

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 53 Florida Catastrophic Storm Risk Management Center

**SPONSOR(S):** Broxson

**TIED BILLS:** **IDEN./SIM. BILLS:** SB 130

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	11 Y, 1 N	Cooper	Cooper
2) Government Operations Appropriations Subcommittee	9 Y, 0 N	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 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 Fund to the Center. 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 Fund to the Center, the bill has no fiscal impact on state or local governments.

The bill is effective July 1, 2015.

**This document does not reflect the intent or official position of the bill sponsor or House of Representatives.**

**STORAGE NAME:** h0053c.GOAS

**DATE:** 3/31/2015

## 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.<sup>1</sup> 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).<sup>2</sup> 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.<sup>3</sup> There are several reasons for these cost savings:<sup>4</sup>

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<sup>5</sup>. 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.

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<sup>1</sup> s. 215.555, F.S. The FHCF was created after Hurricane Andrew in 1992.

<sup>2</sup> 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.

<sup>3</sup> 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 February 6, 2015).

<sup>4</sup> 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 February 6, 2015).

<sup>5</sup> s. 215.555(4)(a), F.S. and s. 215.555(2)(c), F.S.

The Fund's investment income varies by year but has accounted for \$467,258,000 in income over the last ten years as shown in the following historical income chart:

<b>Florida Hurricane Catastrophe Fund Investment Income<sup>6</sup></b>	
<b>Ten Year History of Audited Financial Statements</b>	
<b>Fiscal Year Ending:</b>	<b>Investment Income:</b>
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
June 30, 2014	\$19,174,000
<b>Grand Total</b>	<b>\$467,258,000</b>

The United States Internal Revenue Service has issued a private letter ruling that grants tax exempt status for the Fund<sup>7</sup>. In order to maintain this tax exempt status, the FHCF must devote funding for hurricane mitigation purposes. Beginning in Fiscal Year 1997-1998, the Florida Legislature authorized the appropriation of amounts from the Fund that are no less than \$10,000,000 and no more than 35% of the investment income from the prior fiscal year, providing that the actuarial soundness of the Fund is not jeopardized<sup>8</sup>. These appropriations provide local governments, state agencies, public and private educational institutions, and nonprofit organizations funding support for programs intended to improve hurricane mitigation efforts.

### **Background on The Florida Catastrophic Storm Risk Management Center**

The Florida Legislature created the Florida Catastrophic Storm Risk Management Center (Center) in 2007.<sup>9</sup> 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:<sup>10</sup>

- 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.

<sup>6</sup> 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 February 6, 2015.)

<sup>7</sup> Annual Report of the Florida Hurricane Catastrophe Fund Fiscal Year 2012-2013, pp. 12, 14 available at [http://www.sbafla.com/fhcf/Portals/5/Reports/2012\\_2013\\_FHCF\\_AnnualReport.pdf](http://www.sbafla.com/fhcf/Portals/5/Reports/2012_2013_FHCF_AnnualReport.pdf) (Last accessed February 9, 2015.)

<sup>8</sup> s. 215.555(7)(c), F.S.

<sup>9</sup> Ch. 2007-90, s.24, L.O.F. (creating s. 1004.647, F.S., effective June 11, 2007).

<sup>10</sup> Information gathered from the Florida Catastrophic Storm Risk Management Center webpage available at: <http://www.stormrisk.org/about-the-center> (Last accessed February 6, 2015).

- 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 Fund to the Center. 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 FHCF'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 in the following table:

<b>Hypothetical Calculation of FHCF Investment Income Amounts to be Transferred to the Center</b>			
		<b>The lesser amount to be transferred:</b>	
<b>Fiscal Year Ending:</b>	<b>Investment Income:<sup>11</sup></b>	<b>Calculation: 35 percent of Investment Income minus \$10,000,000</b>	<b>\$1,000,000</b>
June 30, 2010	\$54,298,000	\$19,004,300 - \$10,000,000 = \$9,004,300	<b>\$1,000,000</b>
June 30, 2011	\$29,983,000	\$10,494,050 - \$10,000,000 = <b>\$494,050</b>	\$1,000,000
June 30, 2012	\$26,634,000	\$9,321,900 - \$10,000,000 = <b>\$0</b>	\$1,000,000
June 30, 2013	\$34,638,000	\$12,123,300 - \$10,000,000 = \$2,123,300	<b>\$1,000,000</b>
June 30, 2014	\$19,174,000	\$6,710,900 - \$10,000,000 = <b>\$0</b>	\$1,000,000
<b>Five-Year Total of investment income that would have been transferred to the Center:</b>			\$2,494,050
<b>Five-Year Average of investment income that would have been transferred to the Center:</b>			\$498,810

### 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, 2015.

<sup>11</sup> 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 February 6, 2015.)

## 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 Fiscal Year 2014-2015 General Appropriations Act provides \$1.5 Million in funding that is transferred from the Consumer Assistance budget entity within the Department of Financial Services to the Florida Catastrophic Storm Risk Management Center (Center) located at The Florida State University for the purpose of meeting the requirements set forth in s. 1004.647, F.S. In addition, the Center is directed through proviso to study the storm worthiness and characteristics for the estimated probable maximum loss of state-owned buildings and facilities that are provided insurance coverage by the State Risk Management Trust Fund.

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 Center. 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 Fund to the Center, the bill has no fiscal impact on state or local governments.

### III. COMMENTS

#### A. CONSTITUTIONAL ISSUES:

##### 1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to: require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with counties or municipalities.

##### 2. Other:

None.

#### B. RULE-MAKING AUTHORITY:

None.

#### C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

### IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES