HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 97 Florida Hurricane Catastrophe Fund
SPONSOR(S): Insurance & Banking Subcommittee; Santiago
TIED BILLS: **IDEN./SIM. BILLS:**

REFERENCE	ACTION	ANALYST	**STAFF DIRECTOR** or **BUDGET/POLICY CHIEF**
1) Insurance & Banking Subcommittee	9 Y, 4 N, As CS	Peterson	Luczynski
2) Appropriations Committee			
3) Commerce Committee			

SUMMARY ANALYSIS

The Florida Hurricane Catastrophe Fund (FHCF or Fund) is a tax-exempt trust fund that contracts with each admitted residential property insurer to provide reimbursement for a portion of the insurer's losses that are caused by hurricanes. The purpose of the FHCF is to protect and advance the state's interest in maintaining insurance capacity in Florida by providing a stable and ongoing source of reimbursement.

The FHCF charges insurers the actuarially indicated premium for the coverage it provides, based on the insurer's particular risk of hurricane loss. The FHCF reimburses an insurer for a selected percentage of the insurer's hurricane losses above the insurer's retention (deductible), up to a maximum payout. The current coverage options are 90 percent, 75 percent, or 45 percent, as selected by the insurer when it executes its FHCF reimbursement contract.

Florida law sets the maximum amount the FHCF reimburses insurers each year for the mandatory coverage. This is the FHCF's capacity or maximum obligation. Under current law, the FHCF's maximum obligation with respect to all contracts covering a particular contract year is $17 billion. When the cash balance of the FHCF is insufficient to cover losses from a hurricane, the law authorizes the FHCF to issue revenue bonds. These post-event bonds are funded by emergency assessments on all property and casualty insurance premiums paid by policyholders (subject to certain exceptions), including surplus lines policyholders. The current premium collected by the FHCF includes a 25 percent cash build-up factor that was enacted by the Legislature in 2009 to bolster the FHCF's cash reserves, thereby reducing its reliance on assessment-funded bonding.

The bill creates an additional coverage option for insurers of 60 percent, which will give insurers more flexibility in developing and funding their risk transfer programs.

The bill revises the cash build-up factor to fluctuate, beginning with the 2019-2020 contract year, based on the projected Fund balance. "Projected fund balance" is defined as the projected year-end balance for the prior contract year as published in the October Florida Administrative Register and adjusted for incurred losses. When the projected Fund balance is less than $14 billion, the cash build-up factor is 25 percent. When the projected Fund balance is at or above $16 billion, the cash build-up factor is zero. Between $14 and $16 billion, the cash build-up factor scales at 5 percent increments for every $500 million shift in the projected Fund balance, e.g., 20 percent /$14 billion up to $14.5 billion; 15 percent/$ 14.5 billion up to $15 billion, etc.

Finally, the bill clarifies the intent of the Legislature that emergency assessments be levied only to fund bonds. The authority of the State Board of Administration is expressly limited consistent with this intent.

The bill has no impact on state or local government revenues or expenditures. It may have positive and negative impacts on the private sector.

The proposed committee substitute is effective upon becoming law.

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 that contracts with each admitted residential property insurer,[1] including Citizens Property Insurance Corporation, to provide reimbursement for a portion of the insurer's losses that are caused by hurricanes.[2] Participation in the FHCF is mandatory. The purpose of the FHCF is to protect and advance the state's interest in maintaining insurance capacity in Florida by providing a stable and ongoing source of reimbursement. The FHCF fulfills its mission by providing reliable, dependable, and predictable coverage that is limited to catastrophic losses, and by providing timely and adequate payments.[3]

Historically, the FHCF has been able to sell reinsurance that is less expensive than reinsurance sold by private reinsurance companies, thereby enabling insurers to write more residential property insurance in the state than would otherwise be written and generating significant premium savings for policyholders. This is because:[4]

1. The FHCF operating cost is less than 1 percent of the annual premium collected, whereas, the operating costs for private reinsurance can range from 10 percent to 15 percent 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.

The State Board of Administration (SBA) administers the FHCF, which reimburses a property insurer for a selected percentage of the insurer's hurricane losses above the insurer's retention (deductible), up to a maximum payout. The current coverage options are 90 percent, 75 percent, or 45 percent, as selected by the insurer when it executes its FHCF reimbursement contract.[5] Retention is the amount of losses below which an insurer is not entitled to reimbursement from the Fund. Total annual retention for the Fund is calculated according to a statutory formula; each individual insurer's retention is based on its share of the total retention. Total retention for the 2017-2018 contract year is $7 billion.

The FHCF charges insurers the actuarially indicated premium for the coverage it provides, based on the insurer's particular risk of hurricane loss, as modeled by hurricane loss projection models accepted by the Florida Commission on Hurricane Loss Projection Methodology.[6] "Actuarially indicated" means "an amount determined according to principles of actuarial science to be adequate, but not excessive,

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[1] Residential coverage includes both personal lines residential coverage (homeowner, mobile homeowner, dwelling, tenant, condominium unit owner, cooperative unit owner, and similar policies) and commercial lines residential coverage (condominium association, cooperative association, apartment building, and similar policies) coverage. s. 627.4025(1), F.S..

[2] s. 215.555, F.S. The Legislature created the FHCF in 1993 after Hurricane Andrew.

[3] State Board of Administration, *Florida Hurricane Catastrophe Fund 2016 Annual Report*, p. 4, *available at* https://www.sbafla.com/fhcf/Portals/FHCF/Content/Reports/Annual/20170606_FHCF_2016_AnnualReport_A.pdf?ver=2017-07-06-085215-943 (last visited Jan. 17, 2018).

[4] State Board of Administration, *Florida Hurricane Catastrophe Fund Fiscal Year 2014-2015 Annual Report*, p. 16, *available at* https://www.sbafla.com/fhcf/Portals/FHCF/Content/Reports/Annual/20160330_FHCF_AnnualRpt2014_15.pdf?ver=2016-06-08-121801-380 (last visited Jan. 17, 2018).

[5] Reimbursement contracts run from June 1 – May 31.

[6] The Florida Commission on Hurricane Loss Projection Methodology is an independent body of experts created by the Florida Legislature in 1995 for the purpose of developing standards and reviewing hurricane loss models used in the development of residential property insurance rates and the calculation of probable maximum loss levels.

in the aggregate, to pay current and future obligations and expenses of the fund….”[7] The premium is based on each insurer's reported insured value (exposure), the location of the property insured, the construction type of the property insured, the deductible amounts for the property insured, and other factors.

Florida law sets the maximum amount the FHCF reimburses insurers each year for the mandatory coverage. This is the FHCF's capacity or maximum obligation. Under current law, the FHCF's maximum obligation with respect to all contracts covering a particular contract year is $17 billion. An insurer's maximum reimbursement is the insurer's proportional share of the FHCF's statutory maximum obligation ($17 billion), not to exceed the insurer's proportional share of the actual claims-paying capacity. "Actual claims-paying capacity" is the sum of the Fund's cash balance (from premiums and investment income) as of December 31 of the contract year, risk transfer recoveries (reinsurance proceeds), and debt financing (post-event bonds). The capacity does not increase until the FHCF's cash, risk transfer, and bonding ability exceed $34 billion. Controlling the Fund's capacity in this manner allows the FHCF to accumulate funds in years where there are no hurricanes to pay the maximum mandatory coverage obligations for claims resulting from hurricanes in back-to-back seasons. It also reduces the Fund's potential reliance on post-event bonding. For the 2017-2018 contract year, the Fund's estimated claims-paying capacity[8] reflects a projected year-end cash balance of $15 billion, $1 billion of reinsurance, and post-event borrowing capacity of $7.9 billion. The total estimated claims-paying capacity of $23.9 billion exceeds the Fund's $17 billion single-season reimbursement obligation. The estimate does not take into account any potential losses from Hurricane Irma, which made landfall in Florida on September 10, 2017.[9]

When the cash balance of the FHCF is insufficient to cover losses from a hurricane, the law authorizes the FHCF to issue revenue bonds. These post-event bonds are funded by emergency assessments on all property and casualty insurance premiums paid by policyholders (other than workers' compensation, accident and health, federal flood, and medical malpractice), including surplus lines policyholders. Annual assessments are capped at 6 percent of premium with respect to losses from any one year and a maximum of 10 percent of premium to fund hurricane losses from multiple years. 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.

Cash Build-up Factor

The premium charged by the FHCF includes an additional 25 percent cash build-up factor. The Legislature enacted the cash build-up factor in 2009 when the cash balance of the Fund was near a historic low and the potential risk of assessments was at a near historic high. The factor was phased in over a 5-year period beginning with the 2009-2010 contract year and has remained at the 25 percent level since the 2013-2014 contract year. The estimated reimbursement premium paid by insurers for the 2017-2018 contract year is $1.128 billion. The premium includes: a base premium of $902.3 million and a cash build-up factor amount of $225.7 million.[10]

Effect of the Proposed Committee Substitute

The bill creates an additional coverage option for insurers of 60 percent, which will give insurers more flexibility in developing and funding their risk transfer programs.

The bill revises the cash build-up factor to fluctuate, beginning with the 2019-2020 contract year, based on the projected Fund balance. "Projected fund balance" is defined as the projected year-end balance for the prior contract year as published in the October Florida Administrative Register, adjusted for incurred losses made on or before the date on which the independent actuarial consultant signs the

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[7] s. 215.555(2)(a), F.S.

[8] The estimated claims-paying capacity provides participating insurers with data necessary to assist them in determining their retention and projected payout from the fund for loss reimbursement purposes.

[9] Mandatory year-end proof of loss reports were due to the FHCF December 31, 2107.

[10] Conversation with John Kuczwanski, Manager of External Affairs, State Board of Administration (Jan. 17, 2018).

report of the proposed premium formula. When the projected Fund balance is less than $14 billion, the cash build-up factor is 25 percent. When the projected Fund balance is at or above $16 billion, the cash build-up factor is zero. Between $14 and $16 billion, the cash build-up factor scales at 5 percent increments for every $500 million shift in the projected Fund balance.

Cash Build-Up Factor	Projected Fund Balance
25%	Less than $14 billion
20%	$14 billion, but less than $14.5 billion
15%	$14.5 billion, but less than $15 billion
10%	$15 billion, but less than $15.5 billion
5%	$15.5 billion, but less than $16 billion
0%	At least $16 billion

Finally, the bill clarifies the intent of the Legislature that emergency assessments be levied only to fund bonds. The authority of the SBA is expressly limited consistent with this intent.

B. SECTION DIRECTORY:

Section 1. Amends s. 215.555, F.S., relating to Florida Hurricane Catastrophe Fund.
Section 2. Provides an effective date of upon becoming a law.

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:

A reduction in the cash build-up factor will reduce the premium collected by the FHCF from insurers, which, in turn, will result in a reduction in premiums charged to policyholders. In preparing its fiscal analysis, the FHCF used $2,013 as the average homeowners insurance premium (based on current data of the Office of Insurance Regulation), and assumed that the FHCF premiums account for 10 percent of that premium. Based on these assumptions, the FHCF estimates that for every 5 percent

reduction in the cash build-up factor, homeowners premiums will decrease by 0.4 percent, or $8.05, annually.

Cash Build-Up Factor	Percentage Impact on Average Homeowners Premium	Annual Savings (Based on 2018 Premium Amount)
25%	No change	$0
20%	0.4% lower than 2018 premium	$8.05
15%	0.8% lower than 2018 premium	$16.10
10%	1.2% lower than 2018 premium	$24.15
5%	1.6% lower than 2018 premium	$32.21
0%	2.0% lower than 2018 premium	$40.26

By reducing the cash build-up factor, the bill potentially reduces the FHCF's ability to pay losses out of its cash balance. In turn, this could increase the FHCF's reliance on post-event bonds, which are backed by emergency assessments on substantially all property and casualty insurance policies. The FHCF creates direct benefits only for the residential property insurance market. Thus, individuals and entities that will not benefit from any premium reduction attributable to reducing the cash build-up factor could be required to pay for its added potential risk.

FHCF assessments are levied on the full amount of a policyholder's premium; whereas, the cash build-up factor is levied against only that portion of a residential property insurance policyholder's premium which is attributable to the cost of FHCF coverage. Thus, any reduction in the premiums of residential property owners attributable to a reduction in the cash build-up factor could be more than offset by a future assessment to cover bonds needed to offset a shortage of cash that could result from the losses after one or more significant hurricanes.

The bill eliminates the cash build-up factor when the projected Fund is at or above $16 billion. Without the premium revenues generated by the cash build-up factor, the FHCF believes its subsequent season capacity is unlikely to grow significantly. Subsequent season capacity is a key factor in stabilizing the property insurance market because insurers that want to stay in the Florida market look for assurance that FHCF coverage will remain available even after the next catastrophic "big one."[11]

Because the bill ties the cash build-up factor directly to the value of the projected Fund, policyholders may see larger swings in the cost of their residential property insurance premiums than would occur if the changes in the factor were phased in over time. This would be most likely to occur in a year when the Fund balance is significantly affected by payouts for hurricane losses. In that case, the cash build-up factor could change from zero to 25 percent in one year, i.e., at renewal. Reinstatement of the cash build-up factor following a major loss could create sticker shock for policyholders at a time of great stress in the marketplace. After a major loss, potential reinsurance price spikes and other factors could generate large premium increases for policyholders, which could be intensified by likely increases in FHCF premiums paid by insurers in the contract year following the loss.[12]

[11] State Board of Administration, Agency Analysis of 2018 House Bill 97, p. 6 (Nov. 8, 2017).
[12] *Id.*

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   Not applicable. The proposed committee substitute does not appear to affect county or municipal governments.

2. Other:

   None.

B. RULE-MAKING AUTHORITY:

The proposed committee substitute neither authorizes nor requires administrative rulemaking.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On January 23, 2018, the Insurance & Banking Subcommittee considered a proposed committee substitute and reported the bill favorably as a committee substitute. The proposed committee substitute:

- Removed the proposed 25 percent coverage option;
- Retained current law regarding the FHCF's coverage capacity;
- Retained current law regarding an insurer's maximum reimbursement;
- Removed the proposed surcharge for a wind mitigation program;
- Revised the cash-build up factor to adjust up or down annually based on the projected year-end balance of the fund adjusted for incurred losses; and
- Revised proposed language related to the SBA's authority to levy emergency assessments.

This analysis is drafted to the committee substitute as approved by the Insurance & Banking Subcommittee.