STORAGE NAME: H1711s1.in
DATE: April 13, 1999

HOUSE OF REPRESENTATIVES
COMMITTEE ON
INSURANCE
ANALYSIS

BILL #: CS/HB 1711

RELATING TO: Florida Hurricane Catastrophe Fund

SPONSOR(S): Committee on Insurance and Representative Waters

COMPANION BILL(S): CS/SB 1790

ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:
(1) INSURANCE YEAS 10 NAYS 2
(2) FINANCE & TAXATION
(3) GENERAL GOVERNMENT APPROPRIATIONS
(4)
(5)

I. SUMMARY:

In 1993, the Legislature enacted s. 215.555, F.S., which created the Florida Hurricane Catastrophe Fund. The Catastrophe Fund, or Cat Fund as it is commonly known, provides the equivalent of reinsurance to Florida personal and commercial residential insurers and is funded through a combination of premiums paid by insurance companies and emergency assessments on all property and casualty insurance premiums except for workers' compensation premiums. The Cat Fund is administered by the State Board of Administration (the board).

CS/HB 1711 would the limit the claims-paying capacity of the Cat Fund to $11 billion for a current year, unless the board determines there is $11 billion of capacity for both the current contract year and a subsequent contract year. Any additional growth in capacity would be reserved for losses incurred in a subsequent year, until the claims-paying capacity also reached $11 billion for the subsequent year. If this determination is made by the board, one-half of the Cat Fund's estimated claims-paying capacity in excess of $22 billion would be added to the $11 billion limit for the current contract year.

Any funds left after the Cat Fund has met its contractual obligations with insurers, including the Florida Windstorm Underwriting Association and the Residential Property Joint Underwriting Association, would be paid to the Florida Windstorm Underwriting Association and the Residential Property Joint Underwriting Association, if needed.

To fund reimbursement payouts for a subsequent contract year, the board would be granted an additional 2 percent assessment authority, available only in the event that the original 4 percent assessment capacity has been used in a previous year and events have caused reimbursable losses in a subsequent contract year. Unused assessment authority from prior contract years could be carried forward to subsequent contract years. The maximum assessment the Cat Fund could levy would be 6 percent, but no more than 4 percent could be assessed for any one contract year. By increasing the assessment authority from 4 percent to 6 percent, the Cat Fund would have access to funding to restore a portion of its bonding capacity if losses in a contract year deplete existing Cat Fund capacity. At no time would the total amount of assessment for all years exceed 6 percent.

II. SUBSTANTIVE ANALYSIS:

A. PRESENT SITUATION:

In 1993, the Legislature enacted s. 215.555, F.S., which created the Florida Hurricane Catastrophe Fund. The purposes of the legislation were to create additional reinsurance capacity, safeguard the public against the inability or unwillingness of insurers to maintain sufficient catastrophic protection, and protect the state's residents and economy from the dangers of a shrinking private sector reinsurance market. The Catastrophe Fund, or Cat Fund as it is commonly known, provides the equivalent of reinsurance to Florida personal and commercial residential insurers, funded through a combination of premiums paid by insurance companies and emergency assessments on all property and casualty insurance premiums except for workers' compensation premiums. The Cat Fund is administered by the State Board of Administration (the board).

All admitted insurers writing property insurance in Florida, including the RPCJUA and FWUA, are required to enter into reimbursement contracts with the Cat Fund. In 1998, 298 insurers had contracts with the Cat Fund, representing $800.19 billion in total exposure by those insurers.

According to the Cat Fund, the cost of reinsurance through the Cat Fund generally has been less than one half of the cost of private reinsurance for similar coverage. The cost of reinsurance through the Cat Fund is 4 percent of the coverage received, while the cost of reinsurance through a private reinsurer could cost as much as 10 percent of the coverage received.

The receipts of the Cat Fund consist of reimbursement premiums, emergency assessments and investment income. The monies in the fund may only be used to pay obligations arising from the reimbursement contracts, debts, costs of mitigation programs, costs of procuring reinsurance, and costs of administering the fund. Annual Cat Fund premium revenues total approximately $446 million for 1998, and the Cat Fund projects that the total amount of premium collected for the 1999 contract year will be $467 million.

Insurers may recoup Cat Fund premiums through property insurance premiums. Insurers use different methods for recouping Cat Fund premiums. Some use a uniform percentage surcharge and others build Cat Fund costs into the catastrophe load of their rate base.

In exchange for payment of an actuarially indicated premium, the Cat Fund reimburses insurers for a selected percentage (45, 75 or 90 percent) of their hurricane losses in excess of a specified amount, known as the insurer's "retention." In 1998, there were 146 insurers that chose 45 percent coverage, 9 insurers that chose 75 percent coverage, and 142 that chose 90 percent coverage. An insurer may change its coverage level to a lower percentage if there are no revenue bonds outstanding, or a higher percentage, if it pays an equalization charge determined by the board. According to the Cat Fund, the board has never charged an equalization charge. The FWUA and the RPCJUA are required to elect the 90 percent coverage level. If funds remain after every insurer has been reimbursed, the Cat Fund distributes the remaining funds to insurers on a pro rata basis.

Retention is defined as the amount of an insurer's losses for which the insurer is solely responsible. The Cat Fund compensates insurers for losses above the insurer's retention. The retention level acts to limit Cat Fund reimbursements to claims stemming from hurricanes causing more extensive losses. Aggregate insurer retention was $3.017 billion as of December 31, 1998. In the aggregate, the Cat Fund is responsible for approximately 84 percent of the insurance industry's covered losses in excess of the retention.

Retention and reimbursements are calculated in the following example:

> The Cat Fund premium paid by Company A is $1.5 million, and it elects the 90 percent coverage option. Company A's retention would be $9.3 million, meaning that Company A would have to experience more than $9.3 million in losses before receiving reimbursement from the Cat Fund. This *retention* amount for Company A is calculated by dividing the total adjusted retention for all insurers ($3.017 billion) by the anticipated premiums collected if every insurer elected 90 percent coverage ($495 million). The result (6.2) is then multiplied by Company A's Cat Fund premium ($1.5 million). To calculate Company A's *reimbursements* from the fund, the total amount of Cat Fund cash and bonding capacity (currently, $11 billion) is divided by the total projected premiums for the contract year ($446 million). This results in a payout multiple of 24.66. The multiple is

then applied to Company A's premium, which results in a maximum Cat Fund reimbursement of $36.99 million for Company A. The Cat Fund would pay Company A $36.99 million for its reimbursable losses above Company A's retention of $9.3 million. Company A would pay 10 percent of the amount over $9.3 million as its co-payment as part of selecting 90 percent coverage.

Section 215.555(2)(e)1., F.S., requires that the retention be adjusted each year to reflect the adjusted percentage growth in premium of covered policies for the year. Current practice is to adjust the retention by the adjusted percentage growth in exposure. According to the Cat Fund, exposure is a steadier number to use, whereas premium can fluctuate in one year.

The obligations of the Cat Fund may not exceed the cash on hand and the bonding capacity of the Cat Fund. Bonding capacity is defined as the amount of money that can be raised in a bond market. The bonding capacity is estimated in this case by a financial adviser and is based on current market conditions. The current base for assessments is $15.4 billion in direct written premium. A 4 percent assessment generates over $600 million per year for each year of the levy. The current cash on hand is $2.5 billion and is projected to be approximately $3 billion by the end of 1999. The bonding capacity of the Cat Fund is $8.5 billion, which is based on premium revenues and a 4 percent assessment authority. The Cat Fund has received ratings of at least "A" from financial rating agencies such as Moody's, Standard & Poor's, and Fitch. The higher the Cat Fund is rated, the less interest will be charged on the bonds issued.

Insurers are required to report to the board by December 31 of each contract year their losses from covered events for the year. If in any year the board determines that the cash balance of the fund is insufficient to pay all claims, the board must levy an emergency assessment of up to 4 percent on all insurers writing property and casualty business in the state. Emergency assessments must continue to be collected annually as long as any revenue bonds are outstanding. The total amount of emergency assessments levied by the board for the Cat Fund may not total more than 4 percent in any year. For example, if the Cat Fund issues bonds one year due to losses and an emergency assessment of 2 percent is levied, and the subsequent year the Cat Fund experiences losses and issues bonds before the first bond issue is paid off, the maximum amount of emergency assessment that may be levied the subsequent year is 2 percent.

B. EFFECT OF PROPOSED CHANGES:

The claims-paying capacity of the Cat Fund to would be limited to $11 billion for a contract year, unless the board determines there is $11 billion of capacity for both the current contract year and a subsequent contract year. Any additional growth in capacity would be reserved for losses incurred in a subsequent year, until the claims-paying capacity also reached $11 billion for the subsequent year.

The $11 billion limit on payments would be increased if the board determines that there is sufficient estimated claims-paying capacity to provide for $11 billion for the current year and $11 billion for a subsequent year. If this determination is made, one-half of the Cat Fund's estimated claims-paying capacity in excess of $22 billion would be added to the $11 billion limit for the current year. For example, if there is a total of $23 billion in the Cat Fund, the claims-paying capacity for the current year would be $11.5 billion. This would be calculated by taking one half of the claims-paying capacity over $22 billion ($0.5 billion), and adding it to the current year limit ($11 billion). As a result, there would be $11.5 billion available to pay claims for the current year, $11 billion in claims-paying capacity for a subsequent year, and $0.5 billion available for a third season.

After the Cat Fund has met its contractual obligations to insurers, including the FWUA and the RPCJUA, any remaining funds up to the actual claims-paying capacity of the Cat Fund would be paid to the FWUA and the RPCJUA, if needed. This could keep those residual market entities from having to levy assessments on insurers. Also, if the funds are not needed by either residual market entity, the funds would remain in the Cat Fund and would continue to grow.

The Cat Fund retention multiple would be adjusted each year to reflect the percentage growth in exposure of the fund, rather than premium. This change would codify the current practice of the Cat Fund.

To fund reimbursement payouts for a subsequent contract year, the board would be granted an additional 2 percent assessment authority, available only in the event that the original 4 percent

assessment capacity has been used in a previous year and events have caused reimbursable losses in a subsequent contract year. Unused assessment authority from prior contract years could be carried forward to subsequent contract years. The maximum assessment that could be levied would be 6 percent, but no more than 4 percent could be assessed for any one contract year. By increasing the assessment authority from 4 percent to 6 percent, the Cat Fund would have some bonding capacity if there were a storm causing reimbursable losses in the subsequent year. For example, if there were a storm causing reimbursable losses that depleted the fund balance, the Cat Fund estimates that a 3.7 percent assessment would be required to pay $11 billion in reimbursements based on the current cash on hand and bonding capacity. If a hurricane caused reimbursable losses the next year, the Cat Fund would be able to access any unused assessment capacity and the additional 2 percent assessment authority, provided the Governor has declared a state of emergency. At no time would the total amount of assessment for all years exceed 6 percent.

The Cat Fund would be able to conduct audits to ensure that insurers have properly reported insured values and losses. The cost of such audits would be covered by the board, unless the board incurs additional expenses as the result of an insurers failure to provide the requested information despite proper notice. These audits would be exempt from the public records law as provided in s. 215.557, F.S. This does not expand the current public records law. Currently, the Cat Fund has no statutory authority to conduct these audits.

CS/HB 1711 would make other changes to s. 215.555, F.S. These changes include:

- Restating the legislative intent to state that the Legislature intends for the Cat Fund to provide a “stable and ongoing source” of reimbursement to insurers.
- Amending the definition of “covered policy” to clarify that neither surplus lines insurers nor reinsurers could participate in the Cat Fund.
- Amending language requiring that an equalization charge levied by the board on insurers that increases their level of coverage would not have to be “actuarially appropriate.” According to the Cat Fund, the removal of this term would have no effect on the equalization charge, which is currently not charged by the Cat Fund.
- Allowing insurers to use the potential Cat Fund reimbursements to establish a line of credit at a bank or financial institution in the event of an insolvency.

C. APPLICATION OF PRINCIPLES:

1. <u>Less Government:</u>

a. Does the bill create, increase or reduce, either directly or indirectly:

(1) any authority to make rules or adjudicate disputes?

N/A

(2) any new responsibilities, obligations or work for other governmental or private organizations or individuals?

N/A

(3) any entitlement to a government service or benefit?

N/A

b. If an agency or program is eliminated or reduced:

(1) what responsibilities, costs and powers are passed on to another program, agency, level of government, or private entity?

N/A

(2) what is the cost of such responsibility at the new level/agency?

N/A

(3) how is the new agency accountable to the people governed?

N/A

2. <u>Lower Taxes:</u>

a. Does the bill increase anyone's taxes?

N/A

b. Does the bill require or authorize an increase in any fees?

N/A

c. Does the bill reduce total taxes, both rates and revenues?

N/A

d. Does the bill reduce total fees, both rates and revenues?

N/A

e. Does the bill authorize any fee or tax increase by any local government?

N/A

3. <u>Personal Responsibility:</u>

a. Does the bill reduce or eliminate an entitlement to government services or subsidy?

N/A

b. Do the beneficiaries of the legislation directly pay any portion of the cost of implementation and operation?

N/A

4. <u>Individual Freedom:</u>

a. Does the bill increase the allowable options of individuals or private organizations/associations to conduct their own affairs?

N/A

b. Does the bill prohibit, or create new government interference with, any presently lawful activity?

N/A

5. Family Empowerment:

   a. If the bill purports to provide services to families or children:

      (1) Who evaluates the family's needs?

      N/A

      (2) Who makes the decisions?

      N/A

      (3) Are private alternatives permitted?

      N/A

      (4) Are families required to participate in a program?

      N/A

      (5) Are families penalized for not participating in a program?

      N/A

   b. Does the bill directly affect the legal rights and obligations between family members?

   N/A

   c. If the bill creates or changes a program providing services to families or children, in which of the following does the bill vest control of the program, either through direct participation or appointment authority:

      (1) parents and guardians?

      N/A

      (2) service providers?

      N/A

      (3) government employees/agencies?

      N/A

D. STATUTE(S) AFFECTED:

Amends s. 215.555, F.S.

E. SECTION-BY-SECTION ANALYSIS:

N/A

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE AGENCIES/STATE FUNDS:

1. Non-recurring Effects:

   N/A

2. Recurring Effects:

   N/A

3. Long Run Effects Other Than Normal Growth:

   N/A

4. Total Revenues and Expenditures:

   N/A

B. FISCAL IMPACT ON LOCAL GOVERNMENTS AS A WHOLE:

1. Non-recurring Effects:

   N/A

2. Recurring Effects:

   N/A

3. Long Run Effects Other Than Normal Growth:

   N/A

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

1. Direct Private Sector Costs:

   The maximum aggregate amount that the State Board of Administration could assess insurers for all contract years would be raised from 4 percent to 6 percent. The maximum amount of assessment that could be levied to reimburse for losses for any one contract year would be 4 percent. The additional 2 percent assessment authority would be available only in the event that the original 4 percent assessment capacity has been used in a previous year and events have caused reimbursable losses in a subsequent contract year. Unused assessment authority from prior contract years could be carried forward to subsequent contract years. By increasing the assessment authority from 4 percent to 6 percent, the Cat Fund would have access to funding to restore a portion of its bonding capacity.

2. Direct Private Sector Benefits:

   By limiting the claims-paying capacity of the Cat Fund to $11 billion in any one year, the Cat Fund would be available to reimburse insurers for covered losses for more than one season. The additional assessment capacity would enable the Cat Fund to provide a source of reinsurance for insurers in the aftermath of losses which deplete Cat Fund capacity.

3. Effects on Competition, Private Enterprise and Employment Markets:

   If the Cat Fund reserves funds for a subsequent season, there would be fewer opportunities for reinsurers.

D. FISCAL COMMENTS:

N/A

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

N/A

B. REDUCTION OF REVENUE RAISING AUTHORITY:

N/A

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

N/A

V. COMMENTS:

N/A

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

On April 7, 1999, the Committee on Insurance adopted the bill as a committee substitute. CS/HB 1711 differs from the original bill in the following ways:

- ♦ The multiple used to calculate insurer retention would be adjusted each year to reflect the percentage growth in exposure to the Cat Fund, rather than premium. The current practice of the Cat Fund is to adjust the retention based on the percentage growth in exposure.
- ♦ The “estimated claims-paying capacity” and the “actual claims-paying capacity” would include any reinsurance purchased by the Cat Fund. The proposed language stating that the Cat Fund’s estimated borrowing capacity would be estimated in May and October of each year would be removed, as it is provided for under current law.
- ♦ The proposed language that would define “actual claims-paying capacity” as the balance of the Cat Fund and the amount that the board is able to raise through the issuance of bonds as of December 31 of a contract year would be removed. This term would be defined in another section of the bill.
- ♦ The proposed term “pro rata” used when describing how an insurer’s claim would be paid would be removed.
- ♦ Language would be added to state that nothing in the proposed language regarding the confidentiality of audit reports would expand the Cat Fund’s current public records exemption. Currently, insurers are required to report insured values under covered policies by zip code. The board performs audits to ensure that insurers report their losses and insured values properly.
- ♦ The proposed language that would codify the practice of the Cat Fund that the independent consultant who prepares the formula to set the rates for the Cat Fund be an actuary would be removed.
- ♦ The board would no longer have the authority to charge an equalization charge to those insurers that initially elect a lower percentage coverage level then switch to a higher percentage coverage level. The board has never levied an equalization charge.

- To fund reimbursement payouts for a subsequent contract year, the board would be granted an additional 2 percent assessment authority, available if the Governor declares a state of emergency. Any unused assessment authority from prior contract years could be carried forward to subsequent contract years.

- Allowing insurers to use the potential Cat Fund reimbursements to establish a line of credit at a bank or financial institution in the event of an insolvency.

.

VII. SIGNATURES:

COMMITTEE ON INSURANCE:

Prepared by:	Staff Director:
______________________	______________________
Meredith Woodrum Snowden	Stephen Hogge