



# The Florida Senate

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Committee on Banking and Insurance

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## STATUS OF THE FLORIDA HURRICANE CATASTROPHE FUND

### Statement of the Issue

The Florida Hurricane Catastrophe Fund (FHCF or fund) is a tax-exempt state trust fund that reimburses (reinsures) insurers for a portion of their hurricane losses to residential property. In 2007, ch. 2007-1, L.O.F., increased the coverage limits of the fund for the 2007, 2008, and 2009 hurricane seasons by adding the Temporary Increase in Coverage Limit (TICL) options that allow an insurer to purchase its share of up to \$12 billion in coverage, in \$1 billion increments, above the mandatory fund coverage of approximately \$16 billion. The fund generally does not offer coverage below the industry "retention" (currently \$6.88 billion) that insurers must pay before being reimbursed, but the 2007 legislation required the fund to offer to insurers a total of \$3 billion in Temporary Additional Emergency Coverage Options (TEACO) coverage below the retention, also limited to 2007, 2008, and 2009. The fund also permits qualified "limited apportionment companies" (generally, insurers with \$25 million in surplus or less) to purchase coverage from the fund that reimburses the insurer for up to \$10 million in losses from each of two hurricanes for the 2008 hurricane season only. The Legislature mandated that the savings insurers received from these reforms must be reflected in rate filings and thus passed on to policyholders through lower rates for residential property insurance.

Reimbursements to insurers for losses above the current cash balance of the fund will have to be financed through bonding. If a large storm triggered the full capacity of the FHCF, bond issues totaling over \$20 billion could be necessary for the fund to meet its maximum obligations. Bonds would be funded by an 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. This summer, the State Board of Administration, as administrator of the FHCF, considered options for purchasing reinsurance and risk transfer products available from the capital markets.

This issue brief provides a status report on the FHCF regarding: a) its estimated reimbursement premiums, payment capacity, and bonding capacity for the 2008 hurricane season; b) insurers' selection of optional FHCF coverage; c) the SBA's decision-making regarding the purchase of reinsurance or other risk transfer products; d) new bonds issued to fund increased losses from 2005 and identification of reasons for such increased losses; and e) summary of the rate filings made by insurers to reflect the savings of the expanded FHCF coverage.

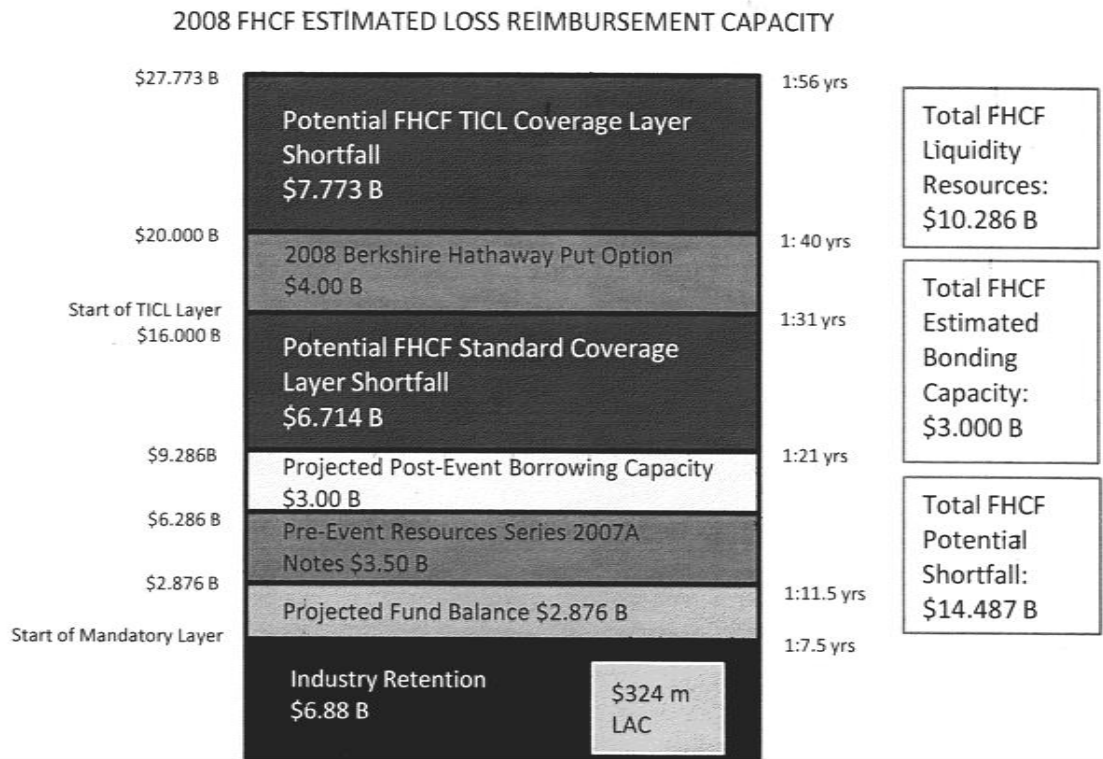
### Discussion

#### Florida Hurricane Catastrophe Fund Premiums and Payment Capacity for the 2008 Hurricane Season; Insurer Selection of Optional FHCF Coverage

Two hundred one (201) insurers have purchased FHCF coverage for the 2008-2009 contract year (2008 hurricane season). Before receiving funds from the FHCF, each insurer must pay its portion of an industry-wide retention of \$6.878 billion for 2008. The mandatory layer of FHCF coverage totals \$16.35 billion, for which insurers were charged \$996 million in premiums. The optional TICL coverage was purchased by 133 insurers for the 2008 hurricane season. The FHCF is providing \$11.143 billion in TICL coverage in return for premiums totaling approximately \$217 million. For the second consecutive year the TEACO coverage was not selected by any insurers, presumably due to the cost, which is much higher than the mandatory coverage and the TICL coverage. The \$10 million limited apportionment coverage option was purchased by 22 companies, for which \$81 million in premium was collected. The FHCF total premium for the 2008 hurricane year is estimated at \$1.29 billion. The

FHCF has a projected \$2.8 billion cash balance and additional access to \$3.5 billion in floating rate notes, providing the fund with approximately \$6.3 billion in liquidity.

The total liabilities of the FHCF could be up to approximately \$28 billion for a single season. Losses above the fund’s \$6.3 billion liquidity level are intended to be financed through the issuance of revenue bonds. However, instability in the worldwide financial markets has greatly reduced the fund’s ability to raise money through bonding. The October 2008 bonding estimates by the fund indicate the ability to borrow a maximum of only \$3 billion via bond issues over the next year assuming market conditions remain unchanged. This would leave the fund with inadequate resources to fully reimburse insurers if a storm during the 2008 hurricane season results in insured residential losses of greater than \$16.2 billion (the \$6.878 industry retention plus the fund’s estimated \$9.286 billion in liquidity and bonding capacity). A storm creating that level of damages is estimated to hit Florida once very twenty-one years, with the probability of such a storm occurring being 5 percent in any given year, but 50 percent over a ten year period. The FHCF has a maximum potential shortfall of approximately \$6.7 billion for the mandatory coverage layer. For the TICL layer of coverage, the only source of funding is the \$4 billion “put option” described below, resulting in a potential \$7.8 billion shortfall. For both the mandatory coverage and TICL coverage combined, the maximum potential shortfall is \$14.5 billion.



The FHCF has approximately \$10.3 billion in liquidity including the \$4 billion put option, the greatest amount of liquid assets in its history. However, the fund also has potential obligations that it cannot pay of approximately \$14.5 billion in the event of a major storm. Based on historical loss patterns, the fund’s current liquidity would enable it to timely reimburse insurers until about 3 to 6 months after the hurricane before resources would be exhausted. At some point, improvements in the financial markets should increase the fund’s bonding capacity and reduce its unfunded obligations. It is also possible that the federal government would lend needed funds by purchasing or guaranteeing FHCF bonds. However, given the great uncertainty in the financial markets, the Legislature may need to consider alternative funding mechanisms for the FHCF and options for reducing the FHCF’s liabilities.

### **SBA Decision to Purchase “Put Option” Risk Transfer Product from Berkshire Hathaway**

On August 8, 2008, the State Board of Administration reached a “put option” agreement with Berkshire Hathaway, Inc., that requires Berkshire Hathaway to purchase \$4 billion of FHCF bonds paying 6.5 percent interest in the event a hurricane causes losses exceeding \$16 billion (essentially the mandatory layer of coverage). The FHCF paid \$224 million for the put option out of the fund’s year-end cash balance (rather than adding the cost to the 2008 premiums for fund coverage), making the potential benefit to the fund approximately \$3.77 billion. The put option expires on May 15, 2009. The put option does not reduce the potential liabilities insurance policyholders face from deficit assessments, but rather creates greater liquidity for the fund in the event of a large storm triggering coverage above the mandatory layer. The purchase of reinsurance by the FHCF may not be practical as the private reinsurance market charges far higher rates for coverage than the fund charges insurers and would result in the payment of much of the fund’s collected premiums to private reinsurers.

### **New Bonding Related to 2005 Loss Development and Possible Causes**

The amount of money (loss reserves) needed by insurers to pay claims stemming from the 2005 hurricanes, and hurricane Wilma in particular, has exceeded earlier projections. In response to increased reimbursement due insurers from the FHCF, this summer the fund issued \$625 million in tax-exempt bonds. The additional debt will be paid by extending for two additional years (until 2014) the 1 percent emergency assessment levied to fund a previous \$1.35 million bond issue to cover losses stemming from the 2004 and 2005 storms.

There is no consensus regarding why the 2005 losses have grown much more than expected. Generally, the blame is placed on “re-opened” claims, which the insurer had previously paid and closed, but the policyholder then re-opened to make a claim for some damage or repair not previously paid. The primary reason cited for the loss development is that often public adjusters solicit policyholders to re-open claims. (“Public adjusters” are hired by and represent the insured, as compared to a “company employee adjuster” or “independent adjuster” employed or hired by an insurance company.) The policyholder is entitled to reimbursement for all damages caused by wind; however there is growing concern that some of these claims may be fraudulent. Others have noted that Citizens has increased its loss reports more than many other insurers and blamed Citizens for inaccurately estimating their losses in the first place, to a greater degree than other insurers. Potential issues for the Legislature include whether public adjusters are engaging in fraudulent practices to reopen claims, any actions necessary to prevent or sanction such acts, and whether Citizens has underestimated claims to a greater degree than other insurers and any steps that may be necessary to ensure this does not reoccur.

### **Rate Filings Made by Insurers to Reflect Savings from the Expanded FHCF Coverage**

The Legislature mandated that the savings insurers realize through purchasing expanded FHCF coverage created by ch. 2007-1, L.O.F., be reflected in rate filings so that the benefits of the fund’s expansion would be passed on to policyholders. To that end, the legislation required the Office of Insurance Regulation (OIR) to determine a presumed savings factor that would be applied to every policy renewed on or after June 1, 2007 by an insurer that purchased expanded FHCF coverage. Each insurer was required to make a rate filing that took the presumed factor into account. In the tables below, the column “proposed presumed factor” refers to the increase or decrease in rate the insurer filed for while taking into account the presumed factor; the column “final presumed factor” is the increase or decrease that the OIR approved.

Because many insurers had not finalized their reinsurance purchases for the 2007 hurricane season at the time they were required to submit the presumed factor filing, the OIR permitted insurers to make a “true-up” rate filing that was designed to take into account all the savings created by ch. 2007-1, L.O.F., and also the actual cost of the final reinsurance treaties that the various insurers had negotiated. The filing was due no later than October 1, 2007, and, if approved, was effective on all new or renewed policies entered into 90 days after that date (essentially after year’s end). The charts’ “proposed true-up filing” columns signify the rate increase or decrease the insurer requested at this filing, while the “final true-up filing” columns provide the increase or decrease the OIR approved. Not all true-up filings have been approved, so the status of the insurer’s true-up filing is found at the far right of each chart. Any additional rate decreases due to mitigation credits are reflected in the

“mitigation discounts” column. The total percentage rate reduction stemming from the 2007 legislation is found in the “total rate change” column. All figures in the columns were provided by the Office of Insurance Regulation.

### Rate Filings for Homeowners Multi-Peril

#### Top Ten Carriers – Statewide Average Percentage Changes

Company	Policies	Proposed Presumed Factor	Final Presumed Factor	Proposed True-Up Filing	Final True-Up Filing	Mitigation Discounts	Total Rate Change	True-Up Filing Status
State Farm Florida	1,007,986	-7	-7	-1.9	-1.9	-1	-9.9	Approved
Universal F & C Ins.	291,082	-8.7	-12.1	-0.7	-3.6	0	-15.7	Approved
Allstate Floridian Ins. Co.	283,685	-14.2	-14.2	43.4	-4.8	-1.3	-20.3	Pending
Nationwide of Florida	209,469	-5	-5	-15.2	-15.7	0	-20.7	Approved
USAA	140,133	-3.1	-3.1	53.9	0	-4.5	-7.6	Disapproved
St. Johns Insurance	110,493	-16.6	-16.6	12.1	11.5	-11	-16.1	Approved
Royal Palm	105,864	-20.7	-20.7	19.4	10.1	-5.6	-13.2	Approved
American Strategic	102,493	-11.4	-11.4	-10.5	-10.5	-3	-24.9	Approved
First Floridian Auto & Home	86,892	-8.3	-8.3	-8.5	-8.5	0	-16.8	Approved
Allstate Floridian Indemn.	84,144	-13.2	-13.2	27.4	-5.8	-2.6	-21.6	Pending

### Rate Filings for Mobile Homeowners

#### Top Ten Carriers – Statewide Average Percentage Changes

Company	Policies	Proposed Presumed Factor	Final Presumed Factor	Proposed True-Up Filing	Final True-Up Filing	Mitigation Discounts	Total Rate Change	True-Up Filing Status
Foremost Insurance Co.	52,487	-11.0	-17.6	22.9	14.9	0.0	-2.7	Approved
Foremost P&C Ins. Co.	42,401	-13.7	-20.9	14.4	13.9	0.0	-7.0	Approved
Safeway Property Ins. Co.	34,564	-27.9	-27.9	-7.8	-8.2	0.0	-36.1	Approved
Omega Insurance Co.	26,856	-17.6	-17.6	0.0	0.0	0.0	-17.6	Approved
American Traditions Ins.	18,856	-27.9	-27.9	0.0	0.0	0.0	-27.9	Approved
State Farm Florida Ins. Co.	17,332	-7.0	-7.0	0.0	0.0	0.0	-7.0	Not Filed
American Southern Home	15,279	-5.2	-10.1	24.6	0.0	0.0	-10.1	Disapproved
American Bankers Ins. Fla.	10,223	-14.1	-14.1	14.3	10.5	0.0	-3.6	Approved
American Reliable Ins. Co.	9,896	-10.2	-10.2	15.4	0.0	0.0	-10.2	Withdrawn
Allstate Floridian Ins. Co.	9,768	-24.6	-24.6	0.0	0.0	0.0	-24.6	Approved