

300 WORDS

(more or less) about

CAT FUND IN CRISIS

PROBLEM—The Florida Hurricane Catastrophe Fund (Cat Fund) was expanded in 2007 to allow insurers to purchase an extra layer of reinsurance. The added exposure brings into serious doubt the ability of the Cat Fund to pay losses in the event of a major storm.

BACKGROUND—The Cat Fund is a state-created entity formed to be a reinsurance backstop for insurers writing property insurance in Florida. All insurers are required to participate. Since it is nonprofit and enjoys tax-free status, it is usually able to offer reinsurance coverage at a rate lower than similar coverage in the voluntary market. Due to the high cost and dwindling availability of reinsurance in the voluntary market, in 2007, the Legislature passed HB 1A, which increased the amount of coverage that an insurer could purchase from the Cat Fund. This added layer was known as the Temporary Increase in Coverage Limits or TICL. It allowed the purchase of reimbursement reinsurance in increments of \$1 billion, up to a maximum of \$12 billion. It also had optional levels of reimbursement at 45 percent, 75 percent, or 90 percent of covered losses. Most insurers choose the 90 percent level. The Fund's ability to pay claims comes from two sources: the premiums charged to the participating insurers, and the ability to float bonds paid for by an assessment process that insurers pay and then, in theory, recoup in the rate-making process. Private reinsurance duplicating that coverage cannot be recouped.

Since passage of HB 1A, most observers agree that the Cat Fund is overexposed. In testimony before the Florida Legislature, Cat Fund CEO Jack Nicholson said that the Cat Fund is way short of funding even its mandatory layer of about \$17 billion for the 2009 hurricane season. There is also widespread agreement that, due to lack of capacity in the international bond market, the estimated \$13 billion of required TICL coverage is likely not bondable.

Potential exposure of the Cat Fund is a combination of two factors: the dollar amount of coverage of the TICL layers and the level of reimbursement option chosen (45, 75, or 90 percent). Therefore, there are three ways to reduce

the TICL exposure: lower the reimbursement percentage; reduce the dollar amount of TICL layer that can be purchased; or do a combination of both.

LEGISLATION—HB 1495 by Rep. Nelson lowers the Cat Fund's exposure by gradually reducing the percentage levels at which the insurers are reimbursed. In five years, it would go from the current 45/75/90 levels of reimbursement, to a 15 percent level of reimbursement for reinsurance contracts year ending May 31, 2016.

HB 437 by Rep. Rader is an approach also advocated by CFO Alex Sink. It addresses the exposure problem in two ways. It reduces the dollar amount of TICL coverage that can be purchased by eliminating the \$10, \$11, and \$12 billion options and lowers the percentage level of reimbursement to only 70 percent.

THE PASS-THROUGH CONCEPT—Most domestic insurers who now write a substantial portion of the Florida property coverage are rated by a company called Demotech. Demotech has informed both the OIR and the Legislature that, after May 15, 2009, Demotech-rated carriers will need to show financing from someplace other than the Cat Fund in order to maintain their Financial Stability Rating. Since most banks and mortgage companies require "rated" insurers, this could have dire results. One solution is to allow carriers to replace portions of the Cat Fund coverage with commercial reinsurance and to pass only the additional cost (if any) along to policyholders without the necessity of an OIR filing and prior approval.

FAIA'S POSITION—We support legislation that reduces or eliminates the Cat Fund's unfunded exposure, such as HB 1495 by Rep. Nelson, HB 437 by Rep. Rader, and we support legislation allowing a pass-through of premiums for commercial reinsurance that replaces Cat Fund coverage.

FOR MORE INFORMATION, CONTACT:

Laura B. Pearce, Esq., FAIA Director of Governmental Affairs & General Counsel, or
Kyle Ulrich, FAIA Director of Political Affairs
E-mail: lpearce@faia.com, kulrich@faia.com



Florida Association of Insurance Agents
PO Box 12129
Tallahassee, FL 32317-2129



Telephone: 850-893-4155
Fax: 850-668-2852
www.faia.com