SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

BILL: CS/SB 2232

SPONSOR: Banking and Insurance Committee and Senator Peaden

SUBJECT: Collateral Protection Insurance

DATE: March 4, 2002 REVISED: ________ ________ ________ ________

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Emrich	Deffenbaugh	BI	Favorable/CS
2.			AGG	
3.			AP	
4.				
5.				
6.				

I. Summary:

The Florida Hurricane Catastrophe Fund ("Cat Fund") was created in 1993 after Hurricane Andrew to stabilize the Florida property insurance market by providing the equivalent of reinsurance to all insurers writing "residential" property insurance coverage in Florida. It is a state trust fund administered by the State Board of Administration (SBA). The Cat Fund provides coverage in exchange for actuarially-indicated premiums paid by insurers, and has the power to issue bonds backed by assessments on all property and casualty insurance policies (except for workers' compensation policies) when cash balances are insufficient to pay covered claims.

Until 1999, a form of insurance known as collateral protection insurance was covered by the Cat Fund, and insurers writing this type of insurance were required to participate in the Fund. Collateral protection insurance covers the interest of a creditor arising out of a credit transaction secured by real or personal property, if the borrower allows his or her coverage to lapse. According to representatives of insurers, collateral protection policies are *all* dual-interest policies (protecting both the financial institution and the borrower) because of federal regulations which do not allow the sale of single-interest policies on the secondary market.

In 1999, the Legislature enacted legislation stating that collateral protection insurance was *not* "residential" coverage. As a result, the Cat Fund did not cover losses attributable to collateral protection insurance policies and insurers were not required to purchase coverage for these policies.

Committee Substitute for Senate Bill 2232 would provide that personal residential losses under collateral protection policies would be termed "covered policies" under the Cat Fund and would require insurers writing these policies to purchase Cat Fund coverage as a condition of doing

business in Florida. Collateral protection insurance would remain classified as not being residential coverage, except for purposes of securing Cat Fund coverage.

This bill substantially amends section 215.555, Florida Statutes.

II. Present Situation:

The Florida Hurricane Catastrophe Fund (Cat Fund)

The Florida Hurricane Catastrophe Fund (Cat Fund), created in 1993 following Hurricane Andrew, is a tax exempt state trust fund administered by the State Board of Administration (SBA) that reimburses insurers for a portion of their hurricane losses in the state.[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.

Each insurance company that writes a "covered policy," i.e., residential property insurance, in Florida must enter into a contract with the SBA each year to purchase reimbursement coverage from the Cat Fund. Covered policies include:

> "any insurance policy covering residential property in the 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."

Accordingly, if an insurance policy does not cover residential property, it is not a "covered policy" and is not eligible to obtain reinsurance through the Cat Fund.

Representatives with the Cat Fund state that the cost of reinsurance through the Fund generally has been less than one-half of the cost of private reinsurance for similar coverage. Data from the Cat Fund indicates that 259 insurers currently have contracts with the Cat Fund, representing an estimated $900 billion in total exposure. In exchange for payment of an actuarially indicated premium, the Cat Fund reimburses insurers for a selected percentage at 45, 75, or 90 percent of the insurer's 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.

Collateral Protection Insurance and the Florida Hurricane Catastrophe Fund

Banks and other financial institutions typically purchase "collateral protection insurance" to insure their interest in property secured by mortgages they issue. It is typically sold under a blanket policy to lending institutions and 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

[1] S. 215.555, F.S.

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.

Prior to 1999, the Cat Fund *included* coverage for "dual-interest" collateral protection insurance, which protects the creditor as well as the property owner.[2] However, the Cat Fund *excluded* collateral protection insurance as a covered exposure when the underlying policy protected only the interest of the financial institution, known as "single-interest" insurance.[3] That exemption applied when the underlying policy protected *only* the interest of the financial institution. Legislation enacted in 1999 excluded collateral protection insurance from the Cat Fund by defining such coverage as "not residential" coverage.[4] Collateral protection insurance was thus defined 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."

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.

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.

III. Effect of Proposed Changes:

This bill would require the Cat Fund to enter into reimbursement contracts with insurers writing collateral protection insurance policies for personal residences 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 coverage for purposes of the Cat Fund would now include the interest a creditor (financial institution) has in personal residential property. According to representatives of insurers (which the department was not able to confirm or deny), collateral protection policies are *all* dual-interest policies (protecting both the financial institution and the borrower) because of federal regulations which do not allow the sale of single-interest policies on the secondary market.

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[2] Under a contract adopted by SBA rule. In general, dual-interest collateral protection insurance policies cover the replacement value of the home, but not usually personal effects or additional living expenses (ALE).
[3] Vendor's single-interest collateral protection insurance policies cover just the balance of the loan.
[4] Ch. 99-237, L.O.F., s. 627.351, F.S.

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

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, i.e., when the policies lapses. Also, residential structures under such properties are already covered by the Cat Fund's contract with the original insurer (prior to policy lapse).

A section by section summary is featured below:

Section 1. Amends s. 215.555, F.S., relating to the Florida Hurricane Catastrophe Fund, to include "collateral protection insurance policies as applied to personal residences" within the definition of "covered policies" under the Fund. The effect of this bill would be to require the Fund to enter into reimbursement contracts with insurers writing collateral protection insurance for personal residences and to require these insurers to purchase Fund coverage as a condition of doing business in Florida.

The effect of this bill is to allow collateral protection insurance to remain classified as commercial (and not residential) coverage, *except* for purposes of securing personal residential coverage under the Florida Hurricane Catastrophe Fund. This would allow collateral protection insurers to secure reinsurance from the Fund at a much cheaper rate than they would be able to obtain in the private market.

According to representatives with 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.

Section 2. Provides that the act will take effect on July 1, 2002.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Under this bill, collateral protection insurers writing coverages for personal residences would be required to contract with the Florida Hurricane Catastrophe Fund for coverage in excess of retention, and as a result pay actuarially determined premiums into the Cat Fund. In turn, the Cat Fund would be required to reimburse such insurers experiencing personal residential losses due to hurricane damage in excess of their retention. As a result, these insurers would enjoy paying much lower reinsurance premiums for the amount of reinsurance coverage procured through the Cat Fund, than in the private market. Representatives with the Cat Fund state that the cost of reinsurance through the Fund generally has been less than one-half of the cost of private reinsurance for similar coverage. Also, under current practice, collateral protection insurers pass these higher reinsurance costs on to lending institutions through premiums and then to the borrower (homeowner) through increased mortgage payments.

According to representatives with the Department of Insurance, the Cat Fund was designed to provide protection to Florida's homeowners by providing "residential coverage," i.e., protection for homes, condominiums, apartment buildings, while collateral protection insurance is *not residential coverage* and protects a creditor, i.e., a commercial bank, savings and loan, credit union, mortgage company, etc. These representatives state that in the event of a Cat Fund assessment after a catastrophe, the effect of this bill would be to assess all Florida homeowners for the losses of commercial creditors. In the event of a catastrophic storm that reached the statutory limit of $11 billion[5] for any one storm event, fewer dollars would be available to pay a homeowner's claims since a portion of the total payment would be used to pay claims for commercial coverage (the collateral protection insurance losses). However, according to representatives of insurers (which the department was not able to confirm or deny), collateral protection policies are *all* dual-interest policies (protecting both the financial institution and the borrower) because of federal regulations which do not allow the sale of single-interest policies on the secondary market.

C. Government Sector Impact:

According to representatives with the Cat Fund, it is unlikely the Fund will experience a large increase in exposure, because the properties insured would only be covered by collateral protection insurance as a last resort, i.e., when the homeowner's insurance policy lapses.

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[5] In 1999, the Legislature limited the claims-paying capacity of the Cat Fund to $11 billion in any one year making funds available for losses for more than one season (Ch. 99-217, L.O.F., s. 215.555, F.S.).

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Amendments:

None.