HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 1353 Florida Hurricane Catastrophe Fund
SPONSOR(S): Waters, Bullard
TIED BILLS: **IDEN./SIM. BILLS:** SB 2556

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) Insurance Regulation (Sub)	9Y,0N	Cheek	Schulte
2) Insurance		Cheek	Schulte
3) Finance & Tax			
4) Appropriations			
5)			

SUMMARY ANALYSIS

The Florida Hurricane Catastrophe Fund ("Cat Fund") was created 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 excess losses due to hurricanes. The Cat Fund derives its revenue from actuarially determined "reimbursement premiums" paid by insurers, and has the ability to levy assessments against all property/casualty insurance premiums (other than workers' compensation) when reimbursement premiums and other fund resources are insufficient to cover the fund's obligations. Assessments are capped at 4 percent of premium with respect to losses from any one storm season and an absolute maximum of 6 percent of premium. Payouts are capped at $11 billion with respect to losses from any one storm season, with provision for a higher cap after the fund is capable of paying $22 billion to cover losses from two storm seasons. This bill:

Expands the capacity of the Cat Fund by increasing both the initial and subsequent season coverage limit to grow with Cat Fund exposure growth (values of insured property). The bill also funds the extra capacity by increasing the amount of emergency assessments. The bill increases these amounts to 5 percent for any one year and 8 percent for all years.

Includes surplus lines policies in the Cat Fund assessment base by extending the Cat Fund assessment base to include surplus lines. The assessments would be made on surplus lines policyholders and collected by the Florida Surplus Lines Service Office to be remitted as directed by the Cat Fund.

Clarifies "prior fiscal year,**"** related to the use of investment income for hurricane mitigation funding, by basing the investment income, which is available for mitigation appropriations, on the most recent fiscal year-end audited financial statements.

Increases the exposure limit from $500,000 to $3 million for allowing insurers to be exempt from the Cat Fund.

Broadens the selection of reinsurers from which the Cat Fund may purchase reinsurance by allowing the purchase of reinsurance from reinsurers acceptable to the Office of Insurance Regulation rather than being limited to the purchase of reinsurance from a reinsurer approved under s. 624.610, F.S.

Provides specific rulemaking authority to address the need to exclude certain covered policies that require individual ratemaking. The bill also provides specific rulemaking authority to allow for the charging of interest on late remittances.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. DOES THE BILL:

1. Reduce government?	Yes[]	No[]	N/A[x]
2. Lower taxes?	Yes[]	No[]	N/A[x]
3. Expand individual freedom?	Yes[]	No[]	N/A[x]
4. Increase personal responsibility?	Yes[]	No[]	N/A[x]
5. Empower families?	Yes[]	No[]	N/A[x]

For any principle that received a "no" above, please explain:

B. EFFECT OF PROPOSED CHANGES:

Importance of the Florida Hurricane Catastrophe Fund

Following Hurricane Andrew, residential property insurers began to re-evaluate their commitment to the Florida market due to their concentrations of exposures (insured values) and in light of the fact that there were major difficulties obtaining private reinsurance. The Florida Hurricane Catastrophe Fund (Cat Fund) was created in a Special Legislative Session in November 1993 in the aftermath of Hurricane Andrew to provide additional reinsurance capacity that enables insurers to continue writing business in the state. A moratorium, which limited insurers withdrawal from the state, was also put into effect around this time period.

The Cat Fund has been important in helping insurers meet their responsibilities to pay losses of Florida residential policyholders in the event of a catastrophic hurricane hitting Florida. If an insurer writes residential property insurance in Florida, it is mandatory that it participate in the Cat Fund.

The Cat Fund provides reinsurance coverage for insurers at stable, affordable prices. It is estimated that coverage purchased through the Cat Fund costs insurers between one-quarter to one-third what it would cost in the private market.

The Cat Fund is financed by three sources: (1) reimbursement premiums charged to participating insurers based on their wind exposure, (2) investment earnings, and (3) emergency assessments on Florida property and casualty insurance premiums (excluding worker's compensation writers). Emergency assessments have never been levied, but would be required in situations where the other resources of the fund are insufficient to reimburse losses to insurers. The cash balance of the Cat Fund is projected to exceed $5 billion during the next hurricane season. Under two Internal Revenue Service private letter rulings, income of the Cat Fund is exempt from federal income taxation and its bonds will be issued on a tax-free basis.

The Cat Fund is administered by the Florida State Board of Administration (SBA), which is composed of the Governor, the Chief Financial Officer, and the Attorney General. The Cat Fund's credit rating is A1/A+/A+ with Moody's, S&P, and Fitch.

Major Changes from Current Law

Expanding Capacity of the Cat Fund

The bill addresses the long-term needs of the residential property insurance marketplace by expanding the Cat Fund's coverage such that capacity increases with the growth of insured values in the state. According to the SBA, benefits provided to insurers have eroded over the last several years, and there is a need to maintain the Cat Fund's reinsurance market share to keep up with the growing needs of the state. This requires that initial season capacity not only be maintained in proportion to insured value growth in the state, but that subsequent season capacity be expanded and maintained as well.

During the 1999 Legislative Session, Cat Fund coverage was expanded to create subsequent season capacity. If the Cat Fund's capacity is wiped out, subsequent season capacity operates to recharge the Cat Fund. Without subsequent season capacity, insurers may need to replace $11 billion of Cat Fund coverage with private reinsurance after a major hurricane event. According to the SBA, this could be very disruptive to the market, because Cat Fund coverage is much less expensive than private reinsurance. Since the cost of reinsurance is passed on to the policyholder, the ultimate impact on the Florida policyholder could be dramatic. Also, private reinsurance may not be available following a large event. The private reinsurance market can be highly volatile and is influenced by world events outside of Florida such as terrorism, earthquakes, and other man-made and natural events.

Although the 1999 Cat Fund legislation provided for subsequent season coverage, it did not go quite far enough in providing "full replacement" for the initial season's capacity. The population of Florida is projected to grow by about 3 million people during the next 10 years. Since 1995, the Cat Fund reported exposure has grown by 47 percent. Over $1 trillion of insured values are now being reported to the Cat Fund. Currently, the growth of the Cat Fund capacity (coverage) is not designed to increase with the growth of insured values, but rather is highly dependent upon the level of interest rates, which tend to fluctuate from year to year. The ability to fully recharge the capacity is also limited under current law to $11 billion. There is a need for the Cat Fund to be structured so that capacity grows with exposure growth in the state and in such a way that there is enough subsequent season capacity to fully recharge the Cat Fund in order to stabilize the market following a major hurricane event that wipes out the Cat Fund. This will require an increase in the potential assessment authority, but such increase is basically required to strengthen subsequent season capacity. Under current law, the emergency assessment authority allows for up to 4 percent to be assessed for hurricanes in any one year, but no more than 6 percent to be assessed in the aggregate. The bill increases the current assessment of 4 percent/6 percent to 5 percent/8 percent.

Due to the growth of cash available for funding (which is expected to exceed $5 billion for 2003), the emergency assessment will not increase for an initial season "worse case" hurricane, but will continue to decline as cash builds in non-triggering contract years. A hurricane event that triggers bonding is expected to occur once every 20 years. Only once every 45 years is it expected that the maximum bonding for an initial season hurricane is needed, and the amount of this assessment is expected to be less than 2 percent. The maximum amount of bonding declines as the cash balance grows each year. According to the SBA, the likelihood of having hurricanes exhaust the Cat Fund in back-to-back years is remote (a probability of about 1/2000). In such a scenario, the total emergency assessment percentage (assuming current interest rate levels) would be 5.5 percent under the current law and 5.91 percent under the proposed law. Under current assumptions regarding the level of interest rates, the probabilities of encountering an 8 percent emergency assessment (hurricanes in 3 years with the maximum assessments outstanding) would be extremely remote. There continues to be a need to establish capacity once an initial season loss occurs, because the subsequent season then becomes the initial season and future capacity becomes subsequent season capacity.

Including Surplus lines in the Cat Fund Base

The proposed legislation also adds surplus lines policies to the Cat Fund's assessment base, thus spreading the potential cost of financing with revenue bonds over a broader base. Surplus lines insurance is insurance coverage provided by an insurer that is not licensed in a particular state, but is permitted to do business in the state because the particular coverage offered is not available from a licensed company. According to the SBA, emergency assessments for surplus lines are anticipated to operate in a similar fashion to the way they are contemplated to work with the newly created Citizens Property Insurance Corporation--the assessments are to be collected by the Florida Surplus Lines Service Office. Currently, the Cat Fund's assessment base includes all property and casualty insurers, excluding workers' compensation writers, and represents gross direct written premium of about $19 billion. The addition of surplus lines adds another $1.9 billion to the assessment base. This increases the Cat Fund's overall capacity by around $1.2 billion and allows overall assessments to be reduced by about 18.5 basis points. For example, the maximum assessment percentage needed for the 2002 hurricane season was estimated at 2.05 percent, but the addition of surplus lines has the impact of reducing this potential assessment to 1.865 percent.

Administrative Changes

The bill addresses five administrative issues:

- Clarifies the term "prior year" as used to define the appropriation of mitigation dollars from the Cat Fund.

- Increases the minimum amount of exposure (insured values) an insurer can write and be exempt from the Cat Fund. Some insurers only write a handful of residential policies as "accommodation business" to support their commercial writings. The proposal is to change the limit from the current $500,000 to $3 million in exposure. This gives another 14 insurers or so the option of not participating in the Cat Fund and facilitates the administration of the Cat Fund where small premiums and very low coverage is involved. The total Cat Fund premium otherwise payable by these insurers would be less than $10,000.

- Creates greater flexibility for the Cat Fund should it ever need to purchase reinsurance by allowing the purchase of reinsurance from a reinsurer that is "acceptable" to the Office of Insurance Regulation, although such reinsurer may not have been previously approved under s. 624.610 F.S. This allows for the use of Bermuda or European reinsurers or other U.S. reinsurers, thus precluding the need for a "fronting company" arrangement and saving on costs. The Cat Fund does not contemplate purchasing private reinsurance, but situations might arise in the future where it makes sense. For example, in 1999 the Cat Fund considered (but rejected) the purchase of reinsurance to protect against a shortfall in bonding.

- Provides for rulemaking authority to exclude, by type or category, certain covered policies that require individual ratemaking methodologies for pricing the coverage if the actuarial soundness of the fund is not jeopardized. Insurers often find it impossible or costly to accurately report various exposures (for the most part, commercial residential insured values) due to the unique way certain policies are written. For example, a policy may cover both commercial residential and commercial business exposures on an excess basis with blanket coverage and/or a blanket deductible on a multi-state basis. Depending on how a policy is written by the insurer, it is often impossible, impractical, or cost prohibitive for insurers to report the residential insured values for such policies. As a result, developing a proper premium and rating such a policy is a major problem.

- Provides specific rule making authority to allow for the charging of interest on late remittances.

C. SECTION DIRECTORY:

Section 1: Amends section 215.555, F.S., relating to the Florida Hurricane Catastrophe Fund.

Section 2: Provides that the act takes effect upon becoming a law.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill extends the Cat Fund assessment base to include surplus lines policies. The assessments would be made on surplus lines policyholders and collected by the Florida Surplus Lines Service Office to be remitted as directed by the Cat Fund.

The private sector impact is contingent upon a series of large hurricanes occurring in successive years triggering the fund. According to the SBA, the likelihood of this is remote. No private impact is anticipated under any circumstance over the next 2 years. The increase in emergency assessment - authority from 4 percent per year and 6 percent in the aggregate to 5 percent per year and 8 percent in the aggregate will not have an immediate impact on the private sector even after a large hurricane event, because the cash balance of the fund is of such size (nearing $5 billion) that it is anticipated that less than a 2 percent emergency assessment is sufficient to fund bonding needs.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   None.

2. Other:

   None.

B. RULE-MAKING AUTHORITY:

The bill provides specific rulemaking authority to address the need to exclude certain covered policies that require individual ratemaking.

The bill also provides specific rulemaking authority to allow for the charging of interest on late remittances.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES

None.