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 6-A

INTRODUCER: Senator Atwater

SUBJECT: National Catastrophe Insurance

DATE: January 16, 2007 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Knudson	Deffenbaugh		**Favorable**
2.				
3.				
4.				
5.				
6.				

I. Summary:

Senate Memorial 6-A 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 Florida Hurricane Catastrophe Fund (FHCF)

The Florida Hurricane Catastrophe Fund is a tax-exempt trust fund created in 1993 after Hurricane Andrew as a form of mandatory reinsurance for residential property insurers,

(s. 215.555, F.S.) 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). The FHCF provides insurers an additional source of reinsurance that is significantly less expensive than what is available in the private market; enabling insurers to generally write more residential property insurance in the state than would otherwise be written. Because of the low cost of coverage from the FHCF, the fund 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. The "actuarially indicated" premium is basically 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, reduced by investment income. The FHCF is priced at a 6.7 percent rate on line, coverage that is estimated at costs of 1/4 to 1/5 of rates in the private market and serves to reduce residential property insurance premiums by approximately 30 ercent if all such reinsurance were purchased from the private market. The Legislature now requires the fund to collect a 25 percent rapid cash build-up factor in the premium formula that produced an additional $213 million in funds for the FHCF for the 2006-07 contract year, (used to pay debt stemming from the 2005 hurricanes). This is in addition to the $852 million in reinsurance premium collected by the fund.

Current law establishes $15 billion as the maximum amount the FHCF must pay in any one year; however that amount may be adjusted annually based on the percentage growth in fund exposure, but not to exceed the dollar growth in the cash balance of the fund. Due to the lack of storms in the 2006 hurricane season, the cap of the fund is expected to increase to approximately $16 billion for 2007-08, after remaining at $15 billion for 2005-06 and 2006-07. The maximum coverage amount for each insurer is 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 had its maximum coverage limited to $1.5 billion (10 percent of $15 billion) for all hurricanes occurring during the 2006-07 contract year.

Insurers must first pay hurricane losses up to their specified "retention" for each hurricane, similar to a deductible, before being reimbursed by the FHCF coverage. The full retention is applied to the two hurricanes causing the greatest losses to the insurer. The retention is adjusted annually based on the FHCF's exposure. 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 had a retention of $530 million, (10 percent of $5.3 billion) for the 2006-07 contract year.

If the cash balance of the FHCF is not sufficient to cover losses, the law allows the issuance of revenue bonds, which are funded by emergency assessments on property and casualty policyholders. The FHCF is authorized to levy emergency assessments against all property and casualty insurance premiums paid by policyholders (other than workers' compensation, flood, accident and health insurance), including surplus lines policyholders. The assessment base for the FHCF is approximately $35 billion for premiums written at year end 2006. Annual assessments are capped at 6 percent of premium with respect to losses from any 1 year and a maximum of 10 percent of premium to fund hurricane losses from multiple years.

The FHCF's estimated initial season capacity for the 2007 hurricane season consists of approximately $2.25 billion in cash and $13.75 billion in bonding capacity. From the inception of the FHCF in 1993 until the 2004 hurricane season, the fund paid insurers for claims for only two hurricanes, Hurricanes Erin and Opal in 1995. Until 2004, the amount the FHCF paid to insurers totaled approximately $13 million. Going into the 2004 hurricane season the FHCF had accumulated over $6 billion in cash. As a result of the 2004 hurricanes, the fund has spent or expects to spend almost $3.95 billion of its cash reimbursing insurers for hurricane losses. Going into the 2005 hurricane season, the fund's cash had decreased to $3 billion. With reimbursement to insurers for 2005 hurricane losses $4.5 billion, the fund was forced to bond $1.35 billion to pay claims and $2.8 billion to provide for liquidity for the 2006 hurricane season, at an estimated cost of $325 to each household in Florida. Thus, the $6 billion accumulated over ten years by the FHCF was depleted in just two years.

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. The Policyholder Disaster Protection Act of 2006 (H.R. 2668) 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.

Multiple members of Florida's congressional delegation 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 insuring 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 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.