HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 949 Florida Hurricane Catastrophe Fund
SPONSOR(S): Patterson
TIED BILLS: **IDEN./SIM. BILLS:** CS/SB 1460

	REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1)	General Government Policy Council	15 Y, 0 N	Callaway	Hamby
2)	Full Appropriations Council on Education & Economic Development	15 Y, 0 N	Fox	Leznoff
3)				
4)				
5)				

SUMMARY ANALYSIS

The Florida Hurricane Catastrophe Fund (Fund) is a tax-exempt trust fund created as a form of reinsurance for residential property insurers. The Fund reimburses (reinsures) insurers for a portion of their hurricane losses to residential property.

The Fund generally operates on a contract year. Historically, the Fund's contract year has run from June 1st to May 31st of the next calendar year. However, 2009 legislation changed the Fund's contract year to a calendar year starting January 1, 2011. In order to provide for a transition from a contract year ending on May 31st to one ending on December 31st, the legislation created a seven month transitional contract year from June 1, 2010 to December 31, 2010. The transitional contract year has created unintended consequences for insurers due to the way in which the cost of reinsurance is amortized (allocated as a cost) on insurers' financial statements. In 2010, an insurer's financial statement will show a larger expense associated with Fund reinsurance than historically shown because of the transitional contract year in 2010. The statement will show an expense equal to five months of Fund reinsurance costs from January 1, 2010 to May 31, 2010. And, the statements will also show an expense equal to 12 months of Fund reinsurance costs over the seven month period from June 1, 2010 to December 31, 2010. This reduces a company's pre-tax income and surplus more than what it is historically reduced each year for the purchase of Fund reinsurance. The reduction in income and surplus could impact the financial solvency of some insurance companies and may negatively impact an insurer's rating from the rating agencies. To remedy the negative financial impact of the transitional contract year, starting June 1, 2010, the bill returns the Fund's contract year to June 1st – May 31st.

The bill also provides legislative intent and findings relating to Fund coverage in order to facilitate insurers' purchase of private reinsurance and provides earlier time frames for the State Board of Administration and insurers to effectuate Fund coverage each year.

The bill changes the way in which the Fund's capacity for mandatory coverage is calculated each year. Instead of allowing the Fund's capacity to increase each year as the Fund's exposure increases (but limited by the increase in the Fund's cash balance), the bill sets the Fund's capacity at $17 billion for each contract year and does not allow the capacity to increase until the Fund's cash and bonding ability exceeds $34 billion.

The bill does not change the way the Fund's retention is calculated but requires the use of earlier exposure data in its calculation.

The bill does not have a fiscal impact on state or local governments. The bill should resolve the financial issues for insurers relating to the amortization of Fund reinsurance. Changes related to the Fund's capacity may reduce the likelihood or amount of assessments levied by the Fund on most property and casualty policyholders. Effectuating Fund coverage earlier in the year may result in lower private reinsurance costs for insurers. Lower private reinsurance costs may reduce property insurance rates for policyholders.

The bill is effective upon becoming a law.

HOUSE PRINCIPLES

Members are encouraged to evaluate proposed legislation in light of the following guiding principles of the House of Representatives

- Balance the state budget.
- Create a legal and regulatory environment that fosters economic growth and job creation.
- Lower the tax burden on families and businesses.
- Reverse or restrain the growth of government.
- Promote public safety.
- Promote educational accountability, excellence, and choice.
- Foster respect for the family and for innocent human life.
- Protect Florida's natural beauty.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Background on the Florida Hurricane Catastrophe Fund
The Florida Hurricane Catastrophe Fund (FHCF or Fund) is a tax-exempt trust fund created after Hurricane Andrew as a form of reinsurance for residential property insurers.[1] The Fund reimburses (reinsures) insurers for a portion of their hurricane losses to residential property. For all residential property insurers, the FHCF must offer three options for reinsurance coverage. One of the three options is mandatory and thus must be purchased by all residential property insurers on their residential property exposure. One optional coverage, the Temporary Emergency Additional Coverage Options (TEACO), offers reinsurance for insurers below the mandatory coverage. The other, Temporary Increase In Coverage Limit Options (TICL) offers reinsurance for insurers above the mandatory coverage. In addition to these three coverage options, the Fund must offer specified insurers $10 million of additional reinsurance coverage.

The FHCF is administered by the State Board of Administration (SBA). Participating insurers choose a percentage level of reimbursement by the FHCF. By statute, insurers can select 45, 75, or 90 percent coverage reimbursement for losses that exceed its deductible/retention for each hurricane.[2] Most insurers choose the 90 percent reimbursement percentage.[3] This means once an insurer triggers FHCF coverage, 90 percent of its losses will be reimbursed by the FHCF, up to the insurer's limit of coverage. Insurers may purchase additional reinsurance in the private market to reimburse them for their hurricane losses in amounts not covered by the FHCF. Reinsurance in the private market can also be purchased for the coinsurance amount (e.g., 10 percent) that is the insurer's responsibility for the coverage provided by the FHCF.

Because the FHCF provides insurers an additional source of reinsurance to what is available in the private market, insurers are generally able to write more residential property insurance in the state than could otherwise be written. Because most reinsurance purchased through the FHCF is significantly less expensive than private reinsurance, the FHCF also acts to lower residential property insurance premiums for consumers.

Changes Relating to the Fund's Contract Year
The FHCF generally operates on a contract year. The contract year dictates when Fund coverage is effective. Historically, the Fund's contract year has run from June 1st to May 31st of the next calendar

[1] s. 215.555, F.S.
[2] s. 215.555(2)(e)2., F.S.
[3] http://fhcf.paragonbenfield.com/pdf/08fin_pre.pdf. (last viewed January 15, 2009).

year. However, in the 2009 Legislative Session, CS/CS/CS/HB 1495[4] was enacted that changed the Fund's contract year to a calendar year starting January 1, 2011. Thus, beginning on January 1, 2011, the Fund's contract year is January 1st to December 31st rather than June 1st to May 31st. In order to provide for a transition from a contract year ending on May 31st to one ending on December 31st, the 2009 legislation created a seven month transitional contract year to run from June 1, 2010 to December 31, 2010.

The creation of the transitional contract year from June 1, 2010 to December 31, 2010 has created unintended consequences for insurance companies. FHCF coverage purchased by insurance companies is accounted for as reinsurance in the company's statutory basis financial statements. Accounting principles[5] allow a company's cost for reinsurance to be earned over the reinsurance contract period in proportion to the amount of reinsurance purchased. Thus, in many cases, insurers' financial statements divide and expense Fund reinsurance on a pro rata basis over the Fund's contract period. This expense directly reduces the insurer's pre-tax income and surplus. In other words, the cost of reinsurance from the FHCF is amortized (allocated as a cost) on the insurance company's financial statement in equal amounts each month of the Fund contract year. Under current law, in 2010, a company will amortize five months of Fund coverage from January 1, 2010 to May 31, 2010 which is the remainder of the 2009-2010 contract year. The company will also amortize all of the transitional contract year's Fund coverage from June 1, 2010 to December 31, 2010.

In 2010, an insurance company's financial statement will show a larger expense associated with Fund reinsurance than historically shown because of the transitional contract year in 2010. The statement will show an expense equal to five months of Fund reinsurance costs from January 1, 2010 to May 31, 2010 for the 2009 - 2010 contract year (consistent with how the Fund reinsurance costs have historically been expensed). And, the statements will also show an expense equal to <u>12 months of Fund reinsurance costs over the seven month period</u> from June 1, 2010 to December 31, 2010 for the transitional contract year. Thus, the transitional contract year results in insurance companies amortizing the equivalent of 17 months of FHCF coverage over 12 months rather than over 12 months as the companies have historically done. This results in an additional expense equal to the cost of five months of Fund reinsurance on the company's financial statement. This additional expense reduces a company's pre-tax income and surplus more than what it is historically reduced each year for the purchase of Fund reinsurance. The additional income and surplus reduction amount is equal to the cost of five months of Fund reinsurance. This reduction in income and surplus will be millions of dollars for insurers and could impact the financial solvency of some insurance companies.[6] An insurer's rating from the rating agencies could also negatively be impacted.

Starting June 1, 2010, the bill returns the Fund's contract year to June 1st – May 31st. This prevents the additional income and surplus decrease for insurers in 2010 and the resulting solvency problem because insurance companies will be amortizing 12 months of Fund reinsurance over 12 months in 2010 and thereafter. This is consistent with how insurers have historically expensed FHCF coverage on their financial statements.

Changes Facilitating Insurers' Purchase of Private Reinsurance

The bill also provides legislative intent and findings relating to Fund coverage in order to facilitate insurers' purchase of private reinsurance. The findings detail the importance of insurers being informed about the specifics of Fund coverage each year as early in the calendar year as possible. To that end, the bill requires the State Board of Administration to publish information that allows insurers to ascertain how much the reinsurance coverage the Fund is going to sell to insurers by January 1st of the year preceding the contract year (i.e. January 1st of each calendar year). Furthermore, the SBA is required to adopt the Fund's reimbursement contract by February 1st of the year preceding the contract year (i.e. February 1st of each calendar year) and insurers are required to execute the Fund's reimbursement contract by March 1st of the year preceding the contract year (i.e. March 1st of each calendar year). This allows insurers to determine the amount of private reinsurance they need so the insurers can purchase

[4] Section 1, Ch. 2009-87, L.O.F.
[5] Statement of Statutory Accounting Principles No. 62, Property and Casualty Reinsurance (SSAP 62).
[6] With limited exceptions, property and casualty insurance companies are required by s. 624.408(1)(a)5. , F.S., to maintain $4 million in surplus at all times in order to keep their certificate of authority.

the needed private reinsurance early in the calendar year. Purchasing private reinsurance early in the calendar year should allow insurers to more competitively negotiate private reinsurance which may in turn reduce the cost of private reinsurance.

Changes Relating to the Fund's Capacity

The FHCF has a maximum amount it will reimburse insurers each year set by statute.[7] This is called the Fund's capacity. Under current law, the maximum amount the FHCF must pay (the capacity) in any one year for the mandatory coverage is $15 billion, adjusted annually based on the percentage growth in Fund exposure, but not to exceed the dollar growth in the cash balance of the Fund.[8] In recent years the Fund's capacity has grown annually due to the growth in exposure for the Fund. For the 2009-2010 contract year, the Fund's capacity for mandatory coverage is $17.175 billion, meaning the most the Fund has to reimburse insurers for property insurance claims paid by insurers is $17.175 billion for the Fund's mandatory coverage.[9]

The bill changes the way in which the Fund's capacity for mandatory coverage is calculated each year. The bill sets the Fund's capacity at $17 billion for each contract year and does not allow the capacity to increase until the Fund's cash and bonding ability exceeds $34 billion.[10] Thus, the Fund's capacity will no longer increase each year if the Fund's exposure increases. The change in the Fund's capacity calculation provided in the bill allows the FHCF to accumulate funds to pay the maximum mandatory coverage Fund obligations ($17 billion a year) for claims resulting from hurricanes in back-to-back seasons.[11] Once this happens, the Fund's capacity will increase. This change reverts the Fund's capacity calculation to how it was from 1999 – 2004. The change will allow the Fund's cash balance to grow in years where there are no hurricanes while keeping the Fund's exposure (capacity) frozen. Accordingly, the Fund will be less reliant on bonding to meet its mandatory coverage obligations.

Changes Relating to the Fund's Retention

Insurers buying reinsurance from the Fund must meet a deductible before the Fund will reimburse the insurer for property claims the insurer has paid. This is called the Fund's retention. Under current law, the total industry retention (aggregate retention) for the mandatory coverage is $4.5 billion per hurricane, adjusted annually based on the FHCF's exposure reported by insurers for the prior year.[12]

The bill requires the Fund's retention to be based on insurers' exposure two years prior to the current contract year, rather than one year prior as under current law.[13] For example, for the contract year beginning on June 1, 2010, the Fund's retention would be calculated on insurers' exposure reported in 2008, rather than in 2009 as under current law. The way the retention is calculated is not changed by the bill; the only change is what exposure time period the retention calculation is based on.
This change allows the Fund to be able to publish the aggregate retention by January 1st each year as the bill requires.

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[7] s. 215.555(4)(c)1., F.S.

[8] s. 215.555(4)(c)1., F.S. For mandatory coverage, the maximum amount of coverage is different for each insurer because it is linked directly to the amount of premiums the insurer pays to the FHCF. Thus, insurers that pay higher premiums to the FHCF have more mandatory coverage than those that pay lower premiums.

[9] The actual maximum payout of the Fund is greater than $17.175 billion because the Fund must reimburse insurers for claims under TICL coverage if the insurer purchased TICL coverage from the Fund.

[10] The capacity being set at $17 billion will start with the contract year beginning on June 1, 2010.

[11] The funds may be accumulated from premiums and bonding.

[12] s. 215.555(2)(e)1., F.S. For the current 2009-10 contract year (June 1, 2009 – May 31, 2010), the insurance industry as a whole has an aggregate retention of $7.223 billion for mandatory coverage, meaning the total of all individual insurer retentions/deductibles will hypothetically total to $7.223 billion per event, assuming all participating insurers reached their retention. Although the insurance industry's aggregate deductible/retention totals $7.223 billion, loss recovery from the FHCF is based on an individual insurer meeting its own retention for mandatory coverage prior to losses being reimbursed.

[13] The change in the time period for the retention calculation contained in the bill results in an aggregate retention for the 2010-2011 contract year that is close to the retention for the 2009-2010 contract year. The aggregate retention for the 2009-2010 contract year is $7.223 billion whereas under the bill the aggregate retention for the 2010-2011 contract year is $7.18 billion.

B. SECTION DIRECTORY:

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

Section 2: Provides an effective date of 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 prevents additional income and surplus decreases for residential property insurers in 2010 due to the FHCF's transitional contract year and the resulting solvency problem because the insurers will be amortizing 12 months of Fund reinsurance costs over 12 months in 2010 and thereafter.

The Fund capacity changes in the bill will allow the Fund to accumulate funds to pay claims without increasing the Fund's capacity. This should reduce the likelihood of assessments on insurers which are passed on to policyholders.[14] In the event assessments are levied, the changes may reduce the amount of the assessments.

Requiring the Fund to publish the specific amount of Fund coverage each year by January 1st should allow insurers to purchase their private reinsurance early in the year. Doing so should enable insurers to more competitively negotiate their private reinsurance which may reduce the cost of the private reinsurance. Private reinsurance costs are passed through to policyholders in rates so if an insurer is able to reduce its private reinsurance costs, its rate should also reduce.

D. FISCAL COMMENTS:

The bill does not have a fiscal impact on the Office of Insurance Regulation[15]. There is also no fiscal impact on the State Board of Administration, which administers the Fund[16].

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[14] The FHCF is authorized to levy emergency assessments against all property and casualty insurance premiums paid by policyholders (other than workers' compensation, accident and health, federal flood and, until May 31, 2010, medical malpractice), including surplus lines policyholders, when reimbursement premiums and other fund resources are insufficient to cover the Fund's obligations. Annual assessments are capped at 6 percent of premium with respect to losses from any one year and a maximum of 10 percent of premium to fund hurricane losses from multiple years. Revenue bonds issued by the FHCF may be amortized over a term up to 30 years. Thus, the FHCF may levy assessments for as long as 30 years. As of October 2009, the FHCF assessment base was $34.9 billion.

[15] Office of Insurance Regulation Fiscal Bill Analysis dated February 22, 2010 on file with the Government Operations Appropriations Committee.

[16] State Board of Administration Fiscal Impact Statement dated February 22, 2010 on file with the Government Operations Appropriations Committee.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to: require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None provided in the bill.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/COUNCIL OR COMMITTEE SUBSTITUTE CHANGES

None.