HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 1107 Florida Hurricane Catastrophe Fund
SPONSOR(S): Insurance & Banking Subcommittee; Hager
TIED BILLS: **IDEN./SIM. BILLS:** HB 1055

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	12 Y, 0 N, As CS	Callaway	Cooper
2) Government Operations Appropriations Subcommittee			
3) Regulatory Affairs Committee			

SUMMARY ANALYSIS

The Florida Hurricane Catastrophe Fund (FHCF or Fund) is a tax-exempt trust fund created as a form of reinsurance for residential property insurers. The Fund reimburses (reinsures) insurers for a portion of their hurricane losses to residential property. Each insurance company writing insurance policies covering residential property or any policy covering a residential structure or its contents must participate in the FHCF. The deductible amount insurers must pay for reinsurance in the FHCF is set by statute and the maximum amount of coverage from the FHCF insurers can buy is also set by statute.

The overarching goal of the bill is to restructure the FHCF to reduce the size and exposure of the Fund so that the Fund relies less on bonding and more on cash resources to pay its obligations to insurers. This will also result in a reduced likelihood and reduced amount of assessments against property and casualty policyholders. Specifically, the FHCF restructuring proposed by the bill:

- reduces the size of the mandatory coverage from $17 billion to $14 billion over three years (2014 to 2016),
- extends the exemption for medical malpractice premiums from the FHCF assessment for another three years (until May 31, 2016), and
- changes the name of the finance corporation used for bonding by the FHCF.

The bill also repeals outdated provisions in the FHCF law.

Currently, some insurers purchase private reinsurance duplicating FHCF coverage to insure against any shortfalls of the Fund. If purchased, current law prohibits these reinsurance costs from being recouped in rates. The bill repeals the prohibition in current law and allows these costs to be recouped in rates, but only for private reinsurance bought to duplicate any FHCF estimated shortfall.

In 2014, property insurance rates will likely increase due to the FHCF restructuring provided by the bill as insurers replace reinsurance sold by the FHCF with more expensive reinsurance sold by private reinsurers. Rates are likely to increase until the bill is fully implemented in 2016. Estimates vary as to the amount of yearly and cumulative rate increases, as discussed in the fiscal analysis. The cumulative rate increase ranges from 3.1% to 4.7%. If private reinsurance costs decrease during the bill's three year implementation period, then the rate increases could be offset by the decrease in these costs. Rates will also increase for insurers who buy reinsurance duplicating the estimated FHCF bonding shortfall because the bill allows these costs to be included in rates and thus passed on to policyholders. This rate increase will occur in the year the insurer purchases the private reinsurance, which could be 2013. The impact the bill could have on Citizens Property Insurance Corporation, insurer solvency, and timely payment of homeowner's insurance claims is discussed in the fiscal analysis. The bill has no fiscal impact on state or local governments.

The bill is effective upon becoming a law, unless expressly provided otherwise.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Background

The Florida Hurricane Catastrophe Fund (FHCF or Fund) is a tax-exempt trust fund created in 1993 as a form of reinsurance for residential property insurers.[1] The purpose of the FHCF is to protect and advance the state's interest in maintaining insurance capacity in Florida by providing reimbursements to insurers for a portion of their catastrophic hurricane losses.

The FHCF sells reinsurance to property insurance companies significantly cheaper than reinsurance sold by private reinsurance companies. It is estimated that coverage purchased through the FHCF costs insurers one-fourth to one-third what it would cost in the private reinsurance market.[2] There are several reasons for these cost savings:[3]

1. The FHCF operating cost is less than 1% of the annual premium collected, whereas, the operating costs for private reinsurance can range from 10% to 15% of the premium collected.
2. The FHCF does not pay reinsurance brokerage commissions.
3. The FHCF has no underwriting costs.
4. The FHCF is a tax-exempt entity that does not pay federal income taxes or state taxes.
5. The FHCF has the ability to issue tax-exempt debt which results in lower financing costs should it become necessary to finance losses with revenue bonds.
6. The FHCF does not include a factor for profit for reinsurance sold by the FHCF.
7. The FHCF does not include a risk load for reinsurance sold by the FHCF.

Each insurance company writing insurance policies covering residential property or any policy covering a residential structure or its contents must participate in the FHCF. (s. 215.555(4)(a), F.S. and s. 215.555(2)(c), F.S.). Residential property is defined in s. 627.4025(1), F.S. to include personal lines and commercial lines residential coverage. This coverage includes the following insurance policies: homeowner's, mobile homeowner's, dwelling, tenant's, condominium unit owner's, condominium association, cooperative association, and apartment building.

The FHCF is administered by the State Board of Administration and reimburses property insurers for a selected percentage (45, 75, or 90%) of hurricane losses to residential property above the insurer's retention (deductible).[4] The amount of hurricane losses the FHCF will <u>not</u> reimburse (45, 25, or 10%) is the insurer's co-pay for FHCF reinsurance. Insurers finance the co-pay with funds from insurance premiums paid by homeowners or with private reinsurance. Most property insurers select the 90% coverage level, meaning the FHCF will reimburse the insurer 90% of the insurer's specified hurricane losses with the insurer paying the remaining co-pay of 10% from other sources.

A reimbursement contract between the FHCF and the property insurer governs an insurer's participation in the FHCF and the percentage of the insurer's reimbursement. Reimbursement contracts run from June 1st–May 30th. The current contract year (2012-2013 contract year) runs from June 1, 2012–May 30, 2013.

The FHCF must offer two options for reinsurance coverage for all residential property insurers. One of the two options is mandatory and thus must be purchased by all insurers on their residential property exposure. The voluntary coverage option, Temporary Increase In Coverage Limit Options (TICL), offers reinsurance to insurers above the mandatory coverage.

For the mandatory coverage, the FHCF charges insurers the "actuarially indicated" premium for the coverage provided by the FHCF, based on hurricane loss projection models found acceptable by the

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[1] s. 215.555, F.S. The FHCF was created after Hurricane Andrew in 1992.
[2] Annual Report of the Florida Hurricane Catastrophe Fund Fiscal Year 2010-2011, p. 19.
[3] Annual Report of the Florida Hurricane Catastrophe Fund Fiscal Year 2010-2011, p. 19.
[4] Retention is defined to mean the amount of losses below which an insurer is not entitled to reimbursement from the Fund. A retention is calculated for each insurer based on its proportionate share of Fund premiums.

Florida Commission on Hurricane Loss Projection Methodology. Each insurer's premium amount for mandatory coverage is different because the premium is based on the insured value of the residential property the insurer insures, the location of the property insured, the construction type of the property insured, the deductible amounts for the property insured, and other factors. The premium for mandatory coverage also includes a cash build-up factor which is charged on top of the actuarially indicated premium. For the 2012-2013 contract year, the cash build-up factor is 20%, meaning an insurer's premium is 20% greater than the actuarially indicated premium. The cash build-up factor increases by 5% each year until it is 25% (2013-2014 contract year).

Florida law sets the maximum amount the FHCF reimburses insurers each year for the mandatory coverage.[5] This is the FHCF's capacity. Under current law, the FHCF's capacity is $17 billion for each contract year. The capacity does not increase until the FHCF's cash and bonding ability exceeds $34 billion. This allows the FHCF to accumulate funds to pay the maximum mandatory coverage FHCF obligations ($17 billion a year) for claims resulting from hurricanes in back-to-back seasons.[6] Once a $34 billion funding level is reached by the FHCF, the FHCF's capacity will increase. The method for calculating the Fund's capacity under current law allows the FCHF's cash balance to grow in years where there are no hurricanes while keeping the FHCF's exposure (capacity) frozen so that the FHCF is less reliant on bonding to meet its mandatory coverage obligations. For the current contract year, the insurance industry as a whole is covered for losses up to $17 billion by the mandatory coverage.

Before FHCF monies are available to pay claims each insurer must meet a retention/deductible. The retention amount for each insurer is different because the amount is based on the amount of premium the insurer pays to the FHCF. For the 2012-2013 contract year, the insurance industry as a whole has an aggregate retention of $7.389 billion for mandatory coverage, meaning the total of all individual insurer retentions/deductibles will total $7.389 billion per hurricane event if all participating insurers reached their retention. Although the insurance industry's aggregate deductible/retention totals $7.389 billion, insurers can obtain reimbursement from the FHCF before the insurance industry losses total $7.389 billion because loss recovery from the FHCF is based on an individual insurer meeting its own retention for mandatory coverage prior to losses being reimbursed.

The TICL options were added to the FHCF in 2007.[7] The purchase of these options is voluntary and if purchased provides the insurer a share of additional coverage above the mandatory FHCF coverage in $1 billion increments. When the TICL options were created in 2007, $12 billion of additional FHCF coverage was available for purchase. However, due to the statutory reductions in TICL options available, for the 2012-2013 Fund contract year, only $4 billion is available for purchase.[8] Of the $4 billion available in TICL coverage this contract year, $0.023 billion was purchased by insurance companies, representing less than 1% of the available coverage. By law, the 2013-2014 contract year is the last contract year TICL options can be purchased by insurers.

For the 2012-13 contract year (June 1, 2012–May 31, 2013), the maximum amount the FHCF would have to reimburse insurers is $17.023 billion, allocated as follows:

- $17 billion for the mandatory coverage.
- $.023 billion for the TICL coverage option.[9]

To fund its obligations of $17.023 billion the FHCF has $8.503 billion in cash.

Because the obligations of the FHCF exceed the cash of the FHCF by approximately $8.5 billion, if the FHCF had to pay its maximum actual obligations of $17.023 billion in the 2012-2013 contract year, the FHCF would have to bond for additional funds of $8.5 billion to pay claims. In October 2012, the Fund estimated it could borrow $7 billion through bonding.[10] Thus, the FHCF would be short $1.5 billion to

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[5] s. 215.555(4)(c)1., F.S.
[6] The funds may be accumulated from premiums and bonding.
[7] Ch. 2007-1, L.O.F.
[8] Under current law, the maximum amount of TICL coverage offered for purchase by the FHCF decreases by $2 billion each contract year.
[9] Report of Claims-Paying Capacity Estimates dated October 9, 2012, available at http://www.sbafla.com/fhcf/AdvisoryCouncil/2012MeetingMaterials/tabid/1311/Default.aspx (last accessed March 8, 2013).
[10] https://www.flrules.org/gateway/readFile.asp?sid=12&tid=12136269&type=1&File=19.htm (last accessed March 8, 3013).

pay claims. However, it is noteworthy that the projected shortfall of $1.5 billion is for the contract year ending on May 31, 2013. Absent a major hurricane before the current contract year expires, the projected shortfall for the hurricane season beginning on June 1, 2013, should be lower. This is because the FHCF will receive additional revenue from the collection of premium for the 2013-2014 contract year. The current estimated additional premium is approximately $1.1 billion.[11]

Revenue bonds issued by the FHCF to pay claims when the FHCF's funds are inadequate are funded by emergency assessments on property and casualty policyholders.[12] The FHCF is authorized to levy emergency assessments against all property and casualty insurance premiums paid by policyholders (other than workers' compensation, accident and health, federal flood and, until May 31, 2013, medical malpractice), including surplus lines policyholders, when reimbursement premiums and other FHCF resources are insufficient to cover the FHCF's obligations.[13] Annual assessments are capped at 6% of premium with respect to losses from any one year and a maximum of 10% of premium to fund hurricane losses from multiple years.[14] Revenue bonds issued by the FHCF may be amortized over a term up to 30 years. Thus, the FHCF may levy assessments for as long as 30 years.

Currently, the FHCF is levying an assessment of 1.3% of premium against all property and casualty insurance policyholders subject to the assessment.[15] Typically, insurers pass this assessment directly to policyholders. The current FHCF assessment is due to a deficit in the Fund associated with the 2005 hurricanes. This is the first assessment the FHCF has had to levy to cover a deficit since its creation in 1993. The current assessment of 1.3% will be levied until December 31, 2016.

Effect of Proposed Changes

The overarching goal of the bill is to restructure the FHCF to reduce the size and exposure of the Fund so that the Fund relies less on bonding and more on cash resources to pay its obligations to insurers. This will also result in a reduced likelihood and reduced amount of assessments against property and casualty policyholders.

Specifically, the FHCF restructuring proposed by the bill:

- reduces the size of the mandatory coverage over three years from 2014-2016,
- extends the exemption for medical malpractice premiums from the FHCF assessment for three years, and
- changes the name of the finance corporation used for bonding by the FHCF.

The bill also allows private reinsurance costs for private reinsurance bought to duplicate FHCF coverage in property insurance rate filings, but only for private reinsurance bought to duplicate any FHCF estimated shortfall. It repeals current law relating to FHCF coverage below the retention which has expired by operation of law.

<u>Reduces the Size of the Mandatory Coverage</u>

Over a three year period starting in 2014, the bill reduces the limits of the FHCF mandatory coverage from the current $17 billion. For the 2014-2015 contract year, the limit is reduced to $16.5 billion; for the 2015-2016 contract year, the limit is reduced to $15.5 billion; and for the 2016-2017 and subsequent contract years, the limit is reduced to $14 billion. After the 2016-2017 contract year, the limit will be more than $14 billion only if the FHCF has enough funding to fully fund a $14 billion single season and a $14 billion second season capacity (a total of $28 billion in funding). The current $17 billion mandatory coverage maximum stays in effect for the 2013-2014 contract year.

The change to the mandatory coverage will reduce the FHCF's reliance on large bonding transactions to raise funds to pay claims. Currently, if the FHCF had to pay its obligations in full, the FHCF is $8.5

[11] The additional $1.1 billion is not all collected at the beginning of the contract year. Instead, it is collected quarterly. Thus, the entire $1.1 billion will not be available to pay claims starting June 1, 2013.
[12] s. 215.555(6)(a)1., F.S.; s. 215.555(6)(b)1., F.S.
[13] s. 215.555(6)(b)1., F.S.; s. 215.555(6)(b)(10), F.S.
[14] s. 215.555(6)(b)2., F.S.
[15] A 1% assessment was levied and paid by insurers from January 1, 2007–December 31, 2010. The 1% assessment was increased to 1.3% on January 1, 2011 due to increasing losses from the 2005 hurricanes.

billion short in funding and is relying on bonding to raise the needed funds. In fact, the Fund's financial advisors estimate the Fund could only borrow $7 billion through bonding in the current financial market. Thus, the Fund has a potential shortfall of over $1.5 billion.

Because of fluctuating financial markets, there is a great deal of risk and uncertainty associated with large bond transactions, making large bond transactions impossible or extremely expensive. Under current law, the FHCF is only obligated to use cash on hand and funds raised through bonding to reimburse insurers for claims.[16] Thus, if the FHCF cannot raise enough funds through bonding to pay its obligations, then the FHCF is not required to pay all its obligations to insurers. This could be problematic for insurers as they rely on the Fund being able to reimburse them for claims when constructing their business model for catastrophes. Insurers do not typically purchase private reinsurance to duplicate reinsurance bought from the FHCF as duplicative reinsurance costs cannot be passed through to policyholders in a rate filing and thus is an added expense for the insurer that cannot be recouped. Furthermore, keeping bonding costs as low as possible is important because bonding costs are included in the calculation of assessments levied by the FHCF and passed through to most property and casualty policyholders.

Reducing the mandatory coverage of the FHCF will likely result in increased property insurance rates for homeowners, if all other costs to the insurer factored into rates are static. Reinsurance purchased from the FHCF is considerably cheaper than reinsurance purchased from private reinsurance companies. It is estimated that coverage purchased through the FHCF costs insurers between one-fourth to one-third what it would cost in the private reinsurance market.[17] For solvency reasons, property insurers are required by the Office of Insurance Regulation (OIR) to purchase reinsurance.[18] Reducing the mandatory coverage layer of the FHCF will require most property insurers to replace FHCF reinsurance with more expensive reinsurance from private reinsurers. The increased reinsurance costs will be passed through to homeowners.[19]

Extends the Exemption for Medical Malpractice Premiums from the FHCF Assessment:
Revenue bonds are issued by the FHCF to pay claims when the FHCF's funds are inadequate. These bonds are funded by emergency assessments levied by the FHCF against property and casualty insurance premiums paid by policyholders (other than workers' compensation, accident and health, federal flood and, until May 31, 2013, medical malpractice), including surplus lines policyholders.[20] The FHCF assessment base is over $34.6 billion.[21] Annual assessments are capped at 6% of premium with respect to losses from any one year and a maximum of 10% of premium to fund hurricane losses from multiple years.[22]

The bill allows medical malpractice insurance policyholders to be exempt from FHCF assessments until May 31, 2016. Although these policyholders are currently exempt from the assessment base, they will be added to the base starting June 1, 2013 because their exemption expires on May 31, 2013.

Changes the Name of the Finance Corporation Used For Bonding By the FHCF The bill changes the name of the Florida Hurricane Catastrophe Fund Finance Corporation to the "State Board of Administration Finance Corporation." The Florida Hurricane Catastrophe Fund Finance Corporation is the corporation that issues revenue bonds for the Florida Hurricane Catastrophe Fund. The Florida Hurricane Catastrophe Fund Corporation had long-term ratings of Aa3/AA-/AA from Moody's, Standard and Poor's, and Fitch, respectively.[23]

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[16] s. 215.555(2)(m), F.S.; s. 215.555(4)(c)1., F.S.
[17] Annual Report of the Florida Hurricane Catastrophe Fund Fiscal Year 2009-2010 , p. 18.
[18] The amount of reinsurance required to be purchased varies from insurer to insurer and is based, in part, on the insurer's exposure and funds on hand to pay claims.
[19] Section 627.062(2)(b), F.S. requires the OIR to consider reinsurance costs when reviewing a rate filing for approval. Section 627.062(2)(k), F.S. allows insurers to make an expedited rate filing in order to change rates based solely on reinsurance costs.
[20] s. 215.555(6)(b)1., F.S.; s. 215.555(6)(b)(10), F.S.
[21] Assessment base total is as of the end of 2011. See Report Prepared for the Florida Hurricane Catastrophe Fund on Claims-Paying Capacity Estimates by Raymond James Public Finance Department, dated October 9, 2012, available at http://www.sbafla.com/fhcf/AdvisoryCouncil/2012MeetingMaterials/tabid/1311/Default.aspx (last accessed February 27, 2013).
[22] s. 215.555(6)(b)2., F.S.
[23] Report Prepared for the Florida Hurricane Catastrophe Fund Claims-Paying Capacity Estimates, dated October 9, 2012, available at http://www.sbafla.com/fhcf/AdvisoryCouncil/2012MeetingMaterials/tabid/1311/Default.aspx (last accessed March 5, 2013).

This change should not impact property insurance rates. However, the change may prevent confusion among bond purchasers with other types of catastrophe bonding and may make bonds issued by the FHCF easier to sell at a lower price.

Allows Costs for FHCF Duplicate Coverage in Property Insurance Rate Filings

The Rating Law for property, casualty, and surety insurance is located in Part I of ch. 627, F.S., (ss. 627.011 – 627.311, F.S.). The primary purpose of the Rating Law is to ensure insurance rates are not excessive, inadequate, or unfairly discriminatory. This standard applies to every property insurance rate.

Section 627.0645, F.S, requires every property insurance company to make a rate filing with the OIR each year. The rate filing contains the insurance company's proposed rates. The OIR reviews the rate filing and either approves or disapproves the proposed rates. If an insurance company does not want to change its rates one year, instead of a rate filing, the insurer can file a certification by an actuary that the existing rate level produces rates which are actuarially sound and which are not inadequate.

In determining whether a rate is excessive, inadequate, or unfairly discriminatory, the OIR uses the following statutory factors.[24]

- Past and prospective loss experience in Florida and in other jurisdictions.
- Past and prospective expenses.
- Degree of competition to insure the risk.
- Investment income reasonably expected by the insurer.
- Reasonableness of the judgment reflected in the filing.
- Dividends, savings, or unabsorbed premium deposits returned to Florida insureds.
- Adequacy of loss reserves.
- Cost of reinsurance.
- Trend factors, including those for actual losses per insured unit.
- Catastrophe and conflagration hazards, when applicable.
- Projected hurricane losses, when applicable.
- A reasonable margin for underwriting profit and contingencies.
- Cost of medical services, when applicable.
- Other relevant factors impacting frequency and severity of claims or expenses.

The Rating Law specifically allows insurers to fully recoup the premiums paid to the FHCF for coverage and private reinsurance costs in rate filings. This means the costs are ultimately passed on to the insurer's policyholders.

Currently, some insurers purchase private reinsurance within the covered layers of the FHCF to insure against any shortfalls of the Fund. If purchased, the costs cannot be recouped in a rate filing because current law specifically prohibits insurers from recouping private reinsurance costs that duplicate coverage provided by the FHCF. The bill allows insurers to recoup private reinsurance costs that duplicate FHCF coverage in rates, but only for the reinsurance purchased to cover any FHCF estimated shortfall. If recouped, these costs are ultimately passed on to the insurer's policyholders.

Repeals Provisions Relating to FHCF Coverage

The bill repeals several provisions in the FHCF governing statute that are obsolete because they sunset. For example, current law allowing certain insurers to buy $10 million of FHCF coverage below their FHCF retention is repealed because current law allowing this purchase expired on May 31, 2012. Also, current law allowing insurers to buy additional reinsurance from the FHCF below their retention (TEACO coverage) is repealed because current law allowed this purchase only through May 31, 2010.

B. SECTION DIRECTORY:

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[24] s. 627.062(2), F.S.

Section 1: Amends s. 215.555, F.S., relating to the Florida Hurricane Catastrophe Fund, effective June 1, 2013.

Section 2: Amends s. 215.555, F.S., relating to the Florida Hurricane Catastrophe Fund, effective June 1, 2013.

Section 3: Amends s. 627.062, F.S., relating to rate standards.

Section 4: Amends s. 627.0629, F.S., relating to residential property insurance; rate filings.

Section 5: Provides an effective date of upon becoming law unless expressly provided otherwise.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Provision Relating to Recoupment of Duplicative Private Reinsurance
Allowing insurers to fully recoup costs for private reinsurance that duplicates any FHCF coverage in the FHCF estimated bonding shortfall will increase property insurance rates and the resulting premiums paid by policyholders if insurers buy duplicative reinsurance. However, if the FHCF has a bonding shortfall, insurers who replace FHCF coverage with private insurance for their amount of FHCF coverage in the shortfall will be able to collect reinsurance proceeds for this amount. This ensures the insurer has sufficient funds to pay claims and remain solvent.

Provision Relating to Medical Malpractice Exemption from Assessments
Extending the exemption for medical malpractice insurance from the FHCF assessment base for another three years will cause policyholders of the other types of property and casualty insurance included in the assessment base to pay higher assessments for those three years. Although medical malpractice is not currently in the FHCF assessment base, it was to be added as of June 1, 2013. Adding additional types of insurance to the assessment base increases the base which lowers the assessment for all types of insurance in the base. As of December 31, 2011, medical malpractice premiums totaled almost $555 million.[25] Thus, the bill precludes the FHCF assessment base of $34.6 billion[26] to increase by $555 million.

[25] This total includes premiums from surplus lines insurance and risk retention groups. Information obtained from the OIR on February 27, 2013, on file with the Insurance & Banking Subcommittee.
[26] Assessment base total is as of the end of 2011. See Report Prepared for the Florida Hurricane Catastrophe Fund on Claims-Paying Capacity Estimates by Raymond James Public Finance Department, dated October 9, 2012, available at http://www.sbafla.com/fhcf/AdvisoryCouncil/2012MeetingMaterials/tabid/1311/Default.aspx (last viewed February 27, 2013).

If the FHCF has to issue revenue bonds to pay claims, it is likely to obtain more favorable bonding terms with a larger the assessment base. Thus, preventing medical malpractice from being added to the assessment base for another three years may result in the FHCF receiving less favorable bonding terms than it would receive had medical malpractice been added to the base on June 1, 2013.

Policyholders of medical malpractice insurance will not have to pay FHCF assessments on their medical malpractice insurance for another three years under the bill. Under current law, these policyholders would have had to start paying FHCF assessments levied due to hurricanes occurring on or after June 1, 2013.

Provisions Relating to Restructuring the FHCF

Because the restructuring of the FHCF proposed by the bill reduces the amount of reinsurance sold by the FHCF, property insurers will likely replace the reinsurance coverage currently sold by the FHCF with more expensive reinsurance sold by private reinsurers. Thus, it is anticipated property insurance rates and resulting premiums will increase due to the changes to the FHCF made by the bill.

The proposed changes will result in no increase in residential property insurance rates for the 2013-2014 contract year (June 1, 2013–May 31, 2014) because the changes reduce coverage offered by the FHCF starting in the 2014–2015 contract year.

Estimate by the Insurance Consumer Advocate (ICA)[27]

The ICA estimates the following rate impact associated with the reduction of the mandatory FHCF coverage as the bill provides:
2014-2015 Contract Year: 0.5% increase
2015-2016 Contract Year: 1.0% increase
2016-2017 Contract Year: 1.6% increase
Cumulative Premium Increase 2014-2016: 3.1%.

Estimate by the Office of Insurance Regulation[28]

The OIR opined the rate impact is different, depending on whether the insurer is Citizens Property Insurance Corporation (Citizens) or not.

For insurers other than Citizens, the OIR estimated the following rate impact associated with the reduction of the mandatory FHCF coverage as the bill provides:
2014-2015 Contract Year: 0.5% increase
2015-2016 Contract Year: 1.1% increase
2016-2017 Contract Year: 1.6% increase
Total Estimated Cumulative Premium Increase 2014-2016: 3.2%.

For Citizens, the OIR estimated the following rate impact associated with the reduction of the mandatory FHCF coverage as the bill provides:[29]
2014-2015 Contract Year: 0.8% increase
2015-2016 Contract Year: 1.6% increase
2016-2017 Contract Year: 2.3% increase
Total Estimated Cumulative Premium Increase 2014-2016: 4.7%.

The OIR also notes rates will increase if any private reinsurance cost that duplicates FHCF coverage is included in an insurer's rates as is allowed under the bill. However, the amount of rate increase is indeterminable because the private reinsurance costs would be specific and different to each insurer.

Impact of Decreasing Private Reinsurance Costs on Rate Increases Resulting from the Bill

Some proponents of the bill assert costs for private reinsurance will decrease for reinsurance sold effective June 1, 2013 because there is more than adequate supply of private reinsurance in the

[27] Email from the ICA dated March 29, 2013, on file with the Insurance & Banking Subcommittee.
[28] Email from the OIR dated March 29, 2013, on file with the Insurance & Banking Subcommittee.
[29] The OIR estimate assumes Citizens will purchase private reinsurance to replace the reduced FHCF reinsurance coverage.

market.[30] Accordingly, the proponents conclude the reduction in private reinsurance costs, which are fully passed through to policyholders in property insurance rates, will more than offset the rate increase associated with restructuring the FHCF. The ICA estimated private insurance rates would have to decrease 1.4% in 2014, 3.1% in 2015, and 4.6% in 2016 (for a cumulative decrease of 9.2% from 2014-2016) to completely offset the rate increase associated with the bill's reduction of the mandatory layer of the FHCF.[31] However, the ICA notes it is impossible to predict whether these estimated revenue neutral reductions in reinsurance premiums will be realized.[32]

Furthermore, the information provided by proponents of the bill to document the anticipated decrease in private reinsurance costs are for costs effective June 1, 2013. No information has been provided to document there will also be a decrease in private reinsurance costs effective June 1, 2014 when the changes made to the FHCF mandatory layer take effect. Because private reinsurance rates depend, in part, on the capacity of the market which depends, in part, on the amount of losses private reinsurers sustained the previous year, it is very speculative to extrapolate reinsurance cost decreases in 2013 to 2014.

Impact on Policy Count of Citizens Property Insurance Corporation

The bill may have a collateral fiscal impact of the bill for Citizens.[33] As property insurance rates in the private market increase due to changes made by the bill while Citizens rate increases are capped,[34] an unintended consequence could develop where consumers decided to enter or remain in Citizens where lower rates may be available. In addition, Citizens' reinsurance costs could increase if reinsurance currently sold by the FHCF is eliminated by the bill and Citizens replaces that reinsurance with more expensive private reinsurance. In this case, Citizens may be unable to fully recoup their reinsurance costs in rates due to the Citizens' rate cap of 10%.[35]

Moreover, further disparity between Citizens' rates and those of private sector insurers may be created if private insurers raise rates more than 10% due to the increased cost of replacing FHCF reinsurance with private reinsurance and Citizens also needs to raise rates more than 10% to recoup reinsurance costs, but cannot due to the 10% rate cap. Additionally, even if Citizens does not replace FHCF reinsurance with private reinsurance, then the rate disparity between Citizens' rates and those of private sector insurers could increase as private insurer's rates go up to account for the purchase of more private reinsurance to replace FHCF reinsurance and Citizens' rates do not increase because the corporation chooses not to purchase private reinsurance to replace FHCF insurance.[36] Thus, depending on Citizens' response to the changes to the FHCF provided by the bill, the bill could result in Citizens offering lower rates than private sector insurers which may increase the number of policies in Citizens, assuming homeowners purchase property insurance solely on rates.

Impact on Solvency of Insurers

The bill could present solvency concerns for some private insurers. As FHCF reimbursements are reduced by the bill, insurers may not be able to obtain or maintain sufficient reinsurance amounts to cover potential losses arising from a hurricane. Insufficient reinsurance impairs the solvency of the insurers.[37]

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[30] Testimony presented at the Insurance & Banking Subcommittee meeting on March 13, 2013.
[31] Email from the ICA dated March 29, 2013, on file with the Insurance & Banking Subcommittee.
[32] Email from the ICA dated March 29, 2013, on file with the Insurance & Banking Subcommittee.
[33] Citizens Property Insurance Corporation (Citizens) is a state-created, not-for-profit, tax-exempt governmental entity whose public purpose is to provide property insurance coverage to those unable to find affordable coverage in the voluntary admitted market. It is not a private insurance company. As of January 31, 2013, Citizens is the largest property insurer in Florida with almost 1.3 million policies extending approximately $418 billion of property coverage to Floridians.
[34] Citizens' rate increases are capped under current law from increasing more than 10% per policy per year until the rates are actuarially sound. (s. 627.351(6)(n), F.S.)
[35] By law, Citizens cannot increase rates more than 10% per policy per year (s. 627.351(6)(n)6., F.S.).
[36] Private insurance companies must maintain a certain amount of reinsurance for solvency purposes, however, Citizens does not have to comply with the solvency requirements required of private insurers so does not have to maintain a certain amount of reinsurance.
[37] This impact was initially noted in the OIR Bill Analysis for HB 833 filed in 2012, but the OIR indicated in an email to staff of the Insurance & Banking Subcommittee on March 12, 2013, the impact would apply to HB 1107 too.

Based on input from its financial advisors, the Fund estimates it cannot issue bonds to obtain over $1.5 billion needed to pay claims if the Fund had to pay its maximum obligations of over $17 billion in the 2012-2013 contract year. Thus, insurers who have purchased reinsurance from the FHCF may not be fully reimbursed by the Fund. Some insurers rely on Fund reimbursement to meet solvency requirements, so not receiving full reimbursement could impair solvency of these insurers. However, because the bill allows insurers that buy duplicate FHCF coverage for the estimated FHCF shortfall to recoup the costs of such in a rate filing, the insurers who buy private reinsurance to cover the projected FHCF shortfall should continue to meet solvency requirements.

Reducing the structure and size of the Fund will provide more assurance to property insurers in the private sector that the Fund will be able to fully reimburse insurers.

Impact on Homeowners' Ability to Have Their Claims Timely Paid
Reducing the size of the FHCF could increase the likelihood homeowners will have their property insurance claims paid in a timely manner following a hurricane. If the FHCF has a bonding shortfall after a hurricane, then the FHCF may have to reimburse insurers at a slower pace while the Fund seeks additional funds to reimburse insurers through bonding. If this happens, property insurers may take longer to pay policyholders' claims as some of the funds they likely rely on to pay these claims of are derived from their receipt of reimbursements from the FHCF.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to: require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None provided in the bill.

C. DRAFTING ISSUES OR OTHER COMMENTS:

Some assert the FHCF current bonding shortfall estimate is theoretical because the FHCF would not have to pay its full obligations in one year as the estimate assumes. Rather, the FHCF would pay the obligations as they are requested by insurers, likely over two or three years. Thus, if the FHCF could not bond for funds to pay its full obligations soon after a hurricane, the FHCF would still have ample time to bond for the remaining funds needed before the full obligations were requested by insurers.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On March 28, 2013, the Insurance & Banking Subcommittee, heard the bill, adopted a strike-all amendment and an amendment to the strike-all amendment, and reported the bill favorably with a committee substitute. The amendments adopted made the following changes to the bill:

- Starting June 1, 2104, reduced the size of the mandatory coverage of the FHCF from $17 billion to $14 billion over three years (reduction of $.5 billion in 2014, $1 billion in 2015, and $1.5 billion in 2016).

- Removed the increases in the insurer's co-pay amounts contained in the bill.
- Removed the increase in payment of loss adjustment expenses by the FHCF contained in the bill.
- Maintained current law allowing commercial self-insurance funds to participate in the FHCF.
- Changed the name of the FHCF Finance Corporation to the State Board of Administration Finance Corporation.
- Extended the exemption for medical malpractice insurance premiums from emergency assessments levied by the FHCF for another three years, until May 31, 2016.
- Deleted obsolete language that has expired by operation of law.
- Allowed private insurers to include the cost of private reinsurance that duplicates the reinsurance sold by the FHCF in property insurance rates, but only the private reinsurance that covers the FHCF's estimated bonding shortfall.

The staff analysis was updated to reflect the committee substitute.