

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/CS/HB 1267 Property Insurance
SPONSOR(S): Policy & Budget Council; Robaina and others
TIED BILLS: **IDEN./SIM. BILLS:** SB 2498

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) <u>Committee on Insurance</u>	<u>(ref. removed)</u>	<u></u>	<u></u>
2) <u>Jobs & Entrepreneurship Council</u>	<u>12 Y, 2 N, As CS</u>	<u>Callaway</u>	<u>Thorn</u>
3) <u>Policy & Budget Council</u>	<u>22 Y, 6 N, As CS</u>	<u>Martin</u>	<u>Hansen</u>
4) <u></u>	<u></u>	<u></u>	<u></u>
5) <u></u>	<u></u>	<u></u>	<u></u>

SUMMARY ANALYSIS

This bill makes changes to the Citizens Property Insurance Corporation ("Citizens") law, allows the Florida Hurricane Catastrophe Fund (Cat Fund) to sell additional reinsurance coverage to certain private insurers, prohibits the formation of new Florida domestic residential property insurance subsidiaries ("pup companies"), and requires rate filings for insurance subsidiaries to include parent company profit information. Specifically, the bill:

- Revises Citizens' legislative intent language emphasizing the need for affordable property insurance to be provided by Citizens;
- Increases the membership of the Citizens' board from eight members to nine members and allows the Governor to appoint the chair, rather than the Chief Financial Officer;
- Creates a Task Force to study Citizens and recommend statutory and operational changes to help Citizens operate as a noncompetitive residual market;
- Allows the Cat Fund to sell additional reinsurance to private insurers who agree to take policies out of Citizens;
- Provides that effective January 1, 2008, the following provisions apply to "pup companies":
 - A new certificate of authority may not be issued to a Florida domestic residential property insurer that is a wholly owned subsidiary of an insurer authorized to conduct business in another state ("pup company"); and,
 - The rate filings of any Florida domestic insurer that is a wholly owned subsidiary of an insurer authorized to do business in another state ("pup company") shall include information relating to the profits of the parent company of the Florida domestic insurer.

This bill is effective upon becoming a law unless otherwise expressly provided in the bill.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

Provide Limited Government, Safeguard Individual Liberty: The bill provides new regulations for insurance companies including the prohibition on new pup companies and the consideration of parent insurer profits in a pup company's rate filing. The bill allows the Florida Hurricane Catastrophe Fund to sell additional reinsurance. The bill creates a Task Force to study Citizens Property Insurance Corporation and to report on the changes needed for Citizens to operate as a noncompetitive residual market.

B. EFFECT OF PROPOSED CHANGES:

Citizens Property Insurance Corporation ("Citizens")

In 2002, the Florida Legislature created Citizens by combining the state's two insurers of last resort, the Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) and the Florida Windstorm Underwriting Association (FWUA).¹ The merger allowed Citizens to become exempt from federal income taxes, resulting in millions of dollars in annual savings, as well as additional administrative and economic efficiencies.

Since that time, Citizens has become the largest property insurer in the State. As of February 28, 2007, Citizens provided coverage to over 1.3 million policyholders with \$432 billion in exposure and a market share of approximately 22 percent based on the number of policies in force.

Citizens' offers three types of property and casualty insurance in three separate accounts:

- Personal Lines Account (PLA) which offers multi-peril policies covering homeowners, mobile homeowners, dwelling fire, tenants, condominium unit owners and similar policies;
- Commercial Lines Account (CLA) which offers multi-peril policies covering commercial residential (condominium associations, apartment buildings, homeowners associations) and commercial nonresidential (business); and
- High-Risk Account (HRA) which covers multi-peril policies or wind-only policies, or both, for personal residential and commercial (residential and non-residential) policyholders.²

The number of policyholders in the three accounts are: PLA = 805,327; CLA = 10,255, and HRA = 407,681.³

The bill amends s. 627.351, F.S., relating to the Citizens Property Insurance Corporation ("Citizens") law. The bill modifies the original Legislative "intent" language in the law which authorized the creation of Citizens in 2002.⁴ The bill makes Legislative findings which emphasize the lack of affordable property insurance in the state; that private insurers are unwilling or unable to provide such affordable coverage which threatens the public health, safety and welfare and the economic health of Florida; that there is a compelling public interest that property be insured at affordable rates to facilitate rehabilitation of damaged or destroyed property; that Citizens provide such affordable property insurance because it is not devoted to private profit making pursuits and is organized to achieve efficiencies and economies, while servicing policyholders, which equals or exceeds the quality provided in the voluntary market; that Citizens serve to increase the availability of affordable property insurance and offer the lowest rates possible consistent with sound business practices. The bill retains the current intent language which

¹ Chapter 2002-240, L.O.F.

² Legislation enacted during the 2007 Special Session (ch. 2007-1, L.O.F.) authorized Citizens to offer multi-peril coverage in its HRA.

³ <http://www.citizensfla.com/> (last viewed April 10, 2007).

⁴ Chapter 2002-240, L.O.F.

provides that it is essential for Citizens to have financial resources to pay claims and that it is the Legislature's intent that Citizens' income be exempt from federal income taxation.

Citizens' Board of Governors

Citizens operates under the direction of an 8-member Board of Governors (Board) representing geographically diverse regions of the state. The Governor, Chief Financial Officer, the Senate President, and the Speaker of the House of Representatives each appoint two members of the Board who serve for 3-year terms.⁵ The Governor appoints the chair of the Board. The CFO appoints a technical advisory board to provide information and advice to the Board of Governors.

The bill makes numerous changes to the Citizens' Board of Governors. It changes the Board from eight members to nine members. It increases the number of board appointments for the Governor from two board members to three members and keeps all other appointing entities (CFO, Senate President, and House Speaker) at two member appointments. The bill changes the appointment of the Chair of the Board from the CFO to the Governor. It requires all Board members to have insurance, bond financing, business management or corporate board expertise and requires the executive director of Citizens to have substantial insurance and managerial expertise. The bill repeals the requirement that Board members reside in different geographical areas of the state. It abolishes the Citizens technical advisory group appointed by the CFO which was charged with providing advice and information to the Board about the Board's duties.

The Citizens Property Insurance Corporation Mission Review Task Force

The bill also creates "The Citizens Property Insurance Corporation Mission Review Task Force" (Task Force). The Task Force's charge is to analyze and compile data pertinent to developing a report specifying the statutory and operational changes needed for Citizens to operate as a state created, noncompetitive residual market. The report is to be submitted to the Governor and the Legislative presiding officers by January 31, 2008.

The bill delineates specific areas the Task Force must provide recommendations on in its report to the Governor and Legislative presiding officers. The Task Force is required to hold meetings, take testimony, and conduct research to fulfill its charge.

The bill specifies the membership of the 17 member Task Force:

- Three members appointed by the House Speaker;
- Three members appointed by the Senate President;
- Three members appointed by the Governor, none of which can be affiliated with insurers; and
- Eight members representing private sector insurers, six of which represent insurance companies with specified policy counts and two of which represent insurance agents.

The bill specifies when the appointing entities must make the Task Force appointments (30 days after the effective date of the bill), when the Task Force must convene its first meeting (within one month of appointment of all Task Force members), and when the Task Force expires (no later than 60 calendar days after report submission). The bill does not allow Task Force members to receive compensation for service but allows them to receive state-allowed per diem. The Task Force is allowed to employ consultants and administrative staff. Citizens' senior staff is required to attend Task Force meetings and to cooperate with the Task Force.

Florida Hurricane Catastrophe Fund (Cat Fund or fund)

HB 1A, enacted during the 2007 Special Session, substantially increased the amount of hurricane losses covered by the Florida Hurricane Catastrophe Fund (Cat Fund or fund), which is a tax-exempt state fund administered by the State Board of Administration (SBA). The Cat Fund reimburses insurers

⁵ s. 627.351(6)(c)4., F.S. (2006).

for a portion of their residential hurricane losses in exchange for a premium that is much lower than what private reinsurers charge.⁶ This results in lower premiums to policyholders and enables a greater number of policies to be written. The Cat Fund helps stabilize the property insurance market, particularly after an active hurricane period, as Florida experienced in 2004 and 2005 that is followed by increased costs and lower availability of private reinsurance.

Currently, some Cat Fund coverage is mandatory and other coverage is optional. For the mandatory coverage, the maximum amount the Cat Fund must pay (the capacity) in any one year is \$15 billion, adjusted annually based on the percentage growth in fund exposure, but not to exceed the dollar growth in the cash balance of the fund.⁷ Every insurer participating in the Cat Fund has coverage based on its Cat Fund reimbursement premium. Each insurer has a maximum amount of coverage the Cat Fund will pay for claims each year. For the current contract year (2006-2007), the insurance industry as a whole is covered for up to \$15 billion, meaning \$15 billion is the most the Cat Fund will pay to the insurance industry on claims for a hurricane season. The mandatory Cat Fund coverage limit for the 2007-2008 contract year is expected to grow to \$15.85 billion because the Cat Fund is not expected to have to reimburse insurers for losses during the 2006-2007 contract year as no hurricanes hit Florida. Thus, the Cat Fund's cash balance will grow in the 2006-2007 contract year leading to an increase in the Cat Fund's capacity for the mandatory Cat Fund coverage.

For the current 2006-07 contract year (June 1, 2006 – May 31, 2007), the insurance industry as a whole has a retention of \$5.3 billion per hurricane for the mandatory Cat Fund coverage. This means the total of all individual insurer retentions/deductibles will hypothetically total to \$5.3 billion per hurricane, assuming all participating insurers reached their retention.⁸ However, the retention level for each insurer is different because the retention level is based on the amount of premium the insurer pays to the Cat Fund. The mandatory Cat Fund coverage retention is adjusted annually based on the Cat Fund's exposure (regardless of any change in the Cat Fund's cash balance). The industry aggregate retention for mandatory Cat Fund coverage is expected to grow to \$6 billion for the 2007-2008 contract year.

The additional Cat Fund coverage authorized by HB 1A is optional to insurers, and is as follows:

- Residential property insurers can purchase additional coverage above the current maximum limits of the Cat Fund, referred to as Temporary Increase in Coverage Limit options ("TICL"), for the 2007, 2008, and 2009 contract years. The TICL options allow an insurer to purchase additional reinsurance for its share of up to \$12 billion, in \$1 billion increments, above the current Cat Fund annual limit of \$15.85 billion estimated for 2007 (i.e., up to a total of \$27.85 billion). The SBA may further increase the limits by an additional \$4 billion (i.e., up to \$32 billion). The TICL coverage will reimburse the insurer for 90 percent, 75 percent, or 45 percent of the insurer's losses above its retention, at the same percentage selected by the insurer for its mandatory Cat Fund coverage. Insurers must pay a premium established by the SBA under the same method for determining "actuarially indicated" premiums for the mandatory Cat Fund coverage, which generally establishes a premium equal to the estimated average annual loss for the coverage purchased. Based on current loss models, this is expected to be a premium equal to about 2.2 to 3 percent of the coverage amount (commonly referred to as a 3 percent "rate-on-line.") These premiums are significantly lower than charged by private reinsurers and are the primary source of premium savings under HB 1A.
- Residential property insurers can purchase additional coverage below each insurer's market share of the Cat Fund retention, referred to as Temporary Emergency Additional Coverage Options ("TEACO"), for the 2007, 2008, and 2009 contract years. For 2007, the Cat Fund

⁶ The CAT Fund currently sells reinsurance at about 6.7% rate-on-line, meaning an insurer has to pay 6.7 cents for a dollar's worth of reimbursement coverage.

⁷ s. 215.555(4)(c)1., F.S. (2006).

⁸ s. 215.555(2)(e)1., F.S. (2006).

retention is estimated to be \$6 billion. Currently, each insurer is responsible for paying all hurricane losses up to its share of the retention for each hurricane, except that the retention drops to one-third of the full retention for the third largest event and subsequent events. The TEACO options allow an insurer to select its share of a retention level of \$3 billion, \$4 billion, or \$5 billion, to cover 90 percent, 75 percent, or 45 percent of its losses up to the normal retention for the mandatory Cat Fund coverage. HB 1A established the premiums that insurers must pay for the TEACO options. For the \$3 billion retention, the premium is an 85 percent rate-on-line; for the \$4 billion retention, the premium is an 80 percent rate-on-line; and for the \$5 billion retention, the premium is a 75 percent rate-on-line. The TEACO coverage applies to two hurricanes for each contract year. The TEACO premiums established by HB 1A are priced at near-market levels. Therefore, these coverage options primarily benefit insurers which are unable to obtain reinsurance at these low levels, but are not expected to generate premium savings for most insurers. The relatively high premiums also serve to significantly reduce the risk to the state for the TEACO coverage.

- Eligible residential property insurers can purchase up to \$10 million in additional Cat Fund coverage at a level significantly below the normal Cat Fund retention and likely to be lower than the lowest retention (\$3 billion) under the TEACO options. The \$10 million coverage amount is above a retention equal to 30 percent of the insurer's surplus, as of December 31, 2006. The premium is set at 50 percent of the coverage amount (i.e., \$5 million for \$10 million coverage). The coverage applies to two hurricanes and is offered only for the 2007 contract year. This is similar to the \$10 million coverage that was offered in 2006 to "limited apportionment companies," which are generally insurers with \$25 million in surplus or less. HB 1A again made this coverage available, this time to insurers who participated in 2006, limited apportionment companies that began writing property insurance in 2007, and insurers approved to participate in either 2006 or 2007 for the Insurance Capital Build-Up Incentive Program pursuant to s. 215.5595, F.S.

Effect of Proposed Changes

The bill allows the State Board of Administration (SBA) to sell additional Cat Fund coverage below the Cat Fund retention to private insurers that agree to take policies out of Citizens. Although the range of the additional Cat Fund coverage authorized in the bill is not specified, because current law allows insurers the option to purchase Cat Fund coverage below each insurer's mandatory Cat Fund retention level (the TEACO option discussed above), the additional Cat Fund coverage provided by the bill should be below the lowest TEACO retention level (\$3 billion). Thus, the additional Cat Fund coverage provided by this bill should allow for \$0 to \$3 billion more in coverage. If the retention for the additional Cat Fund coverage provided by this bill is set by the SBA at \$0, then for those insurers purchasing the coverage, the Cat Fund will reimburse them for every dollar of property loss they incur up to the insurer's reimbursement/coverage limit. The coverage limit associated with the additional coverage provided in the bill is not specified, however, current law sets the coverage limit for the mandatory Cat Fund coverage. Thus, the coverage limit for insurers purchasing the additional Cat Fund coverage authorized under this bill may be their coverage limit for the mandatory Cat Fund coverage.⁹

The SBA has discretion to decide how low the Cat Fund additional coverage retention level should be set and how many policies a private insurer must take out of Citizens in order to be eligible for the additional Cat Fund coverage provided in the bill. It also allows the SBA to negotiate the rate for the additional coverage provided by the bill, but specifies the rate must be 30-60 percent rate-on-line.¹⁰ The bill requires the SBA to determine how much of a discount will be given to Citizens' policyholders

⁹ The coverage limit would increase, however, if the insurer also chose to purchase additional optional Cat Fund coverage in excess of the mandatory Cat Fund coverage, the TICL coverage described above.

¹⁰ Rate-on-line means the premium paid by an insurer to a reinsurer as a percentage of the reinsurer's exposure. The CAT Fund currently sells reinsurance at about 6.7% rate-on-line, meaning an insurer has to pay 6.7 cents for a dollar's worth of reimbursement coverage. As noted previously, the rate-on-line charge for the three TEACO optional coverage levels is as follows: for the \$3 billion retention, the premium is an 85 percent rate-on-line; for the \$4 billion retention, the premium is an 80 percent rate-on-line; and for the \$5 billion retention, the premium is a 75 percent rate-on-line.

but specifies a minimum discount of 10 percent. The bill does not, however, link the discount to Citizens' policyholders to the purchase of additional Cat Fund coverage under the bill. The bill requires the private insurer taking policies out of Citizens that purchase the additional Cat Fund coverage provided by the bill to assume 100 percent of each policy taken out of Citizens.

Certificate of Authority/"Pup" Companies

Insurance companies transacting insurance in Florida or from offices located in Florida are, with limited exceptions, required to have a certificate of authority (COA) issued by the Office of Insurance Regulation (OIR).¹¹ To qualify for a COA, a prospective insurer¹² must meet specified financial criteria including maintaining reserves¹³ applicable to the kind of insurance transacted by the insurer, as well as maintaining specified assets, deposits, capital, and surplus. Insurers must provide the OIR with specified background information and meet trustworthiness, fitness, and criminal history requirements.

A COA may continue in force as long as the insurer meets the statutory requirements¹⁴ of paying its annual license tax,¹⁵ filing its annual statement,¹⁶ and paying applicable taxes under the Insurance Code. The law does allow OIR to suspend or revoke an insurer's COA based on numerous criteria including being in unsound financial condition, committing practices which render its insurance transactions hazardous or injurious to its policyholders and violating lawful orders or rules of the OIR or FSC.

Current law does not forbid the formation of Florida domestic subsidiaries of national insurance companies ("pup companies"). According to the OIR, there may be as many as 27 Florida property and casualty domestic insurers that are wholly owned subsidiaries of insurers authorized to do business in another state. One such example is State Farm Florida Insurance Company¹⁷ which was formed as a wholly owned property insurance subsidiary (offering personal and commercial property insurance coverage) of State Farm Mutual Automobile Insurance Company which is domiciled in Illinois. State Farm Florida received its Florida COA in 1998 from the Department of Insurance.¹⁸ The insurer currently has over one million policies and has a 20.6 percent market share in Florida. State Farm Mutual has always sold property insurance via wholly owned subsidiaries for the past fifty years, according to a State Farm representative.

Although HB 1A did not address the formation of new "pup companies" in Florida, it increased the minimum surplus requirements for residential property insurance "pup companies" from \$5 million to \$50 million.¹⁹

Also, current law does not require and the OIR does not review the profits of national parent companies of wholly owned Florida subsidiaries when considering a rate filing.

Effect of Proposed Changes

The bill provides that effective January 1, 2008, and notwithstanding any other provision of law:

¹¹ Section 624.401, F.S.

¹² Insurers are divided into three categories under the Insurance Code: *domestic insurers* are formed under the laws of Florida; *foreign insurers* are formed under the laws of any state, district, or territory or commonwealth of the United States, other than Florida; and *alien insurers* are defined as insurers other than domestic or foreign insurers. Foreign and alien insurers must also meet certain capital, surplus, and operational requirements.

¹³ Part I of ch. 625, F.S.

¹⁴ Section 624.416, F.S.

¹⁵ Section 624.501(3), F.S.

¹⁶ Section 624.424, F.S.

¹⁷ DOI Case Nos. 26914-98-CO and 26390-98-C.

¹⁸ In 2002, the programs, employees and trust funds of the Department of Insurance were transferred to the Department of Financial Services and the Financial Services Commission (Office of Insurance Regulation). (ch.2002-404, F.S.)

¹⁹ Section 624.407, F.S.

1. A new certificate of authority for the transaction of residential property insurance may not be issued to any insurer domiciled in Florida that is a wholly owned subsidiary of an insurer authorized to do business in any other state; and
2. The rate filings of any insurer domiciled in this state that is a wholly owned subsidiary of an insurer authorized to do business in any other state must include information relating to the profits of the partner company of the insurer domiciled in this state.

Provision # 2 could be interpreted to allow the OIR to consider the profitability of an insurer's parent company during rate reviews. However, according to the OIR, such considerations are outside the bounds of the historical rate review process in virtually every state. The profit of the parent is not relevant to the losses and expenses that support the rate filing of an insurer doing business in Florida. Normally, an insurance regulator reviews premiums, claims costs, loss adjustment expenses and other related expenses it is review of an insurer.

C. SECTION DIRECTORY:

Section 1: Creates an unnumbered section, relating to the State Board of Administration and Florida Hurricane Catastrophe Fund.

Section 2: Amends s. 627.351(6), relating to Citizens Property Insurance Corporation.

Section 3: Creates an unnumbered section, relating to "pup companies" and inclusion of parent company profits in rate filings for "pup companies."

Section 4: Creates an unnumbered section, creating the Citizens Property Insurance Corporation Mission Review Task Force.

Section 5: Provides an effective date of "upon becoming a law" unless otherwise expressly provided in the bill.

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:

There is no appropriation provided for the Task Force.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

The mandates provision does not apply because this bill does not: require counties or municipalities to spend funds or to take an action requiring the expenditure of funds; reduce the authority that municipalities or counties 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 provided in the bill.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

D. STATEMENT OF THE SPONSOR

No statement submitted.

IV. AMENDMENTS/COUNCIL SUBSTITUTE CHANGES

On April 12, 2007, the Jobs and Entrepreneurship Council considered the bill, adopted a strike-all amendment, and reported the bill favorably with a Council Substitute. The strike-all amendment provided as follows:

- Revised legislative findings for Citizens to protect tax exempt status.
- Removed authority for Citizens to offer multi-peril coverage in High Risk Account because this provision is duplicative of what was contained in HB 1A passed during Special Session.
- Allowed a homeowner to obtain property insurance in Citizens even if the homeowner has an offer from the private market if the private market premium is 15% more than the Citizens' premium, rather than 25% more.
- Extended the rate freeze for Citizens rates from 2007 only to 2007 and 2008.
- Prohibited the formation of new pup companies starting January 1, 2008.
- Required the pup insurer's rate filing to include information about the profits of the parent insurer.
- Changed the title from "an act relating to Citizens Property Insurance Corporation" to "an act relating to property insurance" to avoid adequate title susceptibility.

The staff analysis was amended to reflect the adoption of the strike-all amendment.

On April 23, 2007, the Policy & Budget Council heard the bill, adopted five amendments, and reported the bill favorably with a Council Substitute. The amendments adopted made the following changes to the bill:

- Restores the language of the bill to current law requiring the difference in premiums offered by a private insurer to be at least 25 percent greater than that of Citizens in order for a property to be eligible for coverage in Citizens.
- Provides the Citizens' rate freeze remains in effect until January 1, 2008, rather than January 1, 2009. This effectively maintains current law.
- Creates "The Citizens Property Insurance Corporation Mission Review Task Force" (Mission Review Task Force or Task Force) to study and report on the statutory and operational changes needed for Citizens to function as a state-created, noncompetitive residual market. Provides reporting requirements for the Mission Review Task Force. Outlines what issues the Task Force report must make recommendations on. Provides composition of the Task Force members and for appointment of such.
- Changes the Citizens' Board of Governors from eight members to nine members. Gives the Governor three Board appointments instead of two. Keeps all other appointing entities (CFO, Senate President, and House Speaker) at two appointments. Changes the appointment of the Chair of the Board from the CFO to the Governor. Requires all Board members to have insurance, bond financing, business management or corporate board expertise. Repeals the requirement that Board members reside in different geographical areas of the state. Abolishes the Citizens technical advisory group appointed by the CFO which was charged with providing advice and information to the Board about the Board's duties. Require the executive director of Citizens to have substantial insurance and managerial expertise.
- Authorizes the State Board of Administration (SBA) to sell reinsurance below the Florida Hurricane Catastrophe Fund (FHCF) retention level for 30-60 percent rate-on-line to insurers that agree to take a specified number of Citizens' policies out of Citizens. Requires Citizens' policyholders to receive a minimum 10 percent discount. Gives the SBA authority to set parameters relating to the sale of reinsurance below the FHCF retention for insurers who agree to take policies out of Citizens.

The staff analysis was amended to reflect the adoption of the amendments.