

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HJR 659 Florida Hurricane Catastrophe Fund  
**SPONSOR(S):** Reagan  
**TIED BILLS:** None **IDEN./SIM. BILLS:** SJR 720

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REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) Insurance Regulation (Sub)	8Y, 0N	Cheek	Schulte
2) Insurance	17 Y, 0 N	Cheek	Schulte
3) Transportation & Econ. Dev. Apps. (Sub)		Birnholz	Hawkins
4) Appropriations			
5)			

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### SUMMARY ANALYSIS

This House Joint Resolution proposes an amendment to the State Constitution, for approval or rejection by the electors, to limit the use of the assets of the Florida Hurricane Catastrophe Fund (FHCF or "fund") and to restrict legislative appropriations from the fund. As currently required by general law in s. 215.555, F.S, the constitutional amendment would require that the assets of the FHCF be used exclusively for paying catastrophic hurricane loss obligations arising out of reimbursement contracts with insurers, paying debt service on revenue bonds and financing arrangements issued by or on behalf of the fund, reinsurance costs of the fund, administrative expenses of the fund, and an annual appropriation for hurricane loss mitigation programs.

The proposed amendment also provides substantially the same requirement as current law that at least \$10 million be appropriated annually from the FHCF, up to a maximum of 35 percent of the fund's investment income, for hurricane loss mitigation programs, but the amendment differs from current law by requiring that the Legislature appropriate exactly \$10 million from the FHCF in the General Appropriations Act for hurricane loss mitigation programs, and that any additional appropriation from the fund for such programs must be approved by a vote of three-fourths of the membership of each house of the Legislature in a separate bill or bills for that purpose only. The amendment also resolves a current question of statutory interpretation by specifying which fiscal year's investment income must be used for calculating the 35 percent cap.

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

**STORAGE NAME:** h0659c.ap.doc  
**DATE:** April 13, 2003

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. DOES THE BILL:

- |                                      |                              |                             |   |
|--------------------------------------|------------------------------|-----------------------------|---|
| 1. Reduce government?                | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 2. Lower taxes?                      | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 3. Expand individual freedom?        | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. Increase personal responsibility? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. Empower families?                 | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a “no” above, please explain:

#### B. EFFECT OF PROPOSED CHANGES:

##### Florida Hurricane Catastrophe Fund

After Hurricane Andrew, in a Special Session in November 1993, the Legislature created the Florida Hurricane Catastrophe Fund (FHCF or “fund”) to provide a mandatory form of reinsurance for residential property insurers in the state.<sup>1</sup> The FHCF is administered by the State Board of Administration (SBA) and is a tax-exempt source of reimbursement to property insurers for excess losses due to hurricanes.

The law limits the obligations of the FHCF to its claims-paying capacity, not to exceed \$11 billion in any one year. The \$11 billion limit is increased once the claims-paying capacity of the fund for a subsequent year reaches \$11 billion (i.e., \$22 billion for both years combined). Each insurer must pay its first-dollar residential hurricane claims up to a “retention” or deductible, which totals about \$4 billion for all insurers combined for 2002, pursuant to a statutory formula. Each insurer must annually elect coverage from the fund to be reimbursed at 45 percent, 75 percent, or 90 percent of the insurer’s residential hurricane losses above its retention.

The SBA is required to enter into a reimbursement contract with each residential property insurer, and to establish the premiums that insurers must pay for their coverage from the fund. In doing so, the SBA must select an independent consultant to develop a formula for determining the actuarially indicated premium. Hurricane loss projection models found to be accurate and reliable by the Florida Commission on Hurricane Loss Projection Methodology must be used by the FHCF in establishing its premiums.<sup>2</sup> The annual premium charged to insurers generally represents the average annual expected hurricane loss to be paid by the fund, plus annual administrative expenses of the SBA in operating the fund, plus annual legislative appropriations made from the fund (explained below), the total of which is then discounted to present value based on anticipated investment income.

If the FHCF does not have a sufficient fund balance to pay its obligations to insurers in any given year, it may issue revenue bonds or incur other debt, supported by an assessment against each insurer writing property and casualty business in the state of up to 4 percent of premiums written on such business, except workers’ compensation.<sup>3</sup> If necessary to meet its obligations for multiple-year

<sup>1</sup> Ch. 93-409, L.O.F.; s. 215.555, F.S.

<sup>2</sup> S. 627.0628(3)(b), F.S.

<sup>3</sup> S. 215.555(6)(a)3., F.S. The maximum assessment is 2 percent of gross direct written premium for the prior year, except that, if the Governor has declared a state of emergency under s. 252.36, F.S., due to the occurrence of a “covered event” (hurricane), the amount of the assessment for the contract year may be increased to an amount not exceeding 4 percent of such premium.

hurricanes, an additional 2 percent assessment (plus any unused portion of the 4 percent assessment) may be imposed, so that the total assessment levied in any one year may not exceed 6 percent. Insurers are permitted to recoup assessments from their policyholders in higher premiums.<sup>4</sup>

Insurance company premiums for FHCF coverage have averaged \$451.6 million annually, for all insurers combined, from 1995 through 2002. The fund earns investment income, expends funds for administration, and has paid, to date, relatively small reimbursements to insurers (\$13.1 million in 1995 due to Hurricanes Erin and Opal). The fund is authorized to buy private reinsurance, but to date, the SBA has elected not to do so. The estimated fund balance for December 31, 2002 was \$4.892 billion. This fund balance is expected to increase to \$5.52 billion by year-end 2003, after accounting for 2003 premium income, investment income, and administrative expenses. If hurricane losses in 2003 require the fund to pay the \$11 billion limit in annual reimbursement, the SBA currently estimates that this would require a \$5.48 billion bond issue (plus the \$5.52 billion fund balance), supported by an estimated 1.78 percent assessment on property and casualty insurers, based on current interest rate assumptions.

The premiums that insurers are required to pay the FHCF are significantly lower than comparable levels of reinsurance in the private market. As such, the FHCF acts to lower premiums for residential property insurance as well as to expand reinsurance capacity which enables a greater amount of insurance to be written in the state.

Moneys in the FHCF may not be expended, loaned, or appropriated except to pay obligations of the fund arising out of reimbursement contracts, payment of debt service on revenue bonds, costs of mitigation programs, costs of procuring reinsurance, and costs of administration of the fund.<sup>5</sup> The SBA must invest the moneys in the fund pursuant to the same laws that generally apply to investment of funds by the SBA under s. 215.44-215.52, F.S.<sup>6</sup> In practice, the SBA has made relatively low-risk, and highly liquid, fixed maturity investments for the FHCF, due to the need to timely reimburse insurers for hurricane losses.

### **Hurricane Loss Mitigation Funding**

The law directs the Legislature each fiscal year, beginning in fiscal year 1997-1998, to appropriate from the investment income of the FHCF at least \$10 million, but no more than 35 percent of the investment income from the prior fiscal year for the purpose of funding local governments, state agencies, public and private educational institutions, and nonprofit organizations, to support hurricane loss mitigation programs intended to:

- Improve hurricane preparedness;
- Reduce potential losses in the event of a hurricane;
- Provide research into the means to reduce such losses;
- Educate or inform the public as to the means to reduce hurricane losses;
- Assist the public in determining the appropriateness of particular upgrades to structures or in the financing of such upgrades; or
- Protect local infrastructure from potential damage from a hurricane.<sup>7</sup>

These hurricane loss mitigation provisions were enacted in the 1995 act containing provisions determined by the Internal Revenue Service to be necessary in order for the FHCF to be an integral

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<sup>4</sup> S. 215.555(6)(a)3., F.S. This provision states that any rate filing or portion of a rate filing reflecting a rate change attributable entirely to the assessment levied shall be deemed approved when made, subject to the authority of the Department of Insurance to require actuarial justification as to the adequacy of any rate at any time.

<sup>5</sup> S. 215.555(3), F.S.

<sup>6</sup> S. 215.555(3), F.S.

<sup>7</sup> S. 215.555(7)(c), F.S.

part of state government and not be taxable by the federal government.<sup>8</sup> One of the changes was an expansion of the moneys available for a wider range of hurricane loss mitigation projects. The 1995 act required the minimum annual \$10 million appropriation, capped at 35 percent of investment income (a change from the prior law that allowed up to 2 percent of premium income to be used), and the act broadened the hurricane loss mitigation purposes.

Legislation in 1999 created the Hurricane Loss Mitigation Program and required that the \$10 million that must be appropriated from the FHCF for loss mitigation be appropriated to the Department of Community Affairs for specified purposes.<sup>9</sup> As currently required, \$7 million must be used for programs to improve the wind resistance of residences and mobile homes, cooperative programs with local governments and the Federal government, and other efforts to prevent or reduce losses or reduce the cost of rebuilding after a disaster, and \$3 million must be used to retrofit existing facilities used as public hurricane shelters. The law further directs that 40 percent of the \$7 million (less a small administrative deduction) (approximately \$2.8 million) be used to inspect and improve tie-downs for mobile homes and that 10 percent (approximately \$700,000) be allocated to the State University System dedicated to hurricane research. This section is scheduled for repeal on June 30, 2006.<sup>10</sup>

The FY 2003-04 House General Appropriations Bill (HB 1789) appropriates \$3 million for shelter retrofits, \$3.4 million for mobile home inspections and tie-downs and for hurricane research, \$3.4 million for the state portion of match requirements on mitigation projects from federally declared projects, and \$200,000 for program administration. The FY 2003-04 House General Appropriations Bill (HB 1789) also reappropriates approximately \$1.1 million of unencumbered FHCF dollars for shelter retrofits and \$1 million of unencumbered FHCF dollars for local emergency management and mitigation initiatives.<sup>11</sup>

### History of Mitigation Funding; Impact on Premiums

The Legislature was first required to appropriate a minimum of \$10 million in hurricane loss mitigation funds from the FHCF for the 1997-98 fiscal year. The following chart shows the annual appropriations made by the Legislature and the amounts vetoed by the Governor, since that time:

<b>FHCF Hurricane Mitigation Funding</b>		
<u>FY</u>	<u>Total Appropriated by Fla. Legislature</u>	<u>Vetoed by Governor</u>
97-98	\$10,000,000	\$2,822,400
98-99	\$12,500,000	\$0
99-00	\$10,300,000	\$2,200,000
00-01	\$12,200,000	\$0
01-02	\$30,000,000 <sup>12</sup>	\$0
02-03	\$20,002,909 <sup>13</sup>	\$927,600

<sup>8</sup> Ch. 95-1, L.O.F.

<sup>9</sup> Ch. 99-305, L.O.F.

<sup>10</sup> S. 215.559, F.S.

<sup>11</sup> According to staff of the Department of Community Affairs and of the State Board of Administration, because it is based on reappropriated dollars, the spending of this approximately \$2.1 million would not affect residential property insurance premiums. (See the "History of Mitigation Funding; Impact on Premiums" subsection, below.)

<sup>12</sup> The 2001-02 General Appropriations Act (GAA) provided \$10 million to the Department of Community Affairs, of which \$3 million was provided to the Division of Emergency Management in line item 1543 for hurricane loss mitigation programs, and \$7 million was provided to the Division of Housing and Community Development in line items 1605, 1606, and 1607A for hurricane loss mitigation programs. In addition, the GAA appropriated \$20 million to the Department of Environmental Protection in line item 1747A, to be provided to the South Florida Water Management District for storm water/flood mitigation projects in the counties of Palm Beach, Broward and Miami-Dade.

<sup>13</sup> In addition to a \$10 million appropriation, the appropriations implementing bill (s. 29, ch. 2002-394, L.O.F.) added subsection (16) to s. 215.555, F.S., to provide that for the 2002-2003 fiscal year only, the State Board of Administration must disburse funds from the FHCF to the Ecosystem Management and Restoration Trust Fund of the Department of

Even though the law allows an appropriation for hurricane loss mitigation programs in an amount up to 35 percent of investment income for the prior fiscal year, the law further provides that moneys in excess of \$10 million are not available for appropriation if the SBA finds that such an appropriation would *jeopardize the actuarial soundness of the fund*. This raises a “chicken and egg” problem, due to the fact that the SBA has historically established rates for the FHCF in March for contracts beginning on June 1, which is prior to the time that the Legislature typically makes its annual appropriation for the upcoming fiscal year (*sine die* in May). The SBA has also historically established premiums that include exactly \$10 million designated for loss mitigation purposes. The remainder of the premium represents the actuarially determined amount necessary to pay the expected losses and expenses of the fund, based on conservative investment assumptions. Therefore, any amount appropriated in excess of \$10 million for loss mitigation has been deemed to jeopardize the actuarial soundness of the fund unless the SBA increased the premiums to account for the excess appropriation. This occurred in 2001, when the SBA approved a \$20 million increase in FHCF premiums (in addition to approving premium changes due to other factors) to achieve actuarial soundness in response to the legislative appropriation of \$30 million from the FHCF for loss mitigation, as compared to the average \$10 million appropriated in each of the prior years and the \$10 million base amount used by the SBA for their premium calculations.

This \$30 million appropriation in the 2001-02 budget raised concerns due to the impact on residential property insurance premiums. Insurers are expressly allowed to fully recoup FHCF premiums in the premiums they charge to residential property policyholders.<sup>14</sup> The additional \$20 million appropriation, compared to the \$10 million appropriation for each of the prior years, triggered a \$20 million increase in FHCF premiums, which was a 4.1 percent increase. On average, this resulted in about a 0.54 percent increase in residential property insurance premiums, assuming insurers recovered this amount in their approved rate filings.<sup>15</sup>

Last year, in developing the premium formula for 2002-03 before the legislative appropriation was known, the SBA approved rates based on various levels of mitigation ranging from \$10 million to \$50 million in increments of \$5 million. Net of the vetoed amount, the \$19.075 million appropriation resulted in a decrease in FHCF rates, compared to the \$30 million appropriation for the prior year (taking into account only the mitigation funding). But, the rates were higher than they would have been, had only \$10 million been appropriated.

The maximum amount that may be appropriated each year from the FHCF for hurricane loss mitigation is 35 percent of the fund’s investment income for the prior fiscal year. The following chart shows the investment income earned by the fund each year since its inception, and 35 percent of each year’s amount:

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Environmental Protection in an amount equal to 8.47 percent of the appropriation made from that Trust Fund for “Grants and Aids to Local Government and Non-State Entities - Fixed Capital Outlay, Statewide Restoration Projects” in the 2002-2003 General Appropriations Act. The grants from this Trust Fund totaled \$118,098,333. The Governor vetoed item 1769 which totaled \$10,951,833 so, in effect, 8.47 percent of this amount, or \$927,600 was the portion of the vetoed amount from the FHCF.

<sup>14</sup> S. 627.062(5), F.S.

<sup>15</sup> The \$487 million FHCF premium in 2001 was estimated to be about 13.2 percent of the total \$3.7 billion in Florida residential property insurance premiums. Therefore, if FHCF premiums were increased by 4.1 percent, residential property insurance premiums were estimated to increase by 13.2 percent x 4.1 percent, which equals 0.54 percent.

## FHCF Investment Income

<u>Fiscal Year</u>	<u>Investment Income</u>	<u>35 Percent of Investment Income</u>
94-95	\$ 20,183,000	\$ 7,064,050
95-96	\$ 46,379,000	\$16,232,650
96-97	\$ 74,425,000	\$26,048,750
97-98	\$109,979,000	\$38,492,650
98-99	\$132,516,000	\$46,380,600
99-00	\$173,839,000	\$60,843,650
00-01	\$220,915,000	\$77,320,250
01-02	\$122,535,000	\$42,887,250

A question of statutory interpretation is which year's investment income should be used to establish the 35 percent cap. It may be unclear whether the statutory reference to the investment income from the "prior fiscal year" refers to the year prior to the year for which the appropriation is made, or prior to the year during which the Legislature enacts the appropriation. If read to refer to the year prior to the year for which the appropriation is made, the Legislature must estimate the investment income for the fiscal year before it has ended. And, as 2001-02 demonstrates, it cannot be assumed that the later year will have greater investment income.

### The Proposed House Joint Resolution

The House Joint Resolution proposes an amendment to the State Constitution, for approval or rejection by the electors, to limit the use of the assets of the Florida Hurricane Catastrophe Fund and to restrict legislative appropriations from the fund. As currently required by general law in s. 215.555, F.S., the constitutional amendment would require that the assets of the FHCF be used exclusively for paying catastrophic hurricane loss obligations arising out of reimbursement contracts with insurers, paying debt service on revenue bonds and financing arrangements issued by or on behalf of the fund, reinsurance costs of the fund, administrative expenses of the fund, and an annual appropriation for hurricane loss mitigation programs.

The proposed amendment also provides substantially the same requirement as the current statute that an appropriation from the FHCF for hurricane loss mitigation programs may not exceed 35 percent of the fund's investment income, and that at least \$10 million be appropriated annually. However, the amendment differs from current law by requiring that the Legislature appropriate \$10 million from the FHCF (no more, no less) in the General Appropriations Act for hurricane loss mitigation programs, and that any additional appropriation from the fund for such programs must be approved by a vote of three-fourths of the membership of each house of the Legislature in a separate bill or bills for that purpose only.

The proposed amendment also clarifies a question of interpretation of the current statute, by specifying that the relevant year for determining the investment income of the FHCF, for purposes of calculating the 35 percent cap, is the fiscal year that concluded 2 years before the effective date of the appropriation (as compared to "the prior fiscal year" as used in the current statute). For example, if the effective date of the appropriation is July 1, 2003, then June 30, 2002, would be the fiscal year that concluded two years before the effective date of the appropriation. This would allow for the use of fiscal year-end audited financial statements when determining investment income, rather than relying on estimates.

The proposed amendment specifies that it does not limit the authority of the Legislature to abolish or otherwise terminate the operations of the FHCF.

The proposed amendment, in effect, prohibits the Legislature from amending the current law to allow for FHCF funds to be used for any other purposes than those specified in the amendment, which are

substantially the same purposes currently expressed in s. 215.555, F.S. The proposed amendment uses, but does not define or expand upon the phrase, *hurricane loss mitigation programs*. This is the phrase used in the current statute, but the statute also specifies types of programs which qualify as hurricane loss mitigation programs and requires allocation of \$10 million to the Department of Community Affairs for specified purposes, as described in Present Situation, above. These current law provisions do not appear to conflict with the proposed constitutional amendment's limitations to use funds for *hurricane loss mitigation programs*. The Legislature would continue to have relatively broad authority to determine what constitutes a hurricane loss mitigation program. But, the Legislature would be prohibited from amending the law to allow for any less than \$10 million to be appropriated annually for hurricane loss mitigation programs, or more than 35 percent of investment income of the fiscal year that concluded 2 years before the effective date of the appropriation. And, as mentioned, exactly \$10 million must be appropriated in the General Appropriations Act, for such programs, and separate bill or bills subject to super-majority voting requirements would be required for appropriations in excess of this amount.

C. SECTION DIRECTORY:

Please refer to the "Effect of Proposed Changes."

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

Agencies such as the Department of Community Affairs which may be appropriated funds from the FHCF for hurricane loss mitigation programs might be less likely to obtain total funding above \$10 million, due to the requirement for a separate bill and super-majority vote.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

To the extent that agencies such as the Department of Community Affairs (which may be appropriated funds from the FHCF for hurricane loss mitigation programs) might be less likely to obtain total funding above \$10 million, due to the requirement for a separate bill and super-majority vote, local governments having projects that might have been recipients of those funds might receive fewer dollars.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Residential property insurers and their policyholders are afforded greater protection, due to a state constitutional requirement that the funds of the FHCF be used only for those purposes currently authorized by general law. As such, the reinsurance coverage provided by the FHCF, which is significantly less expensive than private reinsurance and tends to lower residential property insurance premiums, is protected from possible legislative changes that allow funds to be used for other purposes, which could negatively impact the availability of residential property insurance in the state. Similarly, hurricane loss mitigation funding above \$10 million may be less likely due to the requirement

for a separate bill and super-majority vote, which lessens the chances of residential property insurance premiums being increased as a result of such additional appropriations.

On the other hand, the bill negatively impacts any potential private sector beneficiary of appropriations from the FHCF beyond those purposes currently authorized by statute or of appropriations in excess of \$10 million.

D. FISCAL COMMENTS:

Not Applicable.

### III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

The legislation does not require expenditure of funds by local governments, does not reduce the authority to raise revenue, nor reduce the percentage of state tax shared with local governments.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

### IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES

None.