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	16 Y, 0 N	Cooper	Hamon

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 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 FHCF is administered by the State Board of Administration and reimburses property insurers for a selected percentage of hurricane losses to residential property above the insurer's retention (deductible).[2] 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.[3] There are several reasons for these cost savings:[4]

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 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:

[1] s. 215.555, F.S. The FHCF was created after Hurricane Andrew in 1992.
[2] 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.
[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] 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).

Florida Hurricane Catastrophe Fund Investment Income[5] (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
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.[6] 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:[7]

- 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

[5] 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).

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

[7] 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).

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:

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*** [8]

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.

[8] 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).

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

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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

On March 5, 2014, the Insurance & Banking Subcommittee considered a proposed committee substitute and reported the proposed committee substitute favorably with a committee substitute.

The proposed committee substitute made the following changes to the filed version of the bill:

- Reduced the limit of the FHCF mandatory coverage from the current $17 billion to $14 billion starting June 1, 2015, but gave insurers the option to purchase their share of additional coverage above the mandatory coverage limit of $14 billion in $1 billion increments up to $17 billion. The filed bill reduced the limit by $1 billion a year for three years starting June 1, 2015 and did not provide optional coverage up to $17 billion.
- Removed the provision in the filed bill allowing certain reinsurance costs related to the FHCF to be included in rate filings.

On April 8, 2014, the Government Operations Appropriations Subcommittee considered a proposed committee substitute and reported it favorably. The adopted committee substitute deleted entirely the language of the committee substitute passed by the Insurance & Banking Subcommittee. This staff analysis reflects the changes made by the committee substitute which was adopted by the Government Operations Appropriations Subcommittee.