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Florida's Cat Fund In a Pickle

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Overexposed

Florida Hurricane Catastrophe Fund bonds sales

ISSUE	AMOUNT	SALE DATE
Revenue bonds, Series 2010A	$676M	May '10
Revenue bonds, Series 2008A	$625M	July '08
Floating rate notes, Series 2007A	$3,500M	Sept. '07
Extendible floating rate notes, Series 2006B	$2,800M	July '06
Revenue bonds, Series 2006A	$1,350M	June '06

Source: Thomson Reuters

Shrinking Size, Building Cash

Firms estimate Cat Fund bond capacity over 12 months

	May '09	Oct. '09	May '10	Oct. '10	May '11	Oct. '11
Citi	$10-$12	$5-$12	$12-$16	$14.5-$16.5	$12-$15	$10-$11
Goldman Sachs	$0-$11	$7-$11	$15-$20	$10-$15	$4	$5
JPMorgan	$3.5-$6.5	$8-$20	$22-$26	$22-$26	$17-$23	$6-$8
Barclays	N/A	N/A	N/A	$10	$10	$8-$10
Overall Range	$0-$12	$5-$20	$12-$26	$10-$26	$4-$23	$5-$11

Dollars in billions

Source: Raymond James & Associates Inc.

BRADENTON, Fla.— The Florida Hurricane Catastrophe Fund is “dangerously overexposed” and should be downsized because unpredictable market conditions could prevent it from selling enough bonds to pay claims, according to the agency’s executive director, Jack Nicholson.

The nonprofit state-run FHCF could be $3.2 billion short of what is needed to pay claims over the next year, a new report says.

The shortage is based on estimates from the reinsurer’s four senior underwriters in a biennial report on potential bonding capacity released last week.

It’s not the first time underwriters have predicted there may not be enough capacity in the bond market to cover claims.

Nicholson told a state Senate Banking Committee last month that the so-called Cat Fund is “dangerously overexposed.”

“There is volatility in the market and tremendous uncertainty,” he told legislators. “I don’t know what the markets are going to be tomorrow.”

Nicholson is proposing legislation to decrease the fund’s reliance on tax-exempt bonding and increase its cash position so it is less susceptible to insolvency, he said in an interview last week. Most of the Cat Fund’s cash comes from insurance premiums.

It is expected to have $7.17 billion in cash at year end.

Sponsors are being sought for a draft bill that Nicholson has prepared.

Some lawmakers on the Banking Committee agreed that it may be time to revamp the reinsurer.

Florida law allows the Cat Fund to provide up to $17 billion of coverage to the property insurance market plus some optional coverage that could boost the amount to $18.38 billion.

That coverage is provided through a combination of cash and tax-exempt bonding, though the fund can only pay claims up to the amount it can raise in the capital markets.

Nicholson wants to trim back the $17 billion obligation over several years to $12 billion, and make the fund's obligations "more guaranteed than speculative," he said.

In addition to reducing the total obligation of the fund and building cash resources more quickly, Nicholson's proposal calls for increasing the amount insurers must pay out in claims before Cat Fund coverage kicks in, and reducing the amount of optional coverage insurers can select.

These steps are aimed at decreasing the agency's exposure.

With uncertainty over the U.S. budget, foreign debt and predictions of municipal debt problems, Nicholson said now is the time to address changes.

"We're trying to look at risk management — the investor base may or may not be there. Today it's not. Tomorrow it possibly may be," he said.

Bond capacity estimates by the agency's four underwriters underscore the reasons why the Cat Fund cannot rely on the bond market as it has in the past, according to Nicholson.

The underwriters — Citi, Goldman Sachs, JPMorgan and Barclays Capital — provided wide-ranging estimates of the tax-exempt bonds the Cat Fund could sell over the next year if necessary to pay reinsurance claims.

Goldman Sachs has estimated that $5 billion of bonding capacity could be available over the next year, while Citi believed $10 billion to $11 billion could be available.

Since the credit market meltdown in 2008, the reinsurer's estimated bonding capacity has ranged from a low of $3 billion to a high of $26 billion with "significant dispersion" between individual underwriters' estimates, according to a report by Raymond James & Associates Inc., the Hurricane Catastrophe Fund's financial advisor.

"Weak economic conditions depressing municipal budgets, investor skittishness in the wake of widespread predictions of municipal financial distress, and general debt fatigue among both issuers and investors" are some of the reasons the bond market has become unpredictable, Raymond James said.

"A smaller market with a more limited buyer base may present challenges that did not previously exist for the FHCF in issuing bonds," it added.

Shrinking the size of the Cat Fund and building cash resources will provide a more "consistent guarantee of our coverage," Nicholson said.

The Cat Fund was created to stabilize hurricane-prone Florida's property insurance market after Hurricane Andrew devastated South Florida in 1992, forcing many private insurers into insolvency and others to leave the state.

The loss of insurers made it difficult for homeowners to get property insurance, and jeopardized the ability of some people to obtain mortgages.

The Legislature created the Florida Hurricane Catastrophe Fund to provide low-cost reinsurance.

The agency bears no resemblance except in name to a company that provides catastrophe bonds.

The Cat Fund has a private-letter ruling from the Internal Revenue Service enabling it to sell tax-exempt bonds after a hurricane to pay property insurers covering residential policies.

Bond sold are secured by premiums, assessments, or both on all property and casualty insurance lines except workers' compensation, medical malpractice, and accident and health policies statewide, if needed.

The assessment base is valued at $33.6 billion.

According to Nicholas, the cost of Cat Fund reinsurance is about one-third of the amount similar coverage could cost in the private market

Given the FHCF's current cash resources, it could need to bond for as much as $11.219 billion after a hurricane, according to Raymond James.

"Bonding needs of this size are extremely large by market standards," the financial firm said in its report, noting that estimating the bonding capacity is an "inexact science."

As of Dec. 31, the Cat Fund had 172 participating insurers and a claims exposure of $2.16 trillion.

About $2.15 billion of tax-exempt bonds are outstanding.

The reinsuer's bonds are rated AA by Fitch Ratings, Aa3 by Moody's Investors Service and AA-minus by Standard & Poor's.

An additional $3.5 billion of taxable floating-rate notes were issued in 2007 to provide liquidity, or additional cash flow, to pay claims in the period immediately after a hurricane. Those notes mature on Oct. 1, 2012.