



FLORIDA HURRICANE CATASTROPHE FUND

Combined Financial Statements

June 30, 2017 and 2016

(With Independent Auditors' Report Thereon)

FLORIDA HURRICANE CATASTROPHE FUND

Table of Contents

| | Page |
|--|-------------|
| Independent Auditors' Report | 1 |
| Required Supplementary Information – Management's Discussion and Analysis | 3 |
| Combined Financial Statements: | |
| Combined Statements of Net Position | 7 |
| Combined Statements of Revenues, Expenses, and Changes in Net Position | 8 |
| Combined Statements of Cash Flows | 9 |
| Notes to Combined Financial Statements | 11 |
| Required Supplementary Information – Net Pension Liability | 51 |
| Required Supplementary Information – Schedule of Contributions | 52 |
| Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards | 53 |



KPMG LLP
4200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402

Independent Auditors' Report

The Trustees of the State Board of Administration of Florida
Florida Hurricane Catastrophe Fund:

We have audited the accompanying combined financial statements of the Florida Hurricane Catastrophe Fund of the State of Florida (the Fund), a proprietary fund of the State of Florida, as of and for the years ended June 30, 2017 and 2016, and the related notes to the combined financial statements, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Fund's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the respective financial position of the Fund, as of June 30, 2017 and 2016, and the changes in its financial position and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



Emphasis of Matter

Emphasis of Matter Regarding Fund Financial Statements

As discussed in note 1, the combined financial statements present only the Fund and do not purport to, and do not, present the financial position of the State of Florida as of June 30, 2017 and 2016, the changes in its financial position, or, where applicable, its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3-6, the schedule of Fund's proportionate share of net pension liability on page 51, and the schedule of Fund's contributions on page 52, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 2, 2017 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

KPMG LLP

Minneapolis, Minnesota
November 2, 2017

FLORIDA HURRICANE CATASTROPHE FUND

Management's Discussion and Analysis

June 30, 2017 and 2016

Our discussion and analysis of the financial performance of the Florida Hurricane Catastrophe Fund (the Fund) provides an overview of the Fund's financial activities for the fiscal years ended June 30, 2017 and 2016. Please read this information in conjunction with the Fund's combined financial statements and notes to the combined financial statements.

Overview of the Financial Statements

The statements presented are the combined statements of net position, the combined statements of revenues, expenses, and changes in net position, and the combined statements of cash flows. These statements represent the financial position of the Fund, which includes the State Board of Administration Finance Corporation (the Corporation). The Corporation was created to provide a mechanism for the cost-effective and efficient issuance of bonds necessary to enable the Fund to carry out its purposes. The Corporation is included as a blended component unit of the Fund because it provides services exclusively for the benefit of the Fund. Separate stand-alone audited financial statements of the blended component unit are not available. Combining statements can be found in the notes to the combined financial statements.

The combined statements of net position present the ending balances of all assets and liabilities of the Fund using the economic resources measurement focus and the accrual basis of accounting. The difference between assets and liabilities is reported as net position of the Fund.

The combined statements of revenues, expenses, and changes in net position present all revenues and expenses of the Fund occurring during the year resulting from operations and the effect of this activity on net position. Revenues are recognized when earned, and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows.

The combined statements of cash flows provide information about how the Fund finances and meets the cash flow needs of its activities.

The notes to the combined financial statements provide additional information related to the data provided in the combined financial statements.

FLORIDA HURRICANE CATASTROPHE FUND

Management's Discussion and Analysis

June 30, 2017 and 2016

Financial Summary

A summary of the combined statements of net position for the Fund and the Corporation is presented below (in thousands):

| | June 30 | | |
|---------------------------------------|----------------------|-------------------|-------------------|
| | 2017 | 2016 | 2015 |
| Current assets | \$ 13,102,878 | 11,095,110 | 6,237,547 |
| Long-term assets | <u>3,733,086</u> | <u>5,086,247</u> | <u>7,524,464</u> |
| Total assets | <u>16,835,964</u> | <u>16,181,357</u> | <u>13,762,011</u> |
| Deferred outflows related to pensions | <u>534</u> | <u>241</u> | <u>137</u> |
| Current liabilities | 154,568 | 614,040 | 31,340 |
| Long-term liabilities | <u>2,701,324</u> | <u>2,700,847</u> | <u>2,000,656</u> |
| Total liabilities | <u>2,855,892</u> | <u>3,314,887</u> | <u>2,031,996</u> |
| Deferred inflows related to pensions | <u>14</u> | <u>97</u> | <u>262</u> |
| Net position: | | | |
| Net investment in capital assets | 8 | 6 | 4 |
| Unrestricted | <u>13,980,584</u> | <u>12,866,608</u> | <u>11,729,886</u> |
| Total net position | <u>\$ 13,980,592</u> | <u>12,866,614</u> | <u>11,729,890</u> |

FLORIDA HURRICANE CATASTROPHE FUND

Management's Discussion and Analysis

June 30, 2017 and 2016

A summary of the combined statements of revenues, expenses, and changes in net position for the Fund and the Corporation is presented below (in thousands):

| | Year ended June 30 | | |
|--|--------------------|------------|------------|
| | 2017 | 2016 | 2015 |
| Net premium revenue (net of reinsurance premium) | \$ 1,068,212 | 1,140,796 | 1,270,271 |
| Net interest on premium adjustments | (35) | (43) | 27 |
| Other | 41 | 42 | 41 |
| Total operating revenues | 1,068,218 | 1,140,795 | 1,270,339 |
| Total nonoperating revenue net of nonoperating expenses | 62,441 | 11,213 | 211,920 |
| Total revenues | 1,130,659 | 1,152,008 | 1,482,259 |
| Hurricane losses | 1,000 | — | — |
| Operating expenses | 5,677 | 5,281 | 5,709 |
| Depreciation | 4 | 3 | 3 |
| Total expenses | 6,681 | 5,284 | 5,712 |
| Income before transfers | 1,123,978 | 1,146,724 | 1,476,547 |
| Transfers to other state agencies | (10,000) | (10,000) | (10,000) |
| Change in net position | 1,113,978 | 1,136,724 | 1,466,547 |
| Net position at beginning of year | 12,866,614 | 11,729,890 | 10,160,221 |
| Adjustments to net position related to pensions | — | — | (595) |
| Adjustments to net position related to change in premium recognition | — | — | 103,717 |
| Net position at beginning of year | 12,866,614 | 11,729,890 | 10,263,343 |
| Net position at end of year | \$ 13,980,592 | 12,866,614 | 11,729,890 |

Financial Highlights

- The increase in current assets and decrease in long-term assets between 2016 and 2017 is a result of an increase in short-term investments due to the expectation of rising interest rates. At the beginning of the fiscal year, the Federal rate was 0.25% and was projected to rise to 1.50% by the end of the fiscal year. The Fund also received \$1.1 billion in premium for the 2016 contract year that was invested by the SBA.
- For fiscal year 2017, the Fund changed its accounting for the recognition of premium revenue. Historically, the Fund recognized premium revenue at the time it was billed to the Fund's participating insurers. The Fund changed the accounting to recognize premium revenue over the term of the Fund's reimbursement contract (the contract) for the purposes of the financial statements only. The contract term is June 1 through May 31, and coincides with the period of coverage provided to each participating insurer by the Fund. This change in revenue recognition was applied retroactively to fiscal years 2015 and 2016. This change is immaterial to the

FLORIDA HURRICANE CATASTROPHE FUND

Management's Discussion and Analysis

June 30, 2017 and 2016

statements as a whole and does not significantly affect the overall presentation of the financial statement. (See Note 2(w))

- Hurricane losses increased to record the reserve for Hurricanes Hermine and Matthew that impacted Florida during the fiscal year. On September 2, 2016, Hurricane Hermine made landfall east of St. Marks, Florida as a Category 1 hurricane. On October 7, 2016, the eye of Hurricane Matthew tracked close to the coast of Florida making its way along the east coast of the United States as a Category 3 hurricane.
- Current liabilities decreased primarily because of no bond principal payments coming due until July 1, 2018.
- Total operating income decreased from 2016 to 2017 as a result of a decrease in reimbursement premium.
- Total nonoperating revenue increased from 2016 to 2017 due to an increase in investment income of \$64 million because of additional investments of \$1.2 billion of the 2016A Revenue Bonds and reimbursement premium of \$1.1 billion received for the 2016 contract year. The increase in 2017 is also a result of the Federal Reserve's decision to increase interest rates in December 2016 and March 2017. The Fund's objective is to invest in securities that are highly liquid, relatively short term, and have a credit quality in accordance with the policy.
- Total nonoperating revenue includes emergency assessment revenue, which decreased in 2016 and 2017, because of the termination of assessments on policies issued or renewed on or after January 1, 2015.
- Aggregate excess catastrophe reinsurance providing coverage for \$1.0 billion in excess of \$11.5 billion was purchased effective June 1, 2017 through May 31, 2018; and \$1.0 billion in excess of \$11.5 billion was purchased effective June 1, 2016 through May 31, 2017. Reinsurance deposit premiums and broker commissions were/are due in three equal installments on August 1, October 1 and December 1 of 2016 and 2017. An accrual of \$5.292 million as of June 30, 2016, and an accrual of \$5.083 million as of June 30, 2017, was established for one month's pro-rata portion of the aggregate reinsurance deposit premium and broker commission. The reinsurance premium and broker commission are reported as operating activities net of the reimbursement premium received on the Combined Statement of Cash Flows.
- During the fiscal year, the Fund issued an Invitation to Negotiate for Financial Advisor services. Raymond James & Associates, Inc. was selected and the contract was executed on June 28, 2017.
- At June 30, 2017, the Fund had the following credit ratings: Moody's, Aa3; Standard and Poor's, AA; and Fitch, AA.

FLORIDA HURRICANE CATASTROPHE FUND

Combined Statements of Net Position

June 30, 2017 and 2016

(In thousands)

| | <u>2017</u> | <u>2016</u> |
|---|----------------------|-------------------|
| Assets: | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 11 | 11 |
| Short-term investments | 12,902,205 | 10,818,319 |
| Investment sales receivable | 88,307 | 175,003 |
| Emergency assessment funds receivable | — | 331 |
| Premium receivable | 93,856 | 94,687 |
| Accrued interest | 18,495 | 6,759 |
| Prepaid expenses | 4 | — |
| Total current assets | <u>13,102,878</u> | <u>11,095,110</u> |
| Long-term assets: | | |
| Long-term investments | 3,733,078 | 5,086,241 |
| Capital assets, net of accumulated depreciation of \$38 and \$31 for June 30, 2017 and 2016, respectively | 8 | 6 |
| Total long-term assets | <u>3,733,086</u> | <u>5,086,247</u> |
| Total assets | <u>16,835,964</u> | <u>16,181,357</u> |
| Deferred outflows of resources: | | |
| Deferred outflows related to pensions (note 14) | 534 | 241 |
| Liabilities: | | |
| Current liabilities: | | |
| Unpaid hurricane losses | 1,000 | — |
| Premium refunds payable | 2 | — |
| Accrued expenses | 6,473 | 6,426 |
| Bonds payable | — | 500,000 |
| Payable for securities purchased | 112,329 | 74,997 |
| Accrued bond interest expense | 34,764 | 32,604 |
| Net pension liability (note 14) | — | 13 |
| Total current liabilities | <u>154,568</u> | <u>614,040</u> |
| Long-term liabilities: | | |
| Bonds payable | 2,700,000 | 2,700,000 |
| Net pension liability (note 14) | 1,107 | 661 |
| Compensated absences, net of current portion | 144 | 127 |
| Other post-employment benefits payable | 73 | 59 |
| Total long-term liabilities | <u>2,701,324</u> | <u>2,700,847</u> |
| Total liabilities | <u>2,855,892</u> | <u>3,314,887</u> |
| Deferred inflows of resources: | | |
| Deferred inflows related to pensions (note 14) | 14 | 97 |
| Net position: | | |
| Net investment in capital assets | 8 | 6 |
| Unrestricted | <u>13,980,584</u> | <u>12,866,608</u> |
| Total net position | <u>\$ 13,980,592</u> | <u>12,866,614</u> |

See accompanying notes to combined financial statements.

FLORIDA HURRICANE CATASTROPHE FUND

Combined Statements of Revenues, Expenses, and Changes in Net Position

Years ended June 30, 2017 and 2016

(In thousands)

| | 2017 | 2016 |
|--|---------------|------------|
| Operating revenues: | | |
| Premium revenue (net of reinsurance premium) | \$ 1,068,212 | 1,140,796 |
| Net interest on premium adjustments | (35) | (43) |
| Other | 41 | 42 |
| Total operating revenues | 1,068,218 | 1,140,795 |
| Operating expenses: | | |
| Hurricane losses | 1,000 | — |
| Administrative and actuarial fees | 2,795 | 2,449 |
| Other professional fees | 1,022 | 1,245 |
| Personnel expenses | 1,574 | 1,391 |
| Depreciation | 4 | 3 |
| Other | 286 | 196 |
| Total operating expenses | 6,681 | 5,284 |
| Operating income | 1,061,537 | 1,135,511 |
| Nonoperating revenue (expense): | | |
| Investment income | 135,538 | 71,159 |
| Investment advisor fees | (3,652) | (3,332) |
| Investment custodian fees | (217) | (201) |
| Emergency assessment revenue | 300 | 3,063 |
| Bond interest expense | (69,529) | (56,091) |
| Bond issuance expense | — | (3,385) |
| Other non-operating income | 1 | — |
| Total nonoperating revenue, net | 62,441 | 11,213 |
| Net income before transfers | 1,123,978 | 1,146,724 |
| Transfers to other state agencies | (10,000) | (10,000) |
| Change in net position | 1,113,978 | 1,136,724 |
| Net position at the beginning of the year | 12,866,614 | 11,729,890 |
| Net position at end of year | \$ 13,980,592 | 12,866,614 |

See accompanying notes to combined financial statements.

FLORIDA HURRICANE CATASTROPHE FUND

Combined Statements of Cash Flows

Years ended June 30, 2017 and 2016

(In thousands)

| | <u>2017</u> | <u>2016</u> |
|--|------------------|--------------------|
| Operating activities: | | |
| Net premium received | \$ 1,068,801 | 1,142,958 |
| Hurricane losses paid | — | — |
| Other cash received from customers | 41 | 42 |
| Administrative and actuarial fees | (2,591) | (2,493) |
| Other professional fees | (1,098) | (1,340) |
| Personnel expenses | (1,469) | (1,481) |
| Other cash paid to vendors | <u>(259)</u> | <u>(210)</u> |
| Net cash provided by operating activities | <u>1,063,425</u> | <u>1,137,476</u> |
| Investing activities: | | |
| Purchases of investments | (117,884,160) | (111,018,102) |
| Sales and maturities of investments | 117,324,740 | 108,687,828 |
| Interest received | 76,526 | 51,788 |
| Investment advisor fees | (3,630) | (3,299) |
| Investment custodian fees | (180) | (209) |
| Other non-operating income | <u>1</u> | <u>—</u> |
| Net cash (used) by investing activities | <u>(486,703)</u> | <u>(2,281,994)</u> |
| Financing from noncapital activities: | | |
| Transfers to other state agencies | (10,000) | (10,000) |
| Emergency assessment funds received | 648 | 4,884 |
| Cash received at bond issuance | — | 1,200,000 |
| Bond principal paid | (500,000) | — |
| Bond interest paid | (67,368) | (46,975) |
| Bond cost of issuance | <u>—</u> | <u>(3,385)</u> |
| Net cash (used) provided by financing from noncapital activities | <u>(576,720)</u> | <u>1,144,524</u> |
| Financing from capital activity: | | |
| Purchases of capital assets | <u>(2)</u> | <u>(4)</u> |
| Net increase (decrease) in cash and cash equivalents | — | 2 |
| Cash and cash equivalents at beginning of year | <u>11</u> | <u>9</u> |
| Cash and cash equivalents at end of year | <u>\$ 11</u> | <u>11</u> |

FLORIDA HURRICANE CATASTROPHE FUND

Combined Statements of Cash Flows

Years ended June 30, 2017 and 2016

(In thousands)

| | <u>2017</u> | <u>2016</u> |
|---|---------------------|------------------|
| Operating income | \$ 1,061,537 | 1,135,511 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation | 4 | 3 |
| (Increase) decrease in premium receivable | 831 | 13,101 |
| Increase (decrease) in allowance for uncollectables | — | (10,538) |
| (Increase) decrease in deposits and prepaid expenses | (4) | 11 |
| Increase (decrease) in premium refunds payable | 2 | — |
| Increase (decrease) in compensated absences | 31 | (69) |
| Increase (decrease) in unpaid hurricane losses | 1,000 | — |
| Increase (decrease) in losses payable | — | — |
| Increase (decrease) in accrued expenses | (47) | (522) |
| Increase (decrease) in other post-employment benefits payable | 14 | 4 |
| Increase (decrease) in pension liability and deferrals | 57 | (25) |
| Net cash provided by operating activities | <u>\$ 1,063,425</u> | <u>1,137,476</u> |

See accompanying notes to combined financial statements.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

(1) Organization

(a) *Business*

The Florida Hurricane Catastrophe Fund (the Fund), a trust fund created in November 1993 during a special Florida State legislative session following Hurricane Andrew, provides catastrophic reinsurance coverage to most authorized primary insurers of habitational structures with wind/hurricane coverage in the State of Florida. All authorized insurers in Florida, which write policies covered by the Fund, are required to pay an annual premium to the Fund. The annual contract period for coverage is June 1 through May 31. Insurers are required by law to enter into a reimbursement contract and neither the insurer nor the Fund has the ability to modify or cancel the contract during the contract year. In order to calculate the premium due, each insurer must submit its total covered property exposure by September 1 for insured values under covered policies as of June 30.

Premiums are calculated for each of the insurers using rates developed based on hurricane modeling of the trended data from the prior year. The modeling takes into consideration factors such as historical records of hurricane strength and landfall patterns, geographic location, type of business, construction, coverage selected, deductible, and mitigation features. The Fund is administered by the State Board of Administration of Florida (SBA), which has contracted for administrative and actuarial services.

The Fund also includes the accounts of its blended component unit, the State Board of Administration Finance Corporation (the Corporation). The Corporation, a public benefits corporation and an instrumentality of the State of Florida, was created to provide a mechanism for the cost-effective and efficient issuance of bonds necessary to enable the Fund to carry out its purposes. The Corporation is included as a blended component unit because it provides services exclusively for the benefit of the Fund. Separate stand-alone audited financial statements of the component unit are not available.

(b) *Basis of Presentation*

The Fund is classified as an enterprise fund, which is a type of proprietary fund. The financial statements of proprietary funds are prepared using the economic resources measurement focus and the accrual basis of accounting. All assets and liabilities associated with the operations of the Fund are included in the combined statements of net position. The combined statements of revenues, expenses, and changes in net position present increases (revenues) and decreases (expenses) in net total assets. The combined statements of cash flows provide information about how the Fund finances and meets the cash flow needs of its activities.

The combined financial statements presented herein relate solely to the financial position and changes in financial position of the Fund, and are not intended to present the financial position of the SBA or the results of its operations and cash flows. The Fund follows Governmental Accounting Standards Board (GASB) pronouncements.

(c) *Adoption of New Accounting Pronouncement*

In June 2015, GASB issued Statement No. 76, The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments. This statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and non-authoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. Adoption of this statement in fiscal year 2016, had no impact on the Fund's financial statements.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

In January 2016, GASB issued Statement No. 80, Blending Requirements for Certain Component Units. The statement was implemented in fiscal year 2017 and establishes an additional blending requirement for the financial statement presentation of component units. Adoption of this statement had no impact on the Fund's financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues – an amendment of GASB statements No. 67, No.68, and No. 73*. All except paragraph 7 was effective in fiscal year 2017. This resulted in a change of presentation of the payroll-related measures in Required Supplementary Information.

(d) Limited Liability of the Fund

The Fund's obligation to participating insurers, in the event of a hurricane(s) that causes reimbursable losses, is limited to the claims-paying capacity of the Fund. For the purpose of defining claims-paying capacity, the SBA shall use the unrestricted net position as of December 31 of the applicable contract year, to which is added reported fund losses (including loss adjustment expense) for the then-current contract year, whether paid or unpaid by the Fund, as of December 31; any reinsurance purchased by the Fund; and the amount the SBA is able to raise through the issuance of revenue bonds up to the statutory annual aggregate fund limit; and from which is subtracted any reinsurance recovered prior to, or recoverable as of, December 31; any obligations paid or expected to be paid with bonding proceeds or receipts from emergency assessments; amounts needed for administration for the then current State of Florida fiscal year, which have not been spent and, which are not reflected on the combined statements of net position; and the amount of undisbursed mitigation funds appropriated for the then-current State of Florida fiscal year.

The Fund has no risk that it will be unable to meet its contractual obligations to participating insurers because its obligation is limited to its ability to pay. Although revenue bonds were issued on behalf of the Fund under authorization of Section 215.555(6) of the Florida Statutes, the State of Florida assumes no liability for the repayment of the bonds. Additionally, the State of Florida has no legal responsibility to make any contribution to the Fund should its obligations exceed available resources.

(e) Risk Management

The Fund is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees and others; and natural disasters. Cash and investments held in the Fund's unrestricted funds are available to pay for hurricane losses for the current year and subsequent years. However, the use of reimbursement premiums and the investment earnings thereon to pay for prior year hurricane losses may jeopardize the tax-exempt status of the bonds currently issued and future bonds to be issued under the private letter rulings issued to the Corporation by the Internal Revenue Service (IRS).

(2) Significant Accounting Policies

(a) Measurement Focus

As mentioned in note 1, the Fund uses the economic resources measurement focus and the accrual basis of accounting.

(b) Cash and Cash Equivalents

The Fund generally considers all cash on hand and on deposit in banks, including demand deposits, time deposits, and non-negotiable certificates of deposit to be cash equivalents. Cash equivalents are recorded at cost, which approximates fair value.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

(c) Investments

The Fund's cash is invested according to an Investment Policy Statement, which sets forth the objectives, guidelines, and requirements applicable to the investments of the Fund. The primary goal of the policy is defined by the following priorities: (1) liquidity, (2) safety of principal, and (3) competitive return. Investments are recorded at fair value and the fair values are primarily obtained from independent quoted market prices; certain investments, such as repurchase agreements and money market funds, are carried at cost, which approximates fair value. The Fund considers all investments with maturity dates of less than one year to be short-term investments. Investments with maturity dates in excess of one year are included in long-term investments. Investment advisory services are provided by the SBA. The Investment Policy Statement was amended effective May 31, 2016.

(d) Emergency Assessment Receivable

Emergency assessments are remitted as a percentage of quarterly direct written premium and are due 45 days following the end of each quarter. Insureds procuring coverage and filing under Section 626.938 of the Florida Statutes report such coverage 30 days after the insurance is procured and remits emergency assessments within 45 days following the quarter after the insurance is procured. The collection of emergency assessments has ended for all new or renewal policies issued on or after January 1, 2015 and refunds or returns of erroneously paid emergency assessments formerly paid out of the Corporation's account are now being paid out of the Fund's corpus account.

The bank account associated with the admitted carriers emergency assessments has been closed as of May 2017. Only emergency assessment funds from the Florida Surplus Lines Office are received as of June 30, 2017.

(e) Premium Receivable

Premiums receivable represent the amount estimated premium revenue for one month of the contract year, which began on June 1 through May 31. As of June 30, 2017, the one month premium receivable is \$93.9 million. As of June 30, 2016, the one month premium receivable is \$94.7 million. Premium receivable also represents amounts from previous billings that have not yet been collected and are net of any allowances management has established to anticipate uncollectible billings. During the year ended June 30, 2017, the Fund changed its accounting for the recognition of premium revenue, impacting premium receivable. See Note 2(w) below.

(f) Loss Reimbursement Advances Receivable

Certain companies may qualify for advances from the Fund, which are in essence loans based on a company's potential recoveries from the Fund (i.e., based on paid and reported outstanding losses). Loss reimbursement advances receivable represent amounts currently outstanding on these advances, including accrued interest. As of June 30, 2017 and 2016, there are no outstanding loss reimbursement advances.

(g) Capital Assets

Capital assets, primarily electronic data processing equipment, are stated at cost, less accumulated depreciation. Depreciation is recorded on a straight-line basis over the estimated useful lives, ranging from three to seven years.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

(h) *Deferred Outflows of Resources*

A consumption of net assets by the Fund that is applicable to a future reporting period is presented as a deferred outflow of resources.

(i) *Premium Refunds Payable*

Premium refunds payable represent amounts due to participating insurers where provisional or estimated premium payments are in excess of amounts actually owed based upon the current exposure data. Also included, are premium amounts received from companies pending exemption. These amounts are returned once an exemption is granted. There were no issued and outstanding premium refund checks as of June 30, 2017.

(j) *Bonds Payable*

Under authorization of Section 215.555(6) of the Florida Statutes, the Fund has issued post-event revenue bonds and pre-event revenue bonds in order to meet current and future obligations. The Fund classifies amounts expected to be paid within the next year as current liabilities, with remaining amounts classified as long-term liabilities. Bond issuance costs are recognized as an expense in the period incurred.

(k) *Compensated Absences*

Compensated absences represent the Fund's obligation to accrue a liability for employees' rights to receive compensation for future absences, such as vacation and sick leave. The Fund allows vested employees to carry forward any unpaid sick leave indefinitely. The short-term portion of this liability, \$62 thousand in 2017 and \$47 thousand in 2016, is included in accrued expenses on the combined statements of net position. The remaining liability is included as compensated absences within long-term liabilities on the combined statements of net position.

(l) *Deferred Inflows of Resources*

A deferred inflow of resources is an acquisition of net assets by the Fund that is applicable to a future reporting period.

(m) *Current Contract Year Premium Revenue*

Premium revenue is recognized over the annual contract period for coverage from June 1 through May 31 in proportion to the amount of risk protection provided. The Fund provides coverage to the participating insurers on a contract-year basis, effective in full as of the first day of the contract year, which runs from June 1 to May 31. Premiums are billed in three installments, with provisional payments due August 1 and October 1, and a final payment due December 1. Due to the timing of the exposure reporting and final premium calculation, the first two installments are provisional billings, each based on one third of the company's prior contract year premium. The third and final installment in December is the actual actuarially indicated premium based on exposure reported September 1 for insured values under covered policies as of June 30 of the current contract year less payments received under the first two provisional installments. During the year ended June 30, 2017, the Fund changed its accounting for the recognition of premium revenue. See Note 2(w) below.

(n) *Operating Revenues and Expenses*

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary fund. For the Fund, these revenues are primarily the premiums charged to all participating

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

insurers. Operating expenses include incurred losses and necessary costs incurred to administer the Fund and to provide loss reimbursements to its participants.

(o) Reinsurance

The reinsurance premium and commission expenses are reported as operating activities net of the reimbursement premium received. As of June 30, 2017 and 2016, an accrual was established for one month's pro-rata portion of the aggregate reinsurance deposit premium and commission expense.

(p) Prior Contract Year Adjustments

Participating insurers remit premium to the Fund based upon current policyholder exposure information. When insurers provide updated or corrected exposure information, the Fund may bill and receive additional premium relating to a prior contract year which is recorded as premium revenue in the year billed; the Fund may also be required to refund amounts to insurers relating to a prior contract year which is recorded as a reduction to premium revenue in the year refunded.

(q) Net Interest on Premium Adjustments

Participating insurers have the option of paying the billed provisional premium or estimating premium for the August and October installments. If the provisional or estimated payments are too high, interest is returned to the insurer on the overpayment after the December installment. Likewise, if estimated premiums are underpaid, interest is charged to the insurer with the December installment. For the contract year ended May 31, 2017, the interest rate was 0.63% for overpayments of premium and 5.63% for underpayments. For the contract year ended May 31, 2016, the interest rate was 0.30% for overpayments of premium and 5.30% for underpayments.

(r) Hurricane Losses

Hurricane losses represent the estimated ultimate cost of all reported and incurred but not reported claims (IBNR) during the year that exceed the participating insurers' individual company retention levels. The reserves for unpaid claims are estimated primarily by management's review of reported loss information obtained from the participating insurers. Although considerable variability is inherent in such estimates, management believes that the reserves for hurricane losses are adequate. The estimates are continually reviewed and adjusted as experience develops or new information becomes known, and such adjustments are included in current operations.

(s) Emergency Assessment

Section 215.555(6)(b) of the Florida Statutes provides for an emergency assessment on all property and casualty lines of business in the state, including surplus lines, but excluding workers' compensation, federal flood, accident and health insurance, and medical malpractice premiums. A maximum annual assessment of 6% is allowed for losses attributable to any one contract year and a maximum aggregate annual assessment of 10% for all contract years. For policies issued or renewed on or after January 1, 2007, a 1% emergency assessment has been levied; except for policies issued or renewed on or after January 1, 2011, where a 1.3% emergency assessment has been levied. For policies issued or renewed on or after January 1, 2015, the emergency assessment is 0.0%.

(t) Transfers

Pursuant to Section 215.555(7)(c) of the Florida Statutes, the Florida Legislature will appropriate from the Fund an amount no less than \$10,000,000 and no more than 35% of the investment income from the

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

prior fiscal year, providing that the actuarial soundness of the Fund is not jeopardized, for the purpose of providing funding for governments, agencies, and educational institutions to support programs intended to improve hurricane preparedness or reduce potential losses in the event of a hurricane. For these purposes, in each of the fiscal years 2017 and 2016, \$10,000,000 was appropriated from the Fund.

(u) Income Taxes

The Fund and the Corporation are exempt from federal and state income taxes. The Fund's tax-exempt status was affirmed by a private letter ruling obtained from the IRS in November 1994. The Corporation received its initial private letter ruling to issue tax-exempt debt in March 1998, and a permanent ruling was received in June 2008.

(v) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of net position available and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of changes in net position during the reporting period. Actual amounts could differ from those estimates.

(w) Immaterial Correction of an Error (in thousands)

During the year ended June 30, 2017, the Fund changed its accounting for the recognition of premium revenue. The change made solely relates to the timing of revenue recognition in the financial statements and does not impact the period or terms of coverage provided by the Fund. Previously, the Fund recognized premium revenue at the time it was billed to the Fund's participating insurers. The Fund corrected the method to recognize premium revenue over the term of the Fund's reimbursement contract (the contract). The contract term is June 1 through May 31, and coincides with the period of coverage provided to each participating insurer by the Fund. This immaterial correction of the 2016 financial statements included within this report resulted in an increase in premium receivable of \$94,687 as of June 30, 2016, an increase in unrestricted net position as of July 1, 2015 (beginning of year) of \$97,250, and a decrease in net premium revenue of \$2,563 for the year ended June 30, 2016.

(3) Investments

Funds are invested in accordance with Section 215.47 of the Florida Statutes, and the Fund's Investment Policy Statement, which includes, but is not limited to, corporate debt securities such as variable rate notes, certificates of deposit, bonds, commercial paper, U.S. government agency notes, U.S. government Treasury bills, state and local government series (SLGS), shares of money market funds, and repurchase agreements that enhance the Fund's investment income while maintaining liquidity and safety of principal.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

The fair value of the Fund's investments is as follows (in thousands):

| | June 30 | |
|--|----------------------|-------------------|
| | 2017 | 2016 |
| Short-term investments: | | |
| Certificates of deposit | \$ 1,715,213 | 2,530,398 |
| Commercial paper | 6,576,183 | 3,417,392 |
| Money market funds | 56,068 | 568,770 |
| Repurchase agreements | 1,050,000 | 925,000 |
| U.S. Treasury bills | 1,306,824 | 1,718,960 |
| U.S. Treasury notes | 1,020,279 | 50,008 |
| Federal agencies – discount notes | 166,761 | 256,769 |
| Federal agencies – unsecured | 485,718 | 427,461 |
| Domestic corporate bonds and notes | 309,862 | 443,639 |
| International government agency discount notes | 20,005 | 24,975 |
| International government bonds and notes | 149,765 | 324,889 |
| International corporate bonds and notes | 45,527 | 130,058 |
| Total short-term investments | <u>12,902,205</u> | <u>10,818,319</u> |
| Long-term investments: | | |
| Certificates of deposit | 50,000 | — |
| U.S. Treasury notes | 341,112 | 400,264 |
| Federal agencies – unsecured | 3,150,866 | 4,685,977 |
| Domestic corporate bonds and notes | 176,970 | — |
| International corporate bonds and notes | 14,130 | — |
| Total long-term investments | <u>3,733,078</u> | <u>5,086,241</u> |
| Total | <u>\$ 16,635,283</u> | <u>15,904,560</u> |

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

As of June 30, 2017, the weighted average maturity of the Fund's investments is as follows (in thousands):

| <u>Investment type</u> | <u>Fair value</u> | <u>Weighted average maturity (days)</u> |
|--|----------------------|---|
| Certificates of deposit | \$ 1,765,213 | 57 |
| Commercial paper | 6,576,183 | 43 |
| Money market funds | 56,068 | 3 |
| Repurchase agreements | 1,050,000 | 6 |
| U.S. Treasury bills | 1,306,824 | 210 |
| U.S. Treasury notes | 1,361,391 | 322 |
| Federal agencies – discount notes | 166,761 | 142 |
| Federal agencies – unsecured | 3,636,584 | 109 |
| Domestic corporate bonds and notes | 486,832 | 208 |
| International government agency discount notes | 20,005 | 284 |
| International government bonds and notes | 149,765 | 54 |
| International corporate bonds and notes | 59,657 | 340 |
| Total fair value | \$ <u>16,635,283</u> | |
| Portfolio weighted average maturity | | 100 |

As of June 30, 2016, the weighted average maturity of the Fund's investments is as follows (in thousands):

| <u>Investment type</u> | <u>Fair value</u> | <u>Weighted average maturity (days)</u> |
|--|----------------------|---|
| Certificates of deposit | \$ 2,530,398 | 31 |
| Commercial paper | 3,417,392 | 51 |
| Money market funds | 568,770 | 1 |
| Repurchase agreements | 925,000 | 15 |
| U.S. Treasury bills | 1,718,960 | 119 |
| U.S. Treasury notes | 450,272 | 663 |
| Federal agencies – discount notes | 256,769 | 123 |
| Federal agencies – unsecured | 5,113,438 | 158 |
| Domestic corporate bonds and notes | 443,639 | 19 |
| International government agency discount notes | 24,975 | 34 |
| International government bonds and notes | 324,889 | 50 |
| International corporate bonds and notes | 130,058 | 33 |
| Total fair value | \$ <u>15,904,560</u> | |
| Portfolio weighted average maturity | | 103 |

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

(a) Interest Rate Risk

Liquidity being a primary concern, the Fund's objective as defined in the Investment Policy Statement is to invest in high quality, highly liquid, relatively short-term investment strategies, which are reviewed on an annual basis to ensure the appropriateness of the strategic goal. The Fund utilizes the weighted average maturity method to limit exposure to interest rate risk. In accordance with the Investment Policy Statement, no individual security shall have a final maturity date longer than 545 days, with the exception of those for government securities and agency securities, which shall not exceed 1,188 days. No more than 30% of total portfolio amortized cost may be invested in fixed rate securities with remaining time to maturity exceeding 545 days. The dollar weighted average maturity to reset (DWAM) of the portfolio shall not exceed 270 days. For purposes of the DWAM calculation, the maturity date is assumed to be the next reset date rather than the stated maturity. The weighted average life (to final maturity) of the portfolio shall not exceed 540 days.

(b) Credit Risk

Funds are invested in accordance with Section 215.47 of the Florida Statutes and the Fund's Investment Policy Statement, which includes, but is not limited to, corporate debt securities such as variable rate notes, certificates of deposit, bonds, commercial paper, U.S. government agency notes, U.S. government Treasury bills, state and local government series (SLGS), shares of money market mutual funds, and repurchase agreements that enhance the Fund's investment income while maintaining liquidity and safety of principal.

The Investment Policy Statement states that all securities must be investment grade at time of purchase. For short-term ratings, this has been defined as being in the highest applicable rating categories by at least two of Moody's, S&P, and/or Fitch and must be a minimum of P-1 by Moody's, A-1 by S&P, and/or F1 by Fitch. For long-term ratings, this has been defined as being obtained from at least two of Moody's, S&P, and/or Fitch and must be a minimum of A2 by Moody's, A by S&P, and/or A by Fitch.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

The schedule below provides the credit quality ratings by Standard and Poor's and Moody's Investor Services at June 30, 2017 (in thousands):

| <u>Investment type</u> | <u>Fair value</u> | <u>Credit quality ratings</u> | |
|--|----------------------|-------------------------------|----------------|
| | | <u>S & P</u> | <u>Moody's</u> |
| Certificates of deposit | \$ 50,005 | AA | A |
| Certificates of deposit* | 1,715,208 | Not Rated | Not Rated |
| Commercial paper | 6,576,183 | A-1 | P-1 |
| Money market funds | 56,068 | AAAm | Aaa-mf |
| Repurchase agreements (collateralized by U.S. guaranteed obligations) | 168,726 | Not Rated | Not Rated |
| Repurchase agreements | 1,223 | AA | Aaa |
| Repurchase agreements | 776 | AA | Not Rated |
| Repurchase agreements | 879,275 | Not Rated | Not Rated |
| U.S. Treasuries | 2,668,215 | Not Rated | Not Rated |
| Federal agencies – discount notes | 166,761 | Not Rated | Not Rated |
| Federal agencies | 2,945,495 | AA | Aaa |
| Federal agencies | 350,118 | AA | Not Rated |
| Federal agencies | 200,932 | Not Rated | Aaa |
| Federal agencies | 140,039 | Not Rated | Not Rated |
| Domestic corporate bonds and notes | 339,693 | AA | Aa |
| Domestic corporate bonds and notes | 56,505 | AA | A |
| Domestic corporate bonds and notes | 90,634 | A | A |
| International corporate bonds and notes | 59,657 | A | Aa |
| International government agency discount notes | 20,005 | Not Rated | Aaa |
| International government bonds and notes | 149,765 | Not Rated | Aa |
| | <u>\$ 16,635,283</u> | | |

* \$1,690,209 of the "not rated" certificates of deposit had short-term issuer ratings of A-1 for S&P. All certificates of deposit had short-term issuer ratings of P-1 for Moody's.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

The schedule below provides the credit quality ratings by Standard and Poor's and Moody's Investor Services at June 30, 2016 (in thousands):

| Investment type | Fair value | Credit quality ratings | |
|--|----------------------|------------------------|-----------|
| | | S & P | Moody's |
| Certificates of deposit | \$ 30,021 | AA | Aa |
| Certificates of deposit | 175,144 | A | A |
| Certificates of deposit | 25,025 | A | Not Rated |
| Certificates of deposit | 75,020 | Not Rated | Aa |
| Certificates of deposit* | 2,225,188 | Not Rated | Not Rated |
| Commercial paper | 3,417,392 | A-1 | P-1 |
| Money market funds | 568,770 | AAAm | Aaa-mf |
| Repurchase agreements (collateralized by U.S. guaranteed obligations) | 109,116 | Not Rated | Not Rated |
| Repurchase agreements | 21,943 | AA | Aaa |
| Repurchase agreements | 793,941 | Not Rated | Not Rated |
| U.S. Treasuries | 2,169,232 | Not Rated | Not Rated |
| Federal agencies – discount notes | 256,769 | Not Rated | Not Rated |
| Federal agencies | 3,854,214 | AA | Aaa |
| Federal agencies | 507,010 | AA | Not Rated |
| Federal agencies | 199,648 | Not Rated | Aaa |
| Federal agencies | 552,566 | Not Rated | Not Rated |
| Domestic corporate bonds and notes | 287,865 | AA | Aa |
| Domestic corporate bonds and notes | 125,000 | AA | A |
| Domestic corporate bonds and notes | 30,774 | A | A |
| International government agency discount notes | 24,975 | Not Rated | Not Rated |
| International government bonds and notes | 199,950 | AA | Aa |
| International government bonds and notes | 124,939 | A | Aa |
| International corporate bonds and notes | 125,022 | AA | Aa |
| International corporate bonds and notes | 5,036 | A | Aa |
| | <u>\$ 15,904,560</u> | | |

* All certificates of deposit, including the \$2,225,188 “not rated” certificates of deposit, had short-term issuer ratings of A-1 for S&P and P-1 for Moody's.

(c) Concentration of Credit Risk (in thousands)

Pursuant to the Investment Policy Statement, securities of a single issuer shall not represent more than 3% of total portfolio amortized cost (excluding government securities, repurchase agreements, money market mutual funds and custodian cash sweep vehicles). According to the Investment Policy Statement a single issuer is interpreted to be the aggregate of all affiliated issuers. The maximum single issuer limit can be 5% if timing issues related to delayed delivery transactions are the sole cause of the discrepancy, so long as the percentage is reduced back to 3% within five business days. Repurchase agreements, which are collateralized at least 102% with U.S. government, agency, or agency mortgage-backed securities, are excluded by the SBA in determining compliance with the guidelines. No more than 10% of the portfolio's amortized cost may be invested in an individual money market fund (including any one treasury or agency money market mutual fund), excluding investments in custodian cash sweeps vehicles. No more than 25% of total portfolio amortized cost may be in a single industry sector.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

At June 30, 2017, securities issued by Bank of Nova Scotia were in compliance with the Investment Policy Statement and represented 6.19% of the portfolio's total fair value. The fair value of Bank of Nova Scotia holdings at June 30, 2017 was \$1,030,017, of which, \$950,000 was held in repurchase agreements issued by Bank of Nova Scotia. The repurchase agreements, which were fully collateralized, matured at full value on their stated maturity dates in July 2017.

At June 30, 2017, the Fund also held \$3,803,344 in federal agency bonds and notes, which was in compliance with the Investment Policy Statement and represented 22.87% of the portfolio's fair value. Federal agency bonds and notes are sponsored by the U.S. government. Holdings of federal agency bonds and notes as of June 30, 2017 are as follows (in thousands):

| Investment type | Fair value | Percentage of portfolio |
|---------------------------------------|--------------|-------------------------|
| Federal Farm Credit Bank | \$ 2,176,845 | 13.09% |
| Federal Home Loan Mortgage Corp | 1,299,393 | 7.81 |
| Federal Agricultural Mortgage Corp | 177,417 | 1.07 |
| Federal Home Loan Banks | 96,898 | 0.58 |
| Federal National Mortgage Association | 52,792 | 0.32 |

At June 30, 2016, securities issued by Bank of Nova Scotia were in compliance with the Investment Policy Statement and represented 7.70% of the portfolio's total fair value. The fair value of Bank of Nova Scotia holdings at June 30, 2016 was \$1,225,158, of which, \$875,000 was held in repurchase agreements issued by Bank of Nova Scotia. The repurchase agreements, which were fully collateralized, matured at full value on their stated maturity dates in July 2016.

At June 30, 2016, securities issued by Morgan Stanley were in compliance with the Investment Policy Statement and represented 3.56% of the portfolio's total fair value. The fair value of Morgan Stanley holdings at June 30, 2016 was \$566,253, all of which was held in money market funds.

At June 30, 2016, the Fund also held \$5,370,207 in federal agency bonds and notes, which was in compliance with the Investment Policy Statement and represented 33.77% of the portfolio's total fair value. Federal agency bonds and notes are sponsored by the U.S. government. Holdings of federal agency bonds and notes as of June 30, 2016 are as follows (in thousands):

| Investment type | Fair value | Percentage of portfolio |
|---------------------------------------|--------------|-------------------------|
| Federal Farm Credit Bank | \$ 2,637,630 | 16.58% |
| Federal Home Loan Mortgage Corp | 1,387,796 | 8.73 |
| Federal Home Loan Banks | 594,432 | 3.74 |
| Federal Agricultural Mortgage Corp | 575,290 | 3.62 |
| Federal National Mortgage Association | 175,060 | 1.10 |

(d) Custodial Credit Risk

The Fund utilizes the State Board of Administration's custodial credit risk policy. To the extent possible, negotiated trust and custody contracts shall require that all deposits, investments, and collateral be held

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

in accounts in the Fund's name. As required, the Fund's investments were held in the Fund's name by the custodial financial institutions at June 30, 2017.

(e) Foreign Currency Risk

There was no exposure to foreign currency risk during the fiscal years ended June 30, 2017 and 2016.

(f) Fair Value Hierarchy

The Fund categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles.

The Fund's investments are measured and reported at fair value and classified according to the following hierarchy:

Level 1 – Investments reflect unadjusted quoted prices in active markets for identical assets.

Level 2 – Investments reflect prices that are based on inputs that are either directly or indirectly observable for an asset (including quoted prices for similar assets), which may include inputs in markets that are not considered to be active.

Level 3 – Investments reflect prices based upon unobservable inputs for an asset.

The categorization of investments within the hierarchy is based upon the pricing transparency of this instrument and should not be perceived as the particular investment's risk.

Debt securities classified in Level 1 of the fair value hierarchy are valued using quoted prices in active markets from the custodian bank's primary external pricing vendors.

Debt securities classified in Level 2 are evaluated prices from the custodian bank's primary external pricing vendors. The pricing methodology involves the use of evaluation models such as matrix pricing, which is based on the securities' relationship to benchmark quoted prices. Other evaluation models use actual trade data, collateral attributes, broker bids, new issue pricings and other observable market information.

Debt securities classified as Level 3 are prices from the custodian bank's external pricing vendors or an alternative pricing source, utilizing inputs such as stale prices, cash flow models, and broker bids. Cost or book value may be used as an estimate of fair value when there is a lack of an independent pricing source.

Certain investments, such as money market funds and repurchase agreements are not included in the tables below because they are carried at cost, and not measured at fair value.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

The Fund has the following fair value measurements as of June 30, 2017 and June 30, 2016 (in thousands):

| | Fair value measurements using | | | |
|---|--|--|--|----------------|
| | Quoted prices in active market for identical assets | Significant other observable inputs | Significant unobservable inputs | |
| | Level 1 | Level 2 | Level 3 | |
| June 30, 2017 | | | | |
| Investments by fair value level: | | | | |
| Debt securities: | | | | |
| Certificates of deposit | \$ 1,765,213 | — | 1,545,213 | 220,000 |
| Commercial paper | 6,576,183 | — | 6,476,183 | 100,000 |
| U.S. Treasuries | 2,668,215 | 1,361,391 | 1,306,824 | — |
| Federal agencies – unsecured | 3,636,584 | — | 3,636,584 | — |
| Federal agencies – discount notes | 166,761 | — | 166,761 | — |
| Domestic corporate bonds and notes | 486,832 | — | 486,832 | — |
| International government bonds and notes | 169,770 | — | 169,770 | — |
| International corporate bonds and notes | 59,657 | — | 59,657 | — |
| Total debt securities measured at fair value | \$ 15,529,215 | 1,361,391 | 13,847,824 | 320,000 |

| | Fair value measurements using | | | |
|---|--|--|--|---------------|
| | Quoted prices in active market for identical assets | Significant other observable inputs | Significant unobservable inputs | |
| | Level 1 | Level 2 | Level 3 | |
| June 30, 2016 | | | | |
| Investments by fair value level: | | | | |
| Debt securities: | | | | |
| Certificates of deposit | \$ 2,530,398 | — | 2,480,398 | 50,000 |
| Commercial paper | 3,417,392 | — | 3,417,392 | — |
| U.S. Treasuries | 2,169,232 | 450,272 | 1,718,960 | — |
| Federal agencies – unsecured | 5,113,438 | — | 5,113,438 | — |
| Federal agencies – discount notes | 256,769 | — | 256,769 | — |
| Domestic corporate bonds and notes | 443,639 | — | 443,639 | — |
| International government bonds and notes | 349,864 | — | 324,889 | 24,975 |
| International bonds and notes | 130,058 | — | 130,058 | — |
| Total debt securities measured at fair value | \$ 14,410,790 | 450,272 | 13,885,543 | 74,975 |

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

(4) Capital Assets

A summary of the Fund's capital assets and the related accumulated depreciation for the years ended June 30, 2017 and 2016 is as follows (in thousands):

| | <u>Equipment</u> | <u>Accumulated depreciation</u> | <u>Net</u> |
|------------------------------------|------------------|-------------------------------------|------------|
| Balance as of June 30, 2015 | \$ 36 | (32) | 4 |
| Additions and depreciation expense | 4 | (2) | 2 |
| Sales or disposals | <u>(3)</u> | <u>3</u> | <u>—</u> |
| Balance as of June 30, 2016 | 44 | (36) | 8 |
| Additions and depreciation expense | 4 | (4) | — |
| Sales or disposals | <u>(2)</u> | <u>2</u> | <u>—</u> |
| Balance as of June 30, 2017 | \$ <u>46</u> | <u>(38)</u> | <u>8</u> |

(5) Hurricane Losses

The State of Florida was impacted by two hurricanes during the 2016 hurricane season. On September 2, 2016, Hurricane Hermine made landfall east of St. Marks, Florida as a Category 1 hurricane.

On October 7, 2016, the eye of Hurricane Matthew tracked close to the coast of Florida making its way along the east coast of the United States as a Category 3 hurricane.

As of June 30, 2017, there are no hurricane loss claims for these events.

The following table provides a reconciliation of the beginning and ending balances for unpaid hurricane losses for 2017 and 2016 (in thousands):

| | <u>Year ended June 30</u> | |
|--|---------------------------|-------------|
| | <u>2017</u> | <u>2016</u> |
| Reserve for unpaid hurricane losses at beginning of year | \$ — | — |
| Provision for hurricane losses occurring in: | | |
| Current year | 1,000 | — |
| Prior years | <u>—</u> | <u>—</u> |
| Net incurred losses during the current year | <u>1,000</u> | <u>—</u> |
| Payments for claims occurring in: | | |
| Current year | — | — |
| Prior years | <u>—</u> | <u>—</u> |
| Net claim payments during the current year | <u>—</u> | <u>—</u> |
| Reserve for unpaid hurricane losses at end of year | \$ <u>1,000</u> | <u>—</u> |

The Fund's reserve for unpaid hurricane losses was \$1 million and \$0 at June 30, 2017 and 2016.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

(6) Changes in Long-term Liabilities

The following table provides the long-term liability activity for the years ended June 30, 2017 and 2016 as follows (in thousands):

| <u>Long-term liabilities as of June 30, 2017</u> | <u>Beginning balance*</u> | <u>Additions</u> | <u>Reductions</u> | <u>Ending balance</u> | <u>Amount Due within 1 year</u> |
|--|---------------------------|------------------|-------------------|-----------------------|---------------------------------|
| Bonds payable | \$ 3,200,000 | — | (500,000) | 2,700,000 | — |
| Net pension liability | 673 | 521 | (87) | 1,107 | — |
| Compensated absences | 174 | 137 | (105) | 206 | 62 |
| Other post employment benefits payable | 59 | 14 | — | 73 | — |

* Long-term liabilities include any related current liability balance. Amounts due in one year are classified as current liabilities on the Statements of Net Position.

| <u>Long-term liabilities as of June 30, 2016</u> | <u>Beginning balance*</u> | <u>Additions</u> | <u>Reductions</u> | <u>Ending balance</u> | <u>Amount Due within 1 year</u> |
|--|---------------------------|------------------|-------------------|-----------------------|---------------------------------|
| Bonds payable | \$ 2,000,000 | 1,200,000 | — | 3,200,000 | 500,000 |
| Net pension liability | 430 | 323 | (80) | 673 | 12 |
| Compensated absences | 243 | 182 | (251) | 174 | 47 |
| Other post employment benefits payable | 55 | 4 | — | 59 | — |

* Long-term liabilities include any related current liability balance. Amounts due in one year are classified as current liabilities on the Statements of Net Position.

(7) Bonds Payable

Post-event Bonds –At June 30, 2017, there were no post-event bonds outstanding.

Pre-event Notes and Bonds – In April 2013, the Corporation issued pre-event Series 2013A Revenue Bonds in the amount of \$2.0 billion to maximize the ability of the Fund to meet future obligations. The proceeds from these bonds may be used to pay for losses incurred from future covered events. Investment earnings on these funds, as well as reimbursement premiums, if necessary, are used to pay the debt service requirements of these bonds. On July 1, 2016, \$500 million of principal, bearing interest at 1.298%, matured. The remainder of the bonds are stated to mature, notwithstanding a prior right of redemption, on July 1 of the following years and bear interest at rates ranging from 2.107% to 2.995% as follows (in thousands):

| <u>Year:</u> | <u>Par outstanding</u> | <u>Interest rates</u> |
|--------------|------------------------|-----------------------|
| 2018 | \$ 500,000 | 2.107% |
| 2020 | 1,000,000 | 2.995 |
| | <u>\$ 1,500,000</u> | |

In March 2016, the Corporation issued pre-event Series 2016A Revenue Bonds in the amount of \$1.2 billion to maximize the ability of the Fund to meet future obligations. The proceeds from these bonds may be used to pay for losses incurred from future covered events. Investment earnings on these funds, as well as

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

reimbursement premiums, if necessary, are used to pay the debt service requirements of these bonds. The bonds are stated to mature, notwithstanding a prior right of redemption, on July 1 of the following years and bear interest at rates ranging from 2.163% to 2.638% as follows (in thousands):

| | Par outstanding | Interest rates |
|-------|----------------------------|---------------------------|
| Year: | | |
| 2019 | \$ 550,000 | 2.163% |
| 2021 | 650,000 | 2.638 |
| | \$ 1,200,000 | |

(8) Compensated Absences

Compensated absences were as follows (in thousands):

| | |
|-----------------------------|---------|
| Balance as of June 30, 2015 | \$ 243 |
| Increases | 182 |
| Decreases | (251) |
| Balance as of June 30, 2016 | 174* |
| Increases | 137 |
| Decreases | (105) |
| Balance as of June 30, 2017 | \$ 206* |

* Includes long-term and current balances, of which \$62.2 thousand and \$47.1 thousand is estimated due within one year of June 30, 2017 and 2016, respectively.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

(9) Premium Revenue

Fiscal year premiums, net of prior contract year adjustments, as reported in the combined statements of revenues, expenses, and changes in net position, relate to contract years as follows (in thousands):

| | <u>Fiscal year ended June 30</u> | |
|--------------------|----------------------------------|------------------|
| | <u>2017</u> | <u>2016</u> |
| Contract year 2017 | \$ 88,773 | * |
| Contract year 2016 | 987,025 | 89,395 * |
| Contract year 2015 | 1,031 | 1,063,912 |
| Contract year 2014 | (7,963) | (10,157) |
| Contract year 2013 | (111) | (2,298) |
| Contract year 2012 | (543) | (56) |
| | <u>\$ 1,068,212</u> | <u>1,140,796</u> |

* As of June 30, 2017 and 2016, which is in contract year 2017 and 2016, respectively, running June 1 through May 31, an accrual was established for one month's pro-rata portion of the aggregate reinsurance deposit premium. Additionally, contract years 2017 and 2016 include one month of accrual.

(10) Related Parties

The Fund paid the SBA \$3.0 million and \$0.6 million for the Fund and the Corporation, respectively, in the fiscal year ended June 30, 2017 and \$2.8 million for the Fund and \$0.5 million for the Corporation in the fiscal year ended June 30, 2016 for investment advisory services.

(11) Legal Defeasance (in thousands)

A legal defeasance of the Series 2010A Revenue Bonds was executed on July 11, 2014 in accordance with the Master Trust Indenture; therefore, the bonds are no longer outstanding as of that date. At the time of defeasance, outstanding debt service on the bonds was as follows:

| <u>Payment date</u> | <u>Rate</u> | <u>Payment for principal</u> | <u>Payment for interest</u> |
|---------------------|-------------|------------------------------|-----------------------------|
| January 1, 2015 | 3.50%–5.00% | \$ — | 16,638 |
| July 1, 2015 | 3.50%–5.00% | 342,455 | 16,638 |
| January 1, 2016 | 3.75%–5.00% | — | 8,224 |
| July 1 2016 | 3.75%–5.00% | 333,465 | 8,224 |
| | | <u>\$ 675,920</u> | <u>49,724</u> |

To provide for the payment of principal and interest on the bonds, and all fees of the escrow agent, \$721.7 million was placed in an irrevocable trust, along with interest earnings thereon. The defeasance resulted in the Corporation recognizing a \$34.7 million loss on the early extinguishment of debt in fiscal year ended June 30, 2015.

With the defeasance of the Series 2010A Revenue Bonds and no outstanding hurricane losses, the Florida Office of Insurance Regulation issued Orders on July 21, 2014 establishing that for all policies issued or renewed on or after January 1, 2015, the emergency assessment is 0.0%.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

(12) Lehman Settlement

In 2009, the SBA filed a claim on behalf of the Fund, along with two other funds, in the Lehman Brothers, Inc. (LBI) Securities Investor Protection Act of 1970 (SIPA) insolvency proceeding in connection with the defaults of the KKR Atlantic, KKR Pacific and Ottimo securities. In this claim, the SBA alleged that LBI sold the SBA unregistered securities without proper reliance on any exemption under the Securities Act.

After several months of discussions and exchanging of formal motions and objections in the litigation, the parties participated in mediation on August 20, 2014, which resulted in a settlement and stipulation by the parties. The court approved this stipulation on September 30, 2014.

After the court approved the stipulation, the SBA had an allowed claim that could be sold, and began seeking quotes from the market. The SBA received a portion of the settlement directly from an LBI trustee, and sold the remainder of the claim to Banc of America Credit Products, Inc. (BACP). The funds from LBI and BACP related to the settlement were received by the SBA on November 26, 2014 and December 3, 2014, respectively, and immediately made distributions to the holders of the defaulted securities. The Fund's share of the proceeds received on November 26, 2014 and December 3, 2014 was \$1 million and \$1.75 million, respectively.

(13) Reinsurance

Aggregate excess catastrophe reinsurance providing coverage for \$1.0 billion in excess of \$11.5 billion was purchased effective June 1, 2017 through May 31, 2018; and \$1.0 billion in excess of \$11.5 billion was purchased effective June 1, 2016 through May 31, 2017. The deposit premium including commission was \$61.0 million for contract year 2017. The premium including commission paid for reinsurance in contract year 2016 was \$62.5 million. The final premium may be adjusted down, but not adjusted up, and is determined based on the actual reimbursement contract aggregate reimbursement premium as of December 31. Reinsurance deposit premium and commission are due in three equal installments on August 1, October 1 and December 1. The effect of reinsurance on premiums for the years ended June 30 was as follows (in thousands):

| | Year ended June 30 | |
|------------------|--------------------|-----------|
| | 2017 | 2016 |
| Direct premiums | \$ 1,130,522 | 1,199,806 |
| 2015 Reinsurance | — | (53,713) |
| 2016 Reinsurance | (57,227) | (5,297) |
| 2017 Reinsurance | (5,083) | — |
| | \$ 1,068,212 | 1,140,796 |
| Net premiums | | |

(14) Pension and Other Postemployment Benefits

All permanent Fund employees are eligible to participate in the following cost-sharing multiple-employer defined benefit pension plans (Plans):

- Florida Retirement System Pension Plan
- Health Insurance Subsidy Program Pension Plan

As an alternative to the Florida Retirement System Pension Plan, employees may elect to participate in the Florida Retirement System Investment Plan (a defined contribution plan).

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

The Florida Department of Management Services (Department) is part of the primary government of the state of Florida and is responsible for administering the Florida Retirement System Pension Plan and Other State-Administered Systems. For each of the fiscal years ended June 30, 2016 and June 30, 2015, the Department issued a publicly available, audited comprehensive annual financial report (CAFR) that includes financial statements, notes and required supplementary information for each of the pension plans which it administers. Detailed information about the plans is provided in the CAFRs which are available online or by contacting the Department.

Copies of this report, as well as the plans' actuarial valuations, can be obtained from the Department of Management Services, Division of Retirement (Division), Bureau of Research and Member Communications, P.O. Box 9000, Tallahassee, Florida 32315-9000; by telephone toll free at 877-377-1737 or 850-488-5706; by email at rep@dms.myflorida.com; or at the Division's website (www.frs.myflorida.com).

For purposes of measuring the net pension liability and deferred outflows/inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the plans and additions to/deductions from the plans' fiduciary net position have been determined on the same basis as they are reported by the Florida Department of Management Services. For this purpose, benefit payments (including refunds of employee contributions) are recognized when currently due and payable in accordance with the benefit terms. Investments are reported at fair value.

1. Defined Benefit Plans

The Florida Retirement System Pension Plan

The Florida Retirement System (FRS) is a cost-sharing multiple-employer public-employee retirement system with two primary plans – the FRS defined benefit pension plan (Pension Plan) and the FRS Investment Plan. The Florida Retirement System (FRS) Pension Plan was created in Chapter 121, Florida Statutes (F.S.), effective December 1, 1970, by consolidating and closing these existing plans to new members: the Teachers' Retirement System (Chapter 238, F.S.), the State and County Officers and Employees' Retirement System (Chapter 122, F.S.), and the Highway Patrol Pension Trust Fund (Chapter 321, F.S.). In 1972, the Judicial Retirement System (Chapter 123, F.S.) was closed and consolidated into the FRS. The FRS was created to provide a defined benefit pension plan for participating public employees. The FRS was amended in 1998 to add the Deferred Retirement Option Program (DROP) under the defined benefit plan and amended in 2000 to provide a defined contribution plan alternative to the defined benefit plan for FRS members effective July 1, 2002. This integrated defined contribution plan is the FRS Investment Plan, which is administered by the State Board of Administration.

Membership

FRS membership is compulsory for employees filling a regularly established position in a state agency, county agency, state university, state college, or district school board, unless restricted from FRS membership under Section 121.053 or Section 121.122, F.S., or allowed to participate in a nonintegrated defined contribution plan in lieu of FRS membership. Participation by cities, municipalities, special districts, charter schools, and metropolitan planning organizations, although optional, is generally irrevocable after election to participate is made. Retirees initially reemployed in regularly established positions on or after July 1, 2010, may not participate in the FRS. Members hired into certain positions may be eligible to withdraw from the FRS altogether or elect to participate in the non-integrated retirement programs in lieu of the FRS except faculty of a medical college in a state university who must participate in the State University System Optional Retirement Program.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

There are five general classes of membership, as follows. Fund employees are all included in one of the first two classes:

- *Regular Class* – Members of the FRS who do not qualify for membership in the other classes.
- *Senior Management Service Class (SMSC)* – Members in senior management level positions in state and local governments as well as assistant state attorneys, assistant statewide prosecutors, assistant public defenders, assistant attorneys general, deputy court administrators, assistant capital collateral representatives, and judges of compensation claims. Members of the Elected Officers' Class may elect to withdraw from the FRS or participate in the SMSC in lieu of the Elected Officers' Class.
- *Special Risk Class* – Members who are employed as law enforcement officers, firefighters, firefighter trainers, fire prevention officers, state fixed-wing pilots for aerial firefighting surveillance, correctional officers, emergency medical technicians, paramedics, community-based correctional probation officers, youth custody officers (from July 1, 2001 through June 30, 2014), certain health-care related positions within state forensic or correctional facilities, or specified forensic employees of a medical examiner's office or a law enforcement agency, and meet the criteria to qualify for this class.
- *Special Risk Administrative Support Class* – Former Special Risk Class members who are transferred or reassigned to nonspecial risk law enforcement, firefighting, emergency medical care, or correctional administrative support positions within an FRS special risk-employing agency.
- *Elected Officers' Class (EOC)* – Members who are elected state and county officers and the elected officers of cities and special districts that choose to place their elected officials in this class.

Beginning July 1, 2001, through June 30, 2011, the FRS Pension Plan provided for vesting of benefits after six years of creditable service for members working on or after July 1, 2001, and initially enrolled before July 1, 2011. Members not actively working in a position covered by the FRS on July 1, 2001 must return to covered employment for up to one work year to be eligible to vest with less service than was required under the law in effect before July 1, 2001. Members initially enrolled on or after July 1, 2011 vest after eight years of creditable service. Regular Class and Senior Management Service Class members are eligible for normal retirement when they have met the requirements listed below. Early retirement may be taken any time after vesting within 20 years of normal retirement age; however, there is a 5% benefit reduction for each year prior to the normal retirement age.

Regular Class Senior Management Service Class eligibility requirements for normal retirement:

- For members initially enrolled in the FRS before July 1, 2011, six or more years of creditable service and age 62, or the age after completing six years of creditable service if after age 62. Thirty years of creditable service regardless of age before age 62.
- For members initially enrolled in the FRS on or after July 1, 2011, eight or more years of creditable service and age 65, or the age after completing eight years of creditable service if after age 65. Thirty-three years of creditable service regardless of age before age 65.

Special Risk Class and Special Risk Administrative Support Class Members:

- For members initially enrolled in the FRS before July 1, 2011, six or more years of Special Risk Class service and age 55, or the age after completing six years of Special Risk Class service if after age 55. Twenty-five years of special risk service regardless of age before age 55. A total of 25 years of service including special risk service and up to four years of active duty wartime service and

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

age 52. Without six years of Special Risk Class service, members of the Special Risk Administrative Support Class must meet the requirements of the Regular Class.

- For members initially enrolled in the FRS on or after July 1, 2011, eight or more years of Special Risk Class service and age 60, or the age after completing eight years of Special Risk Class service if after age 60. Thirty years of special risk service regardless of age before age 60. Without eight years of Special Risk Class service, members of the Special Risk Administrative Support Class must meet the requirements of the Regular Class.

Benefits

Benefit terms under the FRS Pension Plan are established in Chapter 121, F.S. and may only be amended by the Florida Legislature. Benefits under the FRS Pension Plan are computed based on age, average final compensation, creditable years of service, and accrual value per year by membership class. Members are also provided in-line-of-duty or regular disability and survivors' benefits. Pension benefits of retirees and annuitants are increased each July 1 by a cost-of-living adjustment. If the member is initially enrolled in the FRS before July 1, 2011 and all service credit was accrued before July 1, 2011, the annual cost-of-living adjustment is 3% per year. If the member is initially enrolled before July 1, 2011 and has service credit on or after July 1, 2011, there is an individually calculated cost-of-living adjustment. The annual cost-of-living adjustment is a proportion of 3% determined by dividing the sum of the pre-July 2011 service credit by the total service credit at retirement multiplied by 3%. FRS Pension Plan members initially enrolled on or after July 1, 2011 will not have a cost-of-living adjustment after retirement.

The DROP became effective July 1, 1998, subject to provisions of Section 121.091(13), F.S. FRS Pension Plan members who reach normal retirement are eligible to defer receipt of monthly benefit payments while continuing employment with an FRS employer. An employee may participate in the DROP for a maximum of 60 months. Authorized instructional personnel may participate in the DROP for up to 36 additional months beyond their initial 60-month participation period. Monthly retirement benefits remain in the FRS Trust Fund during DROP participation and accrue interest. As of June 30, 2016, the FRS Trust Fund held in trust \$2,322,967,354 in accumulated benefits and interest for 34,160 current and prior participants in DROP.

Administration

The Department of Management Services, Division of Retirement administers the FRS Pension Plan. The State Board of Administration invests the assets of the Pension Plan held in the FRS Trust Fund. Costs of administering the FRS Pension Plan are funded from earnings on investments of the FRS Trust Fund. Reporting of the FRS is on the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the obligation is incurred.

Contributions

All participating employers must comply with statutory contribution requirements. Section 121.031(3), F.S., requires an annual actuarial valuation of the FRS Pension Plan, which is provided to the Legislature as guidance for funding decisions. Employer and employee contribution rates are established in Section 121.71, F.S. Employer contribution rates under the uniform rate structure (a blending of both the FRS Pension Plan and Investment Plan rates) are recommended by the actuary but set by the Legislature. Statutes require that any unfunded actuarial liability (UAL) be amortized within 30 plan years. Pursuant to Section 121.031(3) (f), F.S., any surplus amounts available to offset total retirement system costs are to be amortized over a 10-year rolling period on a level-dollar basis. The balance of

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

legally required reserves for the FRS Pension Plan at June 30, 2016 was \$141,781,028,000. These funds were reserved to provide for total current and future benefits, refunds, and administration of the FRS Pension Plan.

The tables below presents FRS retirement employer contribution rates for the fiscal years ending June 30, 2017 and June 30, 2016. Rates indicated are uniform rates for all FRS members created by blending the FRS Investment Plan and the FRS Pension Plan rates and including UAL contribution rates. These rates do not include a 1.66% Retiree Health Insurance Subsidy (HIS) contribution rate and a 0.06% assessment (0.04% for the fiscal year ended June 30, 2016) for the administration of the FRS Investment Plan and the educational program available to all FRS members. In addition, the July 1, 2016 and the July 1, 2015 statutory employer rates do not include the 3.00% mandatory employee contribution for all membership classes except for members in the Deferred Retirement Option Program.

| Membership class | Uniform employer rates recommended by actuarial valuation for fiscal year 2016–2017 | July 1, 2016 Statutory rates (Ch. 121, F.S.) |
|---|--|---|
| Regular | 5.80% | 5.80% |
| Senior Management Service | 20.05 | 20.05 |
| Special Risk | 20.85 | 20.85 |
| Special Risk Administrative Support | 26.34 | 26.34 |
| Elected Officers – Judges | 34.98 | 34.98 |
| Elected Officers – Legislators/Attorneys/Cabinet | 40.38 | 40.38 |
| Elected Officers – County | 40.75 | 40.75 |
| Deferred Retirement Option Program – applicable to members from all of the above classes or plans | 11.33 | 11.33 |

| Membership class | Uniform employer rates recommended by actuarial valuation for fiscal year 2015–2016 | July 1, 2015 Statutory rates (Ch. 121, F.S.) |
|---|--|---|
| Regular | 5.56% | 5.56% |
| Senior Management Service | 19.73 | 19.73 |
| Special Risk | 20.34 | 20.34 |
| Special Risk Administrative Support | 31.25 | 31.25 |
| Elected Officers – Judges | 34.01 | 34.01 |
| Elected Officers – Legislators/Attorneys/Cabinet | 44.10 | 44.10 |
| Elected Officers – County | 40.57 | 40.57 |
| Deferred Retirement Option Program – applicable to members from all of the above classes or plans | 11.22 | 11.22 |

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

Employee eligibility, benefits, and contributions by class are as previously described. Employees not filling regular established positions and working under the other personal services (OPS) or temporary status are not covered by the FRS.

Retiree Health Insurance Subsidy Program

The Retiree Health Insurance Subsidy (HIS) Program is a cost-sharing multiple-employer defined benefit pension plan established under Section 112.363, F.S. by the authority of the Florida Legislature. Benefit terms are established in Chapter 112.363, F.S. and may only be amended by the Florida Legislature. The benefit is a monthly payment to assist retirees of state-administered retirement systems in paying their health insurance costs and is administered by the Department of Management Services, Division of Retirement. For the fiscal year ended June 30, 2017 and June 30, 2016, eligible retirees and beneficiaries received a monthly HIS payment equal to the number of years of creditable service completed at the time of retirement multiplied by \$5. The payments are at least \$30 but not more than \$150 per month, pursuant to Section 112.363, F.S. To be eligible to receive a HIS benefit, a retiree under a state-administered retirement system must provide proof of eligible health insurance coverage, which can include Medicare.

The HIS Program is funded by required contributions from FRS participating employers as set by the Legislature. Employer contributions are a percentage of gross compensation for all active FRS members. For the fiscal years ended June 30, 2017 and June 30, 2016, the contribution rate was 1.66% of payroll pursuant to Section 112.363, F.S. The Fund contributed 100% of its statutorily required contributions for the current and preceding two years. HIS contributions are deposited in a separate trust fund from which HIS payments are authorized. HIS benefits are not guaranteed and are subject to annual legislative appropriation. In the event the legislative appropriation or available funds fail to provide full subsidy benefits to all participants, the legislature may reduce or cancel HIS payments.

Pension Amounts for Defined Benefit Pension Plans

Net Pension Liability

At June 30, 2017 and June 30, 2016, the Fund reported total liabilities of \$1,107,041 and \$673,160, respectively, for its proportionate share of the net pension liabilities of the defined benefit, multiple employer cost sharing pension plans. The tables below present the fiduciary net position for each plan as well as the Fund's proportion and proportionate share as of the measurement dates of June 30, 2016 and June 30, 2015:

| | Measurement date as of June 30, 2016 | | |
|----------------------------------|--------------------------------------|----------------|-----------|
| | FRS | HIS | Total |
| Plan total pension liability (A) | \$ 167,030,999,000 | 11,768,444,801 | |
| Plan fiduciary net position (B) | (141,780,920,515) | (113,859,055) | |
| Plan net pension liability (A-B) | 25,250,078,485 | 11,654,585,746 | |
| Fund's proportion | 0.002834117% | 0.003358544% | |
| Fund's proportionate share | \$ 715,617 | 391,424 | 1,107,041 |

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

| Measurement date as of June 30, 2015 | | | |
|---|--------------------|----------------|--------------|
| | FRS | HIS | Total |
| Plan total pension liability (A) | \$ 161,370,735,088 | 10,249,201,290 | |
| Plan fiduciary net position (B) | (148,454,393,902) | (50,774,315) | |
| Plan net pension liability (A-B) | 12,916,341,186 | 10,198,426,975 | |
| Fund's proportion | 0.002651678% | 0.003242266% | |
| Fund's proportionate share* | \$ 342,500 | 330,660 | 673,160 |

* The amount of the Fund's proportionate share due within one year is \$0 for the FRS Pension and \$12,620 for the HIS Pension.

The Fund's proportion of the net pension liability was based on contributions paid to the plans by the Fund relative to the contributions paid by all participating employers. The tables below show the change in proportion since the prior measurement date:

| Change in proportionate share from measurement date of June 30, 2015 to June 30, 2016 | | |
|--|--------------|--------------|
| | FRS | HIS |
| Fund's proportionate at prior measurement date, June 30, 2015 | 0.002651678% | 0.003242266% |
| Fund's proportion at measurement date, June 30, 2016 | 0.002834117% | 0.003358544% |
| Increase (decrease) in proportion | 0.000182439% | 0.000116278% |

| Change in proportionate share from measurement date of June 30, 2014 to June 30, 2015 | | |
|--|--------------|--------------|
| | FRS | HIS |
| Fund's proportionate at prior measurement date, June 30, 2014 | 0.002394824% | 0.003032327% |
| Fund's proportion at measurement date, June 30, 2015 | 0.002651678% | 0.003242266% |
| Increase (decrease) in proportion | 0.000256854% | 0.000209939% |

Based on the projected June 30, 2017 proportion, the Fund's total increase in pension liability would be approximately \$96,989, or 8.76% higher than what was reported as of the measurement date of June 30, 2016. There are no other known changes between the measurement date of the collective net pension liability and the Fund's reporting date that are expected to have a significant effect on the Fund's proportionate share of the collective net pension liability of either defined benefit pension plan.

Actuarial Methods and Assumptions

Actuarial assumptions for both defined benefit cost sharing plans are reviewed annually by the Florida Retirement System Actuarial Assumptions Conference. The most recent experience study for the FRS Pension Plan was completed in 2014 for the period July 1, 2008 through June 30, 2013. Because the

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

HIS Program is funded on a pay-as-you-go basis, no experience study has been completed for this program.

The total pension liability for each of the defined benefit plans was determined by an actuarial valuation as of the measurement dates of June 30, 2016 and June 30, 2015 using the entry age normal actuarial cost method. Inflation increases for both plans is assumed at 2.60%. Payroll growth, including inflation, for both plans is assumed at 3.25%.

Both the discount rate and the long-term expected rate of return used for FRS Pension Plan investments is 7.60% (7.65% for the June 30, 2015, measurement date). The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that contributions from participating employers will be made at the statutorily required rates. Based on these assumptions, the plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the discount rate for calculating the total pension liability is equal to the long-term expected rate of return and was applied to all periods of projected benefit payments to determine the total pension liability.

Because the HIS Program uses a pay-as-you-go funding structure, a municipal bond rate of 2.85% for the measurement date of June 30, 2016, and 3.80% for the measurement date of June 30, 2015, was used to determine the total pension liability for the program. The source of the municipal bond rate is the Bond Buyer General Obligation 20-Bond Municipal Bond Index. Mortality assumptions for both plans were based on the Generational RP-2000 with Projection Scale BB tables.

There were no changes in benefit terms for either FRS or HIS that affected the total pension liability since the most recent measurement date.

The following changes in actuarial assumptions occurred in 2016:

- FRS: As of June 30, 2016, the inflation rate assumption remained at 2.60%, the real payroll growth assumption remained at 0.65%, and the overall payroll growth rate assumption remained at 3.25%. The long-term expected rate of return decreased from 7.65% to 7.60%.
- HIS: The municipal rate used to determine total pension liability decreased from 3.80% to 2.85%.

The following changes in actuarial assumptions occurred in 2015:

- FRS: There were no changes in actuarial assumptions. As of June 30, 2015, the inflation rate assumption remained at 2.60%, the real payroll growth assumption remained at 0.65%, and the overall payroll growth rate assumption remained at 3.25%. The long-term expected rate of return remained at 7.65%.
- HIS: The municipal rate used to determine total pension liability decreased from 4.29% to 3.80%.

The long-term expected rate of return on FRS pension plan investments was determined using a forward-looking capital market economic model, which includes an adjustment for the inflation

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

assumption. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following tables:

Measurement date as of June 30, 2016

| Asset class | Target allocation | Long-term expected real rate of return |
|------------------------|--------------------------|---|
| Cash | 1.00% | 3.00% |
| Fixed income | 18.00 | 4.70 |
| Global equity | 53.00 | 8.10 |
| Real estate (property) | 10.00 | 6.40 |
| Private equity | 6.00 | 11.50 |
| Strategic investments | 12.00 | 6.10 |
| | <u>100.00%</u> | |

Measurement date as of June 30, 2015

| Asset class | Target allocation | Long-term expected real rate of return |
|------------------------|--------------------------|---|
| Cash | 1.00% | 3.20% |
| Fixed income | 18.00 | 4.80 |
| Global equity | 53.00 | 8.50 |
| Real estate (property) | 10.00 | 6.80 |
| Private equity | 6.00 | 11.90 |
| Strategic investments | 12.00 | 6.70 |
| | <u>100.00%</u> | |

Sensitivity Analysis

The following tables demonstrate the sensitivity of the net pension liability to changes in the discount rate. The sensitivity analysis shows the impact to the Fund's proportionate share of each plan's net pension liability if the discount rate was 1.00% higher or 1.00% lower than the current discount rate at each of the measurement dates of June 30, 2016 and June 30, 2015.

Measurement date as of June 30, 2016

| Florida Retirement System | | | Health Insurance Subsidy | | |
|----------------------------------|------------------------------|--------------------|---------------------------------|------------------------------|--------------------|
| | Current discount rate | | | Current discount rate | |
| 1% Decrease | | 1% Increase | 1% Decrease | | 1% Increase |
| 6.60% | 7.60% | 8.60% | 1.85% | 2.85% | 3.85% |
| \$ 1,317,499 | 715,617 | 214,629 | 449,053 | 391,424 | 343,596 |

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

Measurement date as of June 30, 2015

| Florida Retirement System | | | Health Insurance Subsidy | | |
|---------------------------|-----------------------|-------------|--------------------------|-----------------------|-------------|
| 1% Decrease | Current discount rate | 1% Increase | 1% Decrease | Current discount rate | 1% Increase |
| 6.65% | 7.65% | 8.65% | 2.80% | 3.80% | 4.80% |
| \$ 887,495 | 342,500 | (111,025) | 376,772 | 330,660 | 292,210 |

Pension Expense and Deferred Outflows (Inflows) of Resources

In accordance with GASB 68, paragraphs 54 and 71, changes in the net pension liability are recognized in pension expense in the current measurement period, except as indicated below. For each of the following, a portion is recognized in pension expense in the current measurement period, and the balance is amortized as deferred outflows or deferred inflows of resources using a systematic and rational method over a closed period, as defined below:

- Differences between expected and actual experience with regard to economic and demographic factors – amortized over the average expected remaining service life of all employees that are provided with pensions through the pension plan (active and inactive employees)
- Changes of assumptions or other inputs – amortized over the average expected remaining service life of all employees that are provided with pensions through the pension plan (active and inactive employees)
- Changes in proportion and differences between contributions and proportionate share of contributions - amortized over the average expected remaining services life of all employees that are provided with pensions through the pension plan (active and inactive employees)
- Differences between expected and actual earnings on pension plan investments – amortized over five years

The average expected remaining service life of all employees provided with pensions through the pension plans at June 30, 2016 and June 30, 2015 was 6.4 years and 6.3 years, respectively, for FRS and 7.2 years for HIS. The Fund's proportionate share of the components of collective pension expense reported in the pension allocation schedules for the fiscal years ended June 30, 2017 (measurement

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

date of June 30, 2016) and June 30, 2016 (measurement date of June 30, 2015) are presented below for each plan.

| Florida Retirement System | | | | |
|--|--|-------------------------------|---|--|
| | Recognized in expense reporting period ending June 30, 2017 | Recognition period | Deferred outflows of resources | Deferred inflows of resources |
| Service cost | \$ 60,449 | Current | — | — |
| Interest cost | 343,186 | Current | — | — |
| Effect of plan changes | 916 | Current | — | — |
| Effect of economic/demographic gains or losses (difference between expected and actual experience) | 9,613 | 6.3 to 6.4 years | 54,793 | (6,663) |
| Effect of assumptions changes or inputs | 10,215 | 6.3 to 6.4 years | 43,293 | — |
| Member contributions | (20,143) | Current | — | — |
| Projected investment earnings | (313,890) | Current | — | — |
| Changes in proportion and differences between contributions and proportionate share of contributions | 14,879 | 6.3 to 6.4 years | 63,895 | — |
| Net difference between projected and actual investment earnings | 18,245 | 5 years | 184,978 | — |
| Contributions subsequent to the measurement date | — | 1 years | 84,998 | — |
| Administrative expenses | 525 | Current | — | — |
| Total | <u>\$ 123,995</u> | | <u>431,957</u> | <u>(6,663)</u> |

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

| Health Insurance Subsidy | | | | |
|--|--|-------------------------------|---|--|
| | Recognized in expense reporting period ending June 30, 2017 | Recognition period | Deferred outflows of resources | Deferred inflows of resources |
| Service cost | \$ 8,622 | Current | — | — |
| Interest cost | 13,124 | Current | — | — |
| Effect of plan changes | — | Current | — | — |
| Effect of economic/demographic gains or losses (difference between expected and actual experience) | (143) | 7.2 years | — | (892) |
| Effect of assumptions changes or inputs | 10,946 | 7.2 years | 61,424 | — |
| Member contributions | — | Current | — | — |
| Projected investment earnings | (104) | Current | — | — |
| Changes in proportion and differences between contributions and proportionate share of contributions | 2,705 | 7.2 years | 23,070 | (6,042) |
| Net difference between projected and actual investment earnings | 72 | 5 years | 198 | — |
| Contributions subsequent to the measurement date | — | 1 year | 17,237 | — |
| Administrative expenses | 6 | Current | — | — |
| Total | <u>\$ 35,228</u> | | <u>101,929</u> | <u>(6,934)</u> |
| Total for all defined benefit pension plans | \$ 159,223 | | 533,886 | (13,597) |

Deferred outflows of resources related to contributions paid subsequent to the measurement date as shown in the tables above will be recognized as a reduction of the net pension liability in the reporting period ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pension expense will be recognized as follows:

| | <u>FRS expense</u> | <u>HIS expense</u> |
|----------------------------------|---------------------------|---------------------------|
| Reporting period ending June 30: | | |
| 2018 | \$ 52,952 | 13,581 |
| 2019 | 52,953 | 13,581 |
| 2020 | 125,068 | 13,542 |
| 2021 | 87,139 | 13,527 |
| 2022 | 17,016 | 13,218 |
| Thereafter | <u>5,168</u> | <u>10,309</u> |
| Total | <u>\$ 340,296</u> | <u>77,758</u> |

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

| Florida Retirement System | | | | |
|--|--|-------------------------------|---|--|
| | Recognized in expense reporting period ending June 30, 2016 | Recognition period | Deferred outflows of resources | Deferred inflows of resources |
| Service cost | \$ 56,058 | Current | — | — |
| Interest cost | 310,818 | Current | — | — |
| Effect of plan changes | — | Current | — | — |
| Effect of economic/demographic gains or losses (difference between expected and actual experience) | 4,933 | 6.3 years | 36,158 | (8,123) |
| Effect of assumptions changes or inputs | 5,287 | 6.3 years | 22,733 | — |
| Member contributions | (18,517) | Current | — | — |
| Projected investment earnings | (297,257) | Current | — | — |
| Changes in proportion and differences between contributions and proportionate share of contributions | 10,863 | 6.3 years | 53,075 | — |
| Net difference between projected and actual investment earnings | (37,314) | 5 years | — | (81,783) |
| Contributions subsequent to the measurement date | — | 1 year | 69,114 | — |
| Administrative expenses | 479 | Current | — | — |
| Total | \$ <u>35,350</u> | | <u>181,080</u> | <u>(89,906)</u> |

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

| Health Insurance Subsidy | | | | |
|--|---|-------------------------------|---|--|
| | Recognized in in expense reporting period ending June 30, 2016 | Recognition period | Deferred outflows of resources | Deferred inflows of resources |
| Service cost | \$ 7,053 | Current | — | — |
| Interest cost | 13,145 | Current | — | — |
| Effect of plan changes | — | Current | — | — |
| Effect of economic/demographic gains or losses (difference between expected and actual experience) | — | 7.2 years | — | — |
| Effect of assumptions changes or inputs | 4,476 | 7.2 years | 26,014 | — |
| Member contributions | — | Current | — | — |
| Projected investment earnings | (100) | Current | — | — |
| Changes in proportion and differences between contributions and proportionate share of contributions | 1,189 | 7.2 years | 16,295 | (7,481) |
| Net difference between projected and actual investment earnings | 54 | 5 years | 179 | — |
| Contributions subsequent to the measurement date | — | 1 year | 17,215 | — |
| Administrative expenses | 6 | Current | — | — |
| Total | \$ 25,823 | | 59,703 | (7,481) |
| Total for all defined benefit pension plans | \$ 61,173 | | 240,783 | (97,387) |

Deferred outflows of resources related to contributions paid subsequent to the measurement date as shown in the tables above will be recognized as a reduction of the net pension liability in the reporting period ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pension expense will be recognized as follows:

| | <u>FRS expense</u> | <u>HIS expense</u> |
|----------------------------------|---------------------------|---------------------------|
| Reporting period ending June 30: | | |
| 2017 | \$ (16,230) | 5,719 |
| 2018 | (16,230) | 5,719 |
| 2019 | (16,230) | 5,719 |
| 2020 | 51,242 | 5,682 |
| 2021 | 15,552 | 5,665 |
| Thereafter | 3,956 | 6,503 |
| Total | \$ 22,060 | 35,007 |

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

Payables to the Defined Benefit Pension Plans

The Fund reported payables of \$7,740 to the FRS and \$1,464 to the HIS Program as of June 30, 2017 for legally required contributions to the plans. The payables are included in accrued expenses as a current liability in the Combined Statements of Net Position.

| Payable at June 30, 2017 | FRS pension plan¹ | HIS Program pension plan |
|---|---|-------------------------------------|
| Employer pension contribution payable for defined benefit plan participants | \$ 5,074 | 1,073 |
| Employer UAL and HIS pension contribution payable for FRS investment plan participants ² | <u>2,666</u> | <u>391</u> |
| Total defined benefit pension expense payable at June 30, 2017 | \$ <u><u>7,740</u></u> | <u><u>1,464</u></u> |

¹ FRS pension plan amounts do not include the fees (.06% of payroll) charged to cover the administrative cost for the FRS Pension Plan and the FRS Financial Guidance Program. The fees owed at June 30, 2017 totaled \$24 for FRS defined benefit plan members and \$14 for FRS investment plan participants.

² The amount reported as employer UAL pension contributions payable for FRS investment plan participants includes \$60 in disability expense paid into the FRS pension plan on behalf of FRS investment plan participants.

The Fund reported payables of \$6,180 to the FRS and \$1,304 to the HIS Program as of June 30, 2016 for legally required contributions to the plans. The payables are included in accrued expenses as a current liability in the Combined Statements of Net Position.

| Payable at June 30, 2016 | FRS pension plan¹ | HIS Program pension plan |
|---|---|-------------------------------------|
| Employer pension contribution payable for defined benefit plan participants | \$ 3,627 | 917 |
| Employer UAL and HIS pension contribution payable for FRS investment plan participants ² | <u>2,553</u> | <u>387</u> |
| Total defined benefit pension expense payable at June 30, 2016 | \$ <u><u>6,180</u></u> | <u><u>1,304</u></u> |

¹ FRS pension plan amounts do not include the fees (.04% of payroll) charged to cover the administrative cost for the FRS Pension Plan and the FRS Financial Guidance Program. The fees owed at June 30, 2016 totaled \$18 for FRS defined benefit plan members and \$9 for FRS investment plan participants.

² The amount reported as employer UAL pension contributions payable for FRS investment plan participants includes \$60 in disability expense paid into the FRS pension plan on behalf of FRS investment plan participants.

2. Defined Contribution Programs

FRS Investment Plan

The State Board of Administration administers the defined contribution plan officially titled the FRS Investment Plan. The Florida Legislature establishes and amends the benefit terms of the plan. Retirement benefits are based upon the value of the member's account upon retirement. The FRS Investment Plan provides vesting after one year of service regardless of membership class. If an

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

accumulated benefit obligation for service credit originally earned under the FRS Pension Plan is transferred to the FRS Investment Plan, the years of service required for vesting under the Pension Plan (including the service credit represented by the transferred funds) is required to be vested for these funds and the earnings of the funds. The employer pays a contribution as a percentage of salary that is deposited into the individual member's account. Effective July 1, 2011, there is a mandatory employee contribution of 3.00%. The FRS Investment Plan member directs the investment from the options offered under the plan. Costs of administering the plan, including the FRS Financial Guidance Program, are funded through an employer assessment of 0.06% (0.04% for the fiscal year ended June 30, 2016) of payroll and by forfeited benefits of plan members. After termination and applying to receive benefits, the member may rollover vested funds to another qualified plan, structure a periodic payment under the FRS Investment Plan, receive a lump-sum distribution, or leave the funds invested for future distribution. Disability coverage is provided; the employer pays an employer contribution to the fund the disability benefit which is deposited in the FRS Trust Fund. The member may either transfer the account balance to the FRS Pension Plan when approved for disability retirement to receive guaranteed lifetime monthly benefits under the FRS Pension Plan, or remain in the FRS Investment Plan and rely upon that account balance for retirement income.

Pension Amounts for the FRS Investment Plan

During the fiscal years ended June 30, 2017, and June 30, 2016, the Fund recognized \$11,920 and \$7,876 in pension expense related to the FRS Investment Plan, respectively, and employee contributions totaled \$8,445 and \$6,963. As of June 30, 2017 and June 30, 2016, the Fund reported current liabilities of \$1,000 and \$985, respectively, for June employer contributions to be paid to employee accounts in the following month. This liability is included in accrued expenses as a current liability on the Combined Statements of Net Position.

Blended rates paid by the employer for employees participating in the FRS Investment Plan include required contributions paid to the Health Insurance Subsidy (HIS) Program Pension Plan, the unfunded actuarial liability (UAL) contributions to the FRS Pension Plan, disability fees (also paid into the FRS Pension Plan), contributions to defined contribution participant accounts, and administrative fees. Amounts paid into the two defined benefit pension plans are already included in the net pension liability for those plans. Forfeiture amounts for the Fund are not available, as forfeitures are used only to offset the overall administrative cost of the defined contribution plan and the amount attributable to reducing the Fund's administrative expenses is unknown. Schedules of employer contributions on behalf of

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

employees in the FRS Investment Plan for June 30, 2017 and June 30, 2016 fiscal years are presented below:

| FRS Investment Plan expenses | Reporting period ended June 30, 2017 | Payable at June 30, 2017 |
|--|---|---------------------------------|
| Gross pension employer contribution | \$ 48,534 | 4,071 |
| Less contributions to HIS Pension Plan | (4,673) | (391) |
| Less UAL contributions to FRS Pension Plan | (31,049) | (2,606) |
| Less disability fees | (723) | (60) |
| Less administrative fees | (169) | (14) |
| Net pension expense/liability | <u>\$ 11,920</u> | <u>1,000</u> |

| FRS Investment Plan expenses | Reporting period ended June 30, 2016 | Payable at June 30, 2016 |
|--|---|---------------------------------|
| Gross pension employer contribution | \$ 19,094 | 3,934 |
| Less contributions to HIS Pension Plan | (3,853) | (387) |
| Less UAL contributions to FRS Pension Plan | (6,690) | (2,493) |
| Less disability fees | (582) | (60) |
| Less administrative fees | (93) | (9) |
| Net pension expense/liability | <u>\$ 7,876</u> | <u>985</u> |

3. Other Postemployment Benefits (OPEB)

The Fund participates in the State Employees Health Insurance Program, a cost-sharing multiple-employer defined benefit postemployment healthcare plan administered by the State of Florida, Department of Management Services, Division of State Group Insurance, to provide group health benefits. Section 110.123, Florida Statutes, provides that retirees may participate in the State's group health insurance programs and assigns the authority to establish and amend benefit provisions to the Department of Management Services. Although premiums are paid by the retiree, the premium cost to the retiree is implicitly subsidized by the commingling of claims experience in a single risk pool with a single premium determination. An actuarial valuation has been performed for the plan and the Fund's employees were included in the actuarial analysis. For more information on the plan regarding the funding policy and actuarial methods and assumptions, see the State of Florida's Comprehensive Annual Financial Report, which is available from the Department of Financial Services. The Fund's postemployment health benefits payable at June 30, 2017 and June 30, 2016 were \$73,392 and \$59,030, respectively.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

(15) Subsequent Events

The Fund has reviewed and considered the events subsequent to the date of the combined financial statements through November 2, 2017, which is the date the combined financial statements were available to be issued, and are disclosing the following subsequent events:

- On September 10, 2017, Hurricane Irma made its first Florida landfall on Cudjoe Key, Florida as a Category 4 hurricane before weakening to a Category 3 and making a second landfall on Marco Island, Florida.
- On October 8, 2017, Hurricane Nate made landfall near Biloxi, Mississippi as a Category 1 hurricane. Although the eye of the storm did not directly hit Florida, the state's panhandle was impacted by the 85 mph winds.
- On August 24, 2017, the Fund received \$1.3 million as a share of the State's settlement involving Barclays Bank PLC and Barclays Capital Inc. related to the U.S. Dollar LIBOR benchmark interest rate index.

(16) Condensed Combining Information

The combined financial statements represent the financial position of the Fund, which includes the Corporation. The Corporation is included as a blended component unit of the Fund because it provides services exclusively for the benefit of the Fund.

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

The following table provides the condensed combining assets information of the Fund as of June 30, 2017 (in thousands):

| <u>Assets</u> | <u>Combined</u> | <u>Florida Hurricane Catastrophe Fund</u> | <u>State Board of Administration Finance Corporation</u> |
|---|----------------------|---|--|
| Current assets: | | | |
| Cash and cash equivalents | \$ 11 | 2 | 9 |
| Short-term investments | 12,902,205 | 10,735,880 | 2,166,325 |
| Investment sales receivable | 88,307 | 78,270 | 10,037 |
| Emergency assessment funds receivable | — | — | — |
| Premium receivable | 93,856 | 93,856 | — |
| Accrued interest | 18,495 | 16,338 | 2,157 |
| Prepaid expenses | 4 | 4 | — |
| Total current assets | <u>13,102,878</u> | <u>10,924,350</u> | <u>2,178,528</u> |
| Long-term assets: | | | |
| Long-term investments | 3,733,078 | 3,093,554 | 639,524 |
| Capital assets, net of accumulated depreciation | 8 | 8 | — |
| Total long-term assets | <u>3,733,086</u> | <u>3,093,562</u> | <u>639,524</u> |
| Total assets | <u>\$ 16,835,964</u> | <u>14,017,912</u> | <u>2,818,052</u> |
| Deferred outflows of resources: | | | |
| Deferred outflows related to pensions (note 14) | \$ 534 | 534 | — |

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

The following table provides the condensed combining liabilities and net position information of the Fund as of June 30, 2017 (in thousands):

| <u>Liabilities</u> | <u>Combined</u> | <u>Florida Hurricane Catastrophe</u> | <u>State Board of Administration Finance Corporation</u> |
|---|----------------------|--|--|
| Current liabilities: | | | |
| Unpaid hurricane losses | \$ 1,000 | 1,000 | — |
| Premium refunds payable | 2 | 2 | — |
| Accrued expenses | 6,473 | 6,410 | 63 |
| Bonds payable | — | — | — |
| Payable for securities purchased | 112,329 | 77,329 | 35,000 |
| Accrued bond interest expense | 34,764 | — | 34,764 |
| Net pension liability (note 14) | — | — | — |
| Total current liabilities | <u>154,568</u> | <u>84,741</u> | <u>69,827</u> |
| Long-term liabilities: | | | |
| Bonds payable | 2,700,000 | — | 2,700,000 |
| Net pension liability (note 14) | 1,107 | 1,107 | — |
| Compensated absences, net of current portion | 144 | 144 | — |
| Other post-employment benefits payable | 73 | 73 | — |
| Total long-term liabilities | <u>2,701,324</u> | <u>1,324</u> | <u>2,700,000</u> |
| Total liabilities | <u>2,855,892</u> | <u>86,065</u> | <u>2,769,827</u> |
| Deferred inflows of resources: | | | |
| Deferred inflows related to pensions (note 14) | 14 | 14 | — |
| Net position: | | | |
| Net investment in capital assets | 8 | 8 | — |
| Unrestricted | 13,980,584 | 13,932,359 | 48,225 |
| Total net position | <u>\$ 13,980,592</u> | <u>13,932,367</u> | <u>48,225</u> |

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

The following table provides the condensed combining revenues, expenses, and changes in net position information of the Fund for the year ended June 30, 2017 (in thousands):

| | Combined | Florida Hurricane Catastrophe Fund | State Board of Administration Finance Corporation |
|--|----------------------|---|--|
| Operating revenues: | | | |
| Net premium revenue (net of reinsurance premium) | \$ 1,068,212 | 1,068,212 | — |
| Net interest on premium adjustments | (35) | (35) | — |
| Other | 41 | 41 | — |
| Total operating revenues | <u>1,068,218</u> | <u>1,068,218</u> | <u>—</u> |
| Operating expenses: | | | |
| Hurricane losses | 1,000 | 1,000 | — |
| Administrative and actuarial fees | 2,795 | 2,795 | — |
| Other professional fees | 1,022 | 1,015 | 7 |
| Personnel expenses | 1,574 | 1,574 | — |
| Depreciation | 4 | 4 | — |
| Other | 286 | 277 | 9 |
| Total operating expenses | <u>6,681</u> | <u>6,665</u> | <u>16</u> |
| Operating income | <u>1,061,537</u> | <u>1,061,553</u> | <u>(16)</u> |
| Nonoperating revenue (expense): | | | |
| Investment income | 135,538 | 112,672 | 22,866 |
| Investment advisor fees | (3,652) | (3,042) | (610) |
| Investment custodian fees | (217) | (180) | (37) |
| Emergency assessment revenue (expense) | 300 | (417) | 717 |
| Bond interest expense | (69,529) | — | (69,529) |
| Other non-operating income | 1 | 1 | — |
| Total nonoperating revenue | <u>62,441</u> | <u>109,034</u> | <u>(46,593)</u> |
| Income before transfers | 1,123,978 | 1,170,587 | (46,609) |
| Transfers to (from) component units | — | (46,012) | 46,012 |
| Transfers to other state agencies | (10,000) | (10,000) | — |
| Change in net position | <u>1,113,978</u> | <u>1,114,575</u> | <u>(597)</u> |
| Net position at beginning of year | <u>12,866,614</u> | <u>12,817,792</u> | <u>48,822</u> |
| Net position at end of year | <u>\$ 13,980,592</u> | <u>13,932,367</u> | <u>48,225</u> |

FLORIDA HURRICANE CATASTROPHE FUND

Notes to Combined Financial Statements

June 30, 2017 and 2016

The following table provides the condensed combining cash flows information of the Fund for the year ended June 30, 2017 (in thousands):

| | <u>Combined</u> | <u>Fund</u> | <u>Corporation</u> |
|---|------------------|--------------------|--------------------|
| Operating activities: | | | |
| Net premium received | \$ 1,068,801 | 1,068,801 | — |
| Hurricane losses paid | — | — | — |
| Other cash received from customers | 41 | 41 | — |
| Administrative and actuarial fees | (2,591) | (2,591) | — |
| Other professional fees | (1,098) | (1,091) | (7) |
| Personnel expenses | (1,469) | (1,469) | — |
| Other cash paid to vendors | (259) | (250) | (9) |
| | <u>1,063,425</u> | <u>1,063,441</u> | <u>(16)</u> |
| Investing activities: | | | |
| Purchases of investments | (117,884,160) | (103,235,941) | (14,648,219) |
| Sales and maturities of investments | 117,324,740 | 102,167,496 | 15,157,244 |
| Interest received | 76,526 | 64,588 | 11,938 |
| Investment advisor fees | (3,630) | (3,020) | (610) |
| Investment custodian fees | (180) | (148) | (32) |
| Other non-operating income | 1 | 1 | — |
| | <u>(486,703)</u> | <u>(1,007,024)</u> | <u>520,321</u> |
| Financing from noncapital activities: | | | |
| Transfers to other state agencies | (10,000) | (56,012) | 46,012 |
| Emergency assessments funds received | 648 | (401) | 1,049 |
| Bond principal paid | (500,000) | — | (500,000) |
| Bond interest paid | (67,368) | — | (67,368) |
| | <u>(576,720)</u> | <u>(56,413)</u> | <u>(520,307)</u> |
| Financing from capital activity: | | | |
| Purchases of capital assets | (2) | (2) | — |
| | <u>—</u> | <u>2</u> | <u>(2)</u> |
| Cash and cash equivalents at beginning of year | | | |
| | <u>11</u> | <u>—</u> | <u>11</u> |
| Cash and cash equivalents at end of year | | | |
| | <u>\$ 11</u> | <u>2</u> | <u>9</u> |

FLORIDA HURRICANE CATASTROPHE FUND

Required Supplementary Information (Unaudited)

June 30, 2017 and 2016

**Cost-Sharing Multiple-Employer Defined Benefit Pension Plans – Last 10 Fiscal Years*
Schedule of Fund's Proportionate Share of Net Pension Liability and Related Ratios as of
Measurement Date**

| | Florida Retirement System 2016 | Florida Retirement System 2015 | Florida Retirement System 2014 |
|--|--|--|--|
| Fund's proportion of the net pension liability | 0.002834117% | 0.002651678% | 0.002394824% |
| Fund's proportionate share of the net pension liability | \$ 715,617 | 342,500 | 146,119 |
| Fund's covered payroll | 1,036,792 | 983,644 | 900,947 |
| Fund's proportionate share of the net pension liability as a percentage of its covered payroll | 69.02% | 34.82% | 16.22% |
| Plan fiduciary net position as a percentage of the total pension liability | 84.88% | 92.00% | 96.09% |
| | Health Insurance Subsidy Program 2016 | Health Insurance Subsidy Program 2015 | Health Insurance Subsidy Program 2014 |
| Fund's proportion of the net pension liability | 0.003358544% | 0.003242266% | 0.003032327% |
| Fund's proportionate share of the net pension liability | 391,424 | 330,660 | 283,530 |
| Fund's covered payroll | 1,036,792 | 983,644 | 900,947 |
| Fund's proportionate share of the net pension liability as a percentage of its covered payroll | 37.75% | 33.62% | 31.47% |
| Plan fiduciary net position as a percentage of the total pension liability | 0.97% | 0.50% | 0.99% |

* Fiscal year 2015 was the first year of implementation; therefore, only three years are shown.

FLORIDA HURRICANE CATASTROPHE FUND

Required Supplementary Information (Unaudited)

June 30, 2017 and 2016

**Cost-Sharing Multiple-Employer Defined Benefit Pension Plans – Last 10 Fiscal Years*
Schedule of Fund's Contributions**

| | Florida Retirement System | | | |
|--|---|-----------------|-----------------|-----------------|
| | <u>2017</u> | <u>2016</u> | <u>2015</u> | <u>2014</u> |
| Contractually required contributions | \$ 84,998 | 69,114 | 64,650 | 52,457 |
| Fund's contributions in relation to the contractually required contributions | <u>(84,998)</u> | <u>(69,114)</u> | <u>(64,650)</u> | <u>(52,457)</u> |
| Contribution deficiency (excess) | <u>\$ —</u> | <u>—</u> | <u>—</u> | <u>—</u> |
| Fund's covered payroll | \$ 1,038,160 | 1,036,792 | 983,644 | 900,947 |
| Contributions as a percentage of covered payroll | 8.19% | 6.67% | 6.57% | 5.82% |
| | Health Insurance Subsidy Program | | | |
| | <u>2017</u> | <u>2016</u> | <u>2015</u> | <u>2014</u> |
| Contractually required contributions | \$ 17,237 | 17,215 | 12,394 | 10,388 |
| Fund's contributions in relation to the contractually required contributions | <u>(17,237)</u> | <u>(17,215)</u> | <u>(12,394)</u> | <u>(10,388)</u> |
| Contribution deficiency (excess) | <u>\$ —</u> | <u>—</u> | <u>—</u> | <u>—</u> |
| Fund's covered payroll | \$ 1,038,160 | 1,036,792 | 983,644 | 900,947 |
| Contributions as a percentage of covered payroll | 1.66% | 1.66% | 1.26% | 1.15% |

* Fiscal year 2015 was the first year of implementation. Additional years' information will be included as it becomes available in future years.



KPMG LLP
4200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402

Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

The Trustees of the State Board of Administration of Florida
Florida Hurricane Catastrophe Fund:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the combined financial statements of the Florida Hurricane Catastrophe Fund (the Fund), which comprise the combined statements of net position as of June 30, 2017 and 2016, and the related combined statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the combined financial statements, and have issued our report thereon dated November 2, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the combined financial statements, we considered the Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the combined financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's combined financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Minneapolis, Minnesota
November 2, 2017