution's interest in real or personal property. When a borrower fails to secure or maintain insurance on a property, even when required to do so by contract, collateral protection insurance automatically insures the lender's interest in the property. Properties covered under collateral protection insurance are covered under a basic policy, regardless of the location or condition of the property. This type of insurance is generally more expensive than conventional insurance, and it is not marketed or made available to individuals.

In 1999, the Legislature enacted legislation stating that collateral protection insurance is not "residential" coverage, defining collateral protection insurance as:

> commercial property insurance of which a creditor is the primary beneficiary and policy holder and which protects or covers an interest of the creditor arising out of a credit transaction secured by real or personal property . . . . *(C)ollateral protection insurance is not residential coverage*.[5]

Because the Cat Fund covers only residential policies covering residential property in this state, and collateral protection insurance is defined as not being residential coverage, the Cat Fund is not required to enter into reimbursement contracts to cover collateral protection insurance policies and insurers have not been required to purchase coverage for these policies.

In 1998, when they were required to participate in the Cat Fund, the nine insurers writing collateral protection insurance paid an estimated $3.35 million in the aggregate in premiums to the Cat Fund. After the Legislature excluded collateral protection insurance policies, these same nine insurers paid the Cat Fund $1.48 million.[6]

C. EFFECT OF PROPOSED CHANGES:

This bill would require the Cat Fund to enter into reimbursement contracts with insurers writing collateral protection insurance and require these insurers to purchase Cat Fund coverage as a condition of doing business in Florida. Collateral protection would remain classified as not being residential coverage, except for purposes of securing Cat Fund coverage. This would mean "residential coverage" for purposes of the Cat Fund would now include the interest a financial institution has in real or personal property of any kind, including real property owned by a commercial entity.

Collateral protection insurers would be required to enter reimbursement contracts with the Cat Fund for losses in excess of the determined retention, and would also be required to pay an actuarially determined premium to the Cat Fund.

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[4] Retention is calculated by dividing the total adjusted retention for all insurers by the anticipated premiums collected by the insurers with the same reimbursement percentage. The result is then multiplied by the premium paid to the Cat Fund.
[5] Sections 215.555, 627.311 and 627.351, F.S.
[6] The Cat Fund has been unable to determine if the decrease resulted from the exclusion of collateral protection insurance, primarily because premiums are based on the total exposure of the insurance company, without regard to the particular lines of insurance offered.

According to the Cat Fund, it is unlikely the Cat Fund will experience a large increase in exposure, because the properties insured will only be covered by collateral protection insurance as a last resort.

D. SECTION-BY-SECTION ANALYSIS:

This section need be completed only in the discretion of the Committee.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

Insurers writing collateral protection insurance would be required to contract with the Cat Fund for coverage in excess of retention, and as a result pay actuarially determined premiums into the Cat Fund.

2. Expenditures:

The Cat Fund would be required to reimburse collateral protection insurers experiencing losses in excess of their retention.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Insurers writing collateral protection insurance should enjoy lower reinsurance costs for the amount of reinsurance cover procured through the Cat Fund. When the insurance market softens, savings should continue to be realized, although to a lesser degree.

D. FISCAL COMMENTS:

N/A

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

The bill does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that municipalities or counties have to raise revenue in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of state tax shared with counties or municipalities.

V. <u>COMMENTS</u>:

A. CONSTITUTIONAL ISSUES:

N/A

B. RULE-MAKING AUTHORITY:

N/A

C. OTHER COMMENTS:

As drafted, in the same section of Florida Statutes, collateral protection insurance would be considered residential coverage in one context but expressly not residential coverage in another.

VI. <u>AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES</u>:

On February 25, 2002, the Committee on Insurance reported the bill favorably and adopted two amendments that made the following changes:

<u>Amendment 1 by the Committee on Insurance (page 1, line 20)</u>: The amendment limited the proposed inclusion of collateral protection insurance policies as a “covered policy” for purposes of the Florida Hurricane Catastrophe Fund to a collateral protection policy as it applies to “personal residences.”

[*For example, as opposed to commercial nonresidential policies.*]

<u>Amendment 2 by the Committee on Insurance (page 2, lines 19 through 21)</u>: The amendment removed a proposed redundant characterization of a collateral protection insurance policy as a “covered policy” under the Florida Hurricane Catastrophe Fund.

[*The proposed revision to the definition of “covered policy” in another part of the bill would include collateral protection insurance.*]

These amendments are traveling with the bill.

VII. SIGNATURES:

COMMITTEE ON INSURANCE:

Prepared by:	Staff Director:
Katherine Scott	Stephen Hogge