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 Committee on Banking and Insurance

BILL:	SB 1262
INTRODUCER:	Senator Hays
SUBJECT:	Florida Hurricane Catastrophe Fund
DATE:	March 11, 2013 REVISED: 3/16/2013

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Knudson	Burgess	BI	**Pre-meeting**
2.			AP	
3.				
4.				
5.				
6.				

I. Summary:

SB 1262 reduces the Florida Hurricane Catastrophe Fund (Cat Fund) coverage limits and maximum reimbursement percentage, and eliminates the Temporary Increase in Coverage Limit option after the conclusion of the 2012-2013 Cat Fund contract year. The bill is designed to reduce the overall financial obligations of the fund, reducing the likelihood and amount of bonding and emergency assessments needed to fund deficits in the event the Fund experiences a shortfall after a major hurricane. The major proposed changes are summarized as follows:

Phases in annual decreases of the $17 billion Cat Fund mandatory coverage limit beginning in the 2013-2014 contract year as follows:

- For the 2013-2014 contract year, $16 billion.
- For the 2014-2015 contract year, $15 billion.
- For the 2015-2016 contract year and thereafter, $14 billion.

Reduces the maximum reimbursement amount from 90 percent to the following percentages:

- For the 2013-2014 contract year, 85 percent.
- For the 2014-2015 contract year, 80 percent.
- For the 2015-2016 contract year and thereafter, 75 percent.

The bill eliminates the $2 billion Temporary Increase in Coverage Limit (TICL) optional coverage layer for the 2013-2014 contract year. The State Board of Administration is required to adopt revised or amended rules and forms, or addenda thereto, necessary to ensure that the

statutory changes made by SB 1262 apply to each participating insurer's Cat Fund reimbursement contract for the 2013-2014 contract year that begins on June 1, 2013.

The bill deletes a prohibition against insurers recouping reinsurance costs that duplicate coverage provided by the Cat Fund.

The effective date of the bill is July 1, 2013.

This bill amends the following sections of the Florida Statutes: 215.555, 624.424, 627.062, 627.0629, and 627.351.

II. Present Situation:

The Florida Hurricane Catastrophe Fund (Cat Fund)

The Cat Fund is a tax-exempt fund created in 1993 after Hurricane Andrew as a form of mandatory reinsurance for residential property insurers. The Cat Fund is administered by the State Board of Administration (SBA) and is a tax-exempt source of reimbursement to property insurers for a selected percentage (45, 75, or 90 percent) of hurricane losses above the insurer's retention (deductible).The Cat Fund 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 Cat Fund, the fund acts to lower residential property insurance premiums for consumers. The Cat Fund 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.

Cat Fund Mandatory Coverage

All insurers that write residential property insurance in Florida are required to buy reimbursement coverage (reinsurance) on their residential property exposure through the Cat Fund. The Cat Fund is authorized by statute to sell $17 billion of mandatory layer coverage. Each insurer that purchases coverage may receive up to its proportional share of the $17 billion mandatory layer of coverage based upon the insurer's share of the actual premium paid for the contract year, multiplied by the claims paying capacity of the fund. For example, if an insurer paid 10 percent of the total premium paid in a contract-year, then that insurer would be eligible to receive up to 10 percent of the mandatory layer of coverage ($1.7 billion of the $17 billion mandatory layer).

Insurers that experience multiple hurricanes causing loss during the contract year may receive reimbursement from the Cat Fund for losses that exceed the applicable retention. The insurer's full retention is applied to each hurricane causing the two largest losses for that insurer. For each other covered event resulting in losses, the insurer's retention is only one-third of the full retention. To access the Cat Fund an insurer must have incurred losses above the retention levels calculated and set by statute. When faced with a multi-storm season, insurers must reach their full retention levels on the two largest storms of the season. The retention level is then reduced to one-third the normal amount for any other storms that season. Citizens Property Insurance

Corporation is the largest purchaser of Cat Fund coverage. For the 2012 - 2013 hurricane season Citizens will have purchased $1.75 billion in private reinsurance coverage along with the $5.73 billion in mandatory layer reinsurance from the Cat Fund.

Cat Fund Premiums

The Cat Fund 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 an amount that is adequate to pay current and future obligations and expenses of the fund. In practice, each insurer pays the Cat Fund annual reimbursement premiums that are proportionate to each insurer's share of the Cat Fund's risk exposure. The cost of Cat Fund coverage is significantly lower than the cost of private reinsurance due to the fact that the fund is a tax-exempt non-profit corporation and does not charge a "risk load."

Cat Fund Bonding and Assessment Authority

Reimbursements to insurers for losses above the current cash balance of the fund are financed through bonding. When the cash balance of the Cat Fund is insufficient to cover losses, the law authorizes the Cat Fund to issue revenue bonds, which are funded by emergency assessments on property and casualty policyholders. If a large storm triggered the full capacity of the Cat Fund, bond issues totaling over $8 billion could be necessary for the fund to meet its maximum obligations.

Bonds would be funded by an emergency assessment of up to 6 percent of premium on most lines of property and casualty insurance for funding losses from a single year, and up to 10 percent of premium for funding losses from multiple years. All lines of property and casualty insurance, including surplus lines insurance, are subject to emergency assessment except for workers' compensation and medical malpractice liability insurance. The Cat Fund's broad-based assessment authority is one of the reasons the Cat Fund was able to obtain an exemption from federal taxation from the Internal Revenue Service as an integral part of state government.

Cat Fund Financial Obligations and Claims Paying Resources

The Cat Fund's coverage obligations for the 2012-2013 hurricane season[1] totaled $17.023 billion dollars for a single storm, which consisted of $17 billion of mandatory coverage and $23 million dollars in optional TICL coverage. The Cat Fund projected year-end cash balance for the 2012-2013 hurricane season is $8.503 billion. Obligations exceeding the cash balance of the Cat Fund would require bonding of up to $8.503 billion. The assessment base for the Cat Fund is approximately $34.640 billion for premiums written at year end 2011, enabling the Cat Fund to levy annual assessments of as much as $2.078 billion for one contract year and $3.454 billion for multiple contract years.

[1] June 1, 2012 – May 31, 2013

Cat Fund Claims-Paying Capacity Estimates

In May and October of each contract year, the SBA is required to publish in the Florida Administrative Weekly a statement of the fund's estimated borrowing capacity, the fund's estimated claims-paying capacity, and the projected balance of the fund as of December 31. After the end of each calendar year, the board is required to notify insurers of the estimated borrowing capacity, estimated claims-paying capacity, and the balance of the fund as of December 31 to provide insurers with data necessary to assist them in determining their retention and projected payout from the fund for loss reimbursement purposes.

The October 9, 2012, Claims Paying Capacity Estimate (Estimate)[2] is the most recent such report to be issued.[3] The report, prepared by Raymond James, evaluated the Cat Fund's bonding capacity by analyzing the current financial markets and obtaining written feedback from a senior managing underwriter from four large financial services firms (Barclay's, Citi, Goldman Sachs, and J.P. Morgan). The October 9, 2012, Estimate noted that the Cat Fund's total obligations of $17.023 billion exceed the projected year-end fund balance of $8.503 billion, thus the Cat Fund may need to raise up to $8.503 billion through bonding in order to fund its liabilities.

The senior managers from Citi, Goldman Sachs, J.P. Morgan, and Barclays estimated the bonding capacity of the Cat Fund to be from $2 billion to $12 billion over the 12 months following a storm, leading to an average estimate of $7 billion in bonding capacity. The Estimate anticipated, however, that the Cat Fund would have an additional bonding capacity of $6 billion from 12 to 24 months after the hurricane, which would have enabled the Cat Fund to pay its entire obligations. A hurricane requiring the Cat Fund to pay its full obligation $17.023 billion would leave an estimated $4.480 billion in bonding capacity and $1.354 billion in new premium collections to fund losses in the subsequent hurricane season, leaving the fund with over $11 billion in unfunded obligations for that subsequent hurricane season.

III. Effect of Proposed Changes:

Section 1. Amends s. 215.555, F.S. by reducing the Florida Hurricane Catastrophe Fund coverage limits and reducing the maximum reimbursement percentage. This section is effective upon becoming a law. The major proposed changes are summarized as follows:

<u>Decreases the Maximum Reimbursement Percentage for Cat Fund Coverage</u>
Under current law, insurers have the option to purchase Cat Fund reinsurance that provides reimbursement of 90 percent, 75 percent, or 45 percent of the insurer's losses within the mandatory Cat Fund layer of coverage. The bill reduces the maximum reimbursement amount from 90 percent to the following percentages:

- For the 2013-2014 contract year, 85 percent.
- For the 2014-2015 contract year, 80 percent.
- For the 2015-2016 contract year and thereafter, 75 percent.

[2] Claims-Paying Capacity Estimates (October 9, 2012).
[3] The first Claims Paying Capacity Estimate for the 2013-2014 hurricane season is due to be published in May 2013.

The bill requires insurers that elect the maximum coverage level available must purchase the following year's renewal of the reimbursement contract at the highest available coverage level if revenue bonds after a covered event (hurricane) are outstanding.

Decreases the Cat Fund Mandatory Coverage Limit
The bill phases in annual decreases of the $17 billion Cat Fund mandatory coverage limit beginning in the 2013-2014 contract year as follows:

- For the 2013-2014 contract year, $16 billion.
- For the 2014-2015 contract year, $15 billion.
- For the 2015-2016 contract year and thereafter, $14 billion.

Other Provisions

The bill terminates the $2 billion layer of Temporary Increase in Coverage Limit (TICL) options Cat Fund coverage. TICL coverage is an optional Cat Fund coverage that insurers may elect to purchase. The coverage was established by the Legislature in Special Session 2007-A to provide additional reinsurance capacity from the Cat Fund beginning in the 2007 hurricane season and ending after the 2013 hurricane season (the 2013-2014 contract year).

The State Board of Administration Finance Corporation (SBA Finance Corporation or Corporation) is the new name of the Florida Hurricane Catastrophe Fund Corporation. The SBA Finance Corporation is the public benefits corporation that issues bonds to fund Cat Fund reimbursements when, after a hurricane, the Corporation board determines that the moneys in the Cat Fund are (or will be) insufficient to pay the amount of reimbursement promised in reimbursement contracts.

Section 2. Amends s. 627.062, F.S., to delete the prohibition against insurers recouping reinsurance costs that duplicate coverage provided by the Cat Fund.

Sections 3-5. Make conforming changes to s. 627.062, F.S., s. 627.0629, F.S., and s. 627.351(6)(v), F.S.

Section 6. Creates an unnumbered statute requiring the State Board of Administration to adopt revised or amended rules and forms, or addenda thereto, necessary to ensure that the statutory changes made by SB 1262 apply to each participating insurer's Cat Fund reimbursement contract for the 2013-2014 contract year that begins on June 1, 2013. Such rules, forms, and addenda supersede previously adopted rules, forms, and addenda that apply to the 2013-2014 contract year in the event of any conflicts. The SBA may use emergency rulemaking to assure timely adoption of the revisions, amendments, and addenda.

Section 7. Provides an effective date of July 1, 2013.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

Eliminating the TICL coverage layer and reducing the mandatory layer to $16 billion and the maximum reimbursement percentage to 85 for the 2013 – 2014 Contract Year could result in an unconstitutional impairment of contracts. Section 215.555(18), F.S., requires insurers purchasing Cat Fund coverage to execute the reimbursement contract (essentially, their Cat Fund policies) by March 1 prior to the upcoming Contract Year. Accordingly, all insurers in the state have executed their reimbursement contract for the coming 2013-2014 Contract Year based upon a 17 billion dollar mandatory layer of coverage and a 90 percent maximum reimbursement. Though the bill authorizes emergency rulemaking to alter the reimbursement contracts, it is questionable whether the state could successfully require insurers to rewrite their reimbursement contacts.

The United States Constitution and the Florida Constitution prohibit the state from passing any law impairing the obligation of contracts.[4] "[T]he first inquiry must be whether the state law has, in fact, operated as a substantial impairment of a contractual relationship. The severity of the impairment measures the height of the hurdle the state legislation must clear."[5] If a law does impair contracts, the courts will assess whether the law is deemed reasonable and necessary to serve an important public purpose.[6] The factors that a court will consider when balancing the impairment of contracts with the public purpose include:

- Whether the law was enacted to deal with a broad, generalized economic or social problem;
- Whether the law operates in an area that was already subject to state regulation at the time the parties undertook their contractual obligations, or whether it invades an area never before subject to regulation; and

---

[4] U.S. Const. art. I, § 10; art. I, s. 10, Fla. Const.

[5] *Susan Cohn v. The Grand Condominium Association, Inc., et al;* 62 So. 3d. 1120 (Fla. 2011). *See also Pomponio v. Claridge of Pompano Condominium, Inc.*, 378 So. 2d 774 (Fla. 1979). *See also General Motors Corp. v. Romein*, 503 U.S. 181 (1992).

[6] *Park Benziger & Co. v. Southern Wine & Spirits, Inc.*, 391 So. 2d 681 (Fla. 1980); *Yellow Cab C. v. Dade County, 412 So. 2d 395* (Fla. 3rd DCA 1982). *See also Exxon Corp. v Eagerton*, 462 U.S. 176 (1983).

- Whether the law effects a temporary alteration of the contractual relationships of those within its scope, or whether it works a severe, permanent, and immediate change in those relationships, irrevocably and retroactively.[7]

A law that is deemed to be an impairment of contract will be deemed to be invalid as it applies to any contracts entered into prior to the effective date of the act.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Representatives from the Cat Fund state that the current mandatory layer of coverage ($17 billion) plus the optional coverages offered under current law ($2 billion in TICL coverage for 2013-2014) place potential liabilities on the fund that it may not be able to meet due to the current status of the financial markets. These representatives note that if a major hurricane had fallen upon Florida during the 2012 hurricane season, the Fund would have needed to rely upon an $8.503 billion bond issue, which is in excess of the estimated $7 billion in bonding posited in the October 2012 Claims Paying Capacity Estimates. Though additional bonding capacity may be available if the bond issues are spread out over a longer period of time (2 years instead of 1 year), some private market insurers may require prompt payment of Cat Fund funds to maintain their ability to pay claims timely and avoid insolvency in the event of a major storm.

Representatives from the Cat Fund assert that lowering coverage limits and the maximum reimbursement percentage will reduce the fund's potential reliance on bonding backed by assessments. In addition, the increase in co-pays will encourage responsible claims practices among insurers, and the reduction in the limit will improve the Cat Fund's ability to provide coverage for subsequent storm seasons after a major event. Changing the name of the Finance Corporation should improve the marketability of the Cat Fund's bonds.

Most insurers likely will purchase reinsurance to offset the reductions in Cat Fund limits and maximum reimbursement percentages, the cost of which will be included in the premiums they charge consumers. Cat Fund representatives note that the costs of reinsurance fluctuate from year to year, and thus it is difficult to make a precise estimate of the consumer impact of this bill. The actuary for the Office of Insurance Consumer Advocate in the Department of Financial Services has projected the following premium impact of the bill:

[7] *Pomponio v. Claridge of Pompano Condominium, Inc.*, 378 So. 2d 774 (Fla. 1979).

- 2013/2014 Contract Year – 1.2 percent premium increase associated with reducing the maximum reimbursement percentage to 85 percent and reducing the mandatory layer to 16 billion.
- 2014/2015 Contract Year – 1.2 percent premium increase associated with reducing the maximum reimbursement percentage to 80 percent and reducing the mandatory layer to $15 billion.
- 2015/2016 Contract Year – 1.2 percent premium increase associated with reducing the maximum reimbursement percentage to 75 percent and reducing the mandatory layer to $14 billion.
- Total Estimated Cumulative Premium Increase – 3.7 percent
  - The premium impact calculations assume that private market reinsurance covering the same layers of coverage as the Cat Fund will be available at a rate on line of 20 percent for the 2013/2014 contract year and subsequent contract years. According to representatives from the Office of the Insurance Consumer Advocate, the rate on line for such coverage was 22 percent during the 2012/2013 contract year. The premium impact of the bill's provisions are directly affected by the cost of private market reinsurance.

Representatives of some business groups have voiced support for reducing the Cat Fund's capacity and reimbursement percentage because these changes will reduce the likelihood that the Cat Fund will be required to levy assessments on all property and casualty lines of business (except workers' compensation and medical malpractice liability insurance). Many of these business groups view these assessments as a "tax" on other lines of insurance (such as motor vehicle insurance) that subsidizes the residential property insurance market. Another asserted benefit is that a smaller Cat Fund will be in a better financial position to pay its obligations the year after a major storm that depletes the cash reserves of the fund and requires bonding. The most recent Cat Fund Claims-Paying Capacity Estimates indicate that if a storm triggered the entire layer of Cat Fund recoverable, the fund anticipates only having $5.824 billion in claims paying resources (cash reserves plus estimated bonding capacity).

Representatives of some insurers and consumer advocates have voiced concern that reducing the mandatory layer and maximum reimbursement percentage of the Cat Fund may have a negative effect on the private homeowners property insurance market. The reductions in the Cat Fund will result in most insurers purchasing additional layers of reinsurance from the global reinsurance market at a higher cost than Cat Fund coverage. The cost of such reinsurance will likely be passed onto policyholders by private market insurers, but not necessarily by Citizens Property Insurance Corporation, which is not required to purchase reinsurance that guarantees the corporation's ability to pay all claims stemming from a 1 in 100 year probable maximum loss storm, a benchmark that most private market insurers meet in their reinsurance programs. These representatives also assert that reductions in Cat Fund size resulting in private market premium increases may hinder the depopulation of Citizens by increasing the disparity between rates charged by Citizens and private market insurers.

The coverage changes effective for the 2013 – 2014 Contract Year are contrary to the provisions of s. 215.555(18), F.S., which discourages the Legislature from passing laws changing Cat Fund coverage that are effective for the Contract Year beginning shortly after the conclusion of the regular session of the Legislature in which the law was passed. The Legislative findings state that because the Legislative session ends approximately 1 month before the new Cat Fund contract year, "participants in the fund always face the possibility that legislative actions will change the coverage provided or offered by the fund with only a few days or weeks of advance notice. The timing issues…can create uncertainties and disadvantages for the residential property insurers that are required to participate in the fund when such insurers negotiate for the procurement of private reinsurance or other sources of capital."

C. Government Sector Impact:

The bill reduces the assessment liability of the Cat Fund, which decreases the probability that the Fund will be required to issue bonds to meet its financial obligations. Supporters of the legislation also note that the Cat Fund is not the only insurance-related state entity granted assessment authority. Citizens and the Florida Insurance Guaranty Association each have statutory authority to issue bond debt to meet obligations incurred in the event a major hurricane exhausts the financial resources of each entity. Reducing the likelihood of Cat Fund bonding and assessments will assist Citizens and FIGA in being able to raise funds from bond issues because Cat Fund bonds will be less likely to be in competition for investors in the event of a storm.

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.