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: CS/SB 482

INTRODUCER: Banking and Insurance Committee and Senator Hays

SUBJECT: Florida Catastrophic Storm Risk Management Center

DATE: March 26, 2014 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Stearns	Yeatman	CA	**Favorable**
2.	Matiyow	Knudson	BI	**Fav/CS**
3.			AP	

Please see Section IX. for Additional Information:

COMMITTEE SUBSTITUTE - Substantial Changes

I. Summary:

The bill requires the State Board of Administration to transfer a portion of the investment income from the Florida Hurricane Catastrophe Fund to the Florida Catastrophic Storm Risk Management Center. The transfer is to begin during the 2014-2015 fiscal year. The amount transferred is to be the lesser of $1 million or 35 percent of the fund's investment income minus $10 million, based on the fund's most recent year-end audit.

II. Present Situation:

Florida Catastrophic Storm Risk Management Center

The Florida Catastrophic Storm Risk Management Center was created by the Florida Legislature in 2007.[1] The Center is located at the Department of Risk Management/Insurance, Real Estate & Legal Studies at the Florida State University College of Business. The focus of the Center is to support the state's ability to prepare for, respond to, and recover from catastrophic storms. Specifically, the Center:

- Coordinates and disseminates research efforts that are expected to have an immediate impact on policy and practices related to catastrophic storm preparedness.

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

- Coordinates and disseminates information related to catastrophic storm risk management, including but not limited to research and information that benefits businesses, consumers and public policy makers.
- Facilitates Florida's preparedness and responsiveness to catastrophic storms and collaborates with other public and private institutions.
- Creates and promotes studies that enhance the educational options available to risk management and insurance students.
- Publishes and disseminates findings primarily related to risk management.
- Organizes and sponsors conferences, symposia and workshops to educate consumers and policymakers.

In previous years the Center has received its funding by way of transfer from the Insurance Regulatory Trust Fund. The transfer of such funds were authorized in the state's yearly budget approved by both House and Senate and signed by the Governor. In fiscal year 2012-2013[2] the amount transferred to fund the operations of the Center was $350,000. In fiscal year 2013-2014[3] the amount transferred was $750,000, but included an additional requirement that the Center study and report to the Legislature alternative methods for managing the size of the Florida Hurricane Catastrophe Fund.[4]

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

[2] Ch. 2012-118, s. 6, Line 2488A, L.O.F.
[3] Ch. 2013-40, s. 6, Line 2410A, L.O.F.
[4] The center is also directed to produce a report on alternative methods for managing the size of the Florida Hurricane Catastrophe Fund. The center shall coordinate its research efforts with the State Board of Administration. The report shall be submitted to the President of the Senate, Speaker of the House of Representatives, the Governor and Cabinet Officers by December 1, 2013.

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).

To access the Cat Fund an insurer must have incurred losses above the retention levels calculated and set by statute. Insurers that experience multiple hurricanes causing losses 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. Citizens Property Insurance Corporation is the largest purchaser of Cat Fund coverage.

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 Claims-Paying Resources

The Cat Fund cash balance at year-end 2014 is estimated to be $11.010 billion.[5] The proceeds from the 2013 $2 billion pre-event bond issue provide additional liquidity.[6] Obligations exceeding the cash balance of the Cat Fund would require bonding of up to $5.236 billion.[7] The assessment base for the Cat Fund is approximately $36.185 billion for premiums written at year end 2012,[8] enabling the Cat Fund to levy annual assessments of as much as $2.171 billion for one contract year and $3.619 billion for multiple contract years.[9]

[5] Florida Hurricane Catastrophe Fund, Annual Report of Aggregate Net Probable Maximum Losses, Financing Options, and Potential assessments, (February 2014).
[6] State Board of Administration, Florida Hurricane Catastrophe Fund, *FHCF Claims-Paying Capacity Estimates*, 2 (October 15, 2013), *available at* http://www.sbafla.com/fhcf/LinkClick.aspx?fileticket=gFTzX4lQxpA percent3d&tabid=1412&mid=4266 (last visited March 27, 2014).*Id.*
[7] *Id.*
[8] *Id.* at 4.
[9] *Id.*

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, this season bond issues totaling over $5 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 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, 2013.[10] 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 15, 2013, Claims-Paying Capacity Estimate (Estimate) is the most recent such report to be issued.[11] 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).

Bonding capacity (the estimated dollar amount of bonds that could be successfully issued) for a 12-month period is estimated to be $6.1 billion, with an additional $5.7 billion of capacity estimated for months 13-24.[12] These amounts are in excess of the maximum amount of bonding that could have been needed for the 2013-2014 contract year. Claims-paying resources for the 2014-2015 contract year will include these amounts plus additional reimbursement premium revenues of approximately $1.3 billion.[13]

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[10] Section 215.555(4)(c)(2), F.S.

[11] The first Claims Paying Capacity Estimate for the 2014-2015 hurricane season is due to be published in May 2014.

[12] *Claims-Paying Capacity Estimates* at 11.

[13] The precise amount of reimbursement premium will not be determined until after the FHCF premium formula is adopted by the SBA Trustees under s. 215.555(5), F.S., and 2014 exposure reports are received from insurers.

Cat Fund Investments

As of December 31, 2013, the market value of the Cat Fund's investment assets was $9,981,130,073.[14] The SBA investment policy covering the Cat Fund's assets is designed to provide adequate liquidity by using highly liquid short-term investment strategies. Liquidity is a primary concern for the Cat Fund since insurers may file claims weekly, and investment strategies are planned accordingly. The primary investment objective of the Cat Fund's investment policy is defined by the following prioritized goals: liquidity, so that reimbursement to insurers can be paid in a timely manner; safety of principal investment; and competitive returns.

The Cat Fund's investment policy provides for a high level of liquidity such that assets can be converted to cash on a timely basis in order to match insurer loss reimbursement needs.The Cat Fund's portfolios include only short-term, high quality and highly liquid fixed income securities. Permitted fixed income securities and their diversification limits include:
- Corporate debt securities (not more than 50 percent of total portfolio amortized cost);
- U.S. Treasury securities and U.S. Government Agency securities (at least 50 percent of total portfolio amortized costs);
- Repurchase Agreements collateralized at least 102 percent with U.S. Government, Agency, or Agency Mortgage Backed Securities (not more than 25 percent of total portfolio amortized cost).

The Cat Fund's investment income for the last 10 years totaled $611,150,000.

Cat Fund Investment Income	
Audited Financial Statements (Excludes Finance Corporation)	
Fiscal Year	**Investment Income**
June 30, 2013	$34,638,000
June 30, 2012	$26,634,000
June 30, 2011	$29,983,000
June 30, 2010	$54,298,000
June 30, 2009	$7,803,000
June 30, 2008	$46,816,000
June 30, 2007	$36,065,000
June 30, 2006	$103,175,000
June 30, 2005	$108,672,000
June 30, 2004	$58,127,000
June 30, 2003	$104,939,000
	Total $611,150,000
*Source: FHCF Audited Financial Statements	

III. Effect of Proposed Changes:

The bill requires the State Board of Administration to transfer a portion of the investment income from the Florida Hurricane Catastrophe Fund to the Florida Catastrophic Storm Risk

[14] Email from the Cat Fund received March 27, 2014 on file with Banking and Insurance staff.

Management Center. The transfer is to begin during the 2014-2015 fiscal year. The amount transferred is to be the lesser of $1 million or 35 percent minus $10 million of the fund's investment income based on the fund's most recent year-end audit.

Based on the Florida Hurricane Catastrophe Fund's Investment Income for the last 5 fiscal years, had the changes in the bill been in place, the funding to the Florida Catastrophic Storm Risk Management Center would have averaged $498,800.00 per year.

Florida Hurricane Catastrophe Fund Investment Income		
Audited Financial Statements (Excludes Finance Corporation)		
Fiscal Year	**Investment Income**	**35 percent of Investment Income – ($10,000,000)**
June 30, 2013	$34,638,000	$12,123,300 – ($10,000,000) = $2,123,300 > **$1,000,000**
June 30, 2012	$26,634,000	$9,321,900 – ($10,000,000) = **$0** < $1,000,000
June 30, 2011	$29,983,000	$10,494,050 – ($10,000,000) = **$494,050** < $1,000,000
June 30, 2010	$54,298,000	$19,004,300 – ($10,000,000) = $9,004,300 > **$1,000,000**
June 30, 2009	$7,803,000	$2,731,050 – ($10,000,000) = **$0** < $1,000,000

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

None.

C. Government Sector Impact:

No more than $1 million per year will be transferred from the Florida Hurricane Catastrophe Fund's investment income to fund the operations of the Florida Catastrophic Storm Risk Management Center.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Statutes Affected:

This bill substantially amends section 215.555 of the Florida Statutes.

IX. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS by Banking and Insurance on March 25, 2014:
The CS struck the entire originally filed bill relating to the Florida Hurricane Catastrophe Fund. The bill now relates to the funding of the Florida Catastrophic Storm Risk Management Center.

B. Amendments:

None.