SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based only on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/SB 1790

SPONSOR: Banking and Insurance Committee and Senator Holzendorf

SUBJECT: Florida Hurricane Catastrophe Fund (Second Season Coverage)

DATE: March 23, 1999 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Deffenbaugh	Deffenbaugh	BI	Favorable/CS
2.			FP	
3.				
4.				
5.				

I. Summary:

Committee Substitute for Senate Bill 1790 makes the following changes to the Florida Hurricane Catastrophe Fund (Cat Fund):

- Limits the total amount the Cat Fund may reimburse all insurers for hurricane losses to $11 billion for any one year. Currently, there is no identified limit an insurer may receive to cover 45%, 75%, or 90% of its losses, as selected by the insurer, above its retention. The total recovery is limited only by the balance of the Cat Fund and the maximum amount the State Board of Administration (SBA) is able to raise through the issuance of revenue bonds financed by a 4% assessment on property and casualty policies, estimated to be $11 billion in 1998 and expected to be about $11.6 billion for 1999.

- Limits each insurer's payment from the Cat Fund for any one year to the current minimum payment, which generally equals each insurer's proportionate share of Cat Fund premiums; however, the two state-created residual market insurers, the Florida Windstorm Underwriting Association (FWUA) and the Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) would *not* be subject to this limitation; and

- Increases the potential maximum assessments on property and casualty policies from 4% to 8% to fund Cat Fund bonds issued by the SBA, but limited to 4% for any one contract year. For example, if hurricane losses in 1999 require the Cat Fund to use its $3 billion cash balance and issue bonds for an additional amount (up to a total limit of $11 billion) funded by a maximum 4% assessment, a new 4% assessment would be authorized if necessary to pay losses for future contract years. This would provide an estimated claims-paying capacity of about $7 billion for contract year 2000, subject to growth in subsequent years due to premium and investment income. There would be continuing authority to generate a new 4% assessment for any contract year following a year when

some or all of the 4% assessment authority is utilized, but limited by the 8% cap on aggregate assessments in any one year for all contract years.

The above changes are intended and expected to preserve reinsurance capacity in the Cat Fund as a relatively stable and ongoing fund for the years following a major hurricane and to help minimize the rate increases and policy cancellations for residential property insurance policies that are likely to occur following a hurricane that significantly depletes the reinsurance capacity of the Cat Fund. This is due to the fact that insurers which depend on the Cat Fund for reinsurance capacity would be less likely to be forced to obtain more expensive private reinsurance to substitute for reduced Cat Fund claims-paying capacity.

The bill is not expected to have any significant impact on rates or availability of coverage in the absence of a hurricane, since both the $11 billion cap and the maximum payment to each insurer under the bill are approximately the same amounts estimated as payments to insurers in 1998, in a maximum bond-issuance situation. That is, insurers will continue to expect the same level of Cat Fund coverage as provided in 1998. There may be a small decrease in Cat Fund premiums (and a corresponding decrease in residential property insurance rates) since the actuarial formula currently accounts for some recoveries above estimated minimum amounts, which become the maximum payment levels under the bill.

Insurers who issue property and casualty policies in Florida (and through rate increases, their policyholders) would be subject to a potential maximum assessment of 8% of premiums, rather than the current 4%, to fund the issuance of bonds to fund Cat Fund obligations to residential property insurers for multiple-year storms. However, the 4% cap remains in place to fund losses for any one contract year. Aggregate assessments in excess of 4% (up to 8%) would only be necessary to pay losses for a hurricane or hurricanes in subsequent years after Cat Fund bonds were first issued, until such bonds are satisfied.

In a macro-sense, the net effect of raising the maximum potential assessment from 4% to 8% is likely to be a zero or minimal increase in assessments on Florida policyholders by the Cat Fund, the FWUA, and RPCJUA, combined. This is due to the fact that the FWUA and RPCJUA are likely to have significant deficits in the event of a subsequent season storm that requires a second Cat Fund bond issuance, together with the fact that both entities are likely to have utilized their available financing for the first storm that required the issuance of Cat Fund bonds. Therefore, the effect of the bill is primarily to transfer existing assessment authority from the FWUA and RPCJUA to the State Board of Administration as administrator of the Cat Fund. It may even result in lower assessments overall, by preventing insurers from canceling policies or otherwise reducing their writings, since such actions would increase the exposure of the residual market insurers.

However, the impact of the extra 4% assessment in the Cat Fund is transferred from all property insurance policyholders in the state (FWUA) and all residential property insurance policyholders in the state (RPCJUA) to all property and casualty policyholders in the state (Cat Fund), which includes motor vehicle insurance, commercial liability, medical malpractice, and other lines of liability insurance that are in the Cat Fund assessment base, but not the assessment base of the FWUA or RPCJUA.

The bill makes other changes to the operation of the Cat Fund, including: (1) specifying that the percentage growth in the insurers' retention is based on the percentage growth in premiums paid to the fund; (2) clarifying the types of policies covered by the fund; (3) adding definitions to clarify the distinction between the estimated and actual claims-paying capacity of the fund; (4) deleting the requirement that the fund charge an equalization charge for insurers increasing their coverage level; (5) requiring insurers to report losses on an interim basis as directed by the SBA; (6) authorizing the SBA to audit records of each insurer's covered policies; (7) authorizing the SBA to collect interest on late reimbursement payments; (8) various provisions intended to protect the interest of bondholders of Cat Fund bonds and, thereby, help assure their marketability; and (9) authorizing the SBA to take any action necessary to enforce its rules and contract requirements.

This bill substantially amends section 215.555 of the Florida Statutes.

II. Present Situation:

Florida Hurricane Catastrophe Fund; Reimbursement Formula

The Florida Hurricane Catastrophe Fund (Cat Fund), created in 1993 following Hurricane Andrew, is a state trust fund administered by the State Board of Administration (SBA) that reimburses insurers for a portion of their hurricane losses in the state. (Ch. 93-409, L.O.F.) The purpose of the Cat Fund, as set forth in the law, is to provide additional reinsurance capacity, thereby increasing the amount of property insurance that insurers are otherwise able to write and enabling insurers to pay all claims in full in the even of a hurricane. [s. 215.555(1), F.S.]

The Cat Fund reimburses insurers for either 45%, 75%, or 90% of each insurer's hurricane losses in any one year, as selected by the insurer, above the insurer's *retention*, or first-dollar losses that an insurer must pay before Cat Fund coverage is triggered. The law provides that for all insurers combined, the retention equals $3 billion in 1995, adjusted annually to reflect the percentage growth in premiums for covered policies, set at $3.2 billion in 1998. Each insurer's retention is set as a multiple of its Cat Fund premium, which was set at 6.2 times premium for the 90% coverage level in 1998. (An insurer's retention is the same at the 45% coverage level, but the premium is one-half of the premium for the 90% coverage level, so the retention multiple in 1998 was 12.4.)

Insurer's Maximum and Minimum Recovery from the Cat Fund

There is no identified maximum amount that an insurer may receive as reimbursement from the Cat Fund, but for all insurers combined, the reimbursement for a particular year shall not exceed the balance of the Cat Fund as of December 31 of that year, plus the maximum amount that the SBA is able to raise through the issuance of revenue bonds. [s. 215.555(4)(c), F.S.]

Each insurer is entitled to receive a specified minimum amount from the Cat Fund if the SBA is unable to pay all insurers at their full selected percentage (45%, 74%, or 90%) of reimbursable losses. Basically, each insurer is promised a minimum percentage of Cat Fund revenues that equals the insurer's percentage of total Cat Fund premiums. Specifically, an insurer's minimum recovery is equal to the insurer's share of the total Cat Fund premium paid for that year, multiplied by the actual claims-paying capacity available for that year. Each year the Cat Fund *estimates* its claims-paying capacity and the "projected payout multiple" which enables each insurer to calculate its estimated minimum recovery from the fund. In 1998, the SBA estimated that its total claims-paying capacity was $11 billion, which resulted in a projected payout multiple of 25. Each insurer multiplied its Cat Fund premium by 25 to calculate its estimated minimum recovery.

For example, an insurer that paid a $10 million premium for its Cat Fund coverage in 1998 expected to recover at least $250 million (25 X $10 mil.) from the Cat Fund in excess of the insurer's $62 million retention (6.2 X $10 mil.), in a worst-case scenario with every member company sustaining a total loss to the fund. However, an insurer could potentially recover a *greater* amount (up to the full 45%, 75%, or 90% of its hurricane losses above its retention) *if* some other member insurers sustain less than a total loss to the fund.

All Residential Property Insurers Must Participate, including RPCJUA and FWUA

Each insurer that writes residential property insurance in Florida must enter into a contract with the SBA, for the year beginning on June 1, to purchase reimbursement coverage from the Cat Fund. This includes the state's two residual market insurers, the Residential Property and Casualty Joint Underwriting Association (RPCJUA) and the Florida Windstorm Underwriting Association (FWUA), both of which (unlike other insurers) *must* obtain coverage at the 90% level. These two state-created residual market insurers, authorized in s. 627.351, F.S., sell residential property insurance to persons who are unable to obtain coverage from an authorized insurer in the voluntary market. The RPCJUA sells standard homeowners coverage and other residential policies statewide, while the FWUA sells only windstorm coverage in geographically limited coastal areas of the state. Policies in both associations are heavily concentrated in Dade, Broward, and Palm Beach Counties.

In addition to Cat Fund coverage, both the RPCJUA and FWUA depend upon debt financing supported by assessments against all Florida property insurers and their policyholders to fund losses in the event of a deficit. All property insurance policies (including commercial property) provide the assessment base for FWUA deficits, while only residential property insurance policies are assessed for RPCJUA deficits. Assessments are limited only by the magnitude of the losses in the RPCJUA or FWUA and the capacity of the bond market, since the annual cap on assessments is 10% of each entity's *deficit*, or 10% of property insurance premiums in the state, whichever is *greater*.

Premiums Charged to Insurers for Cat Fund Coverage

The SBA is required to charge each insurer an actuarially indicated premium for Cat Fund coverage, as developed by an independent consultant and as approved by unanimous vote of the trustees of the SBA [the Governor, Comptroller, and Treasurer (Insurance Commissioner)]. The SBA must, to the extent feasible, use the standards and models approved by the Florida Commission on Hurricane Loss Projection Methodology, as specified in the law which creates the Commission, (s. 627.0628, F.S.). To date, the rates of the Cat Fund have been based on the hurricane loss projection model developed by Applied Insurance Research, the first model approved by the Commission. The rates for 1999 as currently proposed to the SBA, are a blended rate of three models that have been approved by the Commission.

For contract year 1998, Cat Fund premiums totaled $440 million. As currently proposed to the trustees of the SBA, premiums for coverage in 1999 will total $467 million.

Assessments on Property and Casualty Insurers to Support Cat Fund Bonds; Current Reimbursement Capacity

As of December 31, 1998, the Cat Fund had a balance of about $2.5 billion, representing 5 years of premium collections and investment income, minus minimal payments to insurers during that time, administrative expenses, and legislative appropriations of $19.7 million for programs related to mitigation of hurricane losses (required to be at least $10 million annually, beginning in FY 1997-98).

In addition to its cash balance, if necessary to make reimbursement payments in full, the SBA is authorized to issue revenue bonds, supported by a maximum 4% emergency assessment that it may direct the Department of Insurance to levy on each insurer writing property and casualty business in Florida, except workers' compensation policies. By the wording of the statute, the maximum assessment is actually 2% of premiums, but may not exceed 4% if the Governor has declared a state of emergency under s. 252.36, F.S., which would be expected in the event of a major hurricane that results in hurricane losses of this magnitude. [s. 215.555(6)(a), F.S.]

The assessment on all "property and casualty business" includes all lines of business identified on Form 2, Exhibit of Premiums and Losses, in the insurer's annual statement, except for workers' compensation and lines identified as accident and health insurance. In addition to property insurance, this includes private passenger and commercial motor vehicle insurance, commercial multi-peril, medical malpractice, other liability, and other lines of property and casualty insurance. The fact that motor vehicle insurance policies and other liability policies are included, thereby making the assessment a broad-based funding source, was a key factor that led to a ruling by the Internal Revenue Service that the Cat Fund is an integral part of state government and is exempt from federal taxation.

Property and casualty insurers are permitted to pass along the cost of assessments to their policyholders. Specifically, the law provides that any rate filing made by an insurer with the Department of Insurance reflecting a rate change attributable entirely to the amount of the emergency assessment shall be deemed approved when made, subject to the authority of the department to require actuarial justification as to the adequacy of any rate at any time.

For 1998, the SBA estimated that it could raise $8.5 billion through the issuance of revenue bonds. Added to its approximate $2.5 billion cash balance on 12/31/98, the total estimated claims-paying capacity from the Cat Fund was $11 billion for 1998. Adding about $600 million for premium revenue and investment income will increase this capacity in 1999 to about $11.6 billion. Premium revenue and investment income are the sole sources of future capacity growth, subject to changing interest rate assumptions for debt financing (currently very favorable) and the capacity of the bond market. However, payments for covered hurricane losses in any future year could diminish the fund's capacity to its premium and investment income (about $500 million per year) for as many years as bonds remain outstanding secured by the entire 4% assessment.

The law creates the Florida Hurricane Catastrophe Fund Finance Corporation as a public benefits corporation for the cost-effective and efficient issuance of bonds to meet Cat Fund obligations. A favorable ruling was obtained by the SBA from the Internal Revenue Service in 1998 that the bonds issued by the corporation are tax-exempt, which increased the estimated claims-paying capacity due to the lower interest rate assumptions.

Effects of Substantially Reducing Cat Fund Reimbursement Capacity

The Cat Fund is able to provide reinsurance to insurance companies at a premium that is about 40% lower than the premium for private reinsurance. This is due to the fact that the Cat Fund is tax-exempt (it pays no state or federal taxation) and that it does not charge a "risk load" or profit factor in its rates, because it uses debt financing (also tax exempt) rather than equity financing. Also, the expense of SBA administration is low, compared to private reinsurers.

A severe shock to the Florida property insurance market is likely if one or more major hurricanes deplete the bonding capacity of the Cat Fund. If this occurs, insurers who depend on the current claims-paying capacity of the Cat Fund for adequate catastrophe reinsurance will be forced to substitute more expensive private reinsurance at a time when availability of reinsurance is likely to be limited and premiums high. This, in turn, will result in economic pressures on insurers to increase homeowners' rates and reduce exposure to hurricane losses, resulting in policy cancellations and growth in the exposure of the two residual market insurers, the RPCJUA and FWUA. A staff survey was sent to all member insurers of the Cat Fund, which included the following question:

> Question 1: Would the loss of a significant amount of FHCF [Cat Fund] capacity after a major event affect your insurance company's ability to continue offering residential property insurance to all of its existing Florida policyholders without major price increases?

Answer to Ques. 1	**No. of Insurers Responding**
Major Effect	46
Minor Effect	51
No Effect	31
Unknown	18
TOTAL	**146**

The two residual market insurers, the RPCJUA and FWUA, are the insurers most vulnerable to the effects of a major hurricane season that substantially depletes the resources of the Cat Fund. The FWUA estimates that it would be able to recover $2.5 billion from the Cat Fund in 1999, a major element of its $5.88 billion financing plan to cover its projected probable maximum loss (PML) of $5.5 billion for a 100-year storm and partially cover its $9.7 billion PML for a 250-year storm. This FWUA financing plan also includes $414 million in regular assessments, $1.7 billion in pre-event (issued before the storm) note proceeds, and a $1.09 billion line of credit that, if utilized, must be repaid through emergency assessments on all property insurance policyholders in the state.

The RPCJUA's financing plan to cover its estimated $2.4 billion 100-year PML and partially cover its $6.2 billion 250-year PML, includes a $1.1 billion recovery from the Cat Fund, $300 million in regular assessments, $450 million in pre-event note proceeds, and a $1.4 billion line of credit that would also be repaid through emergency assessments on all property insurance policyholders in the state.

Thus, the impact of depleting the Cat Fund after a major hurricane season, is to increase the debt financing that the FWUA and RPCJUA would be forced to obtain to cover expected losses (pre-event debt financing) and actual losses (post-event debt financing) for a subsequent hurricane, financed by assessments ultimately paid by all property insurance policyholders in the state (FWUA) and all residential property insurance policyholders in the state (RPCJUA). In addition, since the rates in the RPCJUA are directly tied to rates charged in the voluntary market, rate increases in the RPCJUA would also be likely.

III. Effect of Proposed Changes:

Summary of Changes and Legislative Intent

CS/SB 1790 would impose limits on the amount that the Florida Hurricane Catastrophe Fund (Cat Fund) would reimburse insurers for hurricane losses in any one year and would increase the maximum allowable assessments on property and casualty policies to fund Cat Fund obligations. The expressed intent of these changes is to revise the Cat Fund to be a *stable and ongoing* source of reimbursement to insurers for a portion of their catastrophic hurricane losses, as stated in the amended findings and purpose clause of s. 215.555(1)(e), F.S.

By preserving reinsurance capacity for a subsequent season, the bill would help minimize the rate increases and policy cancellations for residential property insurance policies that are likely to occur following a hurricane that significantly depletes the reinsurance capacity of the Cat Fund. This is due to the fact that insurers which depend on the Cat Fund for reinsurance capacity would be less likely to be forced to obtain more expensive private reinsurance to substitute for reduced Cat Fund claims-paying capacity.

$11 Billion Maximum Payment to all Insurers from the Cat Fund for Any One Year

The bill would limit to $11 billion, the total amount that the State Board of Administration (SBA) would be obligated to pay all member insurers from the Cat Fund for reimbursable losses for a particular contract year. Reimbursement would be further limited, as in current law, to the maximum amount that the SBA is able to raise through the issuance of revenue bonds, if this amount is less than the $11 billion cap. Such a lower cap is extremely unlikely for the first (next) catastrophic hurricane, given the Fund's current balance and bonding capacity. This lower cap is likely for years closely following a year in which significant losses are paid, when the maximum 4% assessment would generate less than $11 billion, probably about $7 billion based on current estimates, until new premium revenue and investment income built the Fund's capacity back up to $11 billion. [Paragraph (4)(c)]

Maximum (and Minimum) Payment to Each Insurer, Except the RPCJUA and FWUA

The bill makes the current *minimum* payment for each insurer a *maximum* payment, as well. Basically, each insurer is currently promised a minimum percentage of Cat Fund revenues that equals the insurer's percentage of total Cat Fund premiums (as described in more detail in Present Situation, above). Under the bill, this amount would be the maximum amount that any one insurer could receive from the Cat Fund.

The example used in Present Situation, above, is an insurer that paid a $10 million premium for its Cat Fund coverage in 1998, which resulted in a minimum estimated recovery of $250 million (25 X $10 mil.) in excess of the insurer's $62 million retention (6.2 X $10 mil.), in a worst-case scenario with every member company sustaining a total loss to the fund. Under the bill this would be a best-case scenario as well as a worst-case scenario, since the insurer could no longer possibly recover a greater amount (up to the full 45%, 75%, or 90% of its hurricane losses above its retention) if some other member insurers sustain less than a total loss to the fund. This example is particularly appropriate since the estimated claims-paying capacity was $11 billion in 1998, which equals the maximum annual limit under this bill. This further demonstrates the generally nondisruptive impact of the bill by maintaining reimbursement levels at each insurer's current expectations. [Paragraph (4)(d)]

The Florida Windstorm Underwriting Association (FWUA) and the Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) would not be subject to the maximum payment provisions of the bill, as summarized above. [The bill refers to these insurers in paragraph (4)(d) as "entities created pursuant to s. 627.351."] Each of these two residual market insurers would be able to collect up to the full 90% of reimbursable losses, above their respective retentions, subject to the overall $11 billion cap in total Cat Fund payments for any particular year, and payment of promised reimbursement amounts to all other insurers.

Increase in Maximum Assessments from 4% to 8% on Property and Casualty Premiums

The bill increases the maximum aggregate assessment that may be levied in any one year, from 4% to 8% of gross direct written premiums, on each insurer writing property and casualty business in Florida, in order to meet Cat Fund obligations. However, the bill retains the current 4% cap on assessments to fund losses *for* any one contract year. Assessments in excess of 4% would only be authorized if necessary to fund losses for a subsequent contract year, in addition to funding losses for a previous year. There would be continuing authority to generate a new 4% assessment for any contract year following a year when some or all of the 4% assessment authority is utilized, but limited by the 8% cap on aggregate assessments in any one year for all contract years.

The bill does not change the types of property and casualty premiums that are assessed, which includes property insurance, motor vehicle insurance, liability insurance and certain other lines, but not including workers' compensation, accident, or health insurance. (For more detail on lines covered, see Present Situation, above). [Paragraph (6)(a)]

The SBA currently estimates that only about a 3.7% assessment would be necessary to pay $11 billion in 1999, the limit in the bill, based on the current balance and interest rate assumptions.

Reimbursable losses of less than $11 billion would require even lower assessments.

If the SBA uses less than the maximum 4% assessment to fund losses for a contract year, the remaining, unused percentage of the maximum 4% assessment authority would *not* be carried forward to cover subsequent years. The bill would authorize a new 4% assessment to cover losses for subsequent seasons, but there is no additional "carry-over" of unused assessments from the prior year.

It is currently estimated that if the Cat Fund uses its balance and some level of assessments to cover storms in 1999, that a new 4% assessment would generate about $7 billion in claims-paying (bonding) capacity for 2000, subject to about $500 million in premium growth and investment income in each subsequent year.

The smaller reduction in reinsurance capacity from $11 billion to $7 billion for the year following a major hurricane would minimize the need for insurers to replace Cat Fund coverage with private reinsurance, as compared to the current situations reduction from $11.6 billion to about $500 million, which requires a much greater role for private reinsurance to replace lost Cat Fund capacity. (See Economic Impact, below, for further analysis.)

Other Changes

The bill amends s. 215.555, F.S., making additional changes affecting the Cat Fund. The bill:

(1) Clarifies that the Cat Fund does not cover policies issued by a surplus lines insurer or a reinsurer, which is the current interpretation. [Paragraph (2)(c)]

(2) Clarifies the current interpretation given by the SBA to the calculation of the retention for each insurer (the amount each insurer must pay in claims for hurricane losses before Cat Fund coverage is triggered). The law provides that the retention for all insurers combined is $3 billion in 1995, adjusted annually to reflect the percentage growth in premium for covered policies since 1995. The SBA has interpreted the reference to "growth in premium for covered policies" as referring to the growth of premiums for Cat Fund coverage, which the bill clarifies by stating premium *to the fund*. [Paragraph (2)(e)]

(3) Adds definitions for "estimated claims-paying capacity" and "actual claims-paying capacity" which clarify the distinction between the estimated amount that the SBA provides to insurers to enable them to calculate their estimated recovery from the fund for a particular contract year, and the actual claims-paying capacity used to calculate actual payments to insurers in the event the cash balance is insufficient to pay all insurers in full. [Paragraph (2)(l)-(m); as used in (4)(c)]

(4) Deletes the requirement for the SBA to charge "an actuarially appropriate equalization charge" to insurers which elect a higher percentage coverage level than previously elected, such as going from a 45% coverage level to 75% or 90%. In theory, this provision was intended to account for any additional benefit that an insurer would have by paying one-half the premium for 45% coverage (compared to 90%), and then increasing the coverage level at a time when the estimated claims-paying capacity has been increased. To date, the board has

determined that such an equalization charge is not actuarially determinable. [Paragraph (4)(a)]

(5) Requires insurers to report losses from each covered event on an interim basis, as directed by the SBA. This would be in addition to the current requirement that insurers report their losses ("reimbursable" losses, under the bill) no later than December 31 of each year, and quarterly thereafter. [Paragraph (4)(d)]

(6) Authorizes the SBA to inspect, examine and audit the records of each insurer's covered policies at such times as the board deems appropriate, consistent with generally accepted accounting principles. The costs of the audit would be borne by the board (as a cost of administration payable from the Cat Fund). However, the board would be reimbursed by the insurer for any additional audit expenses incurred as a result of an insurer's failure, despite proper notice, to be prepared for the audit or its failure to provide requested information. Any information contained in an audit report, which information is described in s. 215.557, F.S., is confidential and exempt from the public records law, s. 119.07(1) and s. 24(a), Art. I of the State Constitution. (See Public Records/Open Meetings Issues, below.) [Paragraph (4)(f)]

(7) Authorizes the SBA to collect interest on late reimbursement premium payments consistent with the assumptions made in developing the premium formula. [Paragraph (5)(c)]

(8) Various provisions intended to protect the interests of bondholders (and, thereby, help assure the marketability) of Cat Fund bonds, including a clarification that the Florida Hurricane Catastrophe Fund Finance Corporation (corporation) is an instrumentality of the state; a prohibition against the fund or the corporation filing a petition for bankruptcy; providing that the state covenants with holders of bonds that it will not limit or alter the rights vested in the fund or the corporation to fulfill the terms of any agreements made with bondholders or in any way impair the rights of such bondholders as long as the bonds remain outstanding unless adequate provision has been made for the payment of such bonds; providing that any pledge of or other security interest in revenue or contract rights created by the fund or the corporation shall be valid and binding without any physical delivery of the collateral or further act; requiring that assessments otherwise payable to the corporation shall be paid instead to the fund unless and until the Department of Insurance has received notice from the corporation and the fund that the corporation has issued bonds and the fund has no agreement in effect with local governments, and until such date as the corporation has no bonds outstanding, the fund shall have no right or interest in the assessments, except as provided in the fund's agreements with the corporation. [Paragraphs (6)(a)-(d)]

(9) Authorizing the SBA to take any action necessary to enforce the rules, and the provisions and requirements of the reimbursement contract required pursuant to s. 215.555, F.S.

(10) Adding a severability clause that provides that if any provision of s. 215.555, F.S., is adjudicated to be invalid, such judgment shall not affect or invalidate the remainder of the law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

The bill authorizes the SBA to inspect, examine and audit the records of each insurer's covered policies and further provides that any information contained in an audit report, *which information is described in s. 215.557, F.S.,* is confidential and exempt from the public records law, s. 119.07(1) and s. 24(a), Art. I of the State Constitution. This is not an expansion of a current public records exemption that would constitutionally require a separate bill, since the bill expressly states that it does not expand the exemption for the information that is currently exempt from the public records law pursuant to s. 215.557, F.S.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

The bill increases the maximum aggregate assessment to fund Cat Fund bonds for multiple-year storms from 4% to 8% of property and casualty insurance premiums. See Private Sector Impact, below, for the analysis of this impact.

B. Private Sector Impact:

Prevention and mitigation of premium increases and policy cancellations following a hurricane --The limit on the amount that the Cat Fund could pay in any one year and the increase in the maximum allowable assessments on property and casualty policies to fund Cat Fund obligations for multiple-year storms are expected to preserve reinsurance capacity in the Cat Fund as an ongoing fund for the years following a major hurricane. This should lend stability to the residential property insurance market and to help minimize the rate increases and policy cancellations for residential property insurance policies that are likely to occur following a hurricane that substantially depletes the reinsurance capacity of the Cat Fund. Many insurers depend on the Cat Fund for reinsurance, which is about 40% less expensive than private reinsurance. The bill would lessen the need for such insurers to obtain more expensive private reinsurance to substitute for reduced Cat Fund claims-paying capacity.

Stability and predictability -- The bill provides a greater degree of predictability and consistency to the amounts insurers and reinsurers can expect the Cat Fund to pay, which should result in a beneficial impact to consumers on their premiums. By providing a defined limit of coverage, insurers can more accurately determine their need for private reinsurance above (or below) the layer of coverage provided by the Cat Fund. Today, it is still difficult for insurers and reinsurers to negotiate the appropriate premium credit and/or coverage level to be built around the Cat Fund coverage (although this was significantly improved when the minimum payment levels were enacted), due to annually changing bonding estimates for Cat Fund capacity. This can result in an insurer obtaining or paying for more reinsurance than necessary, which this bill should help prevent and, thereby, benefit consumers (policyholders) in the long run.

No short-term impact on rates -- The bill is not expected to have any significant impact on rates or availability of coverage in the absence of a hurricane, since both the $11 billion cap and the maximum payment to each insurer under the bill are approximately the same amounts estimated as payments to insurers in 1998, in a maximum bond-issuance situation. That is, insurers will continue to expect the same level of Cat Fund coverage as currently provided. There may be a small decrease in Cat Fund premiums paid by insurers (and a corresponding decrease in residential property insurance rates) since the actuarial formula currently accounts for some recoveries above estimated minimum amounts, which become the maximum payment levels under the bill.

Increase in Aggregate Maximum Assessment from 4% to 8% -- Insurers who issue property and casualty policies in Florida (and through rate increases, their policyholders) would be subject to a potential maximum assessment of 8%, rather than the current 4%, to fund the issuance of bonds to fund Cat Fund obligations to residential property insurers. However, the bill retains the current 4% maximum percentage assessment to fund Cat Fund obligations for any one year. Total assessments in excess of 4%, up to 8% maximum, would only be necessary if bonds are necessary to pay losses for hurricanes in a second or subsequent contract year after Cat Fund bonds were first issued to pay for losses for a previous contract year, until the first bonds are satisfied.

At current estimates, a 3.7% assessment would be necessary to fund $8 billion in bond revenues needed to add to the $3 billion balance in the fund for 1999 in order to reach the $11 billion cap. (The current interest rate assumption is about 5.1% for tax-free bonds, which would have to rise to about 6.1% in 1999 to require a 4% assessment to raise the $8 billion needed.) For each year after 1999, if there are no payments from the fund, the Cat Fund receives about $600 million in premium and investment income, which lowers the amount needed to bond to achieve a total capacity of $11 billion, and makes it increasingly less likely that a full 4% assessment would be necessary for the first (next) major hurricane.

If the SBA uses less than the maximum 4% assessment to fund losses for a contract year, the remaining, unused percentage of the 4% would *not* be carried forward to cover subsequent years. The bill would authorize a new 4% assessment to cover losses for subsequent seasons, but there is no additional "carry-over" of unused assessments from the prior year.

It is currently estimated that if the Cat Fund uses its balance and any level of assessments to cover storms in 1999, that a new 4% assessment would generate about $7 billion in claims-paying (bonding) capacity for 2000, subject to about $500 million in premium growth and investment income in each subsequent year.

In a macro-sense, the net effect of raising the maximum potential assessment from 4% to 8% is likely to be a zero or minimal increase in assessments on Florida policyholders by the Cat Fund, the FWUA, and RPCJUA, combined. This is due to the fact that the FWUA and RPCJUA are likely to have significant deficits in the event of a subsequent season storm that requires a second Cat Fund bond issuance, together with the fact that both entities are likely to have utilized their available financing for the first storm that required the issuance of Cat Fund bonds. Therefore, the effect of the bill is primarily to transfer existing assessment authority from the FWUA and RPCJUA to the State Board of Administration as administrator of the Cat Fund. It may even result in lower assessments overall, by preventing insurers from canceling policies or otherwise reducing their writings, since such actions would increase the exposure of the residual market insurers.

However, the impact of the potential extra 4% assessment is transferred from all property insurance policyholders in the state (FWUA) and all residential property insurance policyholders in the state (RPCJUA) to all property and casualty policyholders in the state (Cat Fund), which includes motor vehicle insurance, commercial liability, medical malpractice, and other lines of liability insurance that are in the Cat Fund assessment base, but not the assessment base of the FWUA or RPCJUA.

Insurers would be subject to increased administrative costs of: (1) reporting losses to the SBA on an interim basis, as required by the SBA as authorized by this bill; and (2) preparing and providing records related to covered policies for any audit required by the SBA, as authorized by this bill. The cost of the audit itself would be borne by the SBA, except that the insurer would be liable for any additional audit expenses incurred by the SBA as a result of an insurer's failure, despite proper notice, to be prepared for the audit or its failure to provide requested information.

C. Government Sector Impact:

The bill limits payments from the Florida Hurricane Catastrophe Fund to $11 billion for any one contract year and limits each insurer's payment from the Cat Fund for any one year to the current minimum payment, which generally equals each insurer's proportionate share of Cat Fund premiums. There may be a small decrease in annual Cat Fund premiums paid to the SBA since the actuarial formula currently accounts for some recoveries above estimated minimum amounts, which become the maximum payment levels under the bill.

The bill authorizes the SBA to audit the records of each insurer's covered policies at such times as the board deems appropriate. The costs of the audit would be borne by the board as a cost of administration payable from the Cat Fund. However, the board would be reimbursed by the insurer for any additional audit expenses incurred as a result of an insurer's failure, despite proper notice, to be prepared for the audit or its failure to provide requested information.

VI. Technical Deficiencies:

None.

VII. Related Issues:

A survey was conducted by the staff of the Banking and Insurance Committee of member insurers of the Cat Fund. In addition to asking each insurer as to the effects of the loss of a significant amount of Cat Fund capacity, as summarized in Present Situation, above, insurers were also asked for their opinions as to various proposals to limit Cat Fund payments and to preserve reinsurance capacity for subsequent seasons. Committee staff has prepared a separate document as to the results of this survey.

A related issue that is the subject of various legislative proposals is methods to depopulate and otherwise reduce the exposure to losses in the FWUA and RPCJUA. Another related issue, advocated by the Department of Insurance, is repeal of the law that allows residential property insurers to submit a rate filing denied by the department to an arbitration panel, as an alternative to an administrative hearing before the Division of Administrative Hearings.

VIII. Amendments:

None.