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 Banking and Insurance Committee

BILL: SB 1372

INTRODUCER: Senator Alexander

SUBJECT: Florida Hurricane Catastrophe Fund

DATE: February 13, 2012 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Knudson	Burgess	BI	**Pre-meeting**
2.			BC	
3.				
4.				
5.				
6.				

I. Summary:

Senate Bill 1372 revises the Florida Hurricane Catastrophe Fund (FHCF or Fund) coverage limits, reimbursement percentage, retention, cash build-up factor, and optional coverages. 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. The major proposed changes are summarized as follows:

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 (the current Fund limit).
- For the 2013-2014 contract year, $15.5 billion.
- For the 2014-2015 contract year, $14 billion.
- For the 2015-2016 contract year, $12 billion.

Increases the FHCF Retention – The bill increases the FHCF industry retention to $8 billion for the 2013-2014 contract year.

Decreases the Maximum Reimbursement Percentage for FHCF Coverage – 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.
- For the 2015-2016 contract year and all subsequent contract years, 75 percent.

Increases the FHCF Cash Build-Up Factor – Currently, the FHCF charges insurers a "cash build-up factor" that is added to the actuarially indicated reimbursement premium. The cash build-up factor was 15 percent for the 2011-2012 contract year, and will increase to 20 percent for the 2012-2013 contract year and 25 percent for the 2013-2014 contract year. The bill continues increasing the cash build-up factor by 5 percent annually in subsequent years, culminating in a 50 percent factor for the 2018-2019 contract year.

Reduces the FHCF Emergency Assessment Authority – Beginning in the 2015-2016 contract year the bill reduces the FHCF assessment authority to 5 percent of premium for obligations attributable to a particular contract year, and reduces the maximum aggregates assessment to 8 percent of premium. Current law will apply to obligations incurred in prior contract years.

Eliminates the Optional TICL Coverage – The bill repeals the TICL coverage after the 2012-2013 contract year.

This bill substantially amends the following section of the Florida Statutes: 215.555

II. Present Situation:

Florida Hurricane Catastrophe 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 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.

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.[1] 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 Retention

Insurers must first pay hurricane losses up to their specified "retention" for each hurricane, similar to a deductible, before being reimbursed by the FHCF coverage. The full retention is applied to the two hurricanes causing the greatest losses to the insurer. The retention is adjusted annually based on the FHCF's exposure. Like the maximum recovery amount, a retention is calculated for each insurer based on its share of fund premiums. For example, an insurer paying 10 percent of total fund premiums had a retention of $736.9 million, (10 percent of $7.369 billion) for the 2011-012 contract year.

FHCF Optional Coverages

Beginning in 2007, the Legislature increased the coverage limits of the FHCF by adding additional layers of optional coverage that property insurers may buy:

- *Temporary Increase in Coverage Limit Options ("TICL")* – Allows an insurer to purchase additional reinsurance in $1 billion increments, above the FHCF mandatory coverage. A total of $12 billion in additional TICL coverage was made available. In 2009, The Legislature required a staggered phasing out of the TICL layer of coverage over a 6-year period at a rate of $2 billion per year. During the current 2011-2012 contract year private insurers purchased $994 million of the $6 billion in available TICL coverage. For the upcoming 2012-2013 contract year there will be $4 billion dollars in TICL coverage available for purchase.
- *Temporary Emergency Additional Coverage Options ("TEACO")* – Allowed residential property insurers to purchase additional coverage below each insurer's market share of the FHCF retention during the 2007, 2008, and 2009 hurricane seasons. The TEACO options allowed an insurer to select its share of a retention level of $3 billion, $4 billion, or $5 billion, to cover 90 percent, 75 percent, or 45 percent of its losses up to the normal retention for the mandatory FHCF coverage. The TEACO options expired after the 2009-2010 contract year.
- *FHCF Below Retention Coverage* – In 2009, the Legislature re-authorized the sale of $10 million in optional additional FHCF coverage below the fund's mandatory coverage retention

[1] 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.

to limited apportionment companies and companies that had been approved to participate in the Insurance Capital Build-Up Incentive Program. The premium for the coverage is 50 percent of the coverage amount and insurers that purchase the coverage may access it before the mandatory coverage. This coverage option will expire on May 31, 2012, and thus not be available for the 2012-2013 contract year.

FHCF Bonding and Assessment Authority

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[2] coverage; and
- $395 million in optional coverage for insurers that qualify as limited apportionment companies[3] 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.

[2] 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.).

[3] 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. 215.555, F.S., primarily by reducing the Florida Hurricane Catastrophe Fund coverage limits, reducing the maximum reimbursement percentage, increasing the retention, increasing the cash build-up factor, and eliminating the TICL coverage after the 2012-2013 contract year. The major proposed changes are summarized as follows:

Increases the FHCF Retention

The bill increases the FHCF industry retention to $8 billion for the 2013-2014 contract year. The bill maintains current law which authorizes the retention to be adjusted upward based upon the growth in the reported exposure of the fund.

Decreases the Maximum Reimbursement Percentage for FHCF Coverage

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 2013-2014 contract year, 85 percent.
- For the 2014-2015 contract year, 80 percent.
- For the 2015-2016 contract year and all subsequent contract years, 75 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.
- For the 2013-2014 contract year, $15.5 billion.
- For the 2014-2015 contract year, $14 billion.
- For the 2015-2016 contract year, $12 billion.

The bill requires the FHCF coverage limit to be increased after the 2015-2016 contract year if certain events occur. If the State Board of Administration determines that the FHCF has an estimated claims-paying capacity sufficient to provide $12 billion of capacity for the current contract year and an additional $12 billion for subsequent contract years, then the FHCF coverage limit must be increased by one-half of the fund's estimated claims paying capacity in excess of $24 billion. However, the increase may not increase by an amount greater than the dollar growth of the FHCF's balance as of December 31 over the prior calendar year.

Increases the FHCF Cash Build-Up Factor

Current law requires the FHCF to charge insurers a "cash build-up factor" that is added to the actuarially indicated reimbursement premium. The application of the cash build-up factor began with the 2009-2010 contract year at 5 percent and increases in 5 percent increments in each subsequent contract year. During the current 2011-2012 contract year a 15 percent factor was applied, and will continue to increase to 20 percent for the 2012-2013 contract year and 25 percent for the 2013-2014 contract year. The bill creates additional increases to the cash build-up factor as follows:

- For the 2014-2015 contract year, 30 percent.
- For the 2015-2016 contract year, 35 percent.
- For the 2016-2017 contract year, 40 percent.
- For the 2017-2018 contract year, 45 percent.
- For the 2018-2019 contract year and subsequent contract years, 50 percent.

Reduces the FHCF Emergency Assessment Authority

Under current law, when the FHCF has insufficient revenue to fund its obligations, costs, and expenses the SBA may issue revenue bonds for the benefit of the FHCF. When such revenue bonds are issued, the SBA must direct the Office of Insurance Regulation (OIR) to levy emergency assessments on all property and casualty lines of business, including surplus lines insurers, but not including workers' compensation or medical malpractice premiums. The assessments may not exceed 6 percent of premium for losses attributable to a particular contract year, and the aggregate assessments on a policy may not exceed 10 percent of premium.

The bill maintains the current assessment authority for losses attributable to contract years prior to the 2015-2016 contract year. However, beginning in the 2015-2016 contract year the bill reduces the FHCF assessment authority to 5 percent of premium for obligations attributable to a particular contract year, and reduces the maximum aggregate assessment to 8 percent of premium. The reduction in assessment authority beginning in the 2015-2016 contract year corresponds with the reduction of the FHCF mandatory coverage limit to 12 billion dollars during that contract year.

Eliminates the Optional TICL Coverage

The bill repeals the TICL coverage after the 2012-2013 contract year. Current law requires the FHCF to make available $4 billion dollars in TICL coverage above the mandatory layer of FCHF coverage for the 2012-2013 contract year, $2 billion in TICL coverage for the 2013-2014 contract year, and eliminates the coverage thereafter. The bill eliminates the TICL coverage for the 2013-2014 contract year, but otherwise does not change existing law.

Other Provisions

The bill renames the "Florida Hurricane Catastrophe Fund Finance Corporation" the "State Board of Administration Finance Corporation." The name change is proposed to eliminate confusion among private sector investors who may not realize that the bonds issued by the SBA to eliminate FHCF shortfalls are revenue bonds and not other products such as catastrophe bonds. The change may also enable the state to procure such bonds at more advantageous terms by changing the finance corporation's name to eliminate terms with negative connotations such as "hurricane" and "catastrophe."

Repeals language authorizing the FHCF to sell Temporary Emergency Options for Additional Coverage (TEACO) reinsurance. The language is unnecessary because the authorization to offer TEACO coverage ended with the 2009-2010 contract year.

Section 2. Contains a technical conforming amendment to s. 627.0629(5), F.S.

Section 3. The bill is effective upon becoming a law.

<u>Other Potential Implications</u>:

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 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 will cause an increase in policyholder premiums because insurers will replace FHCF reinsurance coverage with private market reinsurance at higher costs. The estimated market-wide premium impact is expected result in an average market-wide cumulative rate increase of approximately 10 percent from the 2012 hurricane season to the 2015 hurricane season. However, representatives from the Fund assert that such premium increases are probably unavoidable because the status of the worldwide financial markets has created a situation where the FHCF may not be able to meet its current obligations. Accordingly, many insurers will seek to procure private market reinsurance to cover amounts that the FHCF estimates cannot be paid in the first 12 months after a storm. This ultimately will harm either the availability or affordability of private market property insurance in the state.

Representatives of some business groups have voiced support for reducing the obligations of the FHCF to $12 billion over time and increasing the retention layer to $8 billion 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.

Representatives of some private market residential property insurers have voiced concerns over the provisions of the bill that reduce the mandatory layer of the Fund while increasing the industry retention. The reductions in the size of the fund would require private market insurers to replace FHCF reinsurance with more expensive private market reinsurance. The most expensive replacement reinsurance coverage will be for coverage "below the retention" because of the greater odds that such coverage will be triggered. Some of the residential property insurers expressing concerns over the bill also assert that the rate impact of the legislation may be greater than estimated by the FHCF, particularly with regard to individual companies.

The representatives of companies concerned about the provisions of the bill assert that the increased costs associated with purchasing private market insurance may harm the ability of some companies to compete with Citizens Property Insurance Corporation (Citizens). These representatives note that Citizens premium increases are generally capped at 10 percent by statute and that Citizens is not required to charge actuarially indicated rates for coverage. Accordingly, private market insurers have difficulty in competing with Citizens in the open market. Increasing the reinsurance cost to private market insurers may exacerbate this problem.

C. Government Sector Impact:

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.)

None.

B. Amendments:

None.