

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HJR 659 Florida Hurricane Catastrophe Fund  
**SPONSOR(S):** Reagan, Gannon, and others  
**TIED BILLS:** **IDEN./SIM. BILLS:** SB 720

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

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### SUMMARY ANALYSIS

The Florida Hurricane Catastrophe Fund ("Cat Fund") was created after Hurricane Andrew as a form of mandatory reinsurance for residential property insurers. The Cat Fund 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 Legislature is required by statute to appropriate certain moneys from the Cat Fund to support hurricane loss mitigation efforts.

HJR 659 creates Section 20 of Article X of the State Constitution. The joint resolution proposes an amendment to the State Constitution to limit the use of the assets of the fund and to restrict legislative appropriations from the fund. As is currently required by general law in s. 215.555, F.S, the constitutional amendment requires the assets of the Cat Fund 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.

With respect to appropriations from the Cat Fund, the proposed constitutional amendment also provides substantially the same requirement as current law. It requires that at least \$10 million be appropriated annually from the Cat Fund, up to a maximum of 35 percent of the fund's investment income, for hurricane loss mitigation programs. The amendment differs from current law by requiring any appropriation from the fund in excess of \$10 million 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 specifies 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:** h0659a.in.doc  
**DATE:** April 8, 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**

As part of its response to Hurricane Andrew (September 24, 2003), the Legislature in 1993 created the Florida Hurricane Catastrophe Fund (Cat Fund) to provide a mandatory form of reinsurance for residential property insurers in the state. The Cat Fund 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.

All authorized insurers writing covered policies (defined as any policy covering residential property in Florida, except for any policy that excludes wind coverage) must enter into reimbursement contracts with the Cat Fund. In exchange for insurer payment of a premium, the Cat Fund agrees to reimburse the insurer for a portion of its hurricane losses in excess of a specified amount, known as the insurer's "retention."

For the calendar year ending December 31, 2002, the Cat Fund had a year-end balance of \$4.89 billion. During calendar year 2002, it received \$489.5 million in premium revenues and earned \$122.5 million in investment income.

##### Use of Cat Fund Assets

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.

If the Cat Fund 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. If necessary to meet its obligations for multiple-year hurricanes, an additional 2 percent assessment (plus any unused portion of the 4 percent assessment) may be imposed, so 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.

Moneys in the Cat Fund 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 (see "Hurricane Loss Mitigation Funding" below), costs of procuring reinsurance, and costs of administration of the fund. Cat Fund investments are governed by the same laws that generally apply to investment of funds by the SBA under ss. 215.44-215.52, F.S. In practice, the SBA has made relatively low-risk, and highly liquid, fixed maturity investments for the Cat Fund, due to the need to timely reimburse insurers for hurricane losses.

## Hurricane Loss Mitigation Funding

Current law directs the Legislature annually to appropriate from the investment income of the Cat Fund at least \$10 million, but no more than 35 percent of the investment income from the prior fiscal year, for the purpose of providing funding to 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.

These hurricane loss mitigation provisions were enacted in 1995 after being determined by the Internal Revenue Service to be necessary in order for the Cat Fund to be exempt from federal income taxation. One of the changes was an expansion of the moneys available for a wider range of hurricane loss mitigation projects.

Legislation in 1999 created the Hurricane Loss Mitigation Program and required that the \$10 million mandatory appropriation be appropriated to the Department of Community Affairs for specified purposes. As currently required, \$7 million must be used for programs to improve the wind resistance of residences and mobile homes 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 (\$2.8 million) be used to inspect and improve tie downs for mobile homes and that 10 percent (\$700,000) be allocated to the State University System, dedicated to hurricane research. The section specifying these allocations is scheduled for repeal on June 30, 2006.

### History of Mitigation Funding; Impact on Premiums

The following chart shows the annual appropriations made by the Legislature, and the amounts vetoed by the Governor, since that time:

<b>Cat Fund Hurricane Mitigation Funding</b>		
<u>FY</u>	<u>Total Appropriated</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	\$0
02-03	\$20,002,909	\$927,600

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. \$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.

In addition to a \$10 million appropriation, the appropriations implementing bill (s. 29, chapter 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 SBA must disburse funds from the Cat Fund to the Ecosystem Management and Restoration Trust Fund of the Department of 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 Cat Fund.

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*. SBA has historically established rates for the Cat Fund 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.

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 Cat Fund 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 Cat Fund 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 Cat Fund premiums in the premiums they charge to residential property policyholders. The additional \$20 million appropriation, compared to the \$10 million appropriation for each of the prior years, triggered a \$20 million increase in Cat Fund premiums, which was a 4.1 percent increase. According to the SBA, 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.

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 Cat Fund 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 following chart shows the investment income earned by the fund each year since its inception, and 35 percent of each year's amount:

Fiscal Year	Investment Income	35 Percent
		of Investment Income
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.

### **Effect of the Proposed Constitutional Amendment**

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 is currently required by general law in s. 215.555., F.S., the constitutional amendment requires that the assets of the Cat Fund 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 Cat Fund 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 Cat Fund 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 specifies the relevant year for determining the investment income of the Cat Fund, 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 2 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 it does not limit the authority of the Legislature to abolish or otherwise terminate the operations of the Cat Fund.

The joint resolution prohibits the Legislature from amending the current law to allow for Cat Fund 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 that 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 continues to have relatively broad authority to determine what constitutes a hurricane loss mitigation program. But, the Legislature is 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 are 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:

The Department of Community Affairs, the Department of Environmental Protection, and other agencies that may be appropriated funds from the Cat Fund for hurricane loss mitigation programs may be less likely to obtain total funding above \$10 million, due to the requirement for a separate bill and super-majority vote.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

Not Applicable.

2. Expenditures:

Not Applicable.

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 Cat Fund be used only for those purposes currently authorized by general law. As such, the reinsurance coverage provided by the Cat Fund, 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 Cat Fund 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:

None.

##### 2. Other:

None.

#### B. RULE-MAKING AUTHORITY:

Not Applicable.

#### C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

### IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES

None.