HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/CS/HB 391 Florida Catastrophic Storm Risk Management Center
SPONSOR(S): Government Operations Appropriations Subcommittee; Insurance & Banking Subcommittee; Hager
TIED BILLS: **IDEN./SIM. BILLS:** CS/SB 482

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	13 Y, 0 N, As CS	Callaway	Cooper
2) Government Operations Appropriations Subcommittee	12 Y, 0 N, As CS	Keith	Topp
3) Regulatory Affairs Committee			

SUMMARY ANALYSIS

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. For solvency reasons, property insurers are required by the Office of Insurance Regulation (OIR) to purchase a certain amount of reinsurance. The amount of reinsurance purchased varies from insurer to insurer and is based on an insurer's financial situation and exposure.

The FHCF sells reinsurance to property insurance companies significantly cheaper than reinsurance sold by private reinsurance companies. 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 Fund, which is administered by the State Board of Administration, reimburses insurers for a portion of their hurricane losses to residential property above the insurer's retention (deductible). The deductible on reinsurance sold by the Fund is set by statute and the maximum amount the Fund reinsures (the Fund coverage) is also set by statute.

The Fund does not receive any state funding (from the General Revenue Fund or other state trust funds) and receives its funding from the reinsurance premium it charges insurers and investment income from investing the reinsurance premium received.

The Florida Catastrophic Storm Risk Management Center (center) was created by the Florida Legislature in 2007. The center is housed within the Department of Risk Management/Insurance, Real Estate & Legal Studies in the College of Business located at The Florida State University. The center's primary focus is to support the state's ability to prepare for, respond to, and recover from catastrophic storms.

The bill provides that the State Board of Administration shall annually transfer a portion of the investment income from the Florida Hurricane Catastrophe Fund to the Florida Catastrophic Storm Risk Management Center located at The Florida State University. The amount of funding to be transferred shall be the lesser amount of $1 million, or 35 percent of the fund's investment income minus $10 million, as determined by using the most recent fiscal year-end audited financial statements of the Fund. The bill specifies that any funds transferred must solely be used for and consistent with the center's statutory purpose of supporting the state's ability to prepare for, respond to, and recover from catastrophic storms.

Other than the transfer of a portion of the investment income from the Florida Hurricane Catastrophe Fund to the Florida Catastrophic Storm Risk Management Center at The Florida State University, the bill has no fiscal impact on state or local governments.

The bill is effective July 1, 2014.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Background on the Florida Hurricane Catastrophe Fund
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 (2013-2014 contract year) runs from June 1, 2013–May 30, 2014.

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

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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 2011-2012, p. 16, available at http://www.sbafla.com/fhcf/Home/FHCFReports/tabid/315/Default.aspx (last viewed December 20, 2013).
[3] Annual Report of the Florida Hurricane Catastrophe Fund Fiscal Year 2011-2012, p. 16, available at http://www.sbafla.com/fhcf/Home/FHCFReports/tabid/315/Default.aspx (last viewed December 20, 2013).
[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.

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 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 2013-2014 contract year, the cash build-up factor is 25%, meaning an insurer's premium is 25% greater than the actuarially indicated premium. By law, the cash build-up factor will remain at 25% for all future years.

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 2013-2014 contract year, the insurance industry as a whole has an aggregate retention of $7.213 billion for mandatory coverage, meaning the total of all individual insurer retentions/deductibles will total $7.213 billion per hurricane event if all participating insurers reached their retention. Although the insurance industry's aggregate deductible/retention totals $7.213 billion, insurers can obtain reimbursement from the FHCF before the insurance industry losses total $7.213 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 statutory reductions in TICL options available, for the 2013-2014 Fund contract year, the last year TICL coverage is available, only $2 billion is available for purchase.[8] Of the $2 billion available in TICL coverage, $207,280 was purchased by insurance companies.

For the 2013-14 contract year (June 1, 2013–May 31, 2014), the maximum amount the FHCF would have to reimburse insurers is $17.0002 billion, allocated as follows:

- $17 billion for the mandatory coverage.

[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.

- $207,208 for the TICL coverage option. [9]

To fund its obligations of $17.0002 billion the FHCF has $9.764 billion in cash.

Because the obligations of the FHCF exceed its cash on hand by approximately $7.24 billion, if the FHCF had to pay its maximum actual obligations of $17.0002 billion this contract year, it would have to bond for $7.24 billion to have enough money to pay claims. The Fund already has $2 billion in pre-event bonds that will be used to pay claims during this contract year. After accounting for these bonds, the Fund must bond for $5.24 billion this year. In October 2013, the Fund estimated it could borrow $6.1 billion through bonding, which is more than the $5.24 billion needed.[10] Thus, it is anticipated that the Fund has sufficient resources from cash and bonding to pay its obligations in the current contract year.

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.[11] 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, 2016, medical malpractice), including surplus lines policyholders, when reimbursement premiums and other FHCF resources are insufficient to cover the FHCF's obligations.[12] 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.[13] 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.[14] 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.

The State Board of Administration (SBA) invests funds from the FHCF in accordance with s. 215.47, F.S. and the Fund's investment policy statement. The primary objective of the policy statement can be defined by the following goals: liquidity, safety of principal, and competitive return. These goals are intended to enhance the Fund's investment income by investing in securities that are highly liquid, relatively short term, and have a credit quality in accordance with the policy in order to maintain safety of principal.

The Fund's investment income varies by year but has accounted for $506,211,000 in income over the last ten years as shown in the following historical income chart:

Florida Hurricane Catastrophe Fund Investment Income[15] (Excluding FHCF Finance Corporation)	
Ten Year History of Audited Financial Statements	
Fiscal Year Ending:	**Investment Income:**
June 30, 2004	$58,127,000
June 30, 2005	$108,672,000
June 30, 2006	$103,175,000

[9] Report of Claims-Paying Capacity Estimates dated October 15, 2013, available at http://www.sbafla.com/fhcf/BondingProgram/BondingCapacityAnalysisReports/tabid/318/Default.aspxlast (last accessed December 20, 2013).
[10] https://www.flrules.org/Gateway/View_notice.asp?id=13718436 (last accessed November 18, 2013).
[11] s. 215.555(6)(a)1., F.S.; s. 215.555(6)(b)1., F.S.
[12] s. 215.555(6)(b)1., F.S.; s. 215.555(6)(b)(10), F.S.
[13] s. 215.555(6)(b)2., F.S.
[14] 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.
[15] Investment income amounts gathered from the Florida Hurricane Catastrophe Fund Audited Financial Statements available at: http://www.sbafla.com/fhcf/Home/AuditedFinancials/tabid/319/Default.aspx (Last accessed April 2, 2014.)

June 30, 2007	$36,065,000
June 30, 2008	$46,816,000
June 30, 2009	$7,803,000
June 30, 2010	$54,298,000
June 30, 2011	$29,983,000
June 30, 2012	$26,634,000
June 30, 2013	$34,638,000
Grand Total	**$506,211,000**

Background on The Florida Catastrophic Storm Risk Management Center

The Florida Legislature created the Florida Catastrophic Storm Risk Management Center (center) in 2007.[16] The center is housed within the Department of Risk Management/Insurance, Real Estate & Legal Studies in the College of Business located at The Florida State University. The center's primary focus is to support the state's ability to prepare for, respond to, and recover from catastrophic storms. The support the center provides includes:[17]

- Coordinating and disseminating research efforts that are expected to have an immediate impact on policy and practices related to catastrophic storm preparedness.
- Coordinating and disseminating information related to catastrophic storm risk management, including but not limited to research and information that benefits business, consumers and public policy makers.
- Facilitating Florida's preparedness and responsiveness to catastrophic storms and collaborating with other public and private institutions.
- Creating and promoting studies that enhance the educational options available to risk management and insurance students.
- Publishing and disseminating findings primarily related to risk management.
- Organizing and sponsoring conferences, symposiums, and workshops to educate consumers and policymakers.

Effect of Proposed Changes

The bill provides that the State Board of Administration shall annually transfer a portion of the investment income from the Florida Hurricane Catastrophe Fund to the Florida Catastrophic Storm Risk Management Center (center) located at The Florida State University. The amount of funding to be transferred shall be the lesser amount of $1 million, or 35 percent of the funds' investment income minus $10 million, as determined by using the most recent fiscal year-end audited financial statements of the Fund. The bill specifies that any funds transferred must solely be used for and consistent with the center's statutory purpose of supporting the state's ability to prepare for, respond to, and recover from catastrophic storms. In addition, the bill is not intended to limit or supplant any funding otherwise available to the center.

Based on provisions of the bill requiring the transfer of the lesser amount of $1 million, or 35 percent of the Florida Hurricane Catastrophe Fund's investment income minus $10 million, the approximate annual average transfer that would have occurred over the previous five years would have been $498,810. The calculation of this figure is shown as follows:

[16] Ch. 2007-90, s.24, L.O.F. (creating s. 1004.647, F.S., effective June 11, 2007)

[17] Information gathered from the Florida Catastrophic Storm Risk Management Center webpage available at: http://www.stormrisk.org/about-the-center (Last accessed April 2, 2014.)

Florida Hurricane Catastrophe Fund Investment Income (Excluding FHCF Finance Corporation)			
Audited Financial Statements			
		The lessor of:	
Fiscal Year Ending:	**Investment Income:**	35 percent of Investment Income less $10,000,000	$1,000,000
June 30, 2009	$7,803,000	$2,731,050 - $10,000,000 = ***$0***	$1,000,000
June 30, 2010	$54,298,000	$19,004,300 - $10,000,000 = $9,004,300	***$1,000,000***
June 30, 2011	$29,983,000	$10,494,050 - $10,000,000 = ***$494,050***	$1,000,000
June 30, 2012	$26,634,000	$9,321,900 - $10,000,000 = ***$0***	$1,000,000
June 30, 2013	$34,638,000	$12,123,300 - $10,000,000 = $2,123,300	***$1,000,000***
Total amount of investment income that would have been transferred for the previous five years:			$2,494,050
Five year average of investment income that would have been transferred:			***$498,810*** [18]

B. SECTION DIRECTORY:

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

Section 2: Provides an effective date of July 1, 2014.

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:

None.

D. FISCAL COMMENTS:

The bill provides that the State Board of Administration shall annually transfer a portion of the investment income from the Florida Hurricane Catastrophe Fund to the Florida Catastrophic Storm Risk Management Center located at The Florida State University. The amount of funding to be transferred shall be the lesser amount of $1 million, or 35 percent of the fund's investment income minus $10 million, as determined by using the most recent fiscal year-end audited financial statements of the Fund. The bill specifies that any funds transferred must solely be used for and consistent with the

[18] Investment income amounts gathered from the Florida Hurricane Catastrophe Fund Audited Financial Statements available at: http://www.sbafla.com/fhcf/Home/AuditedFinancials/tabid/319/Default.aspx (Last accessed April 2, 2014.)

center's statutory purpose of supporting the state's ability to prepare for, respond to, and recover from catastrophic storms.

Other than the transfer of a portion of the investment income from the Florida Hurricane Catastrophe Fund to the Florida Catastrophic Storm Risk Management Center at The Florida State University, the bill has no fiscal impact on state or local governments.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

2. Other:

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES