The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

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

Prepared By: The Professional Staff of the Banking and Insurance Committee

BILL: SM 2452

INTRODUCER: Senator Posey

SUBJECT: Memorial - National Catastrophe Insurance Program

DATE: March 20, 2008 REVISED:

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

I. Summary:

Senate Memorial 2452 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, as of August, 2006 insurers reported nearly $36 billion in estimated gross losses in Florida for these eight hurricanes, with claims payments of over $33 billion. The last of these eight hurricanes, Hurricane Wilma, resulted in the greatest total losses in Florida. The losses and claims payments are summarized in the table below.

Hurricane	**Estimated Gross Probable Loss**	**Claim Payments Made**
Charley (2004)	$10.15 bil.	$9.05 bil.
Frances (2004)	7.95 bil.	7.70 bil.
Ivan (2004)	3.31 bil.	3.20 bil.
Jeanne (2004)	3.63 bil.	3.51 bil.
Dennis (2005)	.30 bil.	0.27 bil.
Katrina (2005)	.85 bil.	0.73 bil.
Rita (2005)	0.03 bil.	0.02 bil.
Wilma (2005)	9.66 bil.	8.85 bil.
Total	**$35.90 bil.**	**$33.35 bil.**

Source: Office of Insurance Regulation (OIR), Hurricane Reporting Summaries (August 2006).

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

The Florida Hurricane Catastrophe Fund (FHCF)

The FHCF 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.

Insurers must first pay hurricane losses up to their "retention" for each hurricane, similar to a deductible, before being reimbursed by the FHCF coverage. In 2005, legislation addressed multiple storm seasons by providing that the retention is reduced to one-third of the regular retention for a third hurricane and each additional hurricane. 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. For the 2007 hurricane season the retention was approximately $6.1 billion for all insurers combined. A retention is calculated for each insurer based on its share of fund premiums.

For the 2007 hurricane season the FHCF provided $15.85 billion in mandatory coverage. That amount is adjusted annually based on the percentage growth in fund exposure, but not to exceed the dollar growth in the cash balance of the fund. The maximum coverage amount for each insurer is based on that insurer's share of the total premiums paid to the fund.

House Bill 1-A added two additional layers of optional coverage that property insurers may buy for the 2007, 2008, and 2009 hurricane seasons:

- Temporary Increase in Coverage Limit options ("TICL"), that allow an insurer to purchase additional reinsurance for its share of up to $12 billion, in $1 billion increments, above the FHCF annual limit of the mandatory coverage (i.e., up to a total of approximately $28 billion). The SBA may further increase the limits by an additional $4 billion (i.e., up to $32 billion). The SBA did not increase the limits in 2007.
- Temporary Emergency Additional Coverage Options ("TEACO"), that allows residential property insurers to purchase additional coverage below each insurer's market share of the FHCF retention. For 2007, the FHCF retention was $6.1 billion. The TEACO options allow an insurer to select its share of a retention level of $3 billion, $4 billion, or $5 billion, to cover 90 percent, 75 percent, or 45 percent of its losses up to the normal retention for the mandatory FHCF coverage.

If the cash balance of the FHCF is not sufficient to cover losses, the law allows the issuance of revenue bonds of up to 30-year terms, 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, medical malpractice, and accident and health insurance), including auto insurance and surplus lines policyholders. 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.

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 major hurricanes and other natural catastrophes present. The United States House of Representatives passed the Homeowners' Defense Act of 2007 (H.R. 3355) by a 258 to 155 vote, and it is now in the Senate and has been referred to the Committee on Banking, Housing and Urban Affordability. The act seeks to provide federal support for state-sponsored insurance programs to help homeowners prepare for and recover from damages caused by natural catastrophes and to promote the use of private market capital as a means to insure against catastrophes. The bill is sponsored by Rep. Ron Klein (FL District 22) and 41 co-sponsors, and has the following major provisions:

- Federal Natural Catastrophe Reinsurance Program – The program will make available for purchase by state reinsurance programs catastrophe reinsurance with an attachment point that is equal to the projected losses from a single event with a 0.5 percent change of occurrence. The reinsurance will provide reimbursement for 90 percent of losses above the attachment point.
- National Homeowners' Insurance Stabilization Program – The program will make loans to qualified state-based reinsurance programs to ensure solvency, improve affordability and availability of homeowners' insurance, encourage risk transfer to the private capital and reinsurance markets, and spread the risk of catastrophic losses.
- National Catastrophe Risk Consortium – The consortium is designed as a nonprofit, nonfederal entity to: (1) inventory catastrophe risk obligations held by state reinsurance funds, and state residual market entities; (2) issue as a conduit, securities and other financial instruments linked to catastrophe risks insured or reinsured through consortium members; (3) establish a centralized repository of state risk information accessible by private market participants seeking to participate in financial instruments or reinsurance contracts that finance catastrophe risk; (4) perform research and analysis that encourages standardization of the risk-linked securities market.

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 approximately $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 to 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. Fiscal Impact Statement:

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. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

B. Amendments:

None.