SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

Prepared By: Banking and Insurance Committee

BILL: SM 1676

INTRODUCER: Senator Garcia

SUBJECT: National Catastrophe Insurance

DATE: April 23, 2006 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	N/A	Twogood	RC	**Withdrawn**
2.	Knudson	Deffenbaugh	BI	**Favorable**
3.				
4.				
5.				
6.				

I. Summary:

Senate Memorial 1676 urges the United States Congress to create a National Catastrophe Insurance Program. The Program should include:

- Private market residential insurance that provides all-perils coverage to consumers;
- Tax-advantaged disaster savings accounts that individuals manage for the purpose of paying for mitigation enhancements and catastrophic losses;
- Tax-deferred catastrophe reserves for insurance companies;
- A national catastrophe financing mechanism that would provide risk management and financing for mega-catastrophes; and
- Aggregate risk pooling of natural disasters funded through sound risk-based premiums paid in correct proportion by all policyholders in the United States.

II. Present Situation:

2004 and 2005 Hurricane Seasons

The 2004 and 2005 hurricane seasons were particularly destructive to Florida, with four hurricanes hitting Florida each year. In total, insurers have reported nearly $39 billion in estimated gross losses in Florida for these eight hurricanes. This includes amounts estimated to be covered by the insureds’ deductibles, estimated to be $3.82 billion, resulting in approximately $35 billion remaining as the insurers’ estimated loss. The last of these eight hurricanes, Hurricane Wilma, resulted in the greatest total losses in Florida. The estimated losses, amounts paid by deductibles, claims payments made, and estimated net retention of insurers not covered by reinsurance, are summarized in the table below.

Insurers' Reported Hurricane Losses in Florida for 2004 and 2005				
Hurricane	**Adjusted Estimated Gross Loss***	**Claims Payments**	**Projected Net Retention**	**Amounts Paid by Residential Insureds' Deductibles**
Charley (2004)	$9.43 bil.	$7.85 bil.	$4.11 bil.	$0.49 bil.
Frances (2004)	8.27 bil.	7.24 bil.	2.62 bil.	0.65 bil.
Ivan (2004)	4.11 bil.	3.26 bil.	1.86 bil.	0.24 bil.
Jeanne (2004)	4.33 bil.	3.59 bil.	2.12 bil.	0.43 bil.
Dennis (2005)	1.24 bil.	0.29 bil.	0.35 bil.	0.12 bil.
Katrina (2005)	1.52 bil.	0.74 bil.	0.47 bil.	not collected
Rita (2005)	0.07 bil.	0.01 bil.	0.06 bil.	not collected
Wilma (2005)	9.91 bil.	8.44 bil.	4.13 bil.	1.89 bil.
Total	**$38.88 bil.**	**$31.42 bil.**	**$15.72 bil.**	**$3.82 bil.**

Source: Office of Insurance Regulation (OIR), Hurricane Reporting Summaries. The summary report for the 2004 hurricanes are as of December 31. 2005 The summary report for the 2005 hurricanes are as of March 21, 2006.

*For each reporting company/group for the 2004 hurricanes, in cases where reported actual payment made exceeded reported estimated gross loss, the reported actual payment amount was used in this total. (OIR note.)

"Projected Net Retention" is the estimated amount of loss retained by the insurer that has not been ceded to a reinsurer (i.e. amount for which the insurer does not have reinsurance covering the loss).

Total amounts may not equal the sum of amounts for individual hurricanes due to rounding.

Florida Hurricane Catastrophe Fund

The Florida Hurricane Catastrophe Fund (FHCF or "fund") is a tax-exempt trust fund created after Hurricane Andrew as a form of mandatory reinsurance for residential property insurers.[1] All insurers that write residential property insurance in Florida are required to buy reimbursement coverage (reinsurance) on their residential property exposure through the FHCF. The FHCF is administered by the State Board of Administration (SBA) and is a tax-exempt source of reimbursement to property insurers for a selected percentage (45, 75, or 90 percent) of hurricane losses above the insurer's retention/deductible.

Because the FHCF provides insurers a source of reinsurance that is additional to the reinsurance available in the private market, insurers are generally able to write more residential property insurance in the state than would otherwise be written. Because reinsurance purchased through the FHCF is significantly less expensive than private reinsurance, the FHCF also acts to lower residential property insurance premiums for consumers.

The FHCF must charge insurers the "actuarially indicated" premium for the coverage provided based on hurricane loss projection models found acceptable by the Florida Commission on Hurricane Loss Projection Methodology. Each insurer's "reimbursement premium" is based on the insured value of the residential property each insurer insures, their location, construction

[1] Section 215.555, F.S. (2005).

type, deductible amounts, and other factors. The "actuarially indicated" premium is the average annual amount expected to be reimbursed to the insurer based on the hurricane loss models plus administrative costs of the Fund, amounts expected to be appropriated for mitigation funding, and discounted for investment income. Law authorizes the SBA to include a rapid cash build-up factor in the premium formula, but the SBA had not done so, as explained below, until its recent approval for 2006-07 premiums.

FHCF operates on a "contract year" that runs from June 1st to May 31st of the next calendar year. The start of hurricane season coincides with the start of the fund's contract year.

By law the maximum amount the FHCF must pay in any year is $15 billion, adjusted annually based on the percentage growth in fund exposure but not to exceed the dollar growth in the cash balance of the fund.[2] Due to the reduction in cash balance of the fund in 2004 and 2005, the cap has remained at $15 billion for 2005-06 and 2006-07. A maximum coverage amount is calculated for each insurer based on that insurer's share of the total premiums paid to the fund. For example, an insurer that pays 10 percent of total fund premiums has its maximum coverage limited to $1.5 billion (10 percent of $15 billion) for all hurricanes occurring during the contract year.

Insurers must first pay hurricane losses up to their "retention" for each hurricane, similar to a deductible, before being reimbursed by the FHCF. In 2005, the Legislature lowered the total industry retention from an estimated $4.96 billion to $4.5 billion per hurricane and addressed multiple storm seasons by reducing the retention to one-third of this amount ($1.5 billion) for a third hurricane and each additional hurricane.[3] The full retention is applied to the two hurricanes causing the greatest losses to the insurer. The retention is adjusted annually based on FHCF's exposure, but unlike the limitation on adjusting the $15 billion cap on fund payments, the retention is adjusted regardless of any change in the FHCF's cash balance.[4] For the 2006-07 contract year, the retention is estimated to be adjusted from $4.5 billion to $5.3 billion, meaning that insurers must absorb a greater amount of losses before being reimbursed. Like the maximum recovery amount, a retention is calculated for each insurer based on its share of fund premiums. For example, an insurer paying 10 percent of total fund premiums will have a retention of $530 million (10 percent of $5.3 billion) for the 2006-07 contract year.

Insurers also choose a percentage level of reimbursement by the FHCF. By statute, an insurer can select 45, 75, or 90 percent coverage reimbursement for losses that exceed its retention for each hurricane.[5] The vast majority of insurers choose the 90 percent reimbursement option.[6] Thus, once an insurer triggers FHCF coverage, 90 percent of its losses will be covered by the FHCF up to the insurer's limit of coverage. Insurers may purchase additional reinsurance in the private market to cover their hurricane losses for amounts below the retention, above their reimbursement limit, or for the coinsurance amount (e.g., 10 percent) that is the insurer's responsibility for the layer of coverage provided by the FHCF.

[2] Section 215.555((4)(c)1., F.S. (2005).
[3] Section 215.555(1)(e)4., F.S. (2005).
[4] Section 215.555(1)(e)1., F.S. (2005).
[5] Section 215.555(1)(e)2., F.S. (2005).
[6] Florida Hurricane Catastrophe Fund, Fiscal Year 2003-2004 Annual Report 23.

The law allows the issuance of revenue bonds, which are funded by emergency assessments on property and casualty policyholders, if the cash balance of the fund is not sufficient to cover losses.[7] The FHCF is authorized to levy emergency assessments against all property and casualty insurance premiums paid by policyholders (other than workers' compensation and, until June 1, 2007, medical malpractice), including surplus lines policyholders, when reimbursement premiums and other fund resources are insufficient to cover the fund's obligations.[8] Notably, this assessment base includes auto insurance, which is not included in the assessment base for Citizens. The assessment base for the FHCF is approximately $31 billion and is expected to grow to about $33 billion for premiums written at year end 2005. Annual assessments (which have never been levied) are capped at 6 percent of premium with respect to losses from any one year and a maximum of 10 percent of premium to fund hurricane losses from multiple years.[9]

The FHCF is expected to pay out $3.8 billion to insurers as a result of the 2004 hurricanes; to date, the fund has already paid $3.5 billion to insurers. Because the amount paid in 2004 was less than FHCF's cash balance, bonding was not necessary. However, as losses develop, the actual payments may exceed the current estimates.

Based on April 2006 data, representatives from FHCF estimate that the fund will experience a cash shortfall of $697 million dollars. Additionally, it is expected that the cash shortfall will grow substantially due to adverse loss development, perhaps resulting in a cash deficit of up to $1.297 billion. The FHCF paid $3.5 billion of $3.8 billion in reported losses stemming from the 2004 hurricanes. The reported losses from the 2005 hurricanes are currently at $3.7 billion, of which $2.4 billion have been paid. However, the loss estimates for the FHCF from the 2005 storms are subject to adverse loss development and have continued to increase from earlier estimates.

Because the FHCF is not likely to have cash to carry over to fund claims resulting from the 2006 hurricane season, it will have to rely solely on premiums collected in 2006 to reimburse insurers for losses. This makes bonding more likely if the fund has to pay claims as a result of 2006 hurricanes. The fund's anticipated premium revenue for 2006 is $800 million. On April 4, 2006, the Trustees of the SBA approved the 2006 FHCF premium formula to include a 25 percent increase known as a rapid cash buildup factor. This increase equates to $200 million in additional premium bringing the total FHCF premium to $1 billion. Premiums to the FHCF are paid by insurers in three installments, on June 1, October 1, and December 1, 2006. Thus, should an early season hurricane occur, it may be necessary for the FHCF to borrow money to cover its losses. This could be done with a simple loan for small losses; for larger losses revenue bonds would need to be issued. The addition of a rapid cash buildup factor will allow the FHCF to reduce its potential shortfall.

In summary, from its inception in 1993 until the 2004 hurricane season, the fund paid insurers on claims for only two hurricanes (Erin and Opal in 1995). Until 2004, the amount FHCF paid to insurers totaled approximately $13 million. Thus, going into the 2004 hurricane season FHCF had accumulated over $6 billion in cash. As a result of the 2004 hurricanes, expected

[7] Section 215.555(6)(a)1., F.S. (2005); s. 215.555(6)(b)1., F.S. (2005).
[8] Section 215.555(6)(b)1., F.S. (2005); s. 215.555(6)(b)(10), F.S. (2005).
[9] Section 215.555(6)(b)2., F.S. (2005).

expenditures from the fund to reimburse insurers for hurricane losses approaches $3.85 billion. Going into the 2005 hurricane season, cash in the fund decreased to $3 billion. With reimbursement to insurers for 2005 hurricane losses expected to be $3.7 billion, bonding may be needed to pay claims and there will be no cash in the fund to start the 2006 hurricane season. The $6 billion it took the FHCF to accumulate over ten years has been depleted in two years.

Task Force on Long-Term Solutions for Florida's Hurricane Insurance Market
During 2005, the Legislature created the Task Force on Long-Term Solutions for Florida's Hurricane Market and charged the Task Force with gathering information and making recommendations for ways to ensure that hurricane insurance is available for Floridians. The task force presented its findings on March 6, 2006. The task-force presented various findings and recommendations regarding how the hurricane insurance market in Florida can be improved by actions from the private insurance market, state government, and residents of the state. However, the task force found that:

> "Any meaningful long-term solution must recognize that there are hurricane events possible that are beyond the capacity of the voluntary market, the public mechanisms and the state's financial wherewithal. For these reasons, any successful long-term solution to the capacity problems in the Florida property insurance market should include a federal backstop. State leaders should continue their efforts to develop a comprehensive national catastrophe program.

National Activity Regarding Catastrophe Insurance
In reaction to the losses stemming from the 2004 and 2005 hurricane season, there has been increased interest nationally in creating mechanisms to deal with the insurance consequences of national disasters. The Catastrophe Working Group of the National Association of Insurance Commissioners (NAIC) released draft recommendations in February 2006. The recommendations include making available to consumers an all-perils residential insurance policy that would pay for damages to a home, with a higher deductible being available for catastrophic losses. Flood damage would be included under such policies, so the recommendation is that the National Flood Insurance Program be converted to a reinsurance program. The draft also calls for greatly expanded disaster mitigation programs for homeowners and a modification of the United States Tax Code to encourage private insurers to build catastrophe reserves. Most importantly, it calls for a national catastrophe insurance mechanism that would provide reinsurance to state catastrophe funds for insured losses resulting from catastrophic events. In addition to the NAIC, the National Conference of Insurance Legislators (NCOIL) has also published a resolution that supports the creation of a national catastrophic insurance plan.

The United States Congress has also begun to investigate ways to address the various difficulties that natural catastrophes such as major hurricanes present. Representative Tom Feeney has sponsored and introduced the Policyholder Disaster Protection Act of 2006 (H.R. 2668). The act would allow homeowners to put money aside on a tax-deferred basis to prepare for the financial impact of a major catastrophe. The bill also provides a tax deduction for insurers who set funds aside to pay for future natural disaster claims, with such monies being deductible from the company's taxable gross income. Insurers may only use assets from the fund to pay natural disaster insurance claims, and the amount an insurer can place in the fund is tied to the insurer's exposure to disaster claims.

Representative Feeney, along with multiple members of Florida's congressional delegation, have also sponsored and introduced the Catastrophe Saving Accounts Act of 2006 (H.R. 4836). The act would allow homeowners to put money aside to prepare for the financial impact of a major catastrophe. Structured in the same manner as Health Savings Accounts, a catastrophe tax-free savings account could be opened to cover current and future catastrophe-related expenses. The earnings from the money deposited would be tax-free with unused balances rolling over from year-to-year. Homeowners with lower deductibles, (up to $1000) may contribute and hold up to $2000 in their account. For homeowners with deductibles higher than $1000 the cap will be twice the amount of the individual's deductible (up to $15,000). The money in the account can be withdrawn to cover qualified disaster expenses tax-free.

Another bill that has been introduced in Congress is the Homewoner's Insurance Availability Act of 2005 (H.R. 846) by Representatives Ginny Brown-Waite and Clay Shaw. The bill would require the implementation of a reinsurance program by the Treasury Department offering reinsurance contracts that would be sold at regional auctions. Additionally, Representative Brown-Waite has also introduced the Homeowners' Insurance Protection Act (H.R. 4366), which would permit the sale of reinsurance contracts backed by the federal government to eligible state catastrophe funds and create a national catastrophe preparation and protection commission.

III. Effect of Proposed Changes:

The Senate Memorial urges the United States Congress to support the creation of a National Catastrophe Insurance Program. The Florida Legislature recommends that the Program be a mechanism created to better respond to the economic losses experienced by policyholders resulting from catastrophic events. The Program would be a joint effort of the private and public sectors including individuals, private industry, local and state governments, and the Federal Government.

The program would help further the achievement of the following goals in Florida and nationwide:

- Promotion of personal responsibility among insurance policyholders
- Supporting strong building codes and development plans
- Encouraging the use of disaster mitigation tools
- Maximization of the risk-bearing capacity of the private markets
- Providing quantifiable risk management through the Federal Government

The Florida Legislature recommends to the Congress that the National Catastrophe Insurance Program encompass the following:

- The Program should offer consumers private market residential insurance that provides all-perils coverage.
- Disaster savings accounts that individuals manage for the purpose of paying for mitigation enhancements and catastrophic losses. The accounts should be similar to health savings accounts and enjoy a tax-advantaged basis.

- Tax-deferred catastrophe reserves for insurance companies. The insurer would place capital into the reserves over time, with the monies only being eligible to be used to pay for catastrophe related losses. The tax-deferred status of the reserves would encourage insurers to use their own capital to pay for catastrophic losses, thus reducing the amount of often costly reinsurance needed by the insurer.
- Enhancing the ability of local and state governments to establish and maintain effective building codes, disaster mitigation education programs, and land use management techniques.
- The promotion of state emergency management, preparedness, and response.
- The creation of state or multi-state regional catastrophic risk financing mechanisms such as the Florida Hurricane Catastrophe Fund.
- The creation of a national catastrophe financing mechanism that would provide risk management and financing for mega-catastrophes.
- Maximizing the risk-bearing capacity of the private markets.
- Allowing for aggregate risk pooling of natural disasters funded through sound risk-based premiums paid in correct proportion by all policyholders in the United States.

The Memorial cites various facts as demonstrating the need for a National Catastrophe Insurance Program. The 2004 and 2005 hurricane seasons did tremendous damage to Florida and states across the gulf coast. In Florida, storms from these two seasons resulted in $35 billion in estimated gross probable insurance losses. Across the gulf coast, high winds, storm surges, torrential rainfalls, and flooding resulting in significant damage. Policyholders have been displaced from their dwellings, lost their homes, and personal belongings destroyed. The storms resulted in the closing of businesses and financial institutions, and created a temporary loss of employment for many. Additionally, the storms created numerous health and safety issues in many communities. Hurricane Katrina, the largest, most damaging and deadly storm from the past two hurricane seasons, became the costliest catastrophe in United States history, leaving the Gulf Coast states with approximately $35 billion in estimated losses. It surpassed another hurricane, Hurricane Andrew at $20.8 in insured losses, as the costliest disaster in U.S. history. Natural disasters such as these continually threaten communities across the United States and endanger the lives, property, and security of the residents of these communities. Because of this reality, the insurance industry, state officials, and consumer groups have been working to develop solutions in insure mega-catastrophes such as hurricanes, earthquakes, tornadoes and the like. On November 16 and 17, 2005, the insurance commissioners of Florida, California, Illinois, and New York convened a summit to devise a national catastrophe insurance program, and have recommended to the United States Congress that such a program be enacted.

Copies of the memorial are to be presented to the President of the United States, the President of the United States Senate, the Speaker of the House of Representatives, and to each member of the Florida delegation in the United States Congress.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The establishment of a catastrophe insurance program could potentially benefit Florida citizens in a number of ways. The primary benefit is to assure that claims can be paid for a mega catastrophe. A national catastrophe catastrophe mechanism that provides financing to pay for the losses resulting from a major natural disaster would reduce the likelihood and magnitude of assessments and surcharges being levied on policyholders to pay for the losses stemming from such an event. Additionally, the availability of such funds may help to encourage insurers to write policies in the Florida marketplace, increasing competition and reducing the current reliance on Citizens Property Insurance Company to provide coverage to Florida residents.

The adoption of an all-perils coverage as recommended by the memorial is likely provide policyholders to provide a greater degree of flood insurance coverage than is currently available from FEMA. The creation of tax-deferred insurance company reserves would benefit the residents of the state by reducing insurers' reliance on reinsurance to cover potential losses, thus potentially leading to lower premium costs.

C. Government Sector Impact:

To the extent that a national catastrophe insurance program could reduce the number of policyholders in Citizens Property Insurance Company, it would benefit the state by reducing the billions of dollars in potential liability faced by the Florida Government, and in turn, Florida residents, resulting from catastrophe losses.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Summary of Amendments:

None.

This Senate staff analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.