

# Economics of Insurance: Who Pays?

Presentation to the Florida House of Representatives

December 4, 2006

# What If...

The state spent an additional

- \$1 billion annually on a property insurance program or
- assumed a \$10 billion or \$ 20 billion obligation paid through debt or assessment mechanism?

# FEMA Eligible Costs for Florida Recent Disaster Events **Pre-2004**

Irene	\$253.3 million
Helene	\$30.3 million
South Fl Floods	\$715.9 million
Freezes	\$0.6 million
Allison	\$33.0 million
Gabrielle	\$33.0 million
Miami Tornados	\$4.1 million
Severe Flooding	<u>\$17.1 million</u>
<b>TOTAL</b>	<b>\$1.087 Billion</b>

# FEMA Eligible Costs for Florida 2004 Disaster Events

Charley	\$889.2 million
Frances	\$994.8 million
Ivan	\$942.6 million
Jeanne	<u>\$768.7 million</u>

**TOTAL**                      **\$3.595 Billion**

# FEMA Eligible Costs for Florida 2005 Disaster Events

Dennis	\$273 million
Katrina	\$281 million
Rita	\$14.2 million
Wilma	\$2.03 billion
<b>TOTAL</b>	<b>\$2.598 billion</b>

# Florida General Revenue Costs for Recent Disaster Events

Pre-2004 events      \$143 million

2004 events            \$472 million

2005 events            \$391 million

**Total                    \$1.006 billion**

# What Florida COULD Experience

- ❑ If Hurricane Andrew (1992) had hit Florida in 2005, the resulting *insured* losses in 2005 dollars have been estimated at \$42 billion.
- ❑ Hurricane Katrina may have caused \$41 billion of *insured* losses, but “the Federal Government to date has appropriated \$120 billion in funding to rebuild the Gulf Coast...”
- ❑ “...(A) mega-catastrophe... could cause in excess of \$250 billion in damage...”

*Source of quotes: The Governor's Property and Casualty Insurance Reform Committee, Final Report, November 15, 2006, p. 71.*

# Florida Hurricane Catastrophe Fund (the CAT Fund)

- ❑ Created in November 1993 during a special legislative session after Hurricane Andrew.
- ❑ Maintains insurance capacity in Florida by providing reimbursements to insurers for a portion of their catastrophic windstorm losses.

# Florida Hurricane Catastrophe Fund (the CAT Fund)

- ❑ Over the first ten years, the CAT Fund built up a cash balance of \$6.2 billion.
- ❑ During the 2004 and 2005 hurricane seasons, the cash was depleted, and an additional \$1.35 billion had to be borrowed through bonds to pay claims.

# Florida Hurricane Catastrophe Fund (the CAT Fund)

## 2004

\$6.2 billion	Cash available to pay claims
<u>\$3.95 billion</u>	Losses
\$2.31 billion	Cash balance

## 2005

\$3.075 billion	Cash available to pay claims
<u>\$4.5 billion</u>	Losses
<b>\$(1.425) billion</b>	<b>Cash shortfall</b>

Annual receipts into the CAT Fund for 2006 are an estimated **\$800 million** (from premiums paid by insurance companies for CAT Fund coverage).

# Florida Hurricane Catastrophe Fund (the CAT Fund)

- 2005 cash **shortfall of \$1.425 billion** was funded from:
  - **\$1.35 billion** from issuance of post-event **bonds**  
(includes issuance costs; net bond proceeds available for payout=\$1.225 billion)
    - Requires a **1% assessment** on consumers' insurance premiums effective January 1, 2007
    - Amortized over **six years**
  - **\$200 million** from 2006 reimbursement premiums (25% rapid cash build-up factor<sup>1</sup>)

<sup>1</sup>Rapid cash build-up required in 2006 by SB 1980: surcharge of 25% on premiums paid by insurers for coverage from the CAT Fund.

# Florida Hurricane Catastrophe Fund (the CAT Fund)

- 2006: issued taxable five-year pre-event notes to generate **\$2.8 billion** to provide liquidity for the 2006 hurricane season and future hurricane seasons.
  - No assessments required – funds are invested and earning enough interest to pay the debt service.
  - Future carrying costs, if any, will be paid from reimbursement premiums.
  - If proceeds are spent for future claims, notes will be refinanced using tax-exempt post-event bonds secured by emergency assessments.

# Florida Hurricane Catastrophe Fund (the CAT Fund)

## Consumer Insurance Premium Assessments:

- ❑ Each 1% assessment on premiums generates about \$350 million for the CAT Fund (used to pay the annual debt service on the bonds).
- ❑ Current assessment base of \$35 billion (consumer insurance premiums) includes all property and casualty lines, including surplus lines, but excludes workers compensation, medical malpractice insurance, accident /health insurance and flood insurance.

# Florida Hurricane Catastrophe Fund (the CAT Fund)

## Consumer Insurance Premium Assessments:

- ❑ Under current law, the 2007 claims paying capacity limit is projected at \$16 billion.
- ❑ With cash available of \$2.5 billion, the current bonding capacity is \$13.5 billion needed to meet the \$16 billion claims payment limit.

# Florida Hurricane Catastrophe Fund (the CAT Fund)

## Consumer Insurance Premium Assessments:

- ❑ For a 10 year, \$13.5 billion bond issue, the assessment to pay \$2.1 billion of annual debt service would be 6.08%, or \$60.80 per \$1,000 of insurance premiums (\$243 for a hypothetical consumer with \$4,000 in total premiums).
- ❑ For a 30 year term the assessment to pay \$942 million of annual debt service would be 2.69%, or \$26.90 per \$1,000 of insurance premiums (\$108 for a hypothetical consumer with \$4,000 in total premiums).

# Florida Hurricane Catastrophe Fund (the CAT Fund)

## WHAT IF:

- Retention is lowered from the projected \$6 billion (2007 estimate); and
- maximum payouts are allowed to rise as needed to match lower retention; and
- 2007 hurricanes require the full CAT Fund capacity for claims payments?

## RESULTS (Dollars In Millions):

<b>2007 Retention</b>	Cash Available (from premiums)	Bond Proceeds Required	Total Claims Payout	<b>Annual Assessment Required (30 year bonds)</b>	Annual Assessment Required (10 year bonds) <sup>1</sup>
<b>\$6 billion</b>	\$2,500	\$13,500	\$16,000	<b>2.69%</b>	6.08%
<b>\$5 billion</b>	\$2,711	\$15,289	\$18,000	<b>3.05%</b>	6.88%
<b>\$4 billion</b>	\$3,016	\$16,984	\$20,000	<b>3.38%</b>	7.64%
<b>\$3 billion</b>	\$3,405	\$18,595	\$22,000	<b>3.70%</b>	8.37%
<b>\$2 billion</b>	\$3,760	\$20,240	\$24,000	<b>4.03%</b>	9.11%

<sup>1</sup> The current maximum single season emergency assessment limit is 6%, and the overall maximum assessment limit is 10%.

# Florida Hurricane Catastrophe Fund (the CAT Fund)

## WHAT IF:

- **Retention** is lowered to **\$2 billion**; and
- 2007 catastrophes require the full CAT Fund capacity for claims payments?

## RESULTS:

- For 2007, maximum bonding required would be **\$20.24 billion**.
- Assessment required (and resulting revenue for annual debt service) would be **4.08%** (**\$1.41 billion per year**) for 30 year bonds.

# Florida Hurricane Catastrophe Fund (the CAT Fund) Assessment Impacts

<b>CAT FUND ASSESSMENTS on \$4,000 Total Premiums</b>				
<b>2006 1% Actual Assessment</b>	<b>2007 Current Law \$13.5 Billion Maximum Debt</b>		<b>2007 \$2 Billion Retention Option \$20.2 Billion Maximum Debt</b>	
	<b><u>10 Year Bonds</u></b>	<b><u>30 Year Bonds</u></b>	<b><u>10 Year Bonds</u></b>	<b><u>30 Year Bonds</u></b>
\$40	\$243	\$108	\$364	\$161
(\$10.00/\$1,000)	(\$60.80/\$1,000)	(\$26.90/\$1,000)	(\$91.10/\$1,000)	(\$40.30/\$1,000)
for <u>6 years</u>				
beginning				
Jan. 1, 2007				

*Assume: Hypothetical homeowner with \$2,500 annual homeowner insurance premium and \$1,500 annual auto insurance premiums: total of \$4,000 in premiums.*

# Citizens Property Insurance Corporation Assessment Impacts

<b>CITIZENS ASSESSMENTS on \$2,500 Homeowner Premium</b>		
	<u><b>2004</b></u>	<u><b>2005</b></u>
<b><u>1 year assessment</u></b>		
Actual (with Legislative \$715m subsidy in 2005)	\$170	\$52
	(\$68.00/\$1,000)	(\$20.70/\$1,000)
<i>Without Leg. \$715m Subsidy in 2005(est.)</i>		<b>\$279</b>
		(\$111.50/\$1,000)
<b><u>10 year assessment</u></b>		<b>\$35</b>
		(\$14.00/\$1,000)

*Assume: Hypothetical homeowner with \$2,500 annual homeowner insurance premium and \$1,500 annual auto insurance premiums: total of \$4,000 in premiums.*

# State Tax-Supported Debt\*

(Dollars in billions)

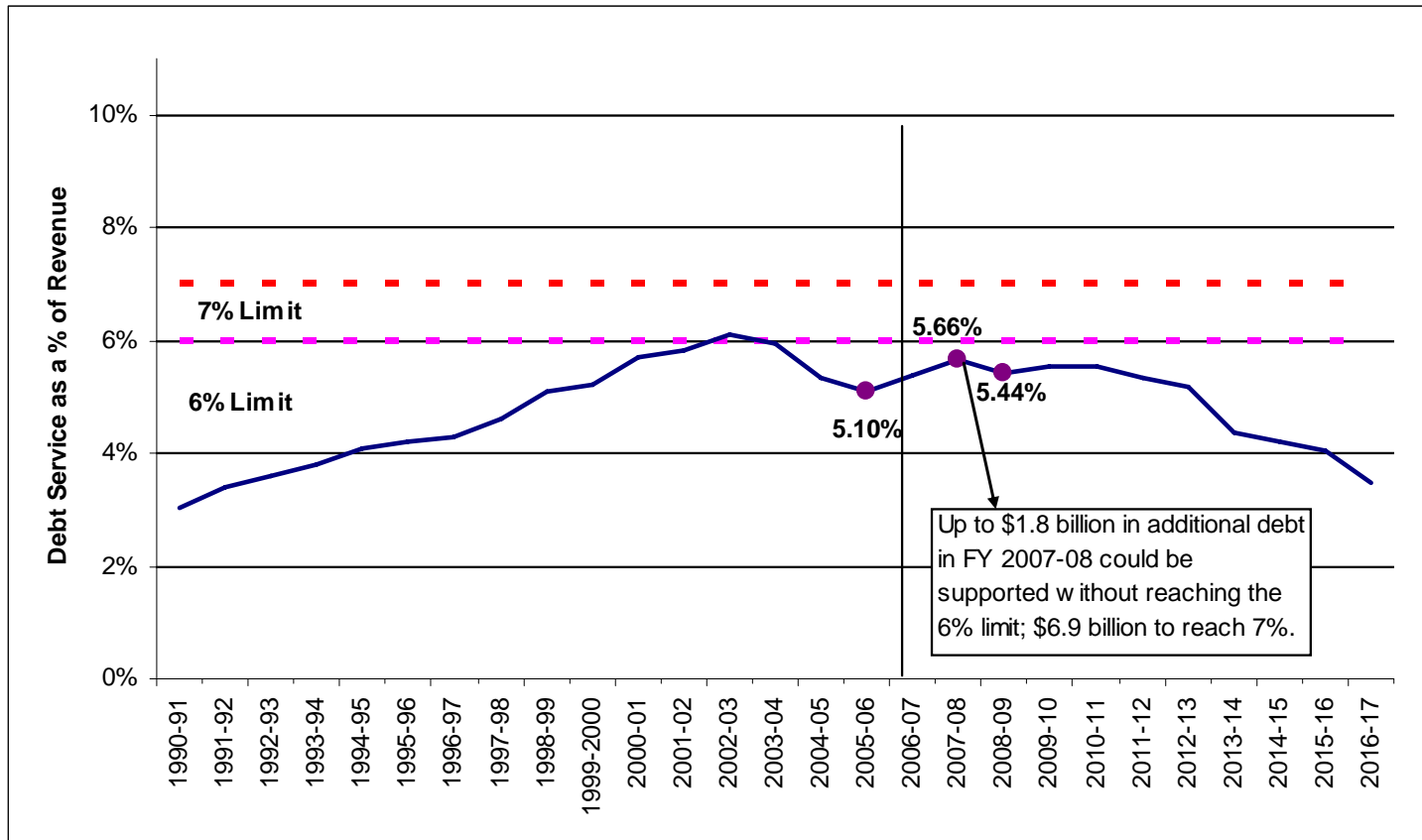
Education Facilities	\$12.042
Environmental Lands	2.723
Transportation (ROW, Ports, other)	2.004
State Buildings	0.328
Prisons	0.298
Affordable Housing	0.264
Other	0.206
<b>TOTAL</b>	<b>\$17.865</b>

(\*)—As of July 1, 2006

# Budgetary Consequences of Debt

- **\$1.681 billion annual debt service** is needed for the \$17.9 billion debt balance.
- This amounts to **5.1% of the revenues available to support the debt** (\$33 billion).
- Future debt issuance under **existing programs will increase this burden**.

# Debt Affordability: Current Law



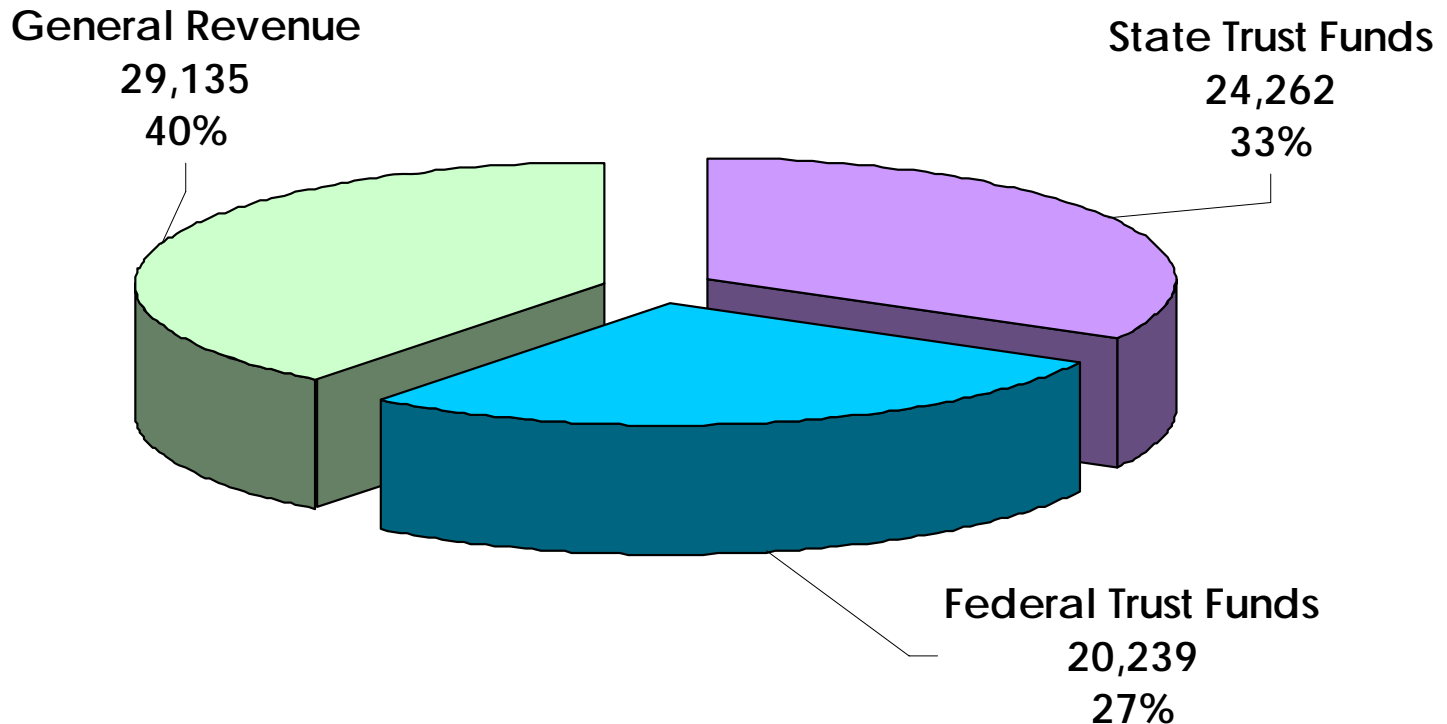
# CAT Fund Debt Could Swamp Current Debt

- ❑ Worst scenarios suggest additional maximum CAT fund debt of **\$13.5 billion to \$20 billion** could be incurred.
- ❑ These amounts represent **75% and 112%** of current state supported debt, respectively.

# FY 2006-07 State Budget General Revenue, Federal & State Trust Funds

**\$73,637**

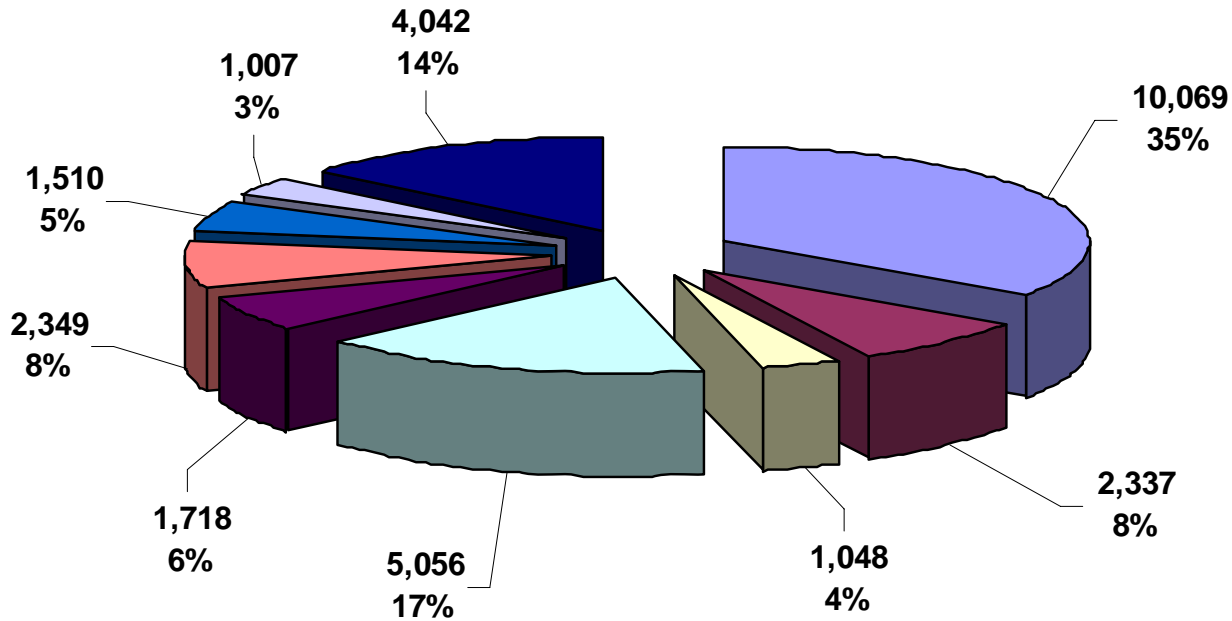
(Dollars in Millions)



# FY 2006-07 General Revenue

## \$29,135

(Dollars in Millions)

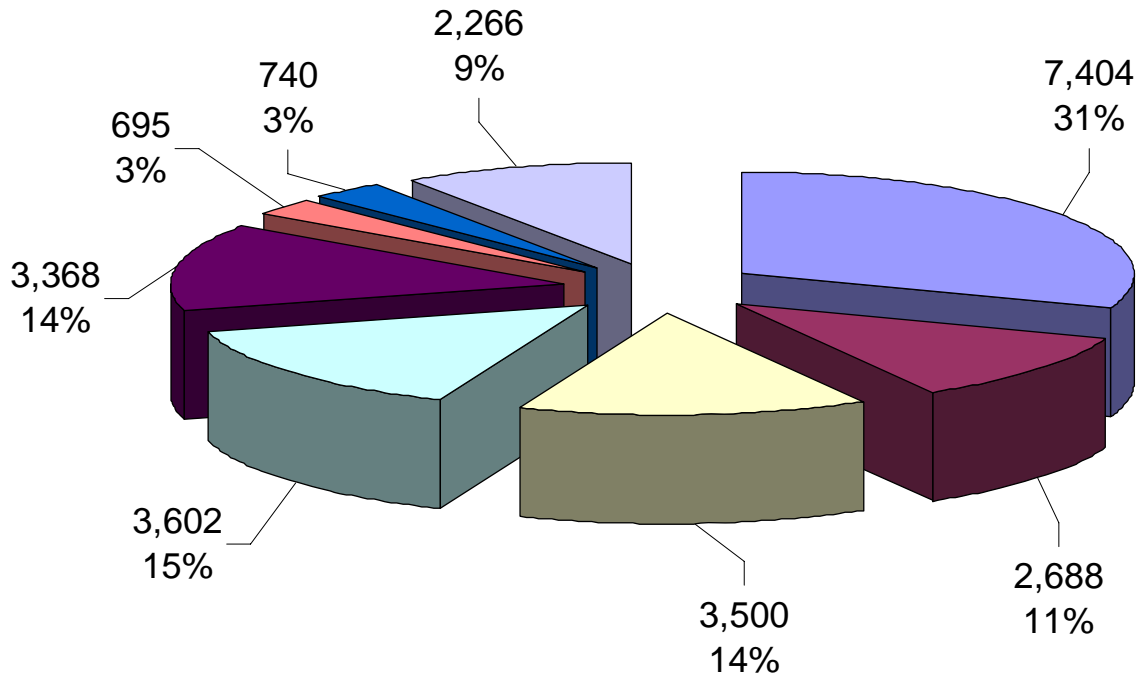


Public School	State Universities	Community Colleges
Medicaid	Adult Incarceration	Other Criminal Justice
Children & Families	Financial Services	Other

# State Trust Funds

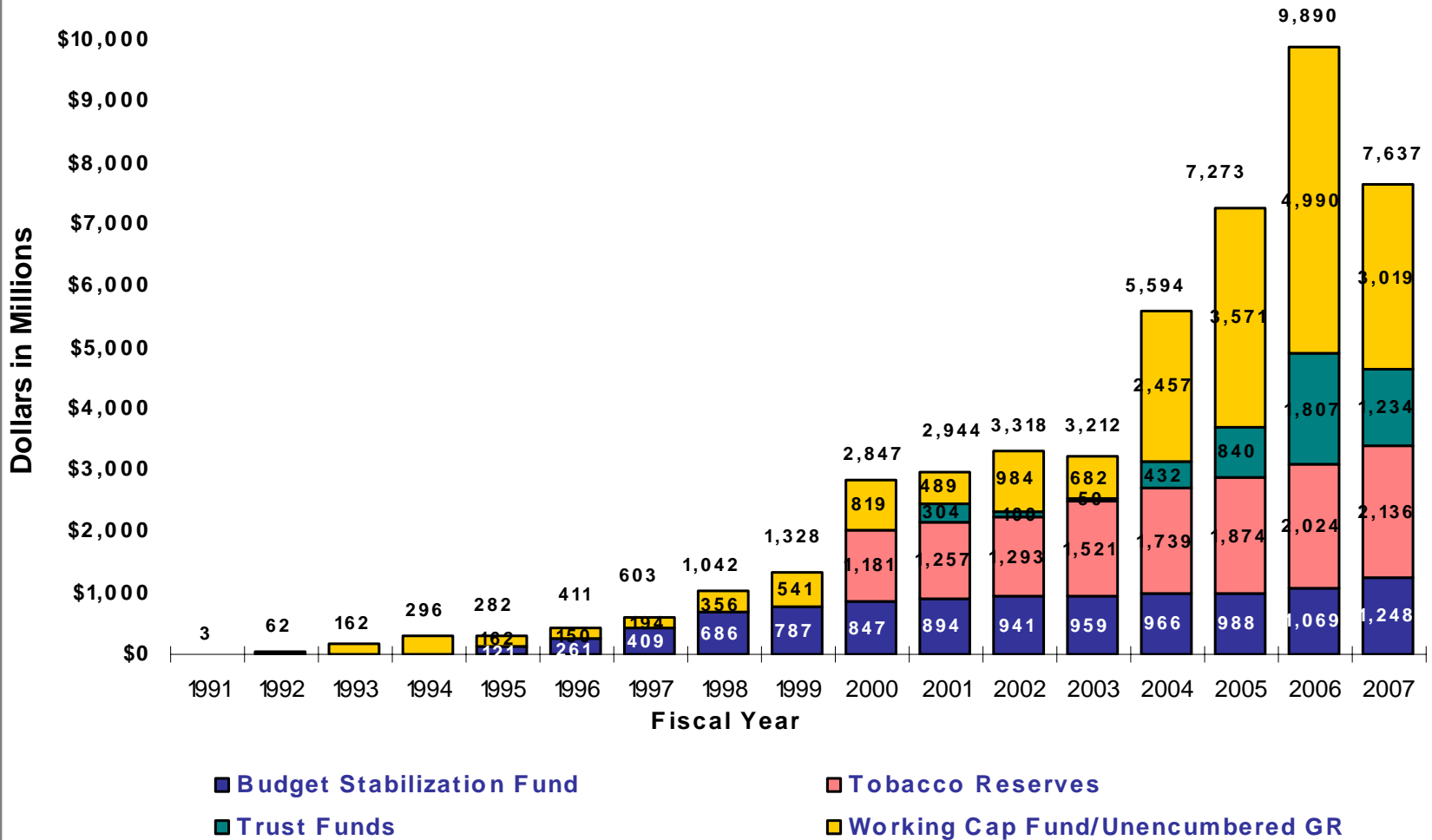
## \$24,262

(Dollars in Millions)

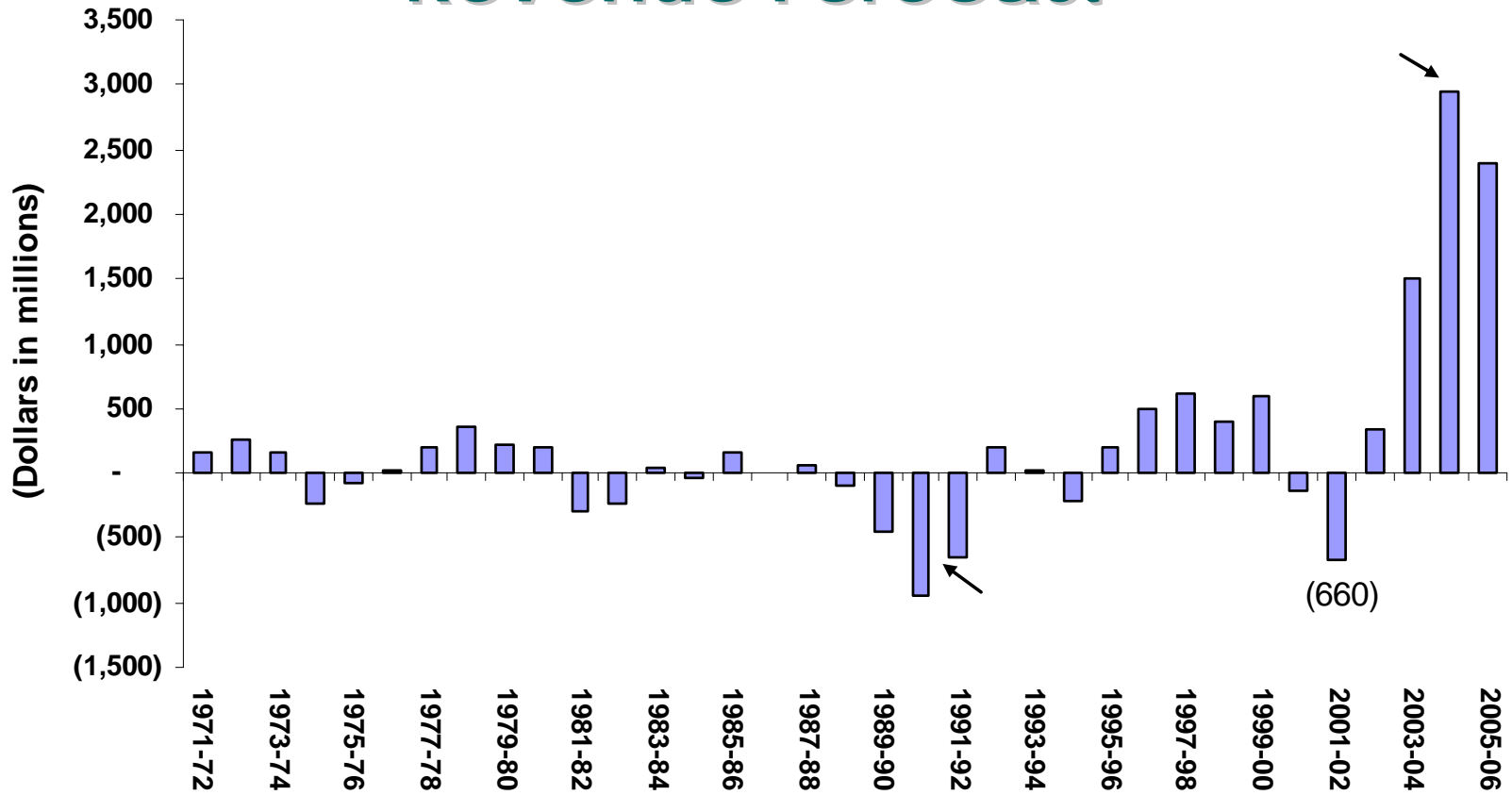


- |                             |                         |
|-----------------------------|-------------------------|
| Transportation              | PECO                    |
| Other Education             | Health & Human Services |
| Environment                 | Public Safety/Courts    |
| Housing/Other Community Aff | General Government      |

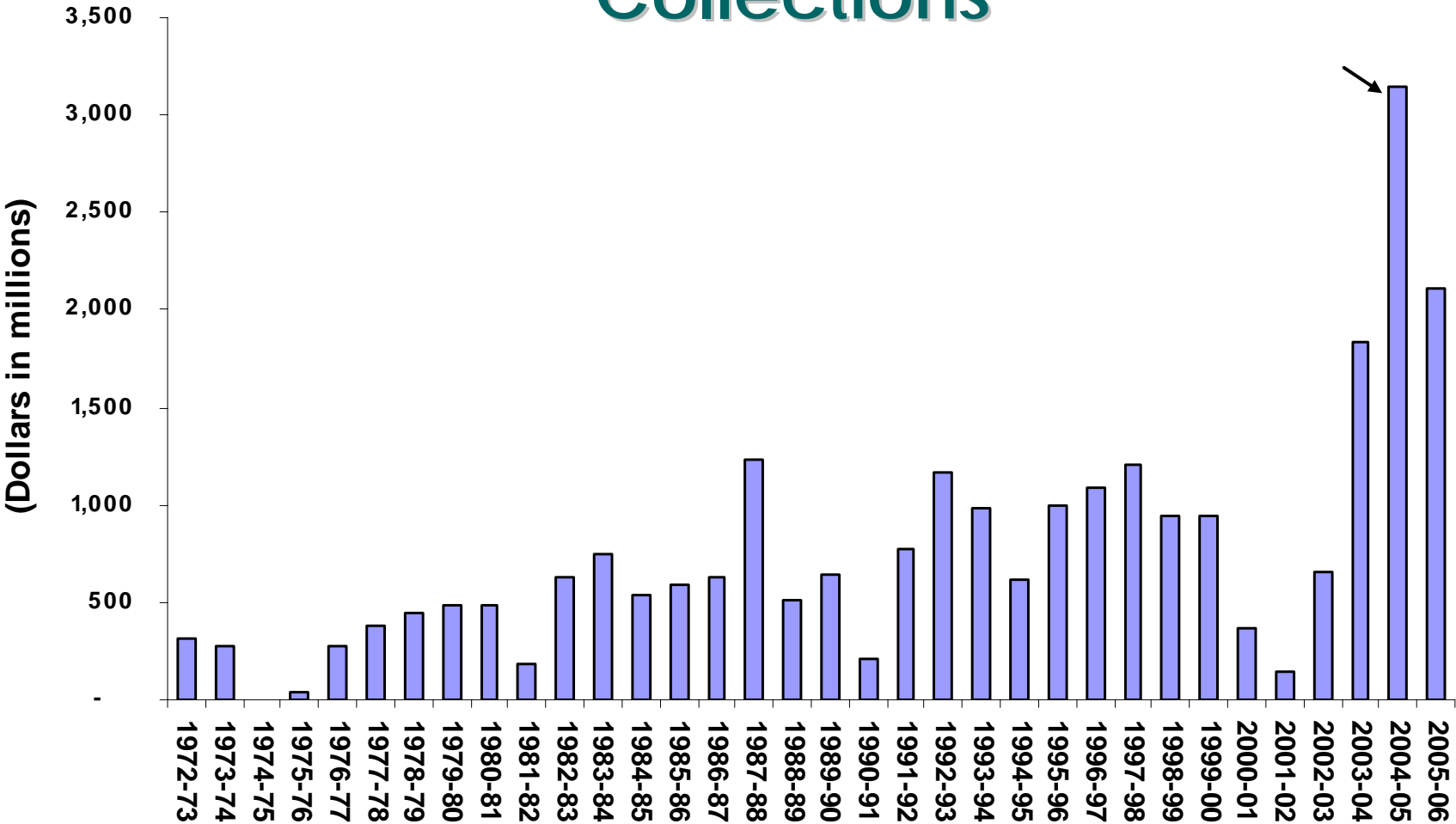
# Florida Reserves



# Error in General Revenue Forecast



# Growth in General Revenue Collections



# Recurring Budget Needs FY 2007-08

Recurring GR Available	28,127.6
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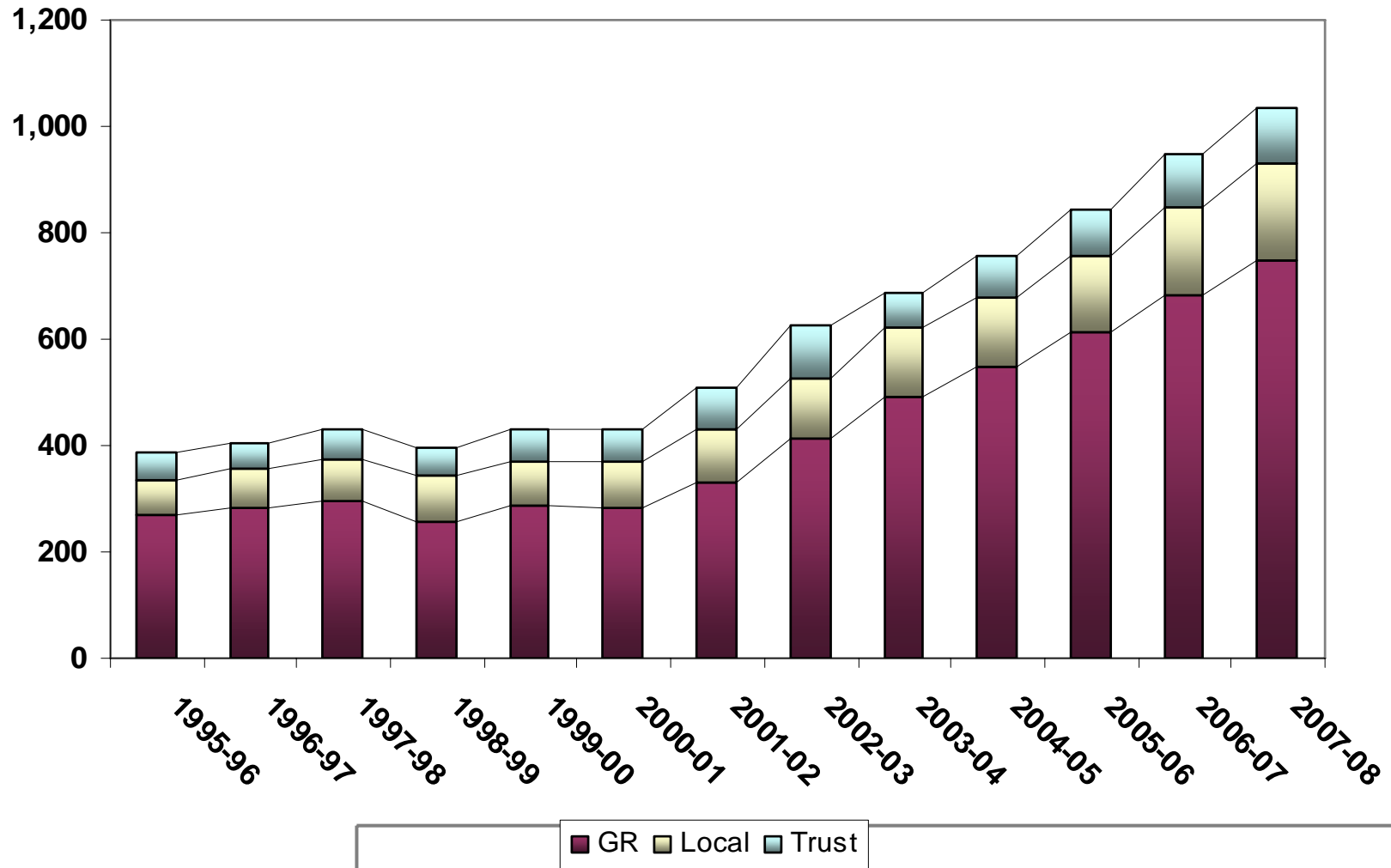
*Less:*

Recurring Base Budget	26,782.2
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Continuation Budget	2,101.4
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Ending Balance	(756)
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# Insurance Premium and Surplus Lines Taxes



**Thank you.**