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 Budget Committee

BILL: CS/SB 1346

INTRODUCER: Budget Committee and Senators Oelrich and Lynn

SUBJECT: Property Insurance

DATE: March 3, 2012 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Knudson	Burgess	BI	**Favorable**
2.	Betta	DeLoach	BGA	**Favorable**
3.	Betta, Knudson	Rhodes	BC	**Fav/CS**
4.				
5.				
6.				

Please see Section VIII. for Additional Information:

A. COMMITTEE SUBSTITUTE.....	X	Statement of Substantial Changes
B. AMENDMENTS........................		Technical amendments were recommended
		Amendments were recommended
		Significant amendments were recommended

I. Summary:

This bill revises the assessment authority of the Citizens Property Insurance Corporation (Citizens) and reduces the reinsurance coverage provided by the Florida Hurricane Catastrophe Fund.

Citizens Property Insurance Corporation

The committee substitute reduces Citizens regular assessment from 6 percent per account to 2 percent for deficits in the Coastal Account and eliminates the regular assessment in the Personal Lines Account (PLA) and the Commercial Lines Account (CLA). The reduction of the regular assessment in the Coastal Account and its elimination for deficits in the PLA and CLA will not reduce the overall assessment authority of Citizens. Instead, greater levies will be imposed through emergency assessments, which are levied on all lines of property and casualty policies (except workers' compensation and medical malpractice[1]) in the state, including Citizens' own policies.

[1] Section 627.351(6)(b)3.e., F.S.

The bill also makes revisions designed to assist Citizens in the promulgation and collection of assessments. Citizens is authorized to levy the policyholder surcharge, a regular assessment for the Coastal Account, and emergency assessments upon a determination by the Citizens Board of Directors that a Citizens account has a projected deficit. The Office of Insurance Regulation (OIR) is authorized to assist Citizens to collect assessments in any way that the OIR deems appropriate. Assessable insurers and the Florida Surplus Lines Service Office (FSLSO) must begin collecting and paying the emergency assessments within 90 days after Citizens levies such assessments. Limited apportionment companies must also begin collecting regular assessments within 90 days of their levy by Citizens. However, the bill expands the time limited apportionment companies have to pay regular assessments in full from 12 months to 15 months after Citizens levies the assessment.

Florida Hurricane Catastrophe Fund

The bill also revises the Florida Hurricane Catastrophe Fund (FHCF or Fund) coverage limits and reimbursement percentage. 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. These provisions are effective upon the bill becoming law. The major proposed changes are summarized as follows:

The bill phases in annual decreases of the FHCF mandatory coverage limit beginning in the 2012-2013 contract year as follows:

- For the 2012-2013 contract year, $17 billion (the current Fund limit).
- For the 2013-2014 contract year, $16 billion.
- For the 2014-2015 contract year, $15 billion

The bill reduces the maximum reimbursement amount from 90 percent to the following percentages:

- For the 2013-2014 contract year, 85 percent.
- For the 2014-2015 contract year, 80 percent

The effective date of the bill is July 1, 2012, except as otherwise provided.

This bill substantially amends sections 215.555 and 627.351, Florida Statutes.

II. Present Situation:

Citizens Property Insurance Corporation

Citizens is a state-created, not-for-profit, tax-exempt governmental entity whose public purpose is to provide property insurance coverage to those unable to find affordable coverage in the voluntary admitted market.[2] Citizens is not a private insurance company,[3] and its book of

[2] See Section 627.351(6)(a), F.S.
[3] See Section 627.351(6)(a)1., F.S.

business is divided into three statutorily separate accounts.[4] Each of the three Citizens accounts has separate calculations with regard to surplus and deficits. By statute, assets of each account may not be comingled or used to fund losses in another account. Citizens' three accounts are:

Personal Lines Account (PLA) – Multi-peril policies which consist of homeowners, mobile homeowners, dwelling fire, tenants, condominium unit owners and similar policies covering damage to property from windstorm and from other perils.

Commercial Lines Account (CLA) – Multi-peril policies which consist of condominium association, apartment building and homeowners' association policies covering damage to property from windstorm and from other perils, as well as Commercial Non-Residential Multi-peril policies.

Coastal Account (Coastal) – Wind-only and Multi-peril policies which consist of personal lines wind-only policies, commercial residential wind-only policies and commercial non-residential wind-only policies issued in limited eligible coastal areas which cover damage to property from windstorm only. It also consists of personal and commercial residential multi-peril policies in specified coastal areas (wind-only zones) issued since 2007 which cover damage to property from windstorm and from other perils. Recently some Commercial Non-Residential Multi-peril policies have been added as well.

Assessments

In the event Citizens incurs a deficit, i.e., its obligations to pay claims exceed its capital plus reinsurance recoveries, it may levy assessments on most of Florida's property and casualty insurance policyholders in a specific sequence set by statute.[5] The three Citizens' accounts calculate deficits and resulting assessment needs independently:

Citizens Policyholder Surcharges:[6] Citizens will first levy surcharges on its policyholders of up to 15 percent of premium per account for a maximum total of 45 percent. This surcharge is collected over 12 months on all Citizens' policies and collected upon issuance and renewal.

Regular Assessments:[7] Upon the exhaustion of the Citizens policyholder surcharge for a particular account, Citizens may levy a regular assessment of up to 6 percent of premium or 6 percent of the deficit per account, for a maximum total of 18 percent. The regular assessment is levied on all lines of property and casualty policies in the state except workers' compensation and medical malpractice, but is not levied on Citizens' policies. Property and casualty insurers with policies subject to the regular assessment provide the assessment to Citizens up front and subsequently recover it from their policyholders at the issuance of a new policy or at renewal of existing policies. Citizens has usually been able to collect regular assessment funds within 30 days after being levied.

[4] Section 627.351(6)(b)2.a., F.S.
[5] Section 627.351(6)(b)3., F.S.
[6] Section 627.351(6)(b)3.h., F.S.
[7] Section 627.351(6)(b)3.a.-b., F.S.

Emergency Assessments:[8] Upon the exhaustion of the Citizens' policyholder surcharge and regular assessment for a particular account, Citizens may levy an emergency assessment of up to 10 percent of premium or 10 percent of the deficit per account, for a maximum total of 30 percent. This assessment can be collected for as many years as is necessary to rectify a deficit. Emergency assessments are levied on all lines of property and casualty policies (except workers' compensation and medical malpractice) in the state, including Citizens' own policies. Initially, property and casualty insurers with policies subject to the emergency assessment collect the assessment from policyholders at the issuance of a new policy or at renewal of existing policies and then remit the assessments periodically to Citizens. Thus, Citizens will not collect funds raised by an emergency assessment immediately after the assessment is levied, but will collect funds intermittently throughout the collection period as policies are renewed and new policies are written.

Citizens Assessment Capacity

Issue Brief 2012-226 by the Banking and Insurance Committee presented findings on the financial condition of Citizens and the corporation's claims resources in the event of a major hurricane event. Due to lack of storm activity for the last 5 years, the current surplus held by Citizens for all three accounts is $5.742 billon: $2.686 billion Coastal and $3.056 billion PLA/CLA. Pursuant to estimates provided by Citizens to committee staff, Citizens has the following assessment capacity:

- Policyholder Surcharge – approximately $1.172 billion: $391 million surcharge capacity for Coastal and $781 million surcharge capacity for PLA/CLA.
- Regular Assessment – approximately $5.580 billion: $1.860 billion Regular Assessment capacity for Coastal and $3.720 billion Regular Assessment capacity for PLA/CLA.
- Emergency Assessment - Citizens Emergency Assessment capacity is unlimited. The projected 1-100 year storm Emergency Assessment estimate is $6.468 billion for Coastal Account.

Reinsurance

A direct insurance writer will often spread its risk by purchasing reinsurance coverage from a reinsurance carrier. The reinsurance contract will specify the layer of the direct writer's risk that is shifted to the reinsurer and the premium that the direct writer must pay the reinsurer to assume the risk. For the contract year 2011-2012, Citizens has purchased private reinsurance coverage totaling $575 million for the Coastal account.

The Florida Hurricane Catastrophe Fund (FHCF or CAT fund)

The FHCF is a tax-exempt fund created in 1993 after Hurricane Andrew as a form of mandatory reinsurance for residential property insurers. The FHCF 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 FHCF 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

[8] Section 627.351(6)(b)3.c., F.S.

more residential property insurance in the state than would otherwise be written. Because of the low cost of coverage from the FHCF, the fund acts to lower residential property insurance premiums for consumers. The FHCF 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.

FHCF 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 FHCF. The FHCF 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).

Insurers that experience multiple hurricanes causing loss during the contract year may receive reimbursement from the FHCF 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.

To access the CAT fund an insurer must have incurred losses above the retention levels calculated and set by statute. When faced with a multi-storm season, insurers must reach their full retention levels on the two largest storms of the season. The retention level is then reduced to one-third the normal amount for any other storms that season. Citizens Property Insurance Corporation is the largest purchaser of CAT Fund coverage. If Citizens were to incur losses above its retention levels, the CAT fund could provide Citizens with an additional $6.591 billion in coverage: $4.010 billion would be available for Coastal and $2.581 billion would be available for PLA/CLA.

FHCF Premiums

The FHCF 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.[9] In practice, each insurer pays the FHCF annual reimbursement premiums that are proportionate to each insurer's share of the FHCF's risk exposure. The cost of FHCF 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."

FHCF Bonding and Assessment Authority

[9] Section 215.555(2)(a), F.S. Additional amounts needed to pay debt service on revenue bonds and provide required debt service coverage may also be included in the actuarially indicated premium that an insurer pays.

Reimbursements to insurers for losses above the current cash balance of the fund are financed through bonding. When the cash balance of the FHCF is insufficient to cover losses, the law authorizes the FHCF 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 FHCF, bond issues totaling over $11 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 FHCF's broad-based assessment authority is one of the reasons the FHCF was able to obtain an exemption from federal taxation from the Internal Revenue Service as an integral part of state government.

FHCF Financial Obligations and Claims Paying Resources

The FHCF's coverage obligations for the 2011-2012 hurricane season totaled $18.389 billion dollars for a single storm, which consisted of:

- $17 billion of mandatory coverage;
- $994 million dollars in optional TICL[10] coverage; and
- $395 million in optional coverage for insurers that qualify as limited apportionment companies[11] or were approved to participate in the Insurance Capital Buildup Program.

The FHCF cash balance for the 2011-2012 hurricane season was $7.17 billion. Obligations exceeding the cash balance of the FHCF would require bonding of up to $11.219 billion. The assessment base for the FHCF is approximately $33.603 billion for premiums written at year end 2010.

[10] Legislation enacted in 2007 (ch. 2007-1, L.O.F.), increased the coverage limits of the FHCF for the 2007, 2008 and 2009 hurricane seasons by adding two additional layers of optional coverage that property insurers may buy: Temporary Increase in Coverage Limit Options ("TICL"), that allows residential property insurers to purchase additional reinsurance above the FHCF mandatory coverage and Temporary Emergency Additional Coverage Options ("TEACO"), that allows such insurers to purchase additional coverage below each insurer's market share of the FHCF retention. In 2009, the Legislature reduced the FHCF's exposure and payout by phasing out the TICL layer of coverage over a 6 year period at a rate of $2 billion a year until the TICL coverage is completely phased out in the 2014-2015 contract year (ch. 2009-87, L.O.F.).

[11] Section 627.351(6)(c)13., F.S.

FHCF 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. 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 18, 2011, Claims Paying Capacity Estimate (Estimate) is the most recent such report to be issued. The report, prepared by Raymond James, evaluated the FHCF's bonding 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). The October 18, 2011 Estimate noted that the FHCF's total obligations of $18.389 billion exceed the projected year-end fund balance of $7.170 billion, thus the FHCF may need to raise up to $11.219 billion through bonding in order to fund its liabilities.

The senior managers from Citi, Goldman Sachs, J.P. Morgan, and Barclays estimated the bonding capacity of the FHCF to be from $5 billion to $11 billion over the 12 months following a storm, leading to an average estimate of $8 billion in bonding capacity. However, the Estimate anticipates that the FHCF will have an additional bonding capacity of $6 billion from 12 to 24 months after the hurricane, which would enable the FHCF to pay its entire obligations and leave an estimated $2.78 billion in bonding capacity to fund losses in a subsequent hurricane season. The first Claims Paying Capacity Estimate for the 2012-2013 hurricane season is due to be published in May 2012.

The Estimate expressed concerns about the ability of the FHCF to successfully issue $11 billion in bonding over the first 12 months after a hurricane. The report notes that the largest single issue in the municipal market since 2009 was a $6.543 billion dollar tax-exempt bond issue by the State of California. The report also found that municipal bond issuance for 2011 declined over 35 percent from the prior year and opined weak economic conditions and investor reluctance to invest capital in such issues as likely major factors in this reduction. However, the Estimate also noted that California was able to issue over $23 billion in municipal debt in 2009 and $10.544 billion in 2010, perhaps indicating that the FHCF could issue sufficient debt to pay its maximum obligation.

III. Effect of Proposed Changes:

Section 1 amends s. 627.351(6), F.S., to reduce the Citizens regular assessment from 6 percent per account to 2 percent for deficits in the Coastal Account and eliminates the regular assessment in the Personal Lines Account (PLA) and the Commercial Lines Account (CLA). The reduction of the regular assessment in the Coastal Account and its elimination for deficits in the PLA and CLA will not reduce the overall assessment authority of Citizens. Instead, greater levies will be imposed through emergency assessments, which are levied on all lines of property and casualty policies (except workers' compensation and medical malpractice) in the state, including Citizens'

own policies. In the event of a storm that requires emergency assessments, Citizens policyholders will be subject to higher assessment liabilities than under current law because regular assessments do not include such policyholders within the assessment base, but emergency assessments do. Conversely, policyholders of property and casualty lines of insurance policies subject to assessment will be subject to lower levels of assessment liability.

The bill also makes revisions designed to assist Citizens in the promulgation and collection of assessments. The bill authorizes the Citizens Board of Governors to levy surcharges and assessments upon projecting that a Citizens account will incur a deficit. Current law requires that the Citizens account actually incur a deficit prior to the levy of surcharges or assessments. Under the bill, the various surcharges and assessments may be levied upon the following determinations:

- Policyholder Surcharge – Upon a determination by the board that a Citizens account has a projected deficit.
- Regular assessments for the Coastal Account – Upon a determination by the board that a Coastal Account will have a projected deficit after accounting for the policyholder surcharge.
- Emergency assessments – Upon a determination by the board that a Citizens account will have a projected deficit after accounting for the policyholder surcharge and, for the Coastal Account, regular assessments.

The Office of Insurance Regulation is authorized to assist Citizens to collect assessments in any ways that the OIR deems appropriate. Assessable insurers and the Florida Surplus Lines Service Office must begin collecting and paying the emergency assessments within 90 days after Citizens levies such assessments. Limited apportionment companies must also begin collecting regular assessments within 90 days of their levy by Citizens. However, the bill expands the time limited apportionment companies have to pay regular assessments in full from 12 months to 15 months after Citizens levies the assessment.

Section 2. amends s. 215.555, F.S. by reducing the Florida Hurricane Catastrophe Fund coverage limits and reducing the maximum reimbursement percentage. This section is effective upon becoming a law. The major proposed changes are summarized as follows:

<u>Decreases the Maximum Reimbursement Percentage for FHCF Coverage</u>

Under current law, insurers have the option to purchase FHCF reinsurance that provides reimbursement of 90 percent, 75 percent, or 45 percent of the insurer's losses within the mandatory FHCF layer of coverage. The bill reduces the maximum reimbursement amount from 90 percent to the following percentages:

- For the 2012-2013 contract year, 90 percent (current law).
- For the 2013-2014 contract year, 85 percent.
- For the 2014-2015 contract year and thereafter, 80 percent.

The bill requires insurers that elect the maximum coverage level available must purchase the following year's renewal of the reimbursement contract at the highest available coverage level if revenue bonds after a covered event (hurricane) are outstanding.

Decreases the FHCF Mandatory Coverage Limit

The bill phases in annual decreases of the FHCF mandatory coverage limit beginning in the 2012-2013 contract year as follows:

- For the 2012-2013 contract year, $17 billion (current law).
- For the 2013-2014 contract year, $16 billion.
- For the 2014-2015 contract year, $15 billion.

Section 3 provides an effective date of July 1, 2012, except for this section and as otherwise provided in the bill.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Representatives from multiple Florida admitted insurance companies assert that the requirement that property and casualty insurers with policies subject to the regular assessment provide the assessment to Citizens up front and subsequently recover it from their policyholders may delay the ability of some insurers to make timely claim payments to their own policyholders. These representatives have also raised the possibility that the requirement to front regular assessment liabilities could imperil the solvency of some insurers.

Representatives from the Office of Insurance Regulation report that some non-admitted property and casualty insurers have cited the requirement that insurers pre-pay the regular

assessment up front to Citizens as a reason they have chosen not to write residential property insurance in the state.

Representatives from the FHCF state that the current mandatory layer of coverage ($17 billion) plus the optional coverages offered under current law ($4 billion in TICL coverage for 2012-2013) place potential liabilities on the fund that it may not be able to meet due to the current status of the financial markets. These representatives note that if a major hurricane had fallen upon Florida during the 2011 hurricane season, the Fund would have needed to rely upon an $11.3 billion bond issue, which would have been a record for municipal debt issuance if issued in a short period of time. Though additional bonding capacity may be available if the bond issues are spread out over a longer period of time (2 years instead of 1 year), the FHCF notes that some private market insurers will likely require prompt payment of FHCF funds to maintain their ability to pay claims timely and avoid insolvency in the event of a major storm.

Representatives from the FHCF assert that residential policyholders save approximately 25 percent to 30 percent on their annual residential property insurance premiums due to savings attributable to reinsurance sold by the Fund. These savings total approximately $2 billion per year. These representatives concede that reducing the Fund’s capacity and reimbursement percentage will cause approximately a cumulative 2 percent increase in policyholder premiums over the 2013-2014 and 2014-2015 contract years because insurers will replace FHCF reinsurance coverage with private market reinsurance at higher costs.

Representatives of some business groups have voiced support for reducing the CAT Fund’s capacity and reimbursement percentage because these changes will reduce the likelihood that the FHCF 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:

Representatives from Citizens state that the bill will not have a negative impact on the corporation’s ability to timely pay claims in the event of a storm that triggers emergency assessments. Citizens’ representatives assert that the ability of the corporation to issue debt will enable it to maintain sufficient funds to timely pay claims and meet its obligations in the event of a storm that requires the levy of emergency assessments. Additionally, allowing Citizens to levy surcharges and assessments upon a determination by the Board of Directors that a deficit exists in a Citizens account will allow Citizens to begin the process of collecting those levies at an earlier time than under current law.According to the Office of Insurance Regulation, there will be an increase in workload associated with the additional regulation related to section 2 of the bill; however, it is unknown if there will be additional costs associated or the OIR can handle within existing resources.

The bill reduces the assessment liability of the FHCF, which decreases the probability that the Fund will be required to issue bonds to meet its financial obligations. Supporters of the legislation also note that the FHCF is not the only insurance-related state entity granted assessment authority. Citizens and the Florida Insurance Guaranty Association 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 FHCF bonding and assessments will assist Citizens and FIGA in being able to raise funds from bond issues because FHCF 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. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:

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

CS by Budget on March 3, 2012:
The CS changes the bill by revising the Florida Hurricane Catastrophe Fund (FHCF or Fund) coverage limits and reimbursement percentage 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. These provisions are effective upon the bill becoming law. The major proposed changes are summarized as follows:

Annual decreases of the FHCF mandatory coverage limit beginning in the 2012-2013 contract year as follows:

- For the 2012-2013 contract year, $17 billion (the current Fund limit).
- For the 2013-2014 contract year, $16 billion.
- For the 2014-2015 contract year, $15 billion

Reduction of the maximum reimbursement amount from 90 percent to the following percentages:

- For the 2013-2014 contract year, 85 percent.
- For the 2014-2015 contract year, 80 percent

B. Amendments:

None.

This Senate Bill Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.