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PERSPECTIVES ON NATURAL DISASTER INSURANCE

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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PERSPECTIVES ON NATURAL DISASTER INSURANCE

Tuesday, March 27, 2007

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND
COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:40 p.m., in the Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the subcommittee] presiding.

Present: Representatives Waters, Cleaver, Green, Murphy; Biggert, Shays, and Neugebauer.

Ex officio: Representative Bachus.

Also present: Representatives Watt and Feeney.

Chairwoman WATERS. This hearing of the Subcommittee on Housing and Community Opportunity will come to order. Without objection, all members' opening statements will be made a part of the record.

I would like to start by introducing each of our witnesses. We have a panel of elected officials here, Members of Congress, who are with us today.

On panel one we have: the Honorable Gene Taylor, representing Mississippi; the Honorable Ron Klein, representing Florida; the Honorable Tim Mahoney, representing Florida; and the Honorable Ginny Brown-Waite, also representing Florida.

Without objection, the written statements will be made a part of the record. You will each be recognized for a 5-minute summary of your testimony. With that, let me just start with Mr. Taylor.

STATEMENT OF THE HONORABLE GENE TAYLOR, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSISSIPPI

Mr. TAYLOR. Thank you, Madam Chairwoman. And I want to thank you for having a hearing to address a problem that affects not just south Mississippi, but 53 percent of all Americans; according to NOAA, 53 percent of all Americans live in a coastal community. In 17 States, from the Gulf of Mexico to the Atlantic Coast, the insurance industry, on a State-by-State basis, is pulling out.

Long experience in south Mississippi is that, despite the efforts of south Mississippians to board up their homes, and to protect their goods, thousands of people lost everything they owned the night of Hurricane Katrina. That was the first tragedy.

The second tragedy was that within days of the storm they were told that because there was wind and water that occurred—even though they had bought all the insurance that was available to them in both a wind policy and a flood policy—they were denied wind coverage. In fact, it seems the only people who were paid their wind claims in the beginning were people who were eye witnesses to the devastation of the storm.

So now, Madam Chairwoman, what I'm going to ask you to do is—in response to the fact that the insurance industry apparently no longer wants to cover people for wind damage in coastal America, or will not provide that coverage at a cost that is reasonable—to consider legislation that will expand the National Flood Insurance Program to include all natural perils.

Under the rules of this House, it would have to be done in a way that pays for itself. Thus, any argument that this would be taxpayer-subsidized would be eliminated because under the new Rules of the House, that is not an option. But it does affect thousands of people.

And quite frankly, people should be encouraged to get out of coastal areas in a time of a storm, rather than encouraged to stay behind with a camera to record the event.

In my State, thousands of people have had to resort to hiring a lawyer, hiring engineers, and having to go to court. In fact, about the only people who have gotten justice were either eyewitnesses, or people who hired high-profile lawyers to settle their claims. That really shouldn't be the case.

In the case of the Flood Insurance Program, we allow the private sector to write that policy, but we also allow them to adjudicate the claim. So, as companies are issuing internal documents that tell their employees to blame everything on the water, and pay the flood claim immediately, that flies in the face of their contractual obligation to our Nation, to a fair adjudication of claims.

So, the present system isn't working. It's not working for individuals who are affected by the storm, and it's not working for our Nation's taxpayers, who paid the difference. I would remind my colleagues that in the same year that the insurance industry had $45 billion in profits, the National Flood Insurance Program lost $20 billion. It doesn't have to be that way.

Our Nation stepped forward in the late 1960's to come up with the National Flood Insurance Program, because there was a need that the private sector chose not to fill, and our Nation wisely filled that need. I think it's time for our Nation to step forward once again for a need that needs to be filled that the private sector, for whatever reason, is choosing not to fill, and that is for all catastrophic—whether it's a tornado in Alabama, an earthquake in California, a fire in the Pacific Northwest, as long as a person has built their home to the proper standards, as long as they have paid their premiums, as long as we can devise a program that is done in a way that pays for itself, the people of America ought to be protected.

Because in south Mississippi right now, it is a common occurrence for people who had 3,000-, 4,000-, or 5,000 square-foot houses to be replacing them with 1,000 square-foot houses. First, because they weren't paid their claim from the last storm, and now they're

being told, "If you do rebuild, you're going to pay 4 or 5 or 6 times more for insurance than you did before." Quite frankly, no one I know wants to pay more on an insurance note than they want to pay on a house note.

It just stands to reason that we have to do better. We have to do better as far as building codes, and we have to do better as far as the national flood elevation maps, which were so grossly inadequate. It's in the Nation's best interest to do this for the 53 percent of all Americans who live in coastal America.

So, Madam Chairwoman, we have had many opportunities to speak about this, but this is the first opportunity to actually offer a piece of legislation. And so, I would very much request that, at your convenience, some sort of a mark-up be held on H.R.—I believe it's 94, with the opportunity to make the case for that, as a stand-alone measure.

I welcome what my colleagues in Florida have to say today. I don't believe reinsurance is the answer, but I am pleased to see such a large delegation recognizing that the problem does exist, and it exists not just for them, for Mississippi, for South Carolina, and Alabama, but for the 53 percent of all Americans who live in a coastal community, and who are looking to their Nation for some help.

Chairwoman WATERS. Thank you very much, Mr. Taylor. I allowed you to give your testimony, because you told me that you may have to leave a little bit early. But if you could remain around, I will then move to allowing the members of the committee to give opening statements.

And then, of course, for those members who wish to remain around for some questions, we would like to have you stay. But if not, we do understand that you all are under some time constraints.

I would first like to thank the ranking member of the Subcommittee on Housing and Community Opportunity, Mrs. Biggert, for working with me to hold today's hearing, "Perspectives on Natural Disaster Insurance."

This is not a prelude to legislation on this issue, although many of you are aware of the various bills that have been introduceed to address natural disasters. Some of the Members of Congress who have introduced bills, certainly, are here today.

So let me just welcome the Members of Congress who are testifying before the subcommittee. Again, I ask you to stay, if you can, after you give your testimony, for questions. But if you have to leave, we do understand that.

The issue of natural disasters and insurance has been front and center in the 110th Congress, as well as in the 109th Congress. If any of you have visited the Gulf Coast region since Hurricanes Katrina and Rita, you understand that it is essential that we come to grips with reality, and the potential for another major disaster.

More than half of the City of New Orleans's pre-storm population of nearly 450,000 remains absent from the City, and large areas of the City are still uninhabitable. The estimate of destroyed or severely damaged housing stock in the Gulf region is as high as 300,000 units, representing billions of dollars in lost equity, pain, and suffering.

We were not adequately prepared to deal with the aftermath of Katrina and Rita, and there are many who feel that we are still not ready for another major disaster. The National Flood Insurance Program estimates that it will reach its $20.78 billion limit in September of 2007, through claims payments and interest payments on outstanding debt. The NFIP has already borrowed more than $17 billion, just to deal with claims from Hurricanes Katrina and Rita. So, if we have a hurricane season this year that is catastrophic in nature, will it be prepared to address the additional claims?

Insurance is also one of the major obstacles to rebuilding in the Gulf region. Both the Louisiana and the State of Mississippi homeowners grant assistance programs have been slowed, in part, by insurance issues.

Each time that I have visited the Gulf, and as recently as February, when the subcommittee held hearings in the Gulf region—New Orleans and Gulf Port, Mississippi, I have heard countless horror stories related to the damage incurred as a result of the hurricanes in the Gulf region, and the problems with insurance.

Insurance is one aspect of recovery that we need to be able to rely on after catastrophic catastrophe, to help make people's lives whole again. The reverse has been true for many, and many insurance claims have gone unpaid, or the claims paid have not been commensurate with the damage to the property. People cannot rebuild without adequate financial resources in the aftermath of a natural disaster.

However, cost is critical. And many are not able to afford insurance. While there are those who have limited and inadequate insurance, prior to a disaster, in places like California, many decided not to carry insurance at all, precisely because they believed that the government will become involved if a natural catastrophe occurs. We all know this is partially true.

Many insurance companies do not offer flood damage insurance. Many homeowners have the option to obtain a policy under a State program, which is unaffordable for most, and it's not carried by many, for this simple reason. In New Orleans, only one-half of the households had flood insurance under the government's National Flood Insurance Program.

Whether the cause of the damage is wind or water, most homeowners merely want to be able to get on with their lives, and have their insurance companies pay their claims.

Last year, the House supported national flood insurance reform legislation, which takes important steps to make the National Flood Insurance Program work, but we still have major gaps in that program, and no program tied to natural disasters.

Today's hearing is a proactive step to establish an effort to answer several questions. What role do insurance companies play in natural catastrophes or disasters? How do insurance companies assist in the recovery process? Or do they undermine the process? Do the efforts of insurance companies support the rebuilding process, where there has been a natural disaster or catastrophe? Is there a role for the Federal Government, and the States in partnership, to provide insurance in the event of a natural disaster? What is the role of the reinsurance industry in natural disasters?

I look forward to hearing from the rest of my colleagues who are on this first panel today and, of course, from the industry experts who will be on the second panel. I thank you, and I will yield to Mrs. Biggert. Is Mr. Bachus here?

Mrs. BIGGERT. Yes.

Chairwoman WATERS. Oh, there you are. I think I had better yield to Mr. Bachus.

Mrs. BIGGERT. I would appreciate it.

Chairwoman WATERS. Would you appreciate that? All right; 5 minutes. Thank you.

Mr. BACHUS. I was actually hoping that Mrs. Biggert would go first, so I could be more informed on the issue. But first of all, let me thank you, Representative Taylor. I know that the last 2 years have been very difficult for you, and for your district, and I appreciate your testimony.

I also thank Chairwoman Waters and Mrs. Biggert for holding this hearing.

Seven of the twelve most costly natural disasters in American history occurred in 2004 or 2005, including Hurricanes Katrina, Rita, and Wilma. Even if the frequency and severity of future storms remains constant, as coastal development and property values expand over time, loss exposures will keep growing with new record damages certain to occur in coming years.

And this prospect has spurred continued pressure for government—you could call it involvement, or you could call it interference, depending on your philosophy—in the marketplace.

One of my concerns for government involvement, or increased involvement, is that the track record in the past has not been sterling. Insurance has accumulated roughly $600 billion of surplus, with tens of billions of disaster reinsurance available, and additional tens of trillions accessible in the investment market, seeking the highest rate of returns.

In fact, despite the enormous 2004 and 2005 losses, the insurance industry still achieved record growth in profits and surplus with relatively few insolvencies. The private market has now proven it has adequate capacity available to handle a $60 billion-plus event. The marketplace will not match the continued growth in coastal insurance demand, unless it can attract new capital by convincing investors that the rate of return outweighs the perceived risk.

Investors want to know, will the government control prices with rates required to be arbitrarily broken down and subject to formal or informal rejection? Will the government dictate what coverage can be afforded or excluded, and for how long? Will the government mandate payment for other insurer's losses through State-mandated subsidies of fair plans and guaranteed funds? And will government programs directly compete with the private market, undercutting fair prices through tax advantage, credit-subsidized State pools?

If these questions continue to be answered affirmatively, no amount of government safety net will bring back the private market. Capital is highly mobile, and excessive government interference becomes the disease, not the cure.

In particular, I am concerned about legislative proposals in the aftermath of Katrina to impose an enormous potential tax increase on all Americans to subsidize coastal insurance, largely in response to the actions by a small number of insurers who allowed their risk portfolios to be overextended in the Gulf Coast region.

And as Congressman Taylor said, we certainly witnessed some questionable conduct by a few of these insurance companies—I don't think all of them—and I think some have been really unfairly the target of criticism or scrutiny, because of the actions of one or two. But certainly there has been some really questionable conduct on the part of one or more of our insurers.

I don't want that questionable conduct of one or more insurers to lead to an overreaction by this Congress, or by government officials, and we should not allow it to become the foundation for Federal excess, in covering up the resulting flight of capital. We should not force rural and middle America to pick up the tab and insure insolvent State programs and insurers that want to maintain their market share without buying reinsurance.

Today, we will hear more testimony about whether the government should increase its involvement in disaster insurance.

I applaud the leadership of Congresswoman Brown-Waite and her fellow Floridians on this. Members of this committee have a long history of trying to establish a Federal backstop for disaster insurance, going back well over a decade. Mrs. Brown-Waite has also worked with Representative Moore from Kansas on streamlining the non-admitted and reinsurance markets, increasing insurance availability by reducing excessive government regulation, and allowing the marketplace to function more freely, in a bill that passed the House unanimously last year.

I am disappointed that Representative Jindal was not allowed to testify. He is not only an original co-sponsor of several bills to increase available disaster insurance for coastal consumers, but he is also the author of legislation to eliminate the tax penalty on long-term catastrophic reserves.

According to insurance regulators, allowing insurers to look forward, as well as back, on catastrophic losses, would help to reduce short-term volatility in coverage available after an event. This critical fix should be considered as part of any comprehensive solution.

Let me simply close by saying that, Congressman Taylor, I do—your idea about an all perils coverage, as opposed to just water or wind, obviously, I think we—because of the events and experiences we have seen along the Gulf Coast, there is a need for us to at least consider some of what you—some of your advice.

It does—it makes very little practical sense to have a property on the beach, where you have wind-driven water, and you find that the coverage—there is no coverage, because it was water, even though it was driven by the wind. And although that's the way the policies were apparently designed, and I guess approved, by the State of Mississippi, and maybe the State of Alabama—if we're going to have flood insurance, if we're going to have a Federal program, if we're going to have these policies, we certainly need to look at that.

And I would say this. I would solicit your advice as we move forward, and will promise that I will keep, at least as one member of

this committee, I will keep an open mind about this entire subject. And what I have read today is actually my opinion, now. That's subject to change. So, thank you.

Chairwoman WATERS. Thank you very much. I will yield 1 minute to the gentleman from Connecticut, Mr. Murphy.

Mr. MURPHY. Thank you, Madam Chairwoman. Just to say—I don't have a formal opening statement, but just to say I look forward of the testimony of, certainly, my two fellow freshmen members, Mr. Klein and Mr. Mahoney, as well as their colleague, who has been leading on this issue for a very long time.

For those of us who are new here, and who have watched what has happened to the Gulf Coast over the past several years, I think we, as well as many other people, understand that it's not enough for us to simply close our eyes and hope that this situation gets better.

Mr. Klein, in his written testimony, talks about a catastrophe financing plan at a national level, and I think that the members of this panel will find a lot of friends from throughout this country, who agree that this is a national concern.

And although the colors may change as you go throughout the country on a map such as that, what we watched happen—not just to those people who had homes right on the water in Louisiana and Florida, but those who made choices to live in their hometowns miles and miles inward from those very coastal areas—that's a national priority for many of us.

I look forward to working with the chairwoman, ranking member, and those members of the panel on that national financing plan. Thank you.

Chairwoman WATERS. Thank you very much. I yield 5 minutes to the ranking member of the subcommittee, the gentlelady from Illinois, Mrs. Biggert.

Mrs. BIGGERT. Thank you very much, Chairwoman Waters, and thank you for holding this hearing today. I would also like to, again, thank Mr. Taylor for his hospitality and his testimony when we held the field hearings in Mississippi.

I will keep my remarks short, so that we can hear from today's witnesses. First, I, too, wish that Mr. Jindal had been invited to testify. He has some interesting market-driven proposals to address insurance catastrophe issues; they fall within the jurisdiction of the Ways and Means Committee, but I think they warrant our attention.

Second, there are several questions that need answering today. Is it necessary for the Federal Government to provide reinsurance? Is there sufficient private reinsurance capacity? If the cost of reinsurance and insurance is rising in the most catastrophic-prone regions of our country, is it okay to let the marketplace assess the risk and price insurance accordingly?

If private insurance and reinsurance prices are high and rising in the most catastrophic-prone regions of our country, but the insurance is available, is it wise to set up the Federal program that offers less expensive reinsurance, putting taxpayers on the hook?

Third, I would like to mention that yesterday Chairman Frank and I introduced H.R. 1682, The Flood Insurance Reform and Modernization Act of 2007. After the 2005 hurricanes in the Gulf Coast,

it became abundantly clear that the National Flood Insurance Program was at risk of becoming insolvent and needed an overhaul.

The bill significantly reforms the program which provides flood insurance coverage for consumers. It does that by updating the Nation's flood maps, increasing enforcement and accountability, and reducing the burden on the taxpayer. This bill has been a long time in coming, but before we consider the proposals to expand the National Flood Insurance Program, we need to reform it, and make sure that it works.

I look forward to today's testimony and I yield back the balance of my time.

Chairwoman WATERS. Thank you, very much. We have two members who are with us who are not members of the subcommittee. I would like to request unanimous consent that they be able to give remarks, and without objection, such will be the order.

I will yield, before going to Mr. Feeney, to the gentleman from Missouri.

Mr. CLAY. Thank you, Madam Chairwoman. I will forgo any opening statement today in order to hear from our colleagues, and to let the other side present opening statements. Thank you.

Chairwoman WATERS. As I understand it, Mr. Neugebauer, you wish to speak, or be recognized for purposes of presentation for 3 minutes. I yield, to recognize you for 3 minutes.

Mr. NEUGEBAUER. Thank you, Madam Chairwoman. Also, I ask unanimous consent to enter into the record testimony submitted by Janice M. Abraham, president and CEO of United Educators Insurance and Reciprocal Risk Retention Group, of Chevy Chase, Maryland.

Thank you. Well, I appreciate this panel here, and I know that many of the people on this panel have been working tirelessly on coming up with a solution to this issue.

Certainly, I am a firm believer, and agree with most everyone, that we need to come up with a solution that doesn't portion liability when we have these events. When somebody runs into your car, or you back your car into a fire hydrant, what happens to your car doesn't really matter. What happens to your car if you suffer damage to your car, you know, your insurance company is responsible for that.

And so, I believe that the products that are offered along our coastline should be consistent, and that whatever the perils that might inflict damage to that house are covered.

I think some of us—and I think the interesting part of this debate will be—is what kind of solutions that we put in place. I have said, and feel very strongly, that, quite honestly, having a flood insurance and then a wind policy and a hurricane policy, and having these divided coverages creates a very similar situation to what Mr. Taylor was alluding to.

And so, what I would hope, as we move forward, is that we look for a policy, working with the insurance industry—I believe very strongly that the insurance industry needs to be driving this train—what are ways that we can encourage market solutions to this problem. I appreciate Ginny Brown-Waite trying to bring, in some way, an incentive to this process to—where the government has a—whatever minimal role it needs to take, in order to be able

to encourage the private sector to come and offer products to do that.

Now, what this is probably going to entail—and this is not something that everybody wants to hear but we have to make sure, also, that whatever kind of plan we put in place has to be actuarially sound. And so, in high-risk areas, the cost of that commodity, or the insurance, is probably going to be higher than in other places.

I live in west Texas, and on that map, we're susceptible to hail storms and tornadoes and wind storms out there. I am sure that we're paying a higher premium for living in that area than some people who are not susceptible to that, but that's just the part that goes with living in that area. I choose to live there, so whatever the fare is, that's what I am going to pay to live there.

But I don't think we need situations where companies are trying to look for a way to get out of the liability, but they have an actuarially sound policy, and when these disasters happen, we have people down there with checkbooks, and not lawyers, trying to keep from paying the claims.

And so, I look forward to this debate. I think this is a good process, with a lot of interesting proposals on the table, and I thank the chairwoman for holding this hearing.

Chairwoman WATERS. Thank you, very much. I recognize Mr. Shays for 3 minutes.

Mr. SHAYS. Thank you, Madam Chairwoman. And I thank the ranking member, as well, for this hearing.

I just want to express, first, my particular admiration to Gene Taylor, who sat in on the Katrina hearings, and provided tremendous insight. And also, just for your whole attitude during what took place, how you dealt with it personally, no complaining. I think you should be very proud of the people in your State, and how they have responded.

Just to say that I was there, a week after Katrina, and I was stunned to be both in Louisiana, where we saw, really, the bathtub of decay that occurred from the flooding of the levees into New Orleans. But then, to be 10 miles inland, in Mississippi, and see a water line 20 feet high. It literally was a water line on a bridge over a road. I was told that people used to bring their cars up there to protect them, 10 miles inland, and there was never any water, so to have 20 feet of just water blew me away.

So, there is a part of me that says that kind of circumstance we need to deal with. But where I have a bit of an issue is folks right on the coastline who are clearly in a high-risk area, and so I am going to be curious how I sort that out. I think that insurance companies have figured into their whole calculations that kind of cost, and I would not want them to then put it on the rest of us. So that's one point.

I do think there is a difference between natural disaster and a terrorist attack. And so I feel like, very clearly, the government needs to step in. So I am kind of someone who has real reservations, but still somewhat of an open mind about what we do here. But I do see a difference between natural and terrorist attacks.

But, again, I thank all of my colleagues, and I know Ginny Brown-Waite a little better than I know our new colleagues, and

I have just tremendous admiration for all of you for being here. Thank you.

Chairwoman WATERS. Thank you, very much. I recognize the gentleman from North Carolina, Mr. Mel Watt, for 3 minutes.

Mr. WATT. Thank you, Madam Chairwoman, and I won't take 3 minutes. I want to express my appreciation to the chairwoman for convening the hearing, and my appreciation for her allowing me to sit in and be a part of it.

The one thing that I think we all recognize in the aftermath of these hurricanes is that the insurance payment and adjusting process was broken in some ways, and that it had multiple parts to it—flood insurance, private insurance, various and sundry other parts—and none of them were working all that well together.

So, the result was that policyholders and non-policyholders came away, quite often, not feeling like they had been dealt with in the most effective way. And as we try to address that, the real concern I have is that we don't duplicate each other's efforts.

We had a hearing in the oversight subcommittee on insurance in general. I wanted to be here today to make sure that, as we chart the next hearing in our oversight subcommittee, we don't redo what another subcommittee has done, but we continue to build the factual record for us to make an effective legislative response to problems that have occurred.

And it's for that purpose I am here, and I appreciate the gentlelady, the chairwoman, and the ranking member, for allowing me to be a part of this, and I yield back.

Chairwoman WATERS. Thank you, very much. I recognize Mr. Feeney for 3 minutes.

Mr. FEENEY. I thank the chairwoman. This is obviously a very important issue to us in Florida. I have been a policymaker since 1990 in the State legislature.

We have a lot of experience with hurricanes. We learned some great lessons in 1993 with Hurricane Andrew. By the way, my son was born in the middle of that hurricane in Orlando. If I had known about his tempestuous personality, his name would probably be Andrew and not Tommy.

But we learned an awful lot of lessons, and I worked with my good friend and colleague, Ron Klein, and with my good friend and colleague, Ginny Brown-Waite, in the Florida legislature. By the way, we all know if that storm had hit 20 or 30 miles north, Congressman Klein, we would have been looking at a $110 billion event, or more, and not a $20 billion or $25 billion event. So, in some ways, we were fortunate, as bad as it was.

We learned a lot of lessons during that event. I think that Kevin McCarty, who will be testifying in the next panel, will share some of those lessons that we brought with us.

I would say that no State, no contemporary State, has thought more, or more successfully, about how to deal with preparation for hurricanes, in terms of response, in terms of the market abnormalities that occur in the aftermath, than Florida. We have experienced it. If you watch the preparation that occurred, and how we dealt with four hurricanes in a 3-month period a couple of years ago, you will see that we have learned some very serious lessons.

But perhaps nothing was more important as the lesson that the hurricanes were not a partisan issue. They're an issue with—where people on the ground have real needs that swamped the ability of local or State governments.

Since we have three Florida panelists here, I won't go into those details. Plus, Mr. McCarty—I am glad they—all three of my colleagues from Florida and Mr. Taylor—are here.

When we're talking about the national CAT fund, or a State and regional CAT fund, or some of the reinsurance bolstering that Representative Brown-Waite has been a leader in, whether we're talking about increasing reserve opportunities, all of these are important things.

But I would like to reiterate what Mr. Neugebauer said, and that is, ultimately, that actuaries and markets need to drive this show wherever and whenever possible. When politicians and bureaucrats drive this show, we're going to end up leaving responsibility in places where the incentives are all wrong and upside-down.

One of the bills I have provides for catastrophic savings accounts. Representative Wasserman-Schultz and I filed that last year. We intend to file it again this week, and it solved some problems of tax equity. The Florida markets—some people now have deductibles, for those in the audience, of as much as $20,000 or more on their home in Florida. So we have a very different market than much of the country.

Providing tax equity, getting people to think ahead of time about how they protect their homes, and how they have resources available, this doesn't work for everybody. But there are a lot of people that this will help, and there are many ways that we can, at a Federal level, adjust policy consistent with actuarial soundness and markets that will not throw the baby out with the bath water, and end up with a socialized property and casualty market.

With that, I thank the chairwoman, and yield back the balance of my time.

Chairwoman WATERS. Thank you, very much. Now we will return to our panel. The Honorable Ron Klein.

STATEMENT OF THE HONORABLE RON KLEIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. KLEIN. Good afternoon, Chairwoman Waters, and Ranking Member Biggert. I sincerely appreciate the opportunity to discuss natural disaster insurance before the subcommittee, particularly in light of the very helpful comments that were made so far today.

I hope that our presence at this hearing emphasizes the seriousness of this problem and demonstrates our commitment to move forward in identifying a national solution.

The 2005 hurricanes illustrated all too well how quickly a natural disaster can change the lives of millions. The most devastating of the storms, which struck from Louisiana to the Florida panhandle, also dealt unprecedented losses through residential, commercial, and industrial property. Hurricane Katrina, in particular, opened many eyes to the problem of natural disaster financing, and showed that it is up to us to make sure that we are adequately prepared to handle a disaster of catastrophic proportions, because it is simply a matter of time before the next one hits.

As such, we must think ahead, proactively, to develop a plan to address natural disasters before the next one hits, rather than simply continuing to operate without a catastrophic financing plan at the national level.

We have seen the consequences of large-scale disasters, and the physical and economic destruction that accompanied them, and must act responsibly and prepare to act responsibly.

We are all familiar with the sights and stories of Hurricane Katrina, but we must also recognize that families across the United States face a variety of other threats that could rise to the level of catastrophic proportions, and hit without warning. Many residents in California certainly remember the devastation caused by the North Ridge earthquake, which killed 60 people, injured 3,800, and caused $43 billion in property damage.

Even with California's history of seismic activity, only about 14 percent of Californians currently have earthquake policies, which is a real eye-opening statistic. It only takes one day of devastation from an earthquake, fire, volcano, flood, or hurricane to make us wish that we had thought ahead to establish a national system to deal with catastrophic financing.

The economic impact accompanying natural disasters resonates throughout our entire Nation. Total economic damages from the 2005 hurricanes will likely exceed $200 billion, with the Federal Government responsible for paying out an excess of $109 billion for disaster relief. This money, which we all agree was entirely necessary to spend, comes from taxpayers throughout our 50 States, not simply from those affected regions.

Those who say that natural disasters are a regional problem limited to coastal States are dead wrong. Until we are able to develop a national financing mechanism to provide certainty for large-scale natural catastrophes, each taxpayer throughout the United States will continue to be responsible following a catastrophic event.

On the local level, more and more families across the country are facing the real prospect of being dropped by the property insurance company. Hundreds of thousands of homeowners in my home State alone have been dropped, or slated for non-renewal by their insurance companies, even after they paid premiums for 15 to 20 years without making a claim. Those who remain insured are confronted with crippling premiums, which in some cases are forcing homeowners to make tough decisions about whether they can go without property insurance, which of course you can't do if you have a mortgage.

Take the case of one of my constituents. We have an individual in my district who was paying $3,100 a year for homeowners insurance in 2005. She is now coping with a premium that reached $16,000 this year. That's a $12,900 increase over 2 years. How can we possibly expect families to make payments each year to protect their homes.

Skyrocketing insurance premiums are posing a real threat to homeownership, particularly among our most vulnerable populations, such as the elderly. Older Americans, many of whom are on fixed incomes, may even have to lose their homes outright.

The property insurance crisis, as I said, is not isolated to Florida, either. Last year, property insurers indicated they planned to stop

offering new coverage in Maryland, and in Virginia's coastal markets. Property insurance carriers have also stopped writing new policies for residents in parts of Delaware, New Jersey, and Connecticut, no matter where in the State the damage may be.

Furthermore, tens of thousands of homeowners in New York, North Carolina, South Carolina, Alabama, and Texas have also been dropped. It is impossible for property owners to be able to get reliable coverage in these markets, and it's precisely for this reason that we need to have a national solution.

Over the last number of weeks, I have worked closely with Mr. Mahoney, Ms. Brown-Waite, Mrs. Maloney, and others, including Mr. Taylor, who has a number of ideas, as well. We have been working with Chairman Frank, who has asked us to work on this, and who also believes the natural solution is necessary. We are now discussing this issue with consumer groups and other interested parties, and we are assembling bi-partisan, multi-regional groups of Congressmen who collectively recognize the problem on a large scale. We're looking forward to a well-developed idea with a national backstop, much of which will be identified with the private sector and private sector financing ideas.

We will also be working to develop incentives for mitigation standards, including property owners' exposure—reducing property owners' exposure to natural disasters, which will be an important part of reducing the national exposure. We want to encourage responsible development through building code standards and other means.

The time for action is now. With the Federal Government clearly in the position of being the de facto insurer of last resort, we hope to establish a more efficient system to foster predictable coverage at reasonable rates.

Again, I would like to thank the subcommittee for holding this hearing today on this very important issue, and I am looking forward to working with all of you, Chairwoman Waters and others, and Ranking Member Biggert, to develop an appropriate solution. Thank you.

[The prepared statement of Mr. Klein can be found on page 52 of the appendix.]

Chairwoman WATERS. Thank you, very much.

The Honorable Tim Mahoney.

STATEMENT OF THE HONORABLE TIM MAHONEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. MAHONEY. Thank you, Chairwoman Waters, and Ranking Member Biggert, for holding this important hearing today, and allowing me to discuss problems that the people of my great State of Florida are having, coping with the devastating impact of natural disasters and their struggles to meet those challenges by having access to comprehensive and affordable homeowner insurance.

Before I begin summarizing the insurance crisis facing my district in the State of Florida, I want to make sure that this committee understands that this isn't just a problem for Florida; it's a national problem. States all around the Gulf Coast, from Texas all the way up to Maine are facing similar situations, due to hurricanes. My colleagues in California, with earthquakes and fires, and

my friends in Oklahoma and Ohio, with tornadoes and floods; we're all facing the same challenge.

The single biggest investment most Americans have is their home. The increased occurrence and severity of natural disasters, whether they be hurricanes, tornadoes, earthquakes, fires, or volcanoes, has caused insurance premiums to rise. In 2 years, the Gulf Coast region was struck by seven major hurricanes. Just one of those hurricanes, Hurricane Katrina, caused more than $40 billion of insured losses; approximately $15.5 billion of that amount was the result of homeowners' claims.

Up until the moment Katrina ravaged New Orleans and the Gulf Coast, my district, District 16, was the single biggest disaster area in the Nation, with no less than 4 major hurricanes destroying homes and businesses. Today, 3 years after Hurricane Charlie ravaged the town of Punta Gorda, you can still see the scarred downtown, and a community working heroically to rebuild.

Despite no major storms during the 2006 hurricane season, many Florida homeowners have seen their insurance premiums double or triple during this past year. Earlier this month, one Florida insurance company won an arbitration case that will allow it to raise premiums on more than 22,000 customers by an average of 75.8 percent.

As anyone who has ever had a mortgage, knows, insurance is a requirement. And the payment of your insurance is non-negotiable. This has created a vicious cycle of terror for our seniors living on fixed incomes and our middle class families struggling to provide for their children.

The toxic cocktail of rising gas prices, skyrocketing property taxes, and exorbitant homeowners' insurance costs have created a situation for the first time in our State's history where we have more people leaving Florida than coming. It is so acute that the real estate industry has a name for these people, "Half-backs." They move to Florida from the north, and due to the out-of-control costs, they leave Florida, and move halfway back, to places like Georgia, Tennessee, and North Carolina.

Madam Chairwoman, in fact, one in five businesses in Florida cannot get property insurance. In January, the Florida legislature passed legislation that was intended to provide consumers with rate cuts. Following the passage of this legislation, a Florida insurance commissioner estimated that the average rate cut for homeowners would be approximately 24 percent.

However, according to one Florida newspaper, Florida's biggest private insurers are asking for price cuts far less than State estimates. For example, State Farm, a Florida insurance company, requested a rate reduction plan that seeks to reduce the average premium in Florida by only 7 percent. Likewise, USAA's requested plan would decrease premiums by a mere 3.1 percent.

The situation is so severe that, in order to have insurance, the people of my State had to get into the business. Today, the State runs Citizens Insurance Company, the largest provider of homeowners' insurance in the State. The solution to our insolvent insurance company was to make it more competitive, by offering fire and theft coverage, as well, clearly the best solution our elected leaders could find when the market failed.

The affordability of property insurance is not the only obstacle facing my constituents. Millions of Florida's hardworking families have paid their insurance premiums on time for years. And despite the increased cost. In addition, many of these families have never filed a claim on their policy. Insurance companies have rewarded these responsible homeowners not with rebates, but with non-renewal notices.

Just a few weeks ago, Nationwide announced that it would continue with its earlier decision to non-renew policies in Florida. As a result, 25,000 Florida homeowners will be receiving notices that their policies will soon be canceled. The recent action by Nationwide, as well as similar decisions by their competitors, communicate that the market is broken, and that they are willing to be part of a solution.

As these companies profit from the freedom, stability, and prosperity this Nation offers, I believe that the industry should consider its corporate responsibility, and join with Congress and the American homeowners in finding a solution to this crisis.

Chairman Frank, at a press conference on this very subject, made the statement that, "The role of government is to step in when markets fail." I am here, Madam Chairwoman, to testify that in my beloved State of Florida, the insurance industry is broken, and as a result, the State is facing an economic crisis.

Floridians are giving up their American dream, and are being forced into foreclosure, or to make decisions not to take their prescription medicine, so that they can afford to pay their homeowners' insurance. Or, they're being forced to sell their homes in a depressed real estate market, and leave the State.

It is clear that homeowners across the country need a national catastrophe insurance program. The program that we in Congress create must assist our private insurance industry, to help them manage risk. Nobody got into the homeowners' insurance business thinking that they would ever need to underwrite the devastation of an Andrew or a Katrina.

Secondly, the homeowner needs to be protected, as it relates to the availability of homeowners' insurance. The policies they purchase must be comprehensive, eliminating the loophole between wind and water.

Finally, responsible legislation must ensure people take responsibility for their decisions to live in high-risk areas. Good legislation should not give people and builders a blank check to ignore risk. Good legislation must provide homeowners and builders with incentives to mitigate risk by employing state-of-the-art technology.

Again, I would like to thank Chairman Frank and Chairwoman Waters for their leadership on this issue, and I thank this committee for the opportunity to testify on behalf of the people of my State of Florida.

[The prepared statement of Mr. Mahoney can be found on page 55 of the appendix.]

Chairwoman WATERS. Thank you, very much.

The Honorable Ginny Brown-Waite.

STATEMENT OF THE HONORABLE GINNY BROWN-WAITE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Ms. BROWN-WAITE. I thank the chairwoman for holding this hearing for and giving us the opportunity to present testimony.

The insurance crisis that Florida and other coastal States are facing is imminent; and I am very grateful that this committee has taken an interest so early in the 110th Congress.

I have been working on this issue with my colleagues for the past 3 years, and while we have made some headway, the perception that natural disaster insurance availability and affordability is only a Florida problem could not be more wrong.

While it is true that Florida is feeling the effects more acutely, lawmakers in Louisiana and Mississippi are having a hard time luring insurance companies back to their States. And consumers as far north as Massachusetts, Chairman Frank's great State, a State that has not experienced significant natural disaster in a decade, are also losing their coverage.

Congress cannot wait for the market to completely collapse before we decide to act. And I thank you for your leadership on this issue.

I have introduced my bill, H.R. 91, the Homeowners Insurance Protection Act, and H.R. 330, the Homeowners Insurance Availability Act. I am also working with my colleagues Ron Klein, Tim Mahoney, Carolyn Maloney, and Vern Buchanan on a bipartisan solution to the property and casualty insurance crisis facing this Nation.

Additionally, my counterparts in the Senate introduced a version of my bill. The proposals are simple and specific. Both of these bills create a Federal catastrophic fund to provide the stability needed in today's market.

The main reason that States are losing providers is the skyrocketing cost of reinsurance. Those representing the insurance industry will testify that they have plenty of capacity. But what they won't tell you is that it is not affordable. In 2002, the cost of reinsurance accounted for 71 cents of every dollar a homeowner spent on insurance, and just 4 years later, in 2006, reinsurance accounted for 44.5 cents of every dollar homeowners' spent.

Madam Chairwoman, I ask for unanimous consent to submit this chart from the Florida office of insurance regulation, detailing the soaring cost of reinsurance.

Chairwoman WATERS. Without objection, it is so ordered.

Ms. BROWN-WAITE. I appreciate that. Until the market stabilizes, and reinsurers provide a product that is available and affordable, the Federal Government must have that role.

Both of my bills accomplish just that. H.R. 330 would divide the Nation into 6 different regions, so the Federal Government could sell reinsurance policies to the insurers. This Federal fund would only be available if a 1-in-100-year event or higher occurred. And this reinsurance would be a fraction of the cost, potentially as low as a quarter of what the current industry costs are.

H.R. 91 takes a different approach. The Federal Government would sell reinsurance policies directly to States, not private insurers, that have established State catastrophic funds. This approach

is more comprehensive, and better for our Nation, because under this bill, States would have to take the responsibility for planning for natural disasters by enacting strong building codes and committing at least 35 percent of their State funds toward mitigation.

Under H.R. 91, States would also have to establish a pass-through mechanism, so that any savings insurers realized from my bill are passed on to the consumers, as we all believe that they should be.

H.R. 91 also establishes tax-deferred reserves for private insurers. These act as kind of a savings account for insurers to plan for future catastrophic disasters, instead of relying so heavily on expensive reinsurance from the private market. Insurers could not use them unless there is a 1-in-100-year event or higher.

The role and responsibility of H.R. 91 is also considerably less than some of the other proposals that are before Congress. Under the bill, the Federal catastrophic fund could not be used unless a 1-in-200-year event or higher occurred. Additionally, once the reinsurance fund is triggered, States must still pay 10 percent of the cost so that the Federal Government is never on the hook for the full cost of the natural disaster.

In short, the bill offers a multi-layered approach to covering natural disasters. First, the primary insurers cover homeowner losses, and the States provide coverage. Then, finally, the Federal Government provides coverage, if need be.

Many members representing non-coastal States have asked me why they should support a national catastrophic fund. These members and their constituents forget that they already are paying under the fragmented insurance system that we operate under today. Congress is the insurer of last resort, even today, as we found out in Katrina.

Many of these projects are needed to help people rebuild their lives. Florida has even been a recipient of these funds from the Federal Government. But wouldn't it be nice if Congress already had a fund, a reinsurance fund, filled with insurer premiums, not tax dollars, to pay for these resurrection projects? For the first time, Congress would be proactive, instead of reactive. How unique.

Consider this. Since its enactment in 2001, not one dollar of the TRIA fund has been spent. Yet, insurers have allocated additional capacity to terrorism risk. Prices have declined, and purchase rates have increased. In 2003, only 27 percent of companies purchased terrorism reinsurance. In 2005, 58 percent purchased this insurance. Again, without one dollar of TRIA funds ever being spent.

I don't propose that my bills are the silver bullet, or the final answer. However, they are part of the solution.

There is only one State in the Nation not susceptible to natural disasters, and that is North Dakota. Every other State in the union is prone to hurricanes, earthquakes, and tornadoes. Either Congress moves everyone to North Dakota, or we enact real, meaningful, proactive solutions to a crisis that affects this whole Nation.

Let's look at who supports the bill: Realtors, bankers, and certainly homeowners are very supportive of these concepts.

Again, Madam Chairwoman, I thank you for your indulgence in holding this hearing, and for helping to shine the light on the need for this kind of Federal action.

[The prepared statement of Ms. Brown-Waite can be found on page 48 of the appendix.]

Chairwoman WATERS. Thank you, very much. I would like to thank all of the members for their patience. I would like to thank you for your concern. I would like to thank you for having decided that you're going to make this a priority on your legislative agenda.

We are confronted with a serious problem in this country. We do need your effort to help us solve it. I have been in the Gulf, I don't know how many times now. I have been with Mr. Taylor. I feel as if I know his district, his area very well, having gone there so many times. I know his passion for trying to help us come up with some answers, and I look forward to working with all of you. Thank you very much for being here today.

With that, we will call our second panel: Commissioner Kevin M. McCarty, Office of Insurance Regulation, State of Florida, on behalf of The National Association of Insurance Commissioners; Mr. Andrew Valdivia, CPCU, ARM, president, White & Company Insurance, Incorporated, on behalf of The Independent Insurance Agents and Brokers of America, from California; Mr. Malcolm Bennett, president, International Realty and Investments, on behalf of The National Multi-Housing Council, not only from California, but from my district; Mr. Robert Porter, executive director, ProtectingAmerica.org; Mr. Gary Thomas, also from California, the Orange County area, broker/owner, Re/MAX Real Estate Services, on behalf of The National Association of Realtors; Ms. Ann Spragens, senior vice president, secretary, and general counsel, Property Casualty Insurers Association of America; Mr. Marc Racicot, president, American Insurance Association; and Mr. Frank Nutter, president, Reinsurance Association of America. Welcome.

Without objection, your written statements will be made a part of the record. You will each be recognized for a 5-minute summary of your testimony. Let us begin with Commissioner Kevin M. McCarty, Office of Insurance Regulation, State of Florida.

STATEMENT OF KEVIN M. McCARTY, OFFICE OF INSURANCE REGULATION, STATE OF FLORIDA, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Mr. MCCARTY. Thank you very much, Madam Chairwoman, Ranking Member Biggert, and members of the subcommittee. Thank you very much for the opportunity to testify today on behalf of the National Association of Insurance Commissioners regarding this very significant issue of natural disasters, and the response of the Federal Government.

I applaud your leadership on this very critical issue of national importance that is not only an insurance issue, but it is an economic recovery issue. My name is Kevin McCarty, and I am the insurance commissioner from the State of Florida.

We have heard from a number of representatives from our State on some ideas on how to resuscitate the property market in our State.

I also serve as a chairman of the National Association's property and casualty insurance committee, as well as its committee on catastrophe insurance. Through these working groups, State insurance commissioners from around the country have been involved in

research and analysis of the impact of natural disasters on our economy and society for the last 20 years.

Insurance commissioners from across our country are working to find solutions to manage the catastrophic risk exposure to their respective States, exposure that, as we know, grows with increased real estate development, rising property values, and expanding commercial development in catastrophically-prone areas.

The NAIC currently is engaged in developing a comprehensive national plan, discussing a structure for governance for a multi-state plan for a multi-state catastrophe fund.

In addition, the NAIC has adopted resolutions, both in December of 2005 and again in June of 2006, supporting a national disaster plan and calling for a Federal commission to further study the issues, weigh the alternatives, and focus this very important debate.

We have a national problem that demands a comprehensive and rational national solution. Our current approach is not working. It is a post-event outpouring of Federal taxpayers' money. As generous and compassionate as the American people are, the current system leaves much to be desired. For those who would argue that this is merely a coastal problem, I would point to the roughly $110 billion in relief allocated following Hurricane Katrina.

Attached to my testimony, Madam Chairwoman, is a State-by-State breakdown of taxpayer dollars allocated for Katrina. From the great State of California, your State's share, Madam Chairwoman, is $13 million. And yet, that money leaves no infrastructure or legacy behind to ensure that your constituents are taken care of when a catastrophe falls on the State of California.

And, again, this is not a coastal problem. The Great Lakes and Plains States will contribute approximately $26 billion to Katrina relief. The NAIC believes that a more proactive system, which prepares the public and mitigates the potential for catastrophe damage, is more practical, less expensive, and better for all taxpayers, in the long run.

Currently, the United States is the only industrialized nation in the world not to have a Federal catastrophe plan. A multi-layered approach, encouraging personal responsibility, maximizing the private sector, and a third layer of Federal participation with the government's commitment to reinsure State entities, is the cap stone of our recovery. We will proactively help any catastrophic recovery, as well as provide stability in our housing market, by allowing State entities to diversify their risk.

Accomplishing this goal is likely to lure additional private capital, which is a critical part of any economic solution, stimulating more availability, more competition, and ultimately, lower premiums for everyone.

A key component of any comprehensive plan must emphasize mitigation efforts. From responsible land use plans that tell us where to build, better building codes that tell us how to build, and retrofitting programs that strengthen what we have already built, these programs may come with some up-front costs, but ultimately will save many dollars in investment. But, moreover, will save American lives.

A comprehensive national strategy should also find ways to expand private capacity. Many non-U.S. insurers are able to deduct reserves from future catastrophe losses, tax free, which potentially gives them a competitive edge over U.S. counterparts. The inability to build catastrophe reserve forces insurers to prepare financially, as if they were going to have a major storm in multiple locations every year.

Given the variety and complexity of these concepts under consideration, the NAIC strongly endorses the concept of a national commission to weigh the merits of each of these plans, and the best mix of solutions. And whatever we come up with must be answered in the context of, "Will this make insurance more available and affordable?"

Thank you, Madam Chairwoman.

[The prepared statement of Mr. McCarty can be found on page 68 of the appendix.]

Chairwoman WATERS. Thank you, very much.

Mr. Andrew Valdivia.

STATEMENT OF ANDREW VALDIVIA, CPCU, ARM, PRESIDENT, WHITE & COMPANY INSURANCE INC., ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

Mr. VALDIVIA. Good afternoon, Chairwoman Waters, Ranking Member Biggert, and members of the committee. My name is Andrew Valdivia, and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America, also known as the "Big I."

I currently serve as the California State and national director for the Big I. I am also president of White & Company Insurance, Inc., in Santa Monica, California, a full-service agency that serves clients in Santa Monica and the surrounding area, with both commercial and personal insurance.

As a Californian, and as your constituent, I first would like to thank you, Madam Chairwoman, for holding this important hearing on an issue that has not only impacted Californians, but millions of Americans in communities across the country.

Our members approach the issue of natural disaster insurance from a very simple perspective. We are here to serve the consumers' needs, whether it is helping them secure coverage to protect their families and their homes prior to an event, or assisting consumers after an event, to ensure that claims are paid quickly and fully.

The Big I strongly believes that our industry must come together with policymakers to find a national solution that will encourage and ensure participation in at-risk markets. We welcome all reasonable ideas that lead us to a healthy and competitive insurance marketplace.

The Big I believes that the private market cannot handle, and is not handling, catastrophic risks. Private market coverage is scarcely available at any rate in some areas. This is fast becoming an availability problem, rather than simply an affordability problem. Many insurers have either stopped writing new business in, or withdrawn completely from at-risk markets. The natural dis-

aster insurance crisis currently threatening the marketplace is not an insurance company issue. It is a consumer issue.

As the conduit between the insurance companies and the consumers, the Big I recently joined the Natural Catastrophe Policy Holders Coalition, as an ex-officio member. The coalition is an alliance of policyholders who have joined together to address issues related to the availability and affordability of catastrophe insurance. In fact, we are working with two other witnesses here today, the National Multi-Housing Council, and the Realtors, as part of this coalition.

I would particularly like to stress that this is not simply a Gulf Coast problem. It is a national problem. Whether it's hurricanes on the Gulf Coast, tornadoes in the Midwest, or earthquakes in California, we all face some risk of natural disaster.

In California, we are particularly susceptible to the earthquake risk. In fact, AIR Worldwide estimates that if there were a 7.9 magnitude quake in San Francisco, the losses could top $100 billion. To put that into perspective, the insured losses from Hurricane Katrina, the costliest natural disaster on record, were just over $40 billion.

California did try to proactively deal with this risk by creating the California Earthquake Authority, or CEA, whose goal is to provide a basic level of residential earthquake coverage to Californians. Despite CEA's existence, only 12 percent of Californians have residential earthquake insurance.

The commercial earthquake market in California is equally precarious. While the CEA offers some earthquake protection for the residential market, it does not offer policies to the commercial market. The primary source of commercial earthquake coverage is the non-admitted market, which is under strain, as a number of commercial policyholders in California are unable to secure coverage at reasonable prices.

Put simply, insuring against natural disasters is a national problem that requires a national solution. Only a program that is national in scope will be able to generate enough capacity to cover the most devastating events. The Big I believes the best solution is for a Federal role to be in place before the events happen, to have a mechanism that encourages the private sector to handle as much risk as possible, and to only trigger Federal involvement as a last resort upon private market failure.

Specifically, the Big I supports a Federal catastrophe reinsurance program. We are also open to a number of potential solutions with limited Federal involvement, including insurer tax-free reserving, and catastrophe savings accounts, among others.

Further, the Big I supports efforts to reduce costs of disasters, whether it is through mitigation, enhanced building codes, or financial incentives to mitigate risk. While it may be a difficult task, we believe that any solution will likely need to be comprehensive in its approach.

We also urge you to consider legislation introduced that would establish a national commission to study the issue, and recommend solutions. A good commission could develop a comprehensive approach, and provide momentum that may be necessary for a legislative solution.

In conclusion, we commend you, Madam Chairwoman, for convening today's hearing. Achieving consensus within the insurance industry for a solution to this growing problem has been elusive. But we hope your continued focus on this issue will encourage the private and public sector to develop new and innovative solutions. We stand ready to assist your efforts in any way we can.

[The prepared statement of Mr. Valdivia can be found on page 130 of the appendix.]

Mr. GREEN. [presiding] We thank you for staying within the allotted amount of time. And Mr. Bennett, you will now be recognized for 5 minutes.

STATEMENT OF MALCOLM N. BENNETT, PRESIDENT, INTERNATIONAL REALTY & INVESTMENTS, ON BEHALF OF THE NATIONAL MULTI-HOUSING COUNCIL AND THE NATIONAL APARTMENT ASSOCIATION

Mr. BENNETT. Thank you, and good afternoon, Chairwoman Waters, Ranking Member Biggert, and distinguished members of the subcommittee. My name is Malcolm Bennett, and I am the founder and president of International Realty & Investment, a firm that specializes in property management and real estate sales and investment in Los Angeles, California.

I am here today representing two trade organizations: The National Multi-Housing Council, and The National Apartment Association. With their combined membership, they represent owners, development, managers, and builders of residential properties.

We would like to commend you, Madam Chairwoman, for holding this meeting today, and say that our members are extremely concerned about the future stability of the insurer's market being able to withstand continued catastrophic events, be they disaster or terrorism. As property owners, we are looking for some assurance that there is some insurance available now and in the future, that is not only available, but is affordable.

As a California multi-family property owner and manager, I find it increasingly difficult to be able to still deliver affordable housing with the unpredicted rising cost of natural and disaster insurance costs. My industry colleagues have national property portfolios that include the Gulf Coast and the East Coast, and they are continuing to have enormous problems in attaining coverage since the 2005 hurricane seasons.

As Congress continues to explore ways to address this critical issue, we welcome the opportunity to participate in this discussion. We strongly feel that any Federal initiative should include relief for the commercial real estate sector, as well as the residential. Previous policy debates focused primarily on homeowners coverage, not realizing the very important part that the industrial and commercial plays in this.

As you know, Katrina had a devastating impact on the property insurance market across the States. California felt the rippling effect with skyrocketing premiums, reduced limits, and a higher deductible for earthquake insurance. While most of the attention was focused on the wind storm coverage in the Gulf Coast States, it is important to understand that the risk pool includes earthquakes,

tornadoes, hurricanes as well, so California property owners and others in the Gulf Coast were impacted by this, as well.

As an industry, we expected rising premiums as a result of the 2005 hurricanes, but they far exceeded our worst case expectations. Property owners with catastrophic exposure such as wind and earthquake reported significant costs ranging anywhere from 100 to 400 percent increases in their policies.

My real estate portfolio is limited to California, where earthquake premiums present the biggest challenge to property owners. After the 1994 earthquake, the insurance industry acted the same way it did after 9/11 and Katrina, which resulted in increasing pricing and limiting availability.

Even though I live in California, we do have the California Earthquake Authority, as was previously mentioned, but multi-family is excluded from that. I have no choice in purchasing earthquake insurance; it's just unaffordable. The only way I would possibly be able to afford it would be to pass the cost on to the residents, but in most areas in Los Angeles, rent control would bar us from being able to do this.

Large and new apartment owners managing national portfolios face the same challenge that we have. It's not uncommon for owners of low-income housing tax credit properties not to purchase earthquake insurance unless mandated by their lender, because unlike market rents, these properties offer no rent adjustment, and no option to offset the costs, because those rents are based on household levels.

The uninsured properties then remain at risk, leaving the owners and lenders exposed. It's really not clear if the government solution exists at this time for this crisis, or if one will come from the private market.

But what we do know is that continued occurrence of catastrophic events, whether they're natural disasters or terrorism, will result in significant cost and impact to our Nation. We realize that the solution will not be an easy one to identify, and no one size fits all.

On behalf of The National Multi-Housing Council and The National Apartments Association, we hope to work with Congress to identify and support a viable legislative initiative that will offer long-term stability for the insurance market, and we have certainly joined with other stakeholders in this.

I would like to thank you for the time to present the views on the multi-family industry, and thank you very much.

[The prepared statement of Mr. Bennett can be found on page 62 of the appendix.]

Chairwoman WATERS. Thank you, very much.

Mr. Robert Porter.

STATEMENT OF ROBERT W. PORTER, EXECUTIVE DIRECTOR, PROTECTINGAMERICA.ORG

Mr. PORTER. Thank you, Madam Chairwoman, Ranking Member Biggert, and members of the subcommittee. My name is Bob Porter, and I am the executive director of ProtectingAmerica.org. I appreciate the opportunity to appear before you today.

ProtectingAmerica.org is a nonprofit organization committed to finding better ways to prepare and protect American families from the devastation caused by natural catastrophes. Our organization was formed in the summer of 2005, right before the onslaught of Hurricanes Katrina, Rita, and Wilma, and is chaired by James Lee Witt, former Director of FEMA, and Admiral James Loy, former Deputy Secretary of Homeland Security, and former commandant of the U.S. Coast Guard.

ProtectingAmerica.org's more than 200 members from some 27 States include the American Red Cross, and other first responders, emergency management officials, insurers, municipalities, small businesses, and Fortune 100 companies, along with thousands of private citizens.

We support the creation of a comprehensive national catastrophe management solution that protects homes and property at a lower cost, improves preparedness, and reduces the financial burden on consumers and taxpayers, all in an effort to speed recovery, protect property, save money, and save lives.

The simple fact is that catastrophe can and does occur virtually anywhere in the country. The unfortunate reality is that tens of thousands of our fellow citizens are not able to pick up their lives where they left off before these catastrophes occurred. Every national and international forecasting agency has predicted that the worst of these storms is yet to come.

Max Mayfield, the recently retired director of the National Hurricane Center, has said that he wished Katrina was the worst storm he would ever see in his lifetime. Current and projected climate signals indicate that U.S. hurricane activity this year will be 75 percent above the 1950 to 2006 average.

Notwithstanding the well-documented problems with the response to Katrina, when catastrophe strikes, Americans have historically done a remarkable job of coming to the aid of those in need. All Americans owe our first responders an enormous debt of gratitude and thanks.

While little can be done to completely eliminate the actual catastrophe, we must break the cycle of build, destroy, and build again in the same way and in the same place. ProtectingAmerica.org believes that we should reduce the enormous taxpayer subsidy of recovery efforts that currently exist. Taxpayers from Maine to Montana are already paying for the Nation's natural catastrophe response. We believe that the time has come for a better solution.

Our solution would include privately financed State catastrophe funds to provide more protection at a lower cost to consumers. These State-level CAT funds would serve as a backstop to the private insurance and reinsurance markets, and would generate investment earnings that, in addition to helping pay claims, would be used for mitigation, prevention, preparation, and first responder programs.

We also support the creation of a national catastrophe fund that would serve as a backstop to participating State funds in the event of a mega-catastrophe, such as another Katrina, or a North Ridge earthquake.

These State catastrophe funds would be financed through mandatory contributions by insurance companies in each participating

State, in an amount that reflects the risks of the policies. Actuarially sound premiums, not tax dollars, would support these funds. Qualified State funds would be required to set aside a minimum of $10 million, up to a maximum of 35 percent of investment income for first responders and prevention and mitigation programs.

Qualified State funds would be able to purchase reinsurance from the national backstop program. Rates for this coverage would, again, be actuarially based, and would only be available to qualified State programs that have established prevention and mitigation funding.

How would this all work? In the event of a major catastrophe, private insurers would be required to meet all of their obligations to their policyholders. Should catastrophic losses exceed those obligations, the State CAP fund would kick in. In the event of an extraordinary catastrophe, the national backstop program would provide benefits to the State, and help pay remaining claims.

Because this is an opt-in State-by-State program based entirely on risk, the likelihood of a taxpayer subsidy is virtually eliminated. This approach requires pre-event funding, and relies on private dollars from insurance companies and States most exposed to catastrophe.

Madam Chairwoman, all of the elements I have mentioned are contained in legislation currently pending before the Congress. These bills have strong bipartisan support, and the support of members from across the Nation. That support, and your hearing today, is indicative of renewed concern in Congress that protection and preparation for massive natural catastrophe must be a national priority.

Our organization commends you and Chairman Frank for making this national priority a priority of this committee. Thank you.

[The prepared statement of Mr. Porter can be found on page 99 of the appendix.]

Chairwoman WATERS. Thank you, very much. Now we will hear from Mr. Thomas, Mr. Gary Thomas.

STATEMENT OF GARY THOMAS, BROKER/OWNER, RE/MAX REAL ESTATE SERVICES, ON BEHALF OF THE NATIONAL ASSOCIATION OF REALTORS

Mr. THOMAS. Thank you, Chairwoman Waters, Ranking Member Biggert, and members of the subcommittee, for inviting me to testify here today before the Subcommittee on Housing and Community Opportunity, and present the views of the National Association of Realtors, NAR, on the issue of natural disaster insurance.

My name is Gary Thomas, and I am a Realtor from Aliso Viejo, California, where I am CEO of RE/MAX Real Estate Services, one of the six largest RE/MAX brokerages in the Nation.

In 2001, I had the honor of serving as the president of the California Association of Realtors. Currently, I serve as chairman of Real Estate Business Services, a subsidiary of the California Association, and as liaison to NAR's public and Federal issues group. NAR is the largest trade association, representing more than 1.3 million members, involved in all aspects of the residential and commercial real estate industries.

The catastrophic events of 2004 and 2005 has shown the need for a comprehensive, forward-looking natural disaster policy. NAR believes that any real solution to the insurance problems now facing this country must go beyond a discussion of natural disaster insurance, and include a comprehensive natural disaster policy that addresses, but is not limited to, insurance availability and affordability.

Such a policy should take into account the responsibilities of multiple actors, including property owners, insurance companies, and each of the different levels of government in preparing and paying for future catastrophic events. My testimony today offers suggestions for what Realtors believe must be included in a comprehensive natural disaster policy.

The availability and affordability of property insurance is, at its core, a consumer issue. The importance of available and affordable insurance to homeowners, commercial property owners, and those who would like to own their own home or place of business, cannot be overstated. This is something that your constituents, Madam Chairwoman, have long understood in California, since we have dealt with problems of insurance availability and affordability numerous times, most recently after the North Ridge earthquake.

The inability to obtain affordable insurance is a serious threat to the residential real estate market, impacting not only single family detached homes, but condominiums, cooperatives, and rental units, as well. Homeowners' insurance is a necessary component in securing a mortgage and buying and selling a home.

NAR believes that people who bear the risk should pay a fair share, by obtaining and maintaining adequate insurance coverage. However, if insurance is not available or affordable, many make the unfortunate, but understandable, decision to purchase only the minimal amount of, or type of, insurance required. This is precisely the decision made by many Californians—buying the required property casualty coverage, but forgoing earthquake insurance, due to its high cost.

The problem with this rational economic decision is that if the big one hits, and people are not insured for that type of catastrophe, then every American taxpayer will pay.

Property owners should have confidence that their homes and businesses will survive future catastrophic events. Appropriate mitigation measures can help to create that confidence. Federal and State governments can provide incentives to property owners to undertake appropriate mitigation measures for their homes and businesses. Research shows that every dollar spent on mitigation saves society an average of $4.

NAR believes that States are the appropriate regulators of property insurance markets. However, there may be a role for the Federal Government to intervene in insurance markets to prevent market disruption and insolvencies. The level of intervention, however, must be set at a level that will not interfere with the normal market forces.

Finally, an essential part of a comprehensive natural disaster policy is a recognition of the basic responsibility of government, at all levels, to build and maintain infrastructure. The failure of the

levees protecting New Orleans during Hurricane Katrina contributed significantly to the loss of life and property from that storm.

According to USA Today, the Army Corps of Engineers has identified 146 levees nationwide—including 42 in California—that pose an unacceptable risk of failing in a major flood. Moving forward, we believe that all levels of government must do a better job of shouldering their respective responsibilities.

We stand ready to work with you, Chairwoman Waters, the Committee on Financial Services, and others in Congress, to develop a responsible natural disaster policy that addresses the needs of consumers, the economy, and the Nation.

NAR is working with others, including two organizations represented here today, The National Multi-Housing Council, and The Independent Insurance Agents and Brokers of America, as members of The National Catastrophe Policy Holders Coalition. NAR will continue to work with these and other organizations to help develop and advocate for a comprehensive solution.

And I thank you very much for inviting me to speak.

[The prepared statement of Mr. Thomas can be found on page 119 of the appendix.]

Chairwoman WATERS. Thank you, very much.

Ms. Ann Spragens. Thank you, very much.

STATEMENT OF ANN W. SPRAGENS, SENIOR VICE PRESIDENT, SECRETARY, AND GENERAL COUNSEL, PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

Ms. SPRAGENS. Thank you, very much. My name is Ann Spragens, and I am senior vice president, secretary, and general counsel of the Property Casualty Insurers Association of America, or PCI.

PCI is a trade association representing over 1,000 property casualty insurers that write almost 40 percent of the homeowners insurance, and 40 percent of the commercial property insurance sold in the United States. Thank you for the opportunity to appear before you today.

Insurers, regulators, and consumers all want the same thing: a healthy and competitive insurance market in which consumers can choose a variety of coverage options from a variety of financially secure insurers. PCI is a strong believer in the power of markets to solve most problems, but at the same time we believe there are some risks in some areas that market solutions alone may not have the tools to address.

These are the mega-catastrophic risks that if not addressed can undermine the economies in these critical areas of the country, and insurers need to work with State and Federal policymakers to develop innovative solutions that promote increased insurance availability and responsible economic development.

PCI wants to work with State and Federal legislators to develop and implement viable, long-term solutions that create insurance markets that consumers, companies, and public policymakers can rely on.

We think that the best way to accomplish this is to design solutions that meet the unique needs of consumers in each State. The solution to market disruptions in Louisiana, South Carolina, or

Massachusetts will look much different from those crafted by Florida legislators, because local conditions are different. That's why we favor a State-by-State approach backed up, at a very high level, by a Federal liquidity protection.

We believe that the Federal Government can play an important role in stabilizing certain markets against the risk of mega-catastrophes by providing high-level Federal liquidity support for responsibly-managed State funds.

Given the very serious catastrophe lessons we have seen over the last several years, and the significance of this issue for our membership, our organization has devoted considerable time and effort to developing a range of sound public policy solutions, including market reforms, stronger loss reduction and prevention, and new approaches to financing catastrophic risk.

PCI suggests several major areas for consideration. First, we need to do more to control and reduce catastrophe exposure, including: State and local governments updating their building codes in catastrophe-prone areas; the establishment of Federal incentives for greater investment in loss reduction and prevention; responsible restriction of development in catastrophe-prone areas; and taking greater steps toward preparedness.

Second, we believe Congress should complete its efforts to reform the National Flood Insurance Program, and we support your bill, Mrs. Biggert. We would like to work with you to smooth out some of the administrative concerns to make that a really good solution.

Third, we must expand private sector capacity to handle the risk, and the best way to accomplish this is for State legislators to give insurance markets greater freedom to respond to the exposures we face. As many have said, it is very important to attract the industry.

We also encourage a review of two additional proposals. First, we endorse establishing voluntary tax-deferred catastrophe reserves, such as H.R. 164 proposes, introduced by Representative Jindal. While there are provisions in this bill PCI believes should be modified, we urge your review and debate of this bill, as well. And we believe Americans would be very surprised to find out insurers didn't have the accounting mechanism necessary to do what that bill would propose.

Second, we will be examining specific steps that might be taken to remove regulatory legal accounting or tax barriers to further growth of the catastrophe bond market, an alternative funding mechanism.

And, finally, with regard to government involvement, as I mentioned in my introductory remarks, PCI believes that there is a role, properly structured, for the Federal Government to play in assisting the financing of mega-catastrophe risk, and we believe it should be given serious consideration by Congress.

We believe the growth in natural catastrophe exposure is of sufficient magnitude in some States that they may need to consider a State natural catastrophe funding facility. Recent events show that the industry can respond to very severe catastrophe events, but private markets may not always have the capacity to fund increasingly more frequent exposure to mega-catastrophes, or to a series of very large events in a single season.

PCI believes, for example, that the Florida Hurricane Catastrophe Fund provides the basis for ongoing improvement in regard to that program.

Where major catastrophes exceed the limits of the market and State catastrophe funds, it may be necessary for the Federal Government to offer liquidity protection to State catastrophe funds at a very high level, so as to maintain stable markets and avoid widespread insurer insolvencies, and assure stable and healthy markets.

Again, let me thank you on behalf of PCI and its members for this opportunity to respond to your questions and provide you with our input on possible solutions. We commend Congress for its leadership on this issue, and pledge to work with you to address an issue that is so critical to Americans and our Nation's economy, because we believe that any solution is between government efforts and free markets for stronger homes and safer families. Thank you.

[The prepared statement of Ms. Spragens can be found on page 111 of the appendix.]

Chairwoman WATERS. Thank you, very much. Mr. Marc Racicot? Correct me if I did not pronounce it correctly.

STATEMENT OF MARC RACICOT, PRESIDENT, AMERICAN INSURANCE ASSOCIATION

Mr. RACICOT. I think that's close enough, Madam Chairwoman. It has been a lifelong problem. I don't think it will be corrected this afternoon, but thank you for being so thoughtful.

Good afternoon, and thank you for the opportunity to appear before you. I am Marc Racicot, president of the American Insurance Association, and I do genuinely appreciate the opportunity to testify this afternoon.

Hurricane Katrina focused renewed attention on the role of the private sector insurance industry in managing natural catastrophe risk, undoubtedly. Fortunately, in our view, the insurance industry is well-positioned to do that. To do so, however, insurers must be allowed to measure, reduce, and fund these exposures. By contrast, quasi-governmental CAT funds, or Draconian regulatory restrictions and new legal liabilities not only fail to address the true problem, they also threaten the viability of our Nation's private insurance mechanism.

In responding to Hurricane Katrina, the insurance industry performed extremely well under very difficult circumstances. To date, claims payments have totaled about $40 billion. More than 95 percent of the claims have been successfully resolved. Yet, in spite of the fact that less than 1 percent of homeowners' claims across the Gulf have resulted in lawsuits, it is those claims that have received most of the attention.

As a Nation, we must make sure that we are prepared for, and can respond quickly to, future catastrophes. Insurers are fully committed to working with local, State, and Federal policymakers to assure that this happens. I have testified before this committee on two other occasions and have recently shared our perspectives with the southern governors at their meeting in Washington last month. Each time I have had the chance to talk with policymakers, I have strongly urged them to act carefully.

Thankfully, last year's hurricane season was remarkably mild, but hurricane experts are calling for another active season in 2007, and each day more and more people populate our Nation's most vulnerable coastal communities. I am here today to, again, urge appropriate scrutiny, but also appropriate care.

As this committee sorts through the various Federal legislative proposals that have been introduced into this Congress, the reality is that there are no quick fixes or easy answers. Moreover, punitive measures directed at insurers, including recently introduced bills to repeal the McCarran-Ferguson anti-trust provision, are wholly unrelated to the issue at hand. They will do nothing to improve the availability or affordability of coastal insurance. In fact, the cruel irony is that they will have a serious and detrimental effect on the very markets that they purport to assist.

The reform agenda we have developed discards the path of least resistance and instead relies upon sound financial capital market and environmental principles. It consists of four major components: mitigation and land use planning; regulatory and legal reforms; tax incentives; and National Flood Insurance Program reforms.

We are also working to identify other measures that could be put in place to address concerns expressed about the availability and affordability of natural catastrophe insurance. These measures would be designed to preserve the essential role that the private insurance sector plays in response and recovery, while at the same time recognizing the post-Katrina challenges that are still facing many coastal communities.

As this committee is well aware, several bills have been introduced this year to address different aspects of the natural catastrophe issue, and I would like to offer just a couple of comments.

First, on the Homeowners Insurance Protection Act, it would create a Federal reinsurance mechanism to encourage States to establish CAT funds, based on the premise that large-scale natural catastrophes are uninsurable by the private sector.

We respectfully, but strongly, disagree with that premise. Even after Hurricane Katrina, private sector capacity for natural disasters has grown. Ironically, the single greatest threat to private sector risk transfer is not the force of hurricane winds, but legislation and regulations that displace available private capital, or make it economically unfeasible for private companies to operate in coastal markets.

Despite the seeming promise of short-term relief, CAT funds are no panacea for natural catastrophe risk, and they can lead to generational inequities among policyholders on fair, geographic, and cross-sectional subsidization, and increased building in catastrophe-prone regions. They have all the wrong incentives.

The Multiple Peril Insurance Act of 2007 would expand the coverage offered by the deficit-laden NFIP from flood-only policies to policies that include flood and wind coverage. While the bill promotes the concept of risk-based pricing and local government mitigation, concepts that we clearly support, it displaces available private market financial capacity and claims handling capabilities and expands, rather than fixes, an already costly Federal program.

As an alternative, we believe there are better ways to resolve disputes among wind versus water claims, and we would be happy to explore them with the committee.

Finally, Madam Chairwoman, and members of the committee, unquestionably, these are tough and complex issues. The private property casualty insurance mechanism, the system we have in place, like any human enterprise, is not perfect. It is not without blemish. But it has been in place since the Civil War, and it takes good care of millions of Americans, and pays out about $250 billion a year.

The last thing we want to do—or any government can afford, for that matter, in the name of reform—is to irreparably compromise the capacity of the industry to continue doing just that. Thank you very kindly.

[The prepared statement of Mr. Racicot can be found on page 105 of the appendix.]

Chairwoman WATERS. Thank you, very much.

Mr. Frank Nutter.

STATEMENT OF FRANKLIN W. NUTTER, PRESIDENT, REINSURANCE ASSOCIATION OF AMERICA

Mr. NUTTER. Madam Chairwoman, Ranking Member Biggert, and members of the committee, I am Frank Nutter, president of the Reinsurance Association of America. The RAA is a national trade association representing property casualty organizations that specialize in assuming reinsurance.

Reinsurance is commonly referred to as the insurance of insurance companies, and one of the most common purposes for utilizing reinsurance is for a primary insurance company to transfer the risk of losses for catastrophic events.

Clearly, any debate about whether there should be a Federal catastrophe fund should include an analysis of the private reinsurance market to provide catastrophe capacity as well as the capacity of insurers to underwrite and retain this risk. Global reinsurers view U.S. catastrophe risk as an essential component of their diverse assumed risk portfolios. That important role is best demonstrated by looking at the 2004 and 2005 hurricane seasons.

In 2004, 4 hurricanes that hit Florida resulted in $30 billion in insured damage. While reinsurers have no direct relationship to insurance consumers, the global reinsurance industry paid approximately one-third of these losses to the insurance companies that did have losses from insurance consumers.

The hurricane season of 2005 was a year of unprecedented losses. Katrina, Rita, and Wilma produced losses estimated to be as high as $60- to $65 billion. The reinsurance industry ultimately will pay approximately one-half of all of these losses.

In what some may see as a counterintuitive measure, the capital markets have actually greatly enhanced reinsurance capacity following Hurricane Katrina. As they did in 1993 after Hurricane Andrew, and in 2002 after the terrorism losses of 9/11, the capital markets promptly provided reinsurance capital and capacity. Since the fall of 2005, approximately $32 billion in new capital has been raised and committed to reinsurance markets. The private reinsur-

ance market is financially strong and diverse, and reinsurance capacity is adequate, even for most peak catastrophe markets.

The RAA believes that natural catastrophe risks are insurable in the private insurance and reinsurance markets, and that State catastrophe funds significantly displace the private market. They are not a long-term solution.

The model of the Florida catastrophe fund is one that offers insurers inexpensive reinsurance premiums up front, because it is back-loaded. When a hurricane occurs that requires the Florida CAT fund to pay losses in excess of its cash balance, as in 2004 and 2005, the CAT fund in Florida issues bonds. The bond debt is not paid by insurance companies who receive the cheap reinsurance up front, it is paid by assessing and taxing Florida policyholders of other lines of insurance.

In essence, the Florida CAT fund, which only covers residential exposures, has disintermediated the reinsurance market, and in its place, put the insured public, commercial, and residential. The irony of Florida is that the people who vilified insurers in 2005 and 2006, together with other policyholders, are now their reinsurers.

State catastrophe funds also violate one of the fundamental tenants of insurance, and that is risk spreading among various risk bearers. Private insurance and reinsurance, however, spread the risk globally. State funds do not reduce the vulnerability of people to natural catastrophes. Rather, they are cost-shifting mechanisms. There is no free lunch; someone will have to pay for these losses.

We do not believe that the creation of a Federal reinsurance program solves a homeowner's insurance availability problem. We believe that policymakers should remove regulatory constraints from the private insurers market's ability to willingly insure risk. If policymakers follow competitive free market principles, a Federal natural disaster reinsurance fund is unnecessary.

With respect to a Federal fund, I would offer the following thoughts. First, the idea of a Federal fund has been debated for many years. Unfortunately, many of those proposals are often with very low attachment, or trigger points, and by doing so, these will compete with the private reinsurance market which is providing capacity.

Second, there is no assurance that a Federal reinsurance program will result in more availability of homeowners insurance.

Third, a Federal fund that sells reinsurance to State catastrophe funds concentrates all of the risk associated with natural catastrophes in government programs. A private market diversifies this risk, spreading it globally.

Some have suggested that a Federal program is appropriate, because we are all paying for disaster recovery now, implying that Federal taxpayers are on the hook for disaster losses. While natural disasters do occur in all States, except, apparently, North Dakota, most are modest potential costs, compared with a few other regions; 97 percent of all earthquake insured losses have occurred in California, and since 1900, 75 percent of all hurricane losses have occurred in Florida, Louisiana, and Texas.

The natural disaster related losses in other States are paid for by insurers in those States, based upon risk premiums. Federal disaster assistance primarily applies to immediate and temporary

shelter and food, infrastructure repairs, and emergency response. These losses would not be covered by a Federal reinsurance program, therefore, it would be expected that taxpayers would continue to support them.

As others, we too look forward to working with the committee on any solutions that are put forward, and appreciate the opportunity to testify.

[The prepared statement of Mr. Nutter can be found on page 86 of the appendix.]

Chairwoman WATERS. Thank you, very much. I appreciate all of the panelists who are here today, testifying before this subcommittee to help us better understand and get a handle on a public policy approach for dealing with what is a serious problem in this country.

I want to make sure that I understand the industry as well as I possibly can, so I am going to address one or two questions to Ms. Spragens, Mr. Nutter, and Mr. R-a-c-i-c-o-t.

[Laughter]

Chairwoman WATERS. On the one hand, we have insurance companies that are saying, "I'm leaving." Allstate and State Farm, I think, in the Gulf region, said that they were going to leave, that they could not be responsible, and bear the kind of risk that they were confronted with, and could be confronted with, possibly, in the future. We have ideas that are emerging about government reinsurance involvement.

We also hear that the property casualty insurers are making a profit. So how do we reconcile all of this? Why, then, if private reinsurance is so good, why can't it reduce the costs more? And if they can't, why shouldn't the government get involved to see if they can't drive those costs down?

Mr. RACICOT. Madam Chairwoman, I am assuming you are addressing that question to me, or multiple questions to me.

Chairwoman WATERS. Yes.

Mr. RACICOT. All of which I think are very relevant questions, and good questions.

Let me start with the last question, first, and that is concerning industry profits, and place it in the proper perspective. I urge you to remember that, in fact, property casualty companies are responsible for claims that sometimes have tails as long as 20 years or longer, number one. Number two, out of the last 20 years, only 2 out of those 20 years have the property casualty companies of this country experienced an underwriting profit. And number three, in 2005, the claims in Louisiana alone wiped out 25 years of homeowners premiums in the State of Louisiana.

So, we need to place those figures in the proper perspective. Because what happens is that they have to have capital available to address claims with long tails. They also have to make certain that they can expand in other areas and offer new products. They have shareholders, of course, that they have to address. And so, at the end of the day, that's the right context.

When you're talking about some of the insurance companies that—and I don't have the inside information to be able to represent their position precisely—but my understanding from public accounts is that they have decided not to write new business in

those particular areas that you were referring to, and that they have a great deal of capital.

I know our companies have a great deal of capital still down in the Gulf, but it doesn't go as far, and it doesn't go as far because the models have changed. With the frequency of hurricanes, you have to build that into the modeling, actuarially, to determine what is an appropriate premium. So as a consequence of that, you have to be very careful.

The regulatory climate and environment is very difficult and oppressive. If you think about it for just a moment, what kinds of signals are being sent to insurers to try and entice them into some of the Gulf States? The attornies general bring suits, contracts are abrogated, and there are suspensions of the capacity to have any regulatory freedom. If you're in the State on a given day, you may be commanded to be there for some significant period of time beyond your voluntary choice.

Those signals, just like they would send a signal to Home Depot, or the mortgage bankers, or to real estate people, or anybody else, are disincentives for those who would like to come back into a State, because they are fearful that they will not be able to do business.

So that, I think, describes the present existing situation. It's not that there is not capacity, as Mr. Nutter has indicated. It's just that you cannot charge a premium that is risk-based, based on cost. And, secondly, the environment is so hostile and so difficult to do business in, that sometimes even though they want to come back, they are fearful about entering into that territory.

Chairwoman WATERS. One last one. Let me just say that there are those who would say that the insurance companies have enjoyed some protections and to—that is something that should be repelled, because of the ability to at least discuss, or share information, places you in a position of being able to have premium cost, I suppose, that cannot be challenged by anybody because of the ability to have this protection. What do you say about that?

Mr. RACICOT. Well, Madam Chairwoman, I would say that it's always possible to reinvent another scheme. But the invention of a new scheme here, which has worked exceptionally well for 62 years, would bring absolute chaos to the industry.

And, frankly, there are 5,000 property casualty companies in this country that—some are very, very large, and some are very, very small. And it would be those that are larger that could do their own actuarial analysis.

This is all done by the light of day by independent modelers. Data is shared or provided by all of these insurers. It's distilled, analyzed, and scrutinized. And then, actuarial analyses are put out for everyone to utilize. It would be all the small companies who would be disenfranchised by movement in that particular direction, and, as a result of that, there would be a lack of competition, and less of a good bargain for consumers.

Chairwoman WATERS. Thank you. Just one last question. Do the private property casualty insurers use the same claims adjusters that we use with our National Flood Insurance Program?

Mr. RACICOT. I believe, Madam Chairwoman, that is a voluntary choice. There are many companies in the country who actually can

contract with, and act as agents of, the U.S. Government to carry out the duties of adjusting claims for flood programs all across the United States.

Chairwoman WATERS. That has been identified as a potential problem—claims being pushed off to the National Flood Insurance Program rather than being assumed by the private insurer. Have you heard any discussion about that?

Mr. RACICOT. Well, Madam Chairwoman, I have not seen demonstrated evidence. I certainly wouldn't suggest to you, however, that there are not imperfections in the system. Any human system or institution has some imperfections. But when you realize that only 1 percent of the claims in this country that were a consequence of Katrina are actually being litigated, that's a fairly good record.

Chairwoman WATERS. Thank you very much. Yes?

Mr. NUTTER. Madam Chairwoman, if I might respond to your first question, if I could, please. With respect to reinsurance and the cost, keep in mind a couple of things.

To the extent that there are concerns about or observations about the insurance industry's profitability in recent years, some of that is a function of the fact that insurers did lay off risk to the reinsurance industry. If you looked at the flip side of the coin, you would find the reinsurance industry was relatively unprofitable in 2001, 2004, and 2005, largely because it served the purpose of bearing the risk that the insurance companies laid off.

And, secondly, you have mentioned a couple of specific companies by name, and I certainly don't represent State Farm or Allstate, and wouldn't presume to. But my understanding is that State Farm reinsurers entirely within the corporate group—so, a Federal or government reinsurance program—really does nothing to address reinsurance costs for what is often the most significant and major insurer in the market.

What the State Farms, Allstates, and others have to do, however, is look at their risk exposure, to balance it against the premiums that the regulatory system allows to charge, and make certain that they remain financially sound and viable to meet their claim obligations.

Chairwoman WATERS. Thank you, very much. Mrs. Biggert?

Mrs. BIGGERT. Thank you, Madam Chairwoman. My first question, I guess, is to Governor Racicot. I guess that some people must have known your name, in order to vote for you, or how to pronounce it.

Mr. RACICOT. I think at some point it becomes so bizarre they can't forget it.

Mrs. BIGGERT. Maybe so. Insurance is currently regulated at the State level, and in many States, it seems that prices and coverage are highly regulated. This is not the case in my home State of Illinois. In fact, we always talk about its being a model for insurance, because it takes the free market approach to pricing.

Do you think that States should relax or rethink price controls as a way to attract more insurers, thereby increasing the availability of insurance for consumers?

Mr. RACICOT. Well, I do believe, Mrs. Biggert, that, in fact, that's a sterling example of how the competitive influences of a private

enterprise system can work with virtually any commodity or service.

I think you would see some similar signs of that with the auto market in New Jersey, as well. It's certainly not occupying the same posture as the regulatory climate in Illinois. But I think that's a very good example of how you can drive a better bargain for consumers by opening up the market.

Mrs. BIGGERT. And then I understand that the AIA disagrees with the catastrophic coverage proposals currently before Congress. I think you mentioned that.

Could you explain how that is different from the availability of terrorism insurance in the private market, and why a Federal backstop might be more appropriate with terrorism insurance, rather than this?

Mr. RACICOT. Yes, ma'am, to the best of my ability. The bottom line is, from our perspective, you should keep as much capacity in the private sector as humanly possible, because that is how you produce the best bargain for the people of this country.

There have been some instances, however, over the course of time, where it has been necessary to look at a partnership between government and the private sector, because there has been an inability to be able to quantify risk. The Flood Program is one of those instances.

Another instance is terrorism. When you think about it, you determine a premium and risk and what it's going to cost by having past historical information from which to draw a judgement, after distilling all the circumstances over a long period of time. Secondly, you are able to keep abreast of what it is that's unfolding presently.

The industry does not have any history with terrorism. Secondly, we do not have top secret intelligence reports every single day. It is virtually impossible for us to calculate a level of premium. And as a consequence of those two circumstances, reinsurers don't offer reinsurance. There is some capacity, but it is so expensive and so small, that it's really not very meaningful.

Mrs. BIGGERT. So, with the national—or catastrophes, you have more experience that you are able to at least have some actuarial or underwriting capabilities?

Mr. RACICOT. Yes, ma'am. We do believe that there are important bridge mechanisms that sometimes have to get you from one place to another. But you always have to keep your eye, ultimately, on maintaining as much of a private market as possible, because it produces the best bargain.

So, we believe there is plenty of capacity if we have the right signals, the right regulatory climate, the right environmental policies. If people quit building on sandbars, we will be in a situation where we can make certain we respond to the needs of the day.

Also, at the end of the day, people have to make value judgements about where they want to live and how much they want to pay to live there.

Mrs. BIGGERT. Thank you. And, Mr. Nutter, would a national reinsurance program negatively affect the amount of capital the insurance industry would receive from investments?

Mr. NUTTER. I don't think there is any question, Mrs. Biggert, that State government or Federal Government programs are going to be far more competitive than the private sector can be. They pay no taxes, have no capital charge, and often don't have a risk-based rate.

Certainly, the Florida experience is that the Florida hurricane catastrophe fund has just disintermediated the private reinsurance market. I would assume that a Federal program would do the same. It seems to me to be a mistake to take off the table a capital commitment from the reinsurance community worldwide, that wants to write catastrophe risk in the United States.

Mrs. BIGGERT. So the free market creates a more diversified insurance?

Mr. NUTTER. Your question to Governor Racicot is a good one, about a competitive rating environment in Illinois. Reinsurance rates and terms are not regulated, either. Reinsurers are regulated for solvency, if they are licensed in the United States.

What you have is a reinsurance market that is highly competitive, globally, and in fact, has attracted capital after every one of the major natural and manmade acts, catastrophe events, in the last 15 years. It attracts capital to serve this market. A competitive rating serves a competitive market very well. And the reinsurance market is a good example of why that's true.

Mrs. BIGGERT. Thank you. I yield back.

Chairwoman WATERS. Thank you. Mr. Cleaver?

Mr. CLEAVER. Thank you, Madam Chairwoman. Could you go back again through the kind of signals, negative signals, that were sent as a result of Rita and Katrina by the officials? You were saying there were negative signals. Can you just—

Mr. RACICOT. Yes, sir. There are—let me just take them, without mentioning any individual State. But at least one State in the Gulf, where almost instantaneously, litigation and investigation began, and efforts to try and change contracts, both private litigation and official investigations by various governmental authorities.

Now, my understanding is that there has been no criminal activity ever discovered or pled, or any court actions presently proceeding in that specific direction.

But when you set about to say that the contracts that you have entered into are no longer sacrosanct, as they have been throughout our history, and suggest that rules are going to be suspended, and that there is a regulatory climate that you can't depend upon, that sends signals. It would to Home Depot, if they were being told that it doesn't matter what a sheet of plywood costs, we're going to sell it for $3.50 here, in the State of Mississippi.

Mr. CLEAVER. Yes. The industry paid out $55 billion in claims and losses in the Gulf Coast.

Mr. RACICOT. I believe, sir, it was around $40 billion, as a result of Hurricane Katrina.

Mr. CLEAVER. Okay, $40 billion, and profitability reached an all-time high. Now, we don't have the numbers in yet, but since Rita and Katrina there are still—profitability numbers in the industry are still climbing.

Mr. RACICOT. The last 2 years that has been true, yes, sir. The previous 18 it was not. And there are long—as I mentioned before,

there are long tails on claims, and there are huge capital requirements. If you're going to diversify and provide more products in more areas, of course you have to have the capital to back it up.

Mr. CLEAVER. Well, yes. But let's stay with the profitability. If you are—if you just spent out record numbers in losses, the industry doesn't appear to have been hurt. If your profitability rises at the highest level ever, and let's assume that maybe the claims were not paid until 2007. The 2007 chart is just going to the sky.

I mean, you're getting ready to have—I'm not mad at you—but the industry is getting ready to have the biggest boom ever, right on the heels of the worst catastrophe in the history of the United States.

Mr. RACICOT. Well, Congressman, I think last year, of course, we were very blessed not to have a great deal of hurricane damage. And as a consequence of that, the Lord has shown us some mercy throughout that period of time. In addition to that—

Mr. CLEAVER. I'm not sure the Lord is involved in the insurance industry. But I have this insurance information institute printout, and there is not a business in this country that wouldn't like to have this.

Mr. RACICOT. Well, Congressman, I don't think that's an entirely fair analysis. I don't think there is any doubt that over the last 2 years, that the property casualty companies of this country—and as I mentioned, there are 5,000 of them—experienced a profit gain. There is no question about that.

But when you compare their generation of some revenue gain over the course of the last year, you will find it's in the range of about 15 percent. And the Standard and Poors average is around 18 percent. So, when you take a look at other industries, you don't find that the industry is in a situation where they have exorbitant returns on capital.

Mr. CLEAVER. Yes?

Mr. NUTTER. If I could supplement the answer, let me go back to something I said earlier to Chairwoman Waters. Some of the reasons for the insurance companies' profitability is that they laid off risk to the reinsurance market.

Mr. CLEAVER. Yes.

Mr. NUTTER. If you had that chart for the reinsurers, what you would see is the following: in 2005, the reinsurance market had a combined ratio of 129. What that means is that with losses and loss adjustment expenses, it paid $1.29 for every dollar of revenue. Lost money. In 2004, it was 125. It paid out $1.25 for every dollar of revenue.

So, the profitability of the insurance companies is, to some extent, a mirror image of what happens in the reinsurance market. The reason that I mention that is that some of the proposals being considered by the Congress are effectively to put the government in competition with the private reinsurance sector, not the private insurance sector.

It would seem to me to be counterintuitive to disintermediate the reinsurance market, when, in fact, it is serving the role of being the risk-bearer for these catastrophe losses to a fairly significant degree.

Mr. CLEAVER. Well, you know, I would really like to see the reinsurance charts, because this appears to fit into what our colleagues have said earlier—you heard the Members of Congress who were here—about what has happened with insurance. And having gone to the Gulf Coast region, and spoken with people down there, you know, if the numbers are accurate, your 1 percent—you're saying that only 1 percent of the claims were in litigation, maybe that's one of the few spots on the planet where we don't have enough lawyers.

Because I can't understand it. I have run into very few people who—and we had lunch with Senator Trent Lott in Gulfport, I guess it was, Gulfport, and I have not heard anyone, not one person, say, "That insurance company really did treat us well. And I—this is a great day for America."

Chairwoman WATERS. Thank you very much. Mr. Neugebauer?

Mr. NEUGEBAUER. Thank you, Chairwoman Waters. Ms. Spragens, I have a question from one of my colleagues, and I will just read that question for you.

Instead of increasing Federal interference in the insurance marketplace, are there ways that the Federal Government can reduce regulatory burdens to increase competitive options and coverages available for consumers? For example, according to a 2005 Government Accountability Office report, the Liability Risk Retention Act has had an important effect in increasing the availability and affordability of commercial liability insurance for certain groups, allowing members to benefit from the consistent prices, targeted coverage, and programs designed to reduce risk.

Shouldn't Congress be looking at attracting new capital, through elimination of unnecessary Federal burdens, such as expanding the Liability Risk Retention Act with appropriate fixes?

Ms. SPRAGENS. Thank you very much for that question, because it has two important parts, and I want to try to answer both of them.

First, in terms of the opening up of the Risk Retention Group Act, our members are very interested in discussing that. You mentioned Janice Abraham in your opening comments, who is one of our members. We are going to be discussing that with them, to try to find that right balance between the interests of those who are insured by risk retention groups, the groups themselves, and insurers, to find the right balance, and take a look at that very thing. And we look forward to working with you on that.

But you also asked about opening up and reducing other government—Federal Government—burdens. And there is a very important one that I alluded to in my opening comments, and that has to do with the tax-deferred catastrophe reserve.

I really do think Americans would be quite surprised to find out that insurers can only reserve for past events. What that means—and this goes to your questions about profits—is that in that rare event when Mother Nature has been kind, and we do show a profit—which, by the way, was for all lines, all products, inland marine, ocean marine, jewelers, all that, it's all there—that all those occasions when we do, mixed in there is the amount we are actually spending on catastrophes most years.

The other thing is, the only way we can show that to you is a profit. We don't have the option of diverting it before taxes into a reserve, where it can be called upon to increase availability, in the event of a catastrophe down the road, because we can't reserve for future events.

And, you know, there is an important historical precedent for that. It goes back to ancient Egypt. There were 7 years of plenty followed by 7 years of drought and famine. And during those 7 years of abundance, the grain that wasn't needed was put into reserves. And during the drought, and during the famine, people did not starve. And that is exactly the position that the insurance industry is in today, because we don't have the ability to use the money that isn't needed in a given year, and put it into a reserve, to be able to call upon it without a pretty heavy tax hit, which reduces its benefit to policyholders.

And so, we would strongly encourage you to consider taking that old, old lesson, and make it possible for insurers to be able to set aside funds that aren't needed, before it becomes profit, and before it becomes heavily taxed.

Mr. NEUGEBAUER. Actually, banks have that option available to them. I believe they can set up loan loss reserves. And I think they get to do that after tax. Is that correct?

Ms. SPRAGENS. It's a before-tax need.

Mr. NEUGEBAUER. I mean before tax, yes.

Ms. SPRAGENS. It's a before-tax need.

Mr. NEUGEBAUER. Yes, I'm sorry. Next question for Mr. Nutter. I understand that the unofficial amount of reinsurance sold for catastrophes in 2006 was around $90 billion, claims for 2005, the largest on record, amounted to $60 billion. And many insurance experts estimate that the industry could withstand a single event in the $100 billion range and remain solvent.

How do you see the reinsurance market growing over the next several years, and do you expect them to be able to increase their capacity?

Mr. NUTTER. Thank you for the question. It is my understanding from market reports that the amount of reinsurance capacity purchased in 2006 was—in the private market—was probably in the $75 billion range. If you add the Florida Hurricane Catastrophe Fund, which is a government fund, it gets to the $90 billion range.

The larger number that you cited would really also reflect the fact that some insurance companies retain all of the risk, and they don't reinsure it at all, and other companies retain much of their risk, and then only reinsure some.

If the past is, in fact, prologue, the reinsurance market has grown in capacity in 2005 and 2006. Estimates are that it grew by 30 percent in 200, and from 2006 to 2007, it grew by another 14 percent. The capital markets have replenished losses. The capital markets have seen this as an opportunity to invest. Reinsurance capacity has increased from—certainly from 2001, where reinsurers paid 60 percent of the losses associated with the events of 9/11, and continue to grow. I see no reason to think that would not continue.

Mr. NEUGEBAUER. Thank you, very much.

Mr. NUTTER. Thank you for the question.

Chairwoman WATERS. Mr. Green?

Mr. GREEN. Thank you, Madam Chairwoman, and I thank the witnesses for appearing today.

Let me move quickly to Ms. Spragens. Ms. Spragens, in your paradigm of a reserve, how is the interest on the untaxed dollars handled?

Ms. SPRAGENS. It needs to be building up inside the reserve during the time that it's there. This is for the purpose of maximizing its benefit to policyholders, sir. The taxes are paid at a later date, when that money is taken down.

Mr. GREEN. Governor, permit me to ask you about your comment on wind versus water. You indicated that you have some thoughts on it that you would share with us, in terms of how it should be handled. How would you handle wind versus water?

Mr. RACICOT. I think, Congressman, that there are several different possibilities. A couple that I would mention to you at the very beginning is, number one, you could try to make certain that you were in a situation where, for example, the NFIP could be amended to require Federal participation in State-sponsored mediations, to determine the extent of damage caused by wind versus water.

Number two, you could encourage greater coordination on the marketing and sales of Federal flood and private property insurance. I think that there are many ways that you could try to bring more precise definition and protocol to this particular situation.

This has obviously been highlighted, it's a matter under extraordinary scrutiny. There ought to be as much clarity and definition as we can possibly bring to bear as part of the process going forward, and I think there are ways to do that.

Mr. GREEN. Let me move quickly to Mr. McCarty. My suspicion is that you have some opinions that will differ slightly from the governor's. Can you at least give us some of your thoughts?

Mr. MCCARTY. Yes, thank you very much. First of all, I would like to address the issue of the private marketplace, and maximizing the private marketplace, and allowing the capital markets to grow. And I share that, because I think a free market is critically important.

But axiomatic to a free market is willing purchasers and willing sellers. And, unfortunately, for homeowners, they are required to buy homeowners' insurance. They are required to buy the risk of hurricane. And, unfortunately, we're getting fewer and fewer sellers. So we really don't have a free market of willing buyers and willing sellers, because we tell the policyholders and homeowners in Florida, "You must have wind exposure." And I think that's the appropriate and prudent thing to do.

Unfortunately, when you compare Florida, which has the risk of hurricanes, California, with the risk of earthquake, Illinois doesn't really have catastrophic risk, with the exception of flooding, which is already taken care of in the Federal Flood Program. They do have the risk of earthquakes, but most people in Illinois do not purchase earthquake coverage—

Mr. GREEN. Let me interrupt you—

Mr. MCCARTY.—because it's not required.

Mr. GREEN.—just a moment, and ask you to respond quickly to the notion of a reserve.

Mr. MCCARTY. We would—the reserve concept, I think, is a very good concept. I think we have to make sure that reserve is in a separate account, to ensure that it is used for the use and benefit of payment of claims, and not dividend to the stockholders.

But to set aside reserves for the future, the United States is about the only country in the industrialized world that does not have some mechanism for tax deferment. And if we had done this—

Mr. GREEN. Let me intercede one more time, because my time is about up. Governor, back to you. Governor, you are a former litigator, are you not?

Mr. RACICOT. I am a former prosecutor, yes, sir.

Mr. GREEN. I would consider you as litigator, as a prosecutor.

And it is your belief that litigation somehow of a—what is perceived to be a legitimate claim of liability is somehow a negative?

Mr. RACICOT. No, sir, not a legitimate claim.

Mr. GREEN. Okay. Well, do you not believe that the legitimacy of the claim lies within the mind of the person who sees the damages, and has to assess the damages, and make some determination? This is why we have lawsuits, because lawyers differ in opinions.

Mr. RACICOT. I think that is entirely accurate. If you are proceeding in good faith, and with the—

Mr. GREEN.—opinion that the attorney general for the State of Louisiana and Mississippi proceeded in something other than good faith, representing the people of those States?

Mr. RACICOT. I don't know that I could offer a precise view about his—

Mr. GREEN. Was it not implicit in your statement that there was something untoward happening, because—

Mr. RACICOT. What I said in my statement is that when you create an environment within which you are going to revisit contracts that people have knowingly and voluntarily entered into, you have sent a very bad signal about how business can be conducted in—

Mr. GREEN. If you are the attorney general of the State of Montana, or governor, and you perceive that your people have been wronged, do you not file lawsuits to protect the interests of the people that you represent?

Mr. RACICOT. If there is evidence to support them, that allows for you to be able to prove your cause beyond a reasonable—

Mr. GREEN. Is it your contention that there is not evidence to support the notion that wind and rain, coupled with—together, should cause one to at least consider the possibility that the water was driven by wind, and that the water driving—the wind driving the water created the problems such that it's the wind, and not the water damage that—

Mr. RACICOT. I think that's a legitimate question that may be subject to litigation, and that is not what I am confusing the situation with.

What I am talking about is whether or not a State, as a matter of practice and climate, is sending the right signals, trying to attract business enterprise into their individual States.

Mr. GREEN. States have the right, under the Constitution, to litigate. You would not oppose this.

Mr. RACICOT. I would not.

Mr. GREEN. And we have judges and juries that make decisions. I cannot believe that you would want to have States that legitimately perceive their citizens to have been wronged not to take appropriate action to litigate.

Mr. RACICOT. I wouldn't—

Mr. GREEN. You would have done this, as governor, wouldn't you?

Mr. RACICOT. I wouldn't ask you to believe that, sir. In fact, I would have a hard time believing that's what I would want, as well.

Mr. GREEN. Well, it seems to be implicit in your statements that the people of Mississippi are not being properly represented by those who would litigate on their behalf.

Mr. RACICOT. No, sir. What I am saying is that when you create an environment, contribute to or precipitate circumstances where you set about—

Mr. GREEN. How the circumstance—

Mr. RACICOT.—to abrogate contracts voluntarily entered into—

Mr. GREEN. Governor, how are those circumstances being created?

Mr. RACICOT. Well, by—in a number of different ways, in a number of different—

Mr. GREEN. Give us some of those ways, Governor. How did—

Mr. RACICOT. I just told you. When you set about, regulatorily, to suspend the ability to have your rates fixed in a competitive environment based upon sound actuarial analysis, when you require insurance companies to remain in a State if they happen to be doing business in your State on that particular day, beyond—

Mr. GREEN. But you spoke earlier about litigation.

Mr. RACICOT.The point where they would voluntarily choose to remain.

Mr. GREEN. Did you not speak about lawsuits earlier?

Mr. RACICOT. When there is a—

Mr. GREEN. I yield back. Thank you, Madam Chairwoman. And thank you, Governor.

Mr. RACICOT. Yes, sir.

Chairwoman WATERS. Thank you. Thank you very much. To the members of this panel, we have a few minutes left, and I would like to recognize each member for an additional 2 minutes. And I will start with the panel here, asking this question.

Of all the possibilities for public policy that you have heard to address this problem, which do you support, if anything? All perils? H.R. 91, H.R. 330, or do you have something of your own that you would recommend today?

Mr. MCCARTY. Thank you, Madam Chairwoman. I am here in the capacity of the National Association of Insurance Commissioners, and also wearing another hat as, obviously, as a commissioner in the—

Chairwoman WATERS. Do you have a recommendation?

Mr. MCCARTY. Our recommendation is for the endorsement of the concept of having a commission to evaluate and focus attention on a number of these issues. Each one of them has a valuable contribution—

Chairwoman WATERS. All right. Okay, I am going to have to move along. I only have 2 minutes. Mr. Valdivia?

Mr. VALDIVIA. Thank you, Chairwoman Waters. The Big I supports H.R. 330. Also, we support S. 292, the coalition.

Chairwoman WATERS. Okay.

Mr. VALDIVIA. Yes.

Chairwoman WATERS. Thank you. Mr. Bennett?

Mr. BENNETT. Yes, Congresswoman. At this point, we are still looking at all of the complex issues, and we have not made a determination on any at this point.

Chairwoman WATERS. All right. Mr. Porter?

Mr. PORTER. We support H.R. 91, but we are open to additions to that. We want to work with the committee to broaden that.

Chairwoman WATERS. Okay. Mr. Thomas?

Mr. THOMAS. Yes. We are still looking at all of the issues, but we, in concept, support the insurance commissioner's recommendation.

Chairwoman WATERS. Okay. Ms. Spragens?

Ms. SPRAGENS. We would support the notion of a Federal credit facility, or a loan, because that would not put you into the business of insurance, and you would not have to be asking for cross-subsidies from other States or other citizens, and therefore, creating divisiveness among your constituents.

Chairwoman WATERS. If the reinsurers are losing money, wouldn't they be glad to get out, if we could step in and do a better job?

Ms. SPRAGENS. Well, ma'am, as you may have noticed, we're taking a lot of strong questions right now, and you could be in this chair if you had gotten into the insurance business.

And so, we urge you, instead, to think about a loan, think about the possibility that if States really do have a market failure—and that's the important thing, we don't think States ought to be creating CAT funds unless there is a market failure, which means our reinsurer friends aren't there—

Chairwoman WATERS. Okay.

Ms. SPRAGENS.—create a CAT fund, and that provides reinsurance. At that point, our reinsurance friends may want to come in and take part of it, which they would be more than welcome—

Chairwoman WATERS. Thank you. All right.

Ms. SPRAGENS.—economical.

Chairwoman WATERS. Thank you. And I like the chair that I am in.

[Laughter]

Chairwoman WATERS. All right. Let us move to Mr. Racicot.

Mr. RACICOT. Thank you, Madam Chairwoman. Of those bills pending, obviously, we want to see the National Flood Insurance Program reforms enacted.

We would like to see the tax incentives and reserve questions visited by the Congress. We would also like to make certain that any of the mitigation efforts that we have proposed are considered and that catastrophe savings accounts be enacted, and allowed as an option for taxpayers across the country.

Chairwoman WATERS. Thank you. Mr. Nutter.

Mr. NUTTER. Yes, thank you. To the extent that we have a view on all of these, the only one that we think is a viable option is really looking at a commission, to see if we can bring together a consensus on an approach.

Chairwoman WATERS. Thank you. Mrs. Biggert?

Mrs. BIGGERT. Thank you, Madam Chairwoman. I will just ask one question, too, if we can go down, and it's similar.

If private insurance and the reinsurance prices are high and rising in the most catastrophic-prone regions of our country, but the insurance is available, is it wise to set up a Federal program that offers less expensive reinsurance, but putting the burden on the taxpayers to pay for it?

Mr. MCCARTY. And the short answer to that is we believe that if it's available, and not affordable, then therefore, it's not available. So there needs to be some alternative to a mega-catastrophe, when all the wheels fall off, for our system, for us to have a mechanism that maximizes the private sector, but at the same time makes the government more efficient.

Mrs. BIGGERT. Thank you. Mr. Valdivia.

Mr. VALDIVIA. We believe that there is a legitimate role for the Federal Government when there is a marketplace failure.

Mrs. BIGGERT. Mr. Bennett?

Mr. BENNETT. Yes. I concur that if the market, the current market, is not working, then we need to look to the government, or some other mechanism to build in a backstop to make it affordable, which would encourage more people to enter it. That way, the risk would be spread longer over a larger number of people, just like the pool for the catastrophic loss, which includes all those areas.

Mrs. BIGGERT. Mr. Porter?

Mr. PORTER. I think in my statement I made it clear that ProtectingAmerica.org supports the public/private partnership, where you would have State and Federal catastrophic funds that would be paid for by private insurers.

Mrs. BIGGERT. Mr. Thomas?

Mr. THOMAS. Only in the case of mega-catastrophes and the capacity failure by the carriers.

Mrs. BIGGERT. Okay. Ms. Spragens?

Ms. SPRAGENS. We recommend that you start your thinking at the level of a high-level Federal loan, as was outlined to you.

Mrs. BIGGERT. Mr. Racicot.

Mr. RACICOT. Mrs. Biggert, we do not believe that it is a panacea, and that is a very dangerous enterprise to undertake. And if you're looking for an example, probably the National Flood Program would be the good example.

Mrs. BIGGERT. Okay. Mr. Nutter.

Mr. NUTTER. Mrs. Biggert, I question your assumption. Reinsurance capacity is, in fact, expanding, and we're in a moderating price environment. It operates like classic economics. And, indeed, this would be exactly the wrong time for government to get into the reinsurance business, at a time when the market is trying to serve these catastrophe-prone areas.

Mrs. BIGGERT. Thank you, thank you.

Chairwoman WATERS. Thank you very much. Mr. Cleaver?

Mr. CLEAVER. Thank you, Madam Chairwoman. I need some short answers, because I don't have enough time.

Ms. Spragens, the judge actually followed up on my question with regard to the reserve fund that you mentioned earlier. And then, Mr. McCarty actually spoke to where I was going, which was would there be any safeguards that reserve dollars would not end up as paid dividends to stockholders?

Ms. SPRAGENS. We have to remember that insurance is just about the most heavily regulated industry out there, and State insurance regulators have extensive reporting requirements. We believe this will actually add to the transparency, and permit them to see exactly where those profits—pre-profit—can go.

Mr. CLEAVER. Okay.

Ms. SPRAGENS. And so we believe it's heavily regulated, and you would be satisfied with that.

Mr. CLEAVER. Yes, I would, with heavy regulation. You mentioned the 7 years of famine, 7 years of growth. Now, you do know that the prophet speaking for God said to the people after the famine, "I will restore to you the years that the locusts hath eaten." And that's kind of where we are going. We want the insurance companies to restore to the people what the lawyers have eaten. And I'm not sure that God is too heavily involved in the insurance industry. But if you want to throw him out here, I have some stuff.

[Laughter]

Chairwoman WATERS. Amen.

Ms. SPRAGENS. Should I respond?

Chairwoman WATERS. Mr. Green.

Mr. GREEN. Just a closing comment. I believe it was Kennedy who said, "Here on Earth, God's work must truly be our own." I think we're doing God's work today. And I yield back.

Chairwoman WATERS. Thank you, very much. I would like to thank the panel for being here today, for your patience, and for the valuable information you have shared with us.

I would also like to ask unanimous consent to include in the record the information that was shared with us by Mr. Neugebauer when he earlier spoke about—before he made his presentation.

I also would ask unanimous consent that the statement of Janice M. Abraham of United Educators Insurance, and the statement of Charles Chamness, on behalf of the National Association of Mutual Insurance Companies, be made part of the record. Without objection, such is the order.

Thank you very much. The Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses, and to place their responses in the record.

With that, this hearing is adjourned. Thank you.

[Whereupon, at 4:59 p.m., the hearing was adjourned.]

A P P E N D I X

March 27, 2007

U.S. Congresswoman
Ginny Brown-Waite
Representing Citrus, Hernando, Lake, Levy, Marion, Pasco, Polk, and Sumter Counties

Subcommittee on Housing and Community Opportunity
"Prospectives on Natural Disaster Insurance"
March 27, 2007

Madam Chairwoman, I cannot thank you enough for holding this hearing today. The insurance crisis that Florida and other coastal states are facing is eminent, and I am grateful that you have taken an interest in this so early in the 110th Congress. I have been working on this issue with my colleagues for the past three years, and while I have made headway, the perception that natural disaster insurance availability and affordability is only a Florida problem could not be more wrong. While it is true that Florida is feeling the effects more acutely, lawmakers in Louisiana and Mississippi are having a very hard time luring insurance providers back to their state. And customers as far north as Massachusetts – a state that has not experienced a significant natural disaster in a decade – are losing their coverage. Congress cannot wait for the market to completely collapse before we decide to act, and I thank you for your leadership on this issue.

As many of you know, I have reintroduced my bills, the HR 91, Homeowners' Insurance Protection Act and HR 330, the Homeowners Insurance Availability Act. I am also working with my colleagues Ron Klein, Tim Mahoney, Carolyn Maloney, and Vern Buchanan on a bipartisan solution to the property and casualty insurance crisis facing this nation. Additionally, my counterparts in the Senate introduced a version of my bill. My proposals are simple and specific –both create a federal catastrophe fund to provide the stability needed in today's market.

The main reason many states are losing providers is the skyrocketing cost of reinsurance. Those representing the reinsurance industry will testify that they have plenty of capacity, but what they won't tell you is that it is not affordable. In 2002 in Florida, the cost of reinsurance was 7.1 cent of every dollar a homeowner spent on insurance. Just four years later in 2006, reinsurance accounted for 44.5 cents of every dollar homeowners spent. Until this market stabilizes and reinsurers provide a product that is available *and* affordable, the federal government must have a role.

Both of my bills assume that role. HR 330 would divide the nation into six different regions so the federal government could sell reinsurance policies to the insurers. This federal fund would only be available if a 1:100 year event or higher occurred, and this reinsurance would be a fraction of the cost, potentially as low as a quarter of current industry costs.

HR 91 takes a different approach. The federal government would sell reinsurance policies directly to states – not private insurers – that have established state catastrophe funds. This approach is more comprehensive and better for our nation because under this bill states would have to take responsibility for planning for natural disasters by enacting strong building codes and committing at least 35% of their state funds toward mitigation. Under HR 91, states would also have to establish a pass through mechanism, so that any savings insurers realize from my bill are passed on to the consumer, as they should be.

HR 91 also establishes tax-deferred reserves for private insurers. These act as "savings accounts" for insurers to plan for future, catastrophic disasters instead of relying so heavily on expensive reinsurance from the private market. Insurers could not use them unless a 1:100 year event or higher occurred, assuring that these reserves truly are used for catastrophic events.

The role and responsibility of HR 91 is also considerably less than some of the other proposals Members have drafted. Under my bill, the federal catastrophe fund could not be used unless a 1:200 year event or higher occurred. Additionally, once the reinsurance fund is triggered, states must still pay 10% of the cost, so the federal government is never on the hook for the full cost of a natural catastrophe.

In short, my bill offers a multi-layered approach to covering natural disasters – first the primary insurers cover homeowner losses, then states provide coverage, and finally the federal government provides coverage if need be.

Many Members representing non-coastal states have asked me why they should support a national catastrophe reinsurance fund. These Members and their constituents forget that they already are paying under the fragmented insurance system we operate under today. Congress is the insurer of last resort today. When a city or state is unprepared, has never enacted building codes, or focused on mitigation and is demolished in a natural disaster, Congress comes to the rescue with taxpayer dollars. And many of these projects are needed to help

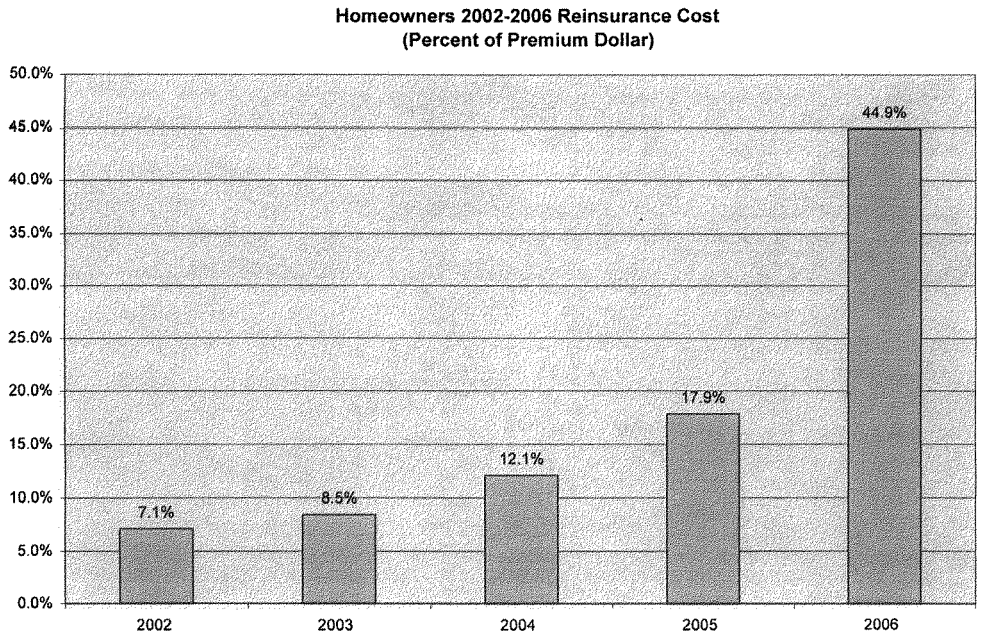
people rebuild their lives – Florida has even been a recipient of these funds. But wouldn't it be nice if Congress already had a fund, a reinsurance fund filled with insurer premiums – not tax dollars – to pay for these resurrection projects? For the first time, Congress could be *pro*-active instead of *re*-active.

Consider this: since its enactment in 2001, not one dollar of the TRIA fund has been spent; yet insurers have allocated additional capacity to terrorism risk, prices have declined, and take-up (purchase) rates have increased. In 2003, only 27% of companies purchased terrorism insurance. In 2005, 58% of companies purchased terrorism reinsurance, and the overall cost of coverage has fallen by 3-5% of total property insurance costs. Again, without one dollar of the TRIA fund being spent.

I don't propose that my bills are the silver bullet or the final answer. However, my bills are part of the solution and if passed with some of the other good proposals Members have introduced could go a very long way to protect property and casualty customers nationwide. The only state in the Union that is not susceptible to a natural disaster is North Dakota. Every other state in the Union is prone to hurricanes, earthquakes, or tornadoes. Either Congress moves everyone to North Dakota or we enact real, meaningful, and proactive solutions to a crisis that affects this whole nation.

Thank you again Madam Chairwoman and I look forward to asking any questions you might have.

Office of Insurance Regulation



State Farm,Allstate,Universal Propertuy Casualty,American Strategic

Statement of U.S. Representative Ron Klein

Twenty-Second District of Florida

Before the House Committee on Financial Services, Subcommittee on Housing and Community Opportunity

Hearing on "Perspectives on Natural Disaster Insurance"

March 27, 2007

Good afternoon Chairwoman Waters and Ranking Member Biggert. I sincerely appreciate the opportunity to discuss natural disaster insurance before the Subcommittee. I hope that our presence at this hearing emphasizes the seriousness of this problem and demonstrates our commitment to move forward in identifying a national solution.

The 2005 hurricanes illustrated all too well how quickly a natural disaster can change the lives of millions. The most devastating of the storms, which struck from Louisiana to the Florida panhandle, also dealt unprecedented losses to residential, commercial, and industrial property. Hurricane Katrina, in particular, opened many eyes to the problem of natural disaster financing, and showed that is up to us to make sure that we are adequately prepared to handle a disaster of catastrophic proportions, because it is simply a matter of time before the next one hits.

As such, we must think ahead proactively to develop a plan to address natural disasters before the next one hits, rather than simply continuing to operate without a catastrophe financing plan at the national level. We have seen the consequences of large-scale disasters, and the physical and economic destruction that accompany them, and must responsibly prepare to act.

We are all familiar with the sights and stories of Hurricane Katrina, but we must also recognize that families across the United States face a variety of other threats that could rise to the level of catastrophic proportions and hit without warning. Many residents in California certainly remember the devastation caused by the Northridge Earthquake, which killed 60 people, injured 3,800, and caused $43 billion in property damage. Even with California's history of seismic activity, only about 14 percent of Californians currently have earthquake policies, which is a real eye-opening statistic. It only takes one day of devastation from an earthquake, fire, volcano, flood, or hurricane to make us wish that we had thought ahead to establish a national system to deal with catastrophe financing.

The economic impact accompanying natural disasters resonates throughout the entire nation. Total economic damages from the 2005 hurricanes will likely exceed $200 billion, with the federal government responsible for paying out in excess of $109 billion for disaster relief. This money, which we all agree was entirely necessary to spend, comes from taxpayers across the country, not simply those from the affected regions.

Those who say that natural disasters are a regional problem limited to coastal states are dead wrong. Until we are able to develop a national financing mechanism to provide certainty for large-scale natural catastrophes, each taxpayer will continue to be responsible following a catastrophic event.

On the local level, more and more families across the country are facing the very real prospect of being dropped by their property insurance company. Hundreds of thousands of homeowners in my home state alone have been dropped or have been slated for non-renewal by their insurance companies. Those who remain insured are confronted with crippling premiums, which in some cases is forcing homeowners to make tough decisions about whether to go without property insurance.

Take the case of one of my constituents. We have an individual back home in my district who was paying $3,100 a year for homeowners' insurance in 2005. She is now coping with a premium that reached $16,000 this year. That is a $12,900 increase over two years. How can we possibly expect families to make these payments each year to protect their homes?

Skyrocketing insurance premiums are posing a real threat to home ownership, particularly among our most vulnerable populations, such as the elderly. Older Americans, many of whom are on fixed incomes and may even own their homes outright, are not able to plan for the increasingly volatile rate increases, and in many cases find themselves with no place to turn for help. We must work together to establish a system to make sure that property insurance is both available and affordable for hard-working families and those most in need.

The property insurance crisis is not isolated to Florida, either. Last year, property insurers indicated that they plan to stop offering new coverage in Maryland and Virginia's coastal markets. Property insurers have also stopped writing new policies for residents in Delaware, New Jersey, and Connecticut, no matter where in the state the property is located.

Furthermore, tens of thousands of homeowners in New York, North Carolina, South Carolina, Alabama, and Texas have already been dropped, as well. It is unacceptable for property owners not to be able to get reliable coverage in these markets. And it is precisely this reason that a national solution is necessary.

Over the past couple of weeks, I have been working closely with Congressman Mahoney, Congresswoman Brown-Waite, and Congresswoman Maloney to move forward on this issue. We have been working with Chairman Frank, who also believes that a national solution is necessary, and are now discussing the issue with consumer groups and other interested parties. Furthermore, we are assembling a bipartisan, multi-regional group of Congressmen, who collectively recognize the problem of large-scale natural catastrophes and have pledged to help work towards a national solution.

We are looking to take a well-thought out, deliberative approach in examining the current insurance paradigm. In doing so, we are particularly interested in exploring the options surrounding a national catastrophe program. Such a program would provide a layer-based national financing mechanism that would allow the private sector to take the lead on property insurance, while the federal government would implement a system to cover a portion of losses when a large-scale natural catastrophe reached a significant level. Cost-savings realized under any proposal that we offer would be passed on directly to the retail level, ensuring that consumers are the primary beneficiaries of the legislation.

We will also be working to develop incentives for mitigation standards. Reducing property-owners' exposure to natural disasters will be an important part of our plan. We are looking to encourage responsible development through building code standards and other means.

The time for action is now. With the federal government currently in the position of being the de facto insurer of last resort, we hope to establish a more efficient system to foster predictable coverage at reasonable rates.

Again, I would like to thank the Subcommittee for holding a hearing on this very important issue and I look forward to working with you, Chairwoman Waters and Ranking Member Biggert, to develop a national solution.

THE HONORABLE TIM MAHONEY
TESTIMONY BEFORE THE U.S. HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY REGARDING "PERSPECTIVES ON NATURAL DISASTER INSURANCE"

Tuesday, March 27, 2007

Thank you Chairwoman Waters and Ranking Member Biggert for holding this important hearing today and allowing me to discuss problems that the people of my great state of Florida are having coping with the devastating impact of natural disasters and their struggles to meet those challenges by having access to comprehensive and affordable homeowner insurance.

Before I begin summarizing the insurance crisis facing my district and the state of Florida, I want to make sure that this Committee understands it is not just a Florida problem – it is a national problem. States all around the Gulf coast from Texas to Maine are facing similar situations due to hurricanes. My colleagues in California with earthquakes and fires. My friends in Oklahoma and Ohio with tornadoes and floods. We all are facing the same challenge.

The single biggest investment most Americans have is their home. The increased occurrence and severity of natural disasters, whether they be hurricanes, tornadoes, earthquakes, fires, or volcanoes, has caused insurance premiums to rise beyond the financial means of many homeowners in my State of Florida and around the country. In two years, the Gulf Coast region was struck by 7 major hurricanes. Just one of those hurricanes – Hurricane Katrina – caused more than $40 billion in insured losses. Approximately, $15.5 billion of that amount was the result of homeowners' claims.

Up until the moment Katrina ravaged New Orleans and the gulf coast, my district was the single biggest disaster area in the nation with no less than four major hurricanes destroying homes and businesses. Today three years after Hurricane Charlie ravaged the town of Punta Gorda you can still see the scarred downtown and a community working heroically to rebuild.

Despite no major storms during the 2006 hurricane season, many Florida homeowners have seen their insurance premiums double or triple during the past year. Earlier this month, one Florida insurance company won an arbitration case that will allow it to raise premiums on more than 22,000 customers by an average of 75.8 percent.

As anyone who has ever had a mortgage knows, insurance is a requirement and the payment of your insurance is non negotiable. This has created a viscous cycle of terror for our seniors living on a fixed income and our middle class families struggling to provide for their children.

The toxic cocktail of rising gas prices, skyrocketing property taxes, and exorbitant homeowners insurance costs have created a situation for the first time in our State's history where we have more people leaving Florida than coming. It is so acute that the real estate industry has a name for these people.... "Half-backs". They move to Florida from the north and due to the out of control costs they leave Florida and move half way back to Georgia, Tennessee and North Carolina.

Madame Chairwoman, in fact one in five business in Florida cannot get property insurance.

In January, the Florida Legislature passed legislation that was intended to provide consumers with rate cuts. Following the passage of this legislation, Florida's Insurance Commissioner, Kevin McCarty, estimated that the average rate cut for homeowners would be approximately 24 percent.

However, according to one Florida newspaper, "Florida's biggest private insurers are asking for price cuts far less than state estimates." For example, State Farm Florida Insurance Company's requested rate reduction plan seeks to reduce the average premium in Florida by only 7 percent. Likewise, USAA's requested plan would decrease premiums by a mere 3.1 percent.

The situation is so severe, that in order to have insurance, the people of my state had to get into the business. Today the state run Citizens insurance company is the largest provider of homeowners insurance in the state! The solution to our insolvent insurance company was to make it more competitive by offering fire and theft coverage as well. Clearly, the best solution our elected leaders could find when the market failed.

The affordability of property insurance is not the only obstacle facing my constituents. Millions of Florida's hardworking families have paid their insurance premiums on time for years – despite the increased cost. In addition, many of these families have never filed a claim on their policy. Insurance companies have rewarded these responsible homeowners – not with rebates, but with non-renewal notices. Just a few weeks ago, Nationwide announced that it would continue with its earlier decision to

non-renew policies in Florida. As a result 25,000 Florida homeowners will be receiving notices that their policies will soon be cancelled.

The recent actions of Nationwide, as well as similar decisions by their competitors, communicate that the market is broken and that they are unwilling to be a part of the solution. As these companies profit from the freedom, stability and prosperity this nation offers, I believe that the industry should consider its corporate responsibility and join with Congress and the American homeowner in finding a solution to this crisis.

Chairman Frank at a press conference on this very subject made the statement that a role for government is to step in when markets fail. I am here Madame Chairman to testify that in my beloved State of Florida the insurance industry is broken and as a result the state is facing an economic crisis. Floridians are giving up on their American dream and are being forced into foreclosure, or to make decisions not to take their prescription medicine so they can afford to pay for insurance or being forced to sell their homes in a depressed real estate market and leave the state.

It is clear that homeowners across this country need a national catastrophe insurance program. The program that we in Congress create must assist our private insurance industry manage risk. Nobody got into the homeowners business thinking that they need to underwrite the devastation of an Andrew or Katrina.

Secondly, the homeowner needs to be protected as it relates to the availability of affordable homeowners' insurance. The policy they purchase must be comprehensive, eliminating the loophole between wind and water.

Finally, responsible legislation must ensure people take responsibility for their decision to live in high risk areas. Good legislation should not give people and builders a blank check to ignore risk. Good legislation must provide homeowners and builders incentives to mitigate risk by employing state-of-the-art construction technology.

Madame Chairman as you know, I have been asked by Chairman Frank and it leadership to work with my colleague Representative Kline to put together a comprehensive national catastrophe program. I look forward to your leadership and working with the Members of this Subcommittee, and Representatives Taylor and Brown-Waite to produce a piece of legislation

that will provide consumers with access to comprehensive affordable homeowners' insurance.

Again, I want to thank Chairman Frank and Ms. Waters for their leadership on this issue and I thank this committee the opportunity to testify on behalf of the people of Florida.

"Perspectives on Natural Disaster Insurance"

Testimony of

Malcolm N. Bennett
President and Founder
International Realty and Investments, Inc.
Los Angeles, California

Before the
U.S. House of Representatives Committee on Financial Services
Subcommittee on Housing and Community Opportunity
Washington, DC

March 27, 2007

Introduction

Good afternoon Chairwoman Waters, Ranking Member Biggert, and distinguished members of the Subcommittee. My name is Malcolm N. Bennett, and I am President and Founder of International Realty and Investments, a real estate company specializing in property management and residential real estate sales and investments in Los Angeles, California. This afternoon I am here on behalf of two trade associations that represent the private apartment industry—the National Multi Housing Council (NMHC) and the National Apartment Association (NAA). NMHC and NAA represent the nation's leading firms participating in the apartment industry. Their combined memberships include apartment owners, developers, managers, builders and lenders.

The National Multi Housing Council represents the apartment industry's largest and most prominent firms. NMHC members are the principal officers of these organizations. NAA is the largest national federation of state and local apartment associations, with 190 affiliates representing nearly 50,000 professionals who own and manage more than six million apartments. NMHC and NAA jointly operate a federal legislative program and provide a unified voice for the private apartment industry.

We commend you, Chairwoman Waters, for your leadership in holding this hearing to discuss industry and congressional perspectives on the market conditions for catastrophic insurance coverage that are challenging property owners across the nation today. I appear before the subcommittee as a California multifamily property owner and manager trying to provide affordable housing in these times of unprecedented natural disasters and escalating costs. I also speak on behalf of my industry colleagues with national property portfolios that include Gulf Coast and East Coast apartment communities who continue to face enormous challenges in obtaining insurance coverage in the aftermath of the 2005 hurricane season relative to pricing and capacity for property insurance.

Our membership is extremely concerned about the future stability of the insurance market and its ability to withstand the continued occurrence of catastrophic events, whether the result of a natural disaster or of terrorism. Policyholders need some assurances that the resources will be available to cover the risks both now and in the future. As Congress continues its deliberations on how best to address this critical issue, we welcome the opportunity to participate in this discussion. We feel strongly that any federal initiative should include relief for the commercial real estate sector as well as the residential homeowner. Previous policy debates have focused primarily on the homeowner, not recognizing the needs of multifamily property owners and other commercial real estate interests.

The Impacts of Hurricane Katrina are Felt Beyond the Gulf Coast

The major catastrophe losses of 2005 from Hurricane Katrina had a devastating impact on the property insurance market in many states across the country. Even California felt the ripple effect of skyrocketing premiums, reduced limits, higher retained risk and higher deductibles for earthquake insurance. While most of the attention has been focused on windstorm coverage associated with hurricanes, insurance carriers include earthquake events in the same risk pool as tornados and hurricanes. As a result, property owners like me in California are impacted much like those located on the East Coast.

It is somewhat frustrating because as policyholders, we have limited control over any of the factors that shape the marketplace for catastrophic property insurance. Other than employing mitigation

measures to harden our properties against damage during a weather event, there is very little the policyholder community can do to influence the pricing and capacity of insurance coverage. It would be easy to lay blame on the insurance carriers for the marketplace conditions policyholders experience today. However, it appears there are other contributing factors that determine the availability and pricing of catastrophic insurance. First, insurers rely on loss modeling to underwrite risks. However, as we now know, these models significantly underestimated the losses of 2004 and 2005 and have been reworked, forcing insurers to take a more conservative view of their risks and how they allocate their capacity in catastrophic areas. Second, the insurance company rating agencies have revised their capital criteria and by more closely scrutinizing carrier's catastrophic exposures, they are forcing some carriers to reduce the number of policies they write. Third, and probably the most direct link to the price increases, is that reinsurers are providing less coverage to their insurers and at much higher prices, thus impacting the insurer's ability to offer coverage to its policyholders. Some carriers are pulling out of markets altogether or limiting business to renewals only.

While many apartment owners expected the 2005 hurricanes to affect their 2006 insurance renewals, apartment property risk managers say the reality far exceeded their worst case expectations. Significant cost increases and rapidly diminishing capacity were common themes cited throughout 2006 renewal periods by both risk managers and insurance industry experts. As a result, property owners with catastrophic exposure such as severe wind and earthquakes, reported significant cost increases ranging from 100-400 percent and reduced policy limits in 2006. The 2007 renewals have not yet been assessed but it is expected that even if the market begins to stabilize, prices will certainly not return to the pre-Katrina levels.

California Earthquake Insurance

My real estate portfolio is limited to California where earthquake insurance presents the biggest challenge to property owners. The 1994 Northridge Earthquake event changed the marketplace for earthquake insurance. These changes are similar to what we saw after 9-11 and what the Gulf Coast and East Coast are now experiencing after Katrina. Prior to this event, coverage was readily available and reasonably priced. These once-in-a-lifetime events wreck havoc in the marketplace and cause insurers to reevaluate the level of risk they are willing to take and whether to leave certain markets or price accordingly for the limited capacity

As you know, commercial as well as homeowner property insurance policies do not include coverage for damage caused by earthquakes. Coverage can be purchased as a separate policy or an endorsement, but its high cost has resulted in very small take-up rates. Homeowners in California have a slight advantage over commercial property owners. They can buy coverage through the California Earthquake Authority (CEA), the privately funded and publicly administered program created by the General Assembly after the Northridge earthquake. Unfortunately, multifamily properties are excluded from this program and can only purchase a policy in the private insurance market. As a small business owner and manager of multifamily units, I have chosen not to purchase earthquake insurance for my properties because I cannot absorb the added cost in my business operation. The only way I could afford this insurance would be if I raised rents to cover the increased costs associated with this insurance coverage. I am not willing to create a financial hardship for my residents. Apartment owners, especially those with older properties, are continually faced with the increasing operating costs required to maintain and upgrade properties so that residents can enjoy a safe, decent and hopefully affordable home. The costs of catastrophic insurance coverage currently exceed a level that is business practicable and threaten the supply of affordable housing in California and storm-prone areas.

Larger apartment owners with national portfolios face the same operating cost challenges. It is not uncommon for apartment owners of properties utilizing the Low Income Housing Tax Credit (LIHTC) program to choose not to purchase earthquake insurance unless it is required by their lender due to the exorbitant cost. Unlike market-rent properties, these properties offer no rent adjustment option to offset the added cost because the rents are based on local household income levels. This is also true of other federally subsidized programs such as the Section 8 program. For the properties that purchase this insurance due to lender requirements, the owner assumes the additional cost, perhaps at the expense of some property improvements. The uninsured properties remain at risk to Mother Nature, leaving the owner as well as the lender exposed. In the event of a large-scale earthquake, many of these affordable assets would have no source of funds to rebuild, thus removing properties from the already limited inventory of affordable housing. Unfortunately, that leaves a significant percentage of California property owners exposed to the ongoing threat of an earthquake and subsequent destruction.

Market Reaction to 2005 Hurricane Season and Impact on Policyholders

The 2005 hurricane season not only broke records for the number of named storms—26 compared to the 1933 record of 21—it also set records in terms of insurance losses. 2005's losses of $61.2 billion were the worst year ever in the United States. (Source: Insurance Information Institute) While weather experts predicted 2006 to be an active season, calling for 17 named storms, the season ended rather quietly with Mother Nature sparing property owners and insurance carriers, at least for now.

However, another kind of disaster was felt during the 2006 renewal cycle, as most apartment firm owners were presented with one of their most challenging years ever in the insurance market. Portfolios with catastrophic (CAT) exposure, including Florida and the Gulf Coast/Houston area (wind storm), California (earthquake) and certain central business districts (terrorism), saw up to 400 percent price increases for some layers of insurance. The-first quarter renewals in March of 2006 reported almost daily changes in pricing, and swiftly deteriorating capacity with analysts predicting a worsening situation by the 2nd quarter renewals. Risk managers sought to move up their renewals in an effort to secure the coverage they needed before capacity totally dried up. Florida property owners reported paying as much as $1,400-$1,500 per unit for the same coverage they paid $400-$500 just a year before. Texas policyholders reported similar experiences in pricing and availability of coverage. Insurance experts reported that carriers were simply not willing to take as much risk as in previous years. It became widely accepted that even at the exorbitant cost and lower limits, a property owner was lucky to have obtained coverage at all.

Is there a need for a federal catastrophic insurance program?

Weather experts are not letting a little lull in the storm season detract from their otherwise gloomy forecast for 2007. Despite last year's mild season, experts are once again forecasting an active 2007 hurricane season. Colorado State University forecasters predict 14 named storms, of which 3 will be major hurricanes. This represents a 40 percent increase over the average storm activity measured over the period from 1950-2000, thus another reason that improved market conditions may not be in the cards for some time

It is not clear that a government solution exists to the current insurance crisis, or if one will come from the private market. What we do know is that the continued occurrence of catastrophic events, whether the result of a natural disaster or terrorism, will have a significant impact on the national

economy. It seems clear that the private insurance market is losing its appetite to take on this significant risk for much longer. Anecdotal accounts of carriers pulling out of certain high-risk states worsen the already deteriorating situation.

It is very likely that in the event of a mega-catastrophe the federal government would step in and take whatever action is necessary to stabilize the markets, regardless of whether a role for them has been defined in legislation. This sentiment has prompted policymakers at the state and federal level to look at the viability of a public/private program.

The apartment industry has much at stake in this debate. Decreased capacity and pricing increases of insurance will result in higher prices for the consumers and ultimately reduce the level of available housing in certain areas. Especially hard hit will be the level of affordable housing, which is already in short supply. This is why we are encouraged by these hearings and by the recent press conferences announcing the intentions of Congress to craft a proposal to address the need for such a program. NMHC and NAA hope to lend support to those proposals we believe offer the best opportunity to ensure a stable insurance market that can withstand future natural catastrophes and offer the coverage necessary and at reasonable prices. The level of government participation is still under consideration.

We recognize it will not be an easy task to identify a one-size-fits-all solution to this problem. Arguments against federal involvement are plentiful and generally caution against the government from direct involvement in providing insurance thus stifling the development of a private market solution. It is also opined that federal subsidies only encourage construction in areas that place people and properties in harm's way. These arguments may have merit but should be carefully weighed against the goal of creating continued stability in the marketplace. Therefore, we encourage Congress to fully consider the various proposals that advance this goal including but not limited to the creation of a federal backstop to state catastrophe funds, tax exempt cat reserves for insurers, National Flood Insurance Program (NFIP) reform, and Risk Retention Act expansion. We also believe the establishment of a bi-partisan commission to examine these and other proposals may make sense, however only to the extent the Commission works in tandem with Congress and does not merely serve to delay serious consideration of legislation.

Industry Policyholder Coalition

NMHC and NAA are currently participating in a newly established policyholder coalition created for the purpose of working with Congress as it addresses this critical issue. In addition to multifamily property owners, our membership includes owners and managers of shopping centers, commercial office properties, hotels, industrial office parks, community bankers, resort developments, residential and commercial Realtors, mortgage bankers, economic development corporations, homebuilders, real estate investment trusts and many other groups representing real estate interests. It is our goal to identify and lend support to a legislative initiative that offers long-term stability in the insurance market by ensuring adequate capacity in times of severe weather events such as earthquakes and hurricanes that cannot be accommodated by the private market alone.

Conclusion

We encourage Congress to move in a deliberative and thoughtful manner rather than react in a time of crisis after another event. Congress should consider the appropriate level of federal participation to ensure adequate coverage is available and at affordable prices to the policyholders of America.

I thank you for the opportunity to testify on behalf of the National Multi Housing Council and the National Apartment Association, and wish to offer our assistance to the Committee as you continue your important work

Testimony of
The National Association of Insurance Commissioners

Before the
Subcommittee on Housing and Community Opportunity
Of the
House Committee on Financial Services

Regarding:
Perspectives on Natural Disaster Insurance

March 27, 2007
Room 2128
Rayburn House Office Building

Kevin M. McCarty
Florida Insurance Commissioner
Chairman of the NAIC Catastrophe Insurance Working Group
Chairman of the NAIC Property & Casualty Insurance Committee

T stimony of Kevin McCarty
Florida Insurance Commissioner
On Behalf of the National Association of Insurance Commissioners

Chairwoman Waters, Ranking Member Biggert and Members of the House Financial Services Subcommittee on Housing and Community Opportunity: Thank you for the opportunity to testify here today on behalf of the National Association of Insurance Commissioners (NAIC) regarding natural disaster insurance. I applaud you for your leadership on this critical issue of national importance.

My name is Kevin McCarty, and I am the Insurance Commissioner for the State of Florida. I serve as Chairman of the NAIC's Property and Casualty Insurance Committee as well as the Committee's Catastrophe Insurance Working Group.

The NAIC, through these groups, has been involved in research and analysis on the impact of natural disasters on our society for a number of years. Insurance Commissioners across the country are working to find solutions to manage the catastrophic risk exposure in their respective states – exposure that grows with increased real estate development, rising property values, and expanding commercial operations in catastrophe prone areas. The NAIC currently is engaged in developing a comprehensive national plan for managing the economy wide risk of catastrophic natural disasters. In addition, the NAIC has adopted resolutions, both in December of 2005 and most recently in June of 2006, supporting a national disaster plan and calling for a Federal Commission to further study the issues, weigh the alternatives, and focus the debate.

Our Current System for Catastrophic Natural Disaster Insurance

As we meet today, the ability of housing markets and local and regional economies to withstand and recover from the next natural catastrophe depends critically on what type of peril creates the disaster, where the disaster occurs, and the severity of the disaster event. The varying types of catastrophic natural disasters are managed very differently

within our current insurance framework. This, in turn, can lead to highly different outcomes.

Wind events, including tornados and hurricanes, are considered a basic covered peril in the vast majority of homeowner's insurance policies. Flood, on the other hand, is written only rarely by the private insurance industry for residential property; since 1968 the National Flood Insurance Program (NFIP) has been the public solution to managing this risk. Finally, seismic events, particularly earthquakes, are not considered a standard covered peril, and aside from the California Earthquake Authority (CEA), there is no public mechanism to underwrite the risk; therefore, coverage is restricted to being an optional coverage, where available, in the private insurance market. It also is worth noting that the coverage provided by the CEA is somewhat limited (the standard policy carries a 15 percent deductible and offers $5,000 for contents coverage and $1,500 for additional living expenses due to loss of use).

If the next natural catastrophe is a significant flood event, the ability of the affected areas to recover is going to depend critically on the degree to which affected properties were insured with the NFIP. Unfortunately, recent evidence from 2004 and 2005 suggests that far too many properties damaged by flood were uninsured; either they were outside of the mandatory flood plains as dictated by antiquated maps, or they were in the mandated flood zones but were uninsured anyway. A recent study by the Rand Corporation provides evidence that suggests that the rate of take-up (that is how often the coverage is purchased) outside of the mandated zones is around 5 percent, and the take-up rate in mandated zones is only about 75 percent.

If the next natural catastrophe is an earthquake, the ability of the affected regional economy to recover will depend on the degree of disaster relief that comes from the federal government. The reason is really quite simple: the majority of residential property in earthquake prone areas is not insured for this very real risk. In California, for example, it is estimated that the take-up rate for optional earthquake insurance has fallen to about 12 percent or less. The same take-up rate is frequently suggested to be true in

the earthquake prone areas in the Midwest's New Madrid area and along the eastern seaboard's seismically active areas.

As you can see, our current system lacks a comprehensive approach to managing the devastating effects of catastrophic natural disasters. Our current policy relies heavily on the Federal government. For example, the federal government so far has allocated $110 billion, in addition to insured loss payments, to facilitate recovery and rebuilding following Hurricane Katrina. As generous and compassionate as the American people are, this current system leaves much to be desired. Although our current reliance on federal payments for large-scale disaster spreads the cost of these events across a broad pool – the American taxpaying public – it does so rather ineffectively and inefficiently.

One of the arguments against a comprehensive national approach to manage this nation's natural disasters is that people in areas with lower perceived levels of risk do not want their money paying for events in other areas. This argument ignores the reality that, in the context of a major catastrophe, those areas already pay for risk in other areas – in the most ineffective way and with little tangible benefit going forward. In documents attached to this testimony, you will find some estimates prepared by the Florida Office of Insurance Regulation on the federal tax burden, by state, of the Katrina allocation of $110 billion. This analysis highlights one important truth about the consequences of large-scale natural disasters: they are a national issue rather than local or regional problems. As the estimates show, the Great Lakes and Plains states will contribute, based on their proportionate percentage of individual federal tax filers, approximately $26 billion to Katrina initiatives. These tax dollars are not risk-based, and they leave little legacy that guarantees relief for the next natural catastrophe, regardless of where it strikes. Precious little of the money that we spend collectively on catastrophes is invested in lasting solutions or efforts to limit losses. Our current system is based largely on a post-event reaction. The NAIC believes that a more proactive system, which prepares the public and mitigates the potential for catastrophic damage following such an event, is more practical and less expensive in the long run to both affected individuals and the public at large.

The problem of insurance availability and affordability in the Gulf Coast has been widely publicized, but it is a problem that is now affecting other states, as well. The Connecticut Department of Insurance recently conducted a study of its homeowner's insurance market (available on the Department's website at: http://www.ct.gov/cid/lib/cid/finalcoastalreport.pdf) and determined that insurance availability within 1,000 feet of the shore is difficult to find in the traditional market. Coverage that is available is often significantly more expensive and available only through the nonadmitted insurance market. Homeowners insurance availability between 1,001 feet and a half mile of the shore is available in the standard market, but appears to be tightening with increased mitigation and underwriting requirements imposed by carriers. Similar problems are being felt from Cape Cod to the Carolinas. The response from insurers is aimed at coastal exposure, but it ignores the very real possibility that the next major catastrophe will not touch a coastline. Our country has a relatively brief history, but in that time virtually every region of the country has experienced some form of catastrophic event. Also in the documents attached to this testimony, you will find maps of the catastrophic exposure to natural disaster facing each state. As these maps show, very few Americans are not moderately or severely exposed to the effects of a natural disaster. The hurricanes in the gulf are only our most recent reminder of the risk from natural disasters, but it would be naïve to think they will be the last.

Other Approaches to Managing Disaster Risk and Insurance

What then can be done to create a comprehensive plan for managing our national natural catastrophe risk? Both within the U.S. and across other developed economies, a variety of programs have been created to manage the economic consequences of catastrophic events. These programs differ in their structure based on underlying premises regarding the nature of the risk. As such, the resulting roles of the private insurance market and government entities vary considerably across programs. The Government Accountability Office (GAO) report, "U.S. and European Approaches to Insure Natural Catastrophe and Terrorism Risks," GAO-05-199 published in February 2005, provides a thorough description of these various approaches.

Public policy frequently enters the debate as to whether or not a natural catastrophe is an insurable risk. Here in the US, with the creation of the National Flood Insurance Program in 1968, it was decided that flood was not an insurable risk. Interestingly, other countries consider flood an insurable risk. Using the same premise, both France and Spain have created risk pools for mandated natural catastrophe coverage that result in the state assuming the risk on an unlimited basis.

On the other hand, many natural catastrophes are considered insurable as a matter of public policy, and government is used sparingly to facilitate the private sector mechanism. Perhaps the most common tool provided under this premise is the insurer's ability to set aside reserves to pay for catastrophic losses on a tax-deferred basis. Although differences exist in how these reserves are structured and monitored, they are common throughout the world. As a measure of their perceived importance, a recent International Accounting Standard ruling (accounting guidance followed by most of the rest of the world except the U.S. at this point) would have done away with this reserving mechanism. Virtually all European nations, along with a number of other jurisdictions, chose not to adopt this new rule.

The U.S. does not allow for the creation of tax-deferred reserves by insurers; however, a number of variants of a tax-deferred reserve have been developed and proposed since Hurricane Andrew in 1992.

A second tool found in many nations is a risk pool funded by private insurers but managed by the government. In Switzerland, for example, coverage for all natural catastrophes, except earthquake, is mandated in property insurance policies. Private insurers as well as state-owned canon specific insurers, pool these risks together and an average actuarial rate is determined and charged by all insurers.

Federal Support of Disasters and Disaster Insurance

As observed from Hurricane Katrina, the Indian Ocean tsunami, and the 2005 earthquake in Pakistan, national governments become involved when a national catastrophe strikes its citizens. One important policy question is whether this support is provided before or after an extreme event. It is like the old television commercial featuring the auto mechanic telling the camera, "You can pay me now, or you can pay me later." It is always less expensive to finance disaster recovery before a catastrophe occurs than it is after-the-fact. This is precisely the purpose of insurance – to pay prior to the event and provide an economic cushion to survive its adverse effects.

Although I believe this Subcommittee should consider all options for federal involvement, it is important to stress that the solution to handling natural catastrophes, and ensuring a stable insurance market, does not begin or end necessarily with a massive federal program. In its Constitutional powers of taxation and interstate commerce, Congress' powers directly and indirectly affect state insurance markets. The loan conditions put on federal mortgages, the tax treatment of insurance company's reserves, economic incentives for individuals to retrofit their homes, improved building codes, and even upgrading our nation's infrastructure are all areas Congress may address to impact the insurance marketplace positively. In the following section, I will attempt to summarize a few of the key ideas currently being considered.

Improve Disaster Preparedness and Disaster Response

Disaster planning and disaster response are the very first steps to saving lives and protecting communities. The sad evidence from Hurricane Katrina bears solemn testament to this fact. The recently released study of community disaster preparedness by the Department of Homeland Security (DHS) suggests that there is still much to be done around the country. The report states that the "current catastrophic planning is unsystematic and not linked within a national planning system." It continues that, "this is incompatible with 21st century homeland security challenges," and suggests the need for a "fundamental modernization of our Nation's planning processes." The NAIC has

endorsed disaster planning as a top priority and maintains a disaster preparedness manual for use by all states.

Build Better Homes

Although we cannot stop natural disasters, there are measures that we can take to mitigate damage. The first component of any comprehensive national strategy must be mitigation – meaning preemptive measures taken to reduce or eliminate risk to property from hazards and their effects. In practical terms, this involves toughening building codes for new structures by making them more resistant to hazards such as wind, flood, and earthquakes. It also means stricter state and local guidelines to limit construction in highly hazardous areas.

In Florida, we are implementing rules mandating that insurance companies provide appropriate insurance premium discounts for homes that employ mitigation measures. In 2002, the Department of Community Affairs commissioned a study by the Applied Research Associates that calculated potential savings based on mitigation procedures. Shortly thereafter, the Florida Legislature passed a law that requires companies to implement mitigation credits. Initially, the Florida Office of Insurance Regulation adopted one-half of the recommended credits, but after two years of hurricane damage related data, the Florida Cabinet has approved the full ARA credits. The message is clear: we must provide economic incentives for private citizens to protect themselves from catastrophic loss.

The federal government can affect these decisions positively by predicating federal loan decisions through the Federal Home Association (FHA) and Rural Development Home Program to only allow the purchase of homes that meet the most stringent building code standards. If a home does not meet these standards, a procedure for requiring the retrofitting of the home must be enforced.

Mitigation techniques work and are cost effective; we also have witnessed their successful utilization. In Florida, the Department of Financial Services provided $2.3

million to develop four model "hurricane houses" with advanced building techniques to withstand 140mph winds. In 2004, the eye of Hurricane Frances, a category 2 hurricane passed over one of these houses located in Ft. Pierce. The house survived with no appreciable damage. In Tulsa, the development of education and marketing to extol the value of "saferooms" has met with tremendous success and increased significantly the demand for this tornado mitigation safety device.

Although strengthening building codes for new structures will improve the housing stock on a going-forward basis, it will have a minor impact on the entire book of business for property insurers in the short-run. The majority of the housing stock in the U.S. is built. This is true even in rapidly growing states; the average age of a house in Florida is 24 years. Many of these houses were built prior to any building code standards, much less the most recent, even in areas where building codes are in place.

During last year's legislative session, the Florida Legislature passed the Florida Comprehensive Hurricane Mitigation Program, which provides for free home inspections, as well as 50 percent matching grants of up to $5,000 to encourage single-family homes to reduce vulnerability to hurricane damage. The response was overwhelming. The Florida Department of Financial Services received over 65,000 applications for the free home inspections that will alert consumers how to strengthen their homes. Regrettably the target for the year was to inspect 12,000 homes based on resource constraints, but this illustrates the interest homeowners have in protecting their homes when the proper financial incentives are provided. As well, these programs are being expanded moving forward.

Mitigate by Improving Infrastructure

Another element of improving the homeowners market is to improve our nation's infrastructure. This includes dikes, levees, tunnels, bridges, solid waste facilities, transportation facilities, and roads. During the Hurricane Katrina tragedy in New Orleans, many structures withstood the initial damage of the storm, only to be destroyed

due to the failed levee system. The American Society of Civil Engineers' March 2005 Report Card showed deteriorating conditions in 13 of the 15 infrastructure areas surveyed. In California, low lying areas around the Sacramento and San Joaquin rivers are protected by thousands of miles of earthen levees, many that date to the Gold Rush era. These levees protect a delta that provides freshwater to nearly 25 million Californians. If those levees break, either from disrepair or seismic activity, the consequences could be devastating.

Insurers are factoring in these aspects of infrastructure, and they are becoming reluctant to insure structures in areas with outdated or outmoded infrastructure risks. A commitment to improving our infrastructure, especially as it relates to structures that place homes in greater risk during a catastrophic event, will help prevent or mitigate damages to homes.

Expand the Capacity of the Insurance Marketplace

The current system of insurance effectively handles "normal" disasters ranging from car accidents, to storms, and even to large hurricanes. Catastrophic natural disasters, especially the prospect of mega-catastrophes (i.e. the "big one" hitting California, a category 3 or 4 hurricane hitting New York, major seismic activity along the New Madrid Fault in the Midwest), create risks that simply could destroy an insurance company or potentially the entire industry. This risk of ruin likely will keep the private sector from offering sufficient capacity for entirely rational reasons. No potential rate of return is going to be worth the risk of losing the entire company.

Expand Insurance Coverage

One of the unfortunate truths revealed after every large-scale natural disaster is that a number of affected citizens did not have insurance in place to protect themselves. As Congress considers the challenges of insuring natural catastrophes, care must be given to ensure that any solution has the ability to encourage participation. Part of this is

accomplished through affordability of any insurance solution, but this must be weighed against providing a subsidy that encourages building in risk prone areas or offers post-event assistance that encourages people not to buy insurance to manage their risk.

Natural Catastrophe Reserves

In order to expand the capacity base, both the quantity available and the terms at which coverage is offered, several things can be done. One concept being discussed is to develop a catastrophe reserve for individuals. This has also been articulated as a Catastrophe Savings Account (CSAs). Modeled after the success of the Health Savings Accounts (HSAs), this would allow individuals to set aside money on a yearly basis that would accumulate tax free and that only could be withdrawn for specific purposes, such as paying their hurricane deductible or, perhaps, to take mitigation measures to the homes to lessen hurricane damage. Although originally envisioned for hurricane risk, it is a concept that could be expanded to include all catastrophe risk for homeowners.

Another concept is to amend the IRS tax code to provide incentives for individual insurance companies to set aside reserves for catastrophic losses on a tax-deferred basis. Current tax laws discourage property & casualty insurers from accumulating assets to pay for future catastrophe losses. Payments for catastrophe losses are made from unrestricted policyholder surplus after losses have incurred. Current tax law and accompanying accounting standards require insurers to limit the recording of loss reserves to events which already have occurred, and require the recognition of catastrophe premiums during the periods in which they are written.

Currently, if a company obtains higher than average profits and creates an excess reserve, these reserves would be taxed at an ordinary tax rate, as well as negatively affect future rate requests. These limitations are not necessarily true for alien (overseas) insurers. Some non-U.S. insurers are able to deduct reserves for future catastrophe losses tax-free, which potentially gives them a competitive advantage over their U.S. counterparts. The inability to build catastrophe reserves forces insurers to prepare financially as if they

were going to have a major storm in multiple locations every year. This necessitates annual reinsurance purchases with no credit or residual benefit toward next year if no losses occur. Allowing U.S. companies to join those in most other industrialized nations by setting aside tax-deferred reserves specifically for catastrophes, when structured appropriately as not shelter income, could provide additional capacity for the market. Tax-free catastrophe reserves also could help mitigate some of the "boom or bust" cycle in the property insurance market to everyone's benefit.

For the creation of a federal backstop, a number of innovative ideas have been proposed. One concept is to have the federal government, through the U.S. Treasury Department, implement a reinsurance program to offer reinsurance contracts sold at regional auctions. A variation of this proposal would be to allow private insurers to obtain reinsurance contracts. Other proposals would restrict these reinsurance funds to authorized state catastrophe funds, similar to our Florida Catastrophe Fund, or the California Earthquake Authority. More recently, there has been discussion of limiting the role of the federal government to providing "credit lines" to state or regional funds, which would be repaid over an intermediate term after a qualifying event.

National Catastrophe Reinsurance

Currently, the United States is one of the only industrialized nations in the world not to have a federal comprehensive catastrophe plan. A multi-layered approach, with the federal government's commitment to reinsure state entities against a mega-catastrophe as its capstone, will proactively help in any catastrophe recovery effort, as well as provide stability in the housing insurance market by allowing state agencies to diversify their risk. Accomplishing this goal likely will lure additional private capital to the insurance market, thereby stimulating more availability, more competition, and ultimately lower premiums.

Given the variety and complexity of concepts under consideration, the NAIC strongly endorses the concept of a National Commission on Catastrophe Preparation to weigh the merits of each and develop the best mix of solutions. Clearly, there are a number of

forward thinking ideas that require further consideration, but they should be framed to answer the question, "Will this make insurance for individuals and businesses more available and affordable?" State insurance commissioners look forward to working with this Subcommittee to find the right answers to this question. The lessons of recent catastrophes may be the only warning we get to start making those decisions.

Thank you for holding this hearing, for inviting the NAIC here today to participate, and for your continued interest and leadership on this crucial issue. I am pleased to answer any questions that you may have.

Allocating the Federal Cost of Katrina

United States	# of Individual Returns	% of Individual Tax Returns	Tax Burden For Individual Return*	% Share of Total Tax Burden	Gross State Product (GSP)	Tax Burden/ GSP
New England	**6,785,928**	**5.17%**	**$5,684,164,730**	**5.17%**	**$690,689,000,000**	**0.82%**
Connecticut	1,663,080	1.27%	$1,393,062,331		$194,469,000,000	0.72%
Maine	618,210	0.47%	$517,837,424		$45,070,000,000	1.15%
Massachusetts	3,057,144	2.33%	$2,560,786,100		$328,535,000,000	0.78%
New Hampshire	642,173	0.49%	$537,909,792		$55,690,000,000	0.97%
Rhode Island	499,781	0.38%	$418,636,557		$43,791,000,000	0.96%
Vermont	305,540	0.23%	$255,932,526		$23,134,000,000	1.11%
Mideast	**21,820,285**	**16.62%**	**$18,277,543,527**	**16.62%**	**$2,263,452,000,000**	**0.81%**
Delaware	394,909	0.30%	$330,791,575		$54,354,000,000	0.61%
District of Columbia	276,974	0.21%	$232,004,501		$82,777,000,000	0.28%
Maryland	2,630,345	2.00%	$2,203,282,186		$244,899,000,000	0.90%
New Jersey	4,099,869	3.12%	$3,434,214,269		$430,787,000,000	0.80%
New York	8,613,865	6.56%	$7,215,317,879		$963,466,000,000	0.75%
Pennsylvania	5,804,323	4.42%	$4,861,933,118		$487,169,000,000	1.00%
Great Lakes	**21,224,096**	**16.16%**	**$17,778,151,773**	**16.16%**	**$1,836,746,000,000**	**0.97%**
Illinois	5,756,784	4.38%	$4,822,112,550		$560,236,000,000	0.86%
Indiana	2,848,276	2.17%	$2,385,829,909		$238,638,000,000	1.00%
Michigan	4,560,071	3.47%	$3,819,697,872		$377,895,000,000	1.01%
Ohio	5,439,800	4.14%	$4,556,594,072		$442,440,000,000	1.03%
Wisconsin	2,619,165	1.99%	$2,193,917,371		$217,537,000,000	1.01%
Plains	**9,027,463**	**6.87%**	**$7,561,764,107**	**6.87%**	**$794,607,000,000**	**0.95%**
Iowa	1,333,959	1.02%	$1,117,377,417		$114,291,000,000	0.98%
Kansas	1,228,885	0.94%	$1,029,363,231		$105,448,000,000	0.98%
Minnesota	2,405,900	1.83%	$2,015,278,076		$233,292,000,000	0.86%
Missouri	2,583,130	1.97%	$2,163,733,013		$216,069,000,000	1.00%
Nebraska	808,565	0.62%	$677,286,387		$70,263,000,000	0.96%
North Dakota	304,992	0.23%	$255,473,499		$24,178,000,000	1.06%
South Dakota	362,032	0.28%	$303,252,484		$31,066,000,000	0.98%
Southeast	**32,187,001**	**24.51%**	**$26,961,119,518**	**24.51%**	**$2,779,264,000,000**	**0.97%**
Alabama	1,906,296	1.45%	$1,596,789,781		$149,796,000,000	1.07%
Arkansas	1,134,378	0.86%	$950,200,388		$86,802,000,000	1.09%
Florida	8,115,915	6.18%	$6,798,215,041		$674,049,000,000	1.01%
Georgia	3,775,196	2.87%	$3,162,255,177		$364,310,000,000	0.87%
Kentucky	1,755,511	1.34%	$1,470,486,234		$140,359,000,000	1.05%
Louisiana	1,886,871	1.44%	$1,580,518,624		$166,310,000,000	0.95%
Mississippi	1,174,560	0.89%	$983,858,438		$80,197,000,000	1.23%
North Carolina	3,762,836	2.87%	$3,151,901,947		$344,641,000,000	0.91%

South Carolina	1,839,987	1.40%	$1,541,246,711		$139,771,000,000	1.10%
Tennessee	2,603,548	1.98%	$2,180,835,947		$226,502,000,000	0.96%
Virginia	3,484,282	2.65%	$2,918,573,974		$352,745,000,000	0.83%
West Virginia	747,621	0.57%	$626,237,254		$53,782,000,000	1.16%
Southwest	**14,095,441**	**10.73%**	**$11,806,905,199**	**10.73%**	**$1,388,035,000,000**	**0.85%**
Arizona	2,365,284	1.80%	$1,981,256,490		$215,759,000,000	0.92%
New Mexico	824,600	0.63%	$690,717,944		$69,324,000,000	1.00%
Oklahoma	1,474,272	1.12%	$1,234,909,198		$120,549,000,000	1.02%
Texas	9,431,285	7.18%	$7,900,021,567		$982,403,000,000	0.80%
Rocky Mountain	**4,376,074**	**3.33%**	**$3,665,574,625**	**3.33%**	**$410,351,000,000**	**0.89%**
Colorado	2,106,319	1.60%	$1,764,337,047		$216,064,000,000	0.82%
Idaho	592,912	0.45%	$496,646,808		$47,178,000,000	1.05%
Montana	439,213	0.33%	$367,902,377		$29,851,000,000	1.23%
Utah	994,387	0.76%	$832,938,327		$89,836,000,000	0.93%
Wyoming	243,243	0.19%	$203,750,067		$27,422,000,000	0.74%
Far West	**21,805,660**	**16.60%**	**$18,265,293,042**	**16.60%**	**$2,239,824,000,000**	**0.82%**
Alaska	344,971	0.26%	$288,961,508		$39,872,000,000	0.72%
California	15,311,402	11.66%	$12,825,442,771		$1,621,843,000,000	0.79%
Hawaii	604,667	0.46%	$506,493,266		$53,710,000,000	0.94%
Nevada	1,088,156	0.83%	$911,482,992		$110,546,000,000	0.82%
Oregon	1,602,105	1.22%	$1,341,987,232		$145,351,000,000	0.92%
Washington	2,854,359	2.17%	$2,390,925,273		$268,502,000,000	0.89%
	131,321,948	1	$110,000,516,523	100.00 %	12,402,968,000,000	0

Region	# of Individual Returns	% of Individual Tax Returns	Tax Burden	% share of total Tax Burden	GSP	Tx Burden/ GSP
Southeast	**32,187,001**	**24.51%**	**$26,961,119,518**	**24.51%**	**$2,779,264,000,000**	**0.97%**
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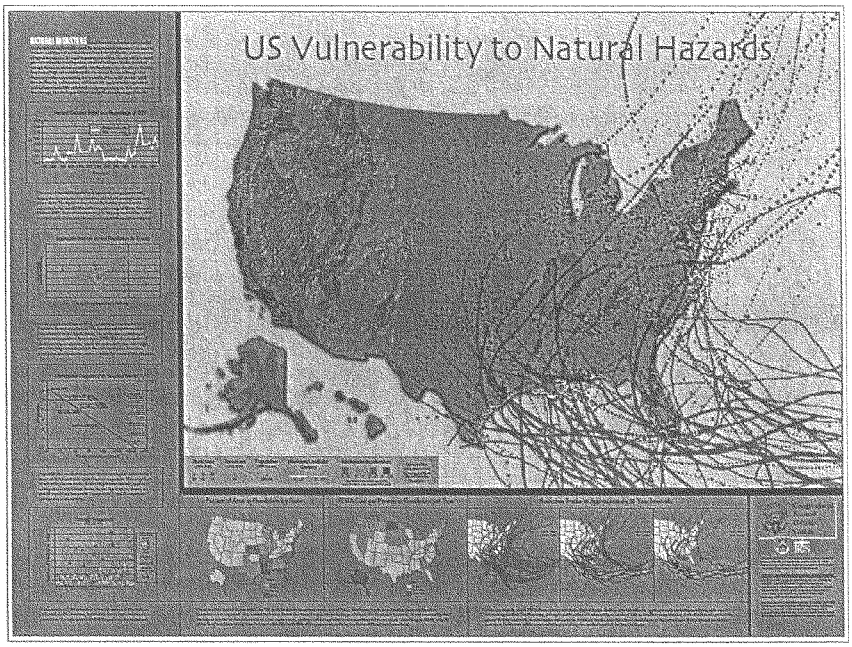
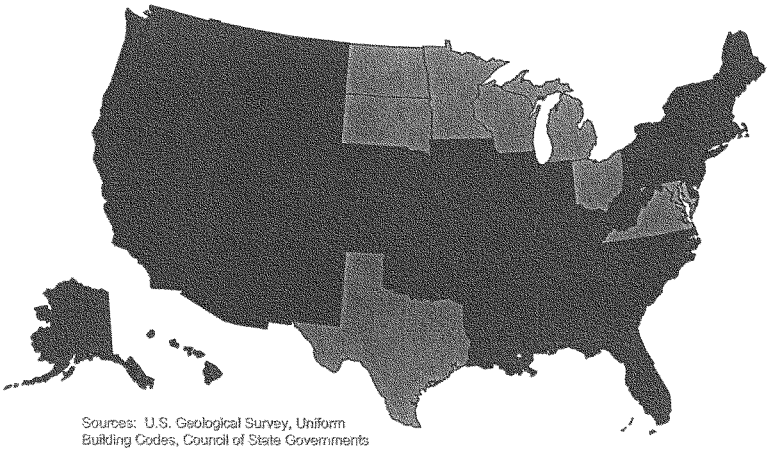
* - Individual Tax Return burden = $110,000,000 authorized divided by 131,321,948 tax returns filed in 2005

Data: Bureau of Economic Analysis, Internal Revenue Service, 2005 (latest data available)


US Vulnerability to Natural Hazards

States With Significant Risk of:

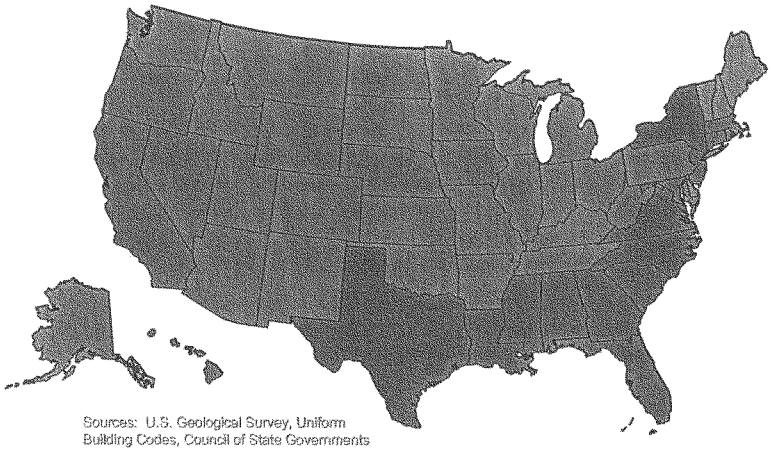
EARTHQUAKE



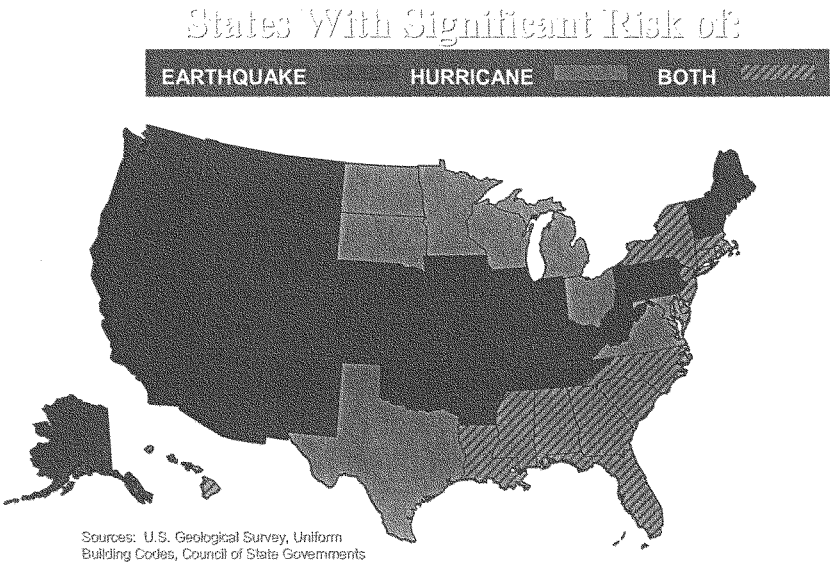
Sources: U.S. Geological Survey, Uniform Building Codes, Council of State Governments

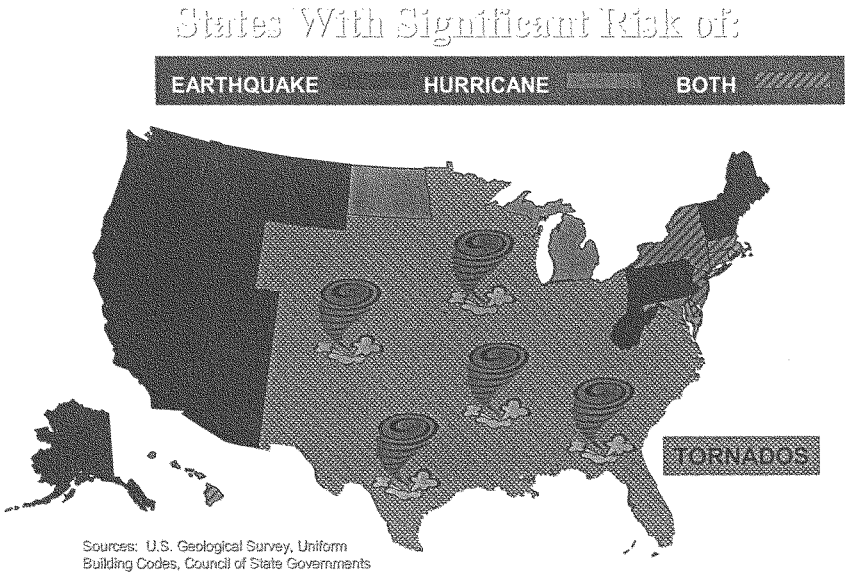
States With Significant Risk of:

HURRICANE



Sources: U.S. Geological Survey, Uniform Building Codes, Council of State Governments


States With Significant Risk of:
EARTHQUAKE
HURRICANE
BOTH
Sources: U.S. Geological Survey, Uniform Building Codes, Council of State Governments


States With Significant Risk of:
EARTHQUAKE
HURRICANE
BOTH
TORNADOS
Sources: U.S. Geological Survey, Uniform Building Codes, Council of State Governments

RAA

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STATEMENT

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TESTIMONY

OF

FRANKLIN W. NUTTER
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PERSPECTIVES ON NATURAL DISASTER INSURANCE

BEFORE

THE SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

March 27, 2007

Chairman Waters, Ranking Member Biggert and Members of the Subcommittee on Housing and Community Opportunity:

My name is Frank Nutter and I am President of the Reinsurance Association of America (RAA). It is an honor to appear before you on behalf of the RAA. The RAA is a national trade association representing property and casualty organizations that specialize in assuming reinsurance. Together, RAA members write nearly 2/3 of the reinsurance coverage provided by U.S. property and casualty reinsurers and affiliates.

Reinsurance is commonly referred to as the insurance of insurance companies. Reinsurance plays a critical role in maintaining the financial health of the primary insurance marketplace and ensuring the availability of property and casualty insurance for U.S. consumers and businesses. Reinsurance is used for several reasons. One of the most common purposes is for a primary insurance company to transfer the risk of losses from catastrophic events such as hurricanes, earthquakes, and in the case of September 11, 2001, acts of terrorism. To that end, reinsurers have assisted in the recovery after virtually every major U.S. catastrophe over the past century. For natural disasters typically one-third of the insured losses are passed on to reinsurers and in the events of September 11, two-thirds of the losses were absorbed by the reinsurance industry. Fifty percent of 2005 losses associated with hurricanes Katrina, Rita and Wilma ultimately were born by reinsurers.

As the Committee has called this hearing to address the question of "Perspectives of Natural Disaster Insurance," I am here to share with you the reinsurance perspective on this most important matter. My testimony will focus on: 1) status of the 2007

reinsurance marketplace and 2) the RAA's general concerns with the creation of state and federal catastrophe reinsurance funds.

The Property and Casualty Reinsurance Marketplace Today

An important component of ensuring the availability of homeowners' insurance is the reinsurance market and its capacity, that is, the amount of reinsurance it is able to provide to primary companies. Any debate on whether there should be a federal catastrophe fund should include an analysis of the ability of the private reinsurance market to provide catastrophe capacity to insurance companies as well as the capacity of insurers to underwrite and retain this risk.

The U.S. attracts reinsurance capacity from all over the world. Global reinsurers view U.S. catastrophe risk as an essential component of their diverse assumed risk portfolios. The important role reinsurance plays in our nation's economy is best demonstrated by evaluating the 2004 and 2005 hurricane seasons (since 2006 did not result in any significant hurricanes).

As you are aware, in 2004 there were four major hurricanes that hit Florida resulting in $30 billion of damage. The global reinsurance industry paid approximately one-third of those losses, enabling insurance companies who purchased reinsurance to honor their obligations to their homeowner policyholders. Despite this huge financial hit to reinsurers, there were no reinsurer insolvencies and the reinsurance market was able to meet the primary insurance community demand for the 2005 hurricane season.

The hurricane season of 2005 turned out to be a year of unprecedented losses in terms of frequency and severity. The insurance/reinsurance industry weathered the single largest loss in the industry's history (Katrina). Insured Katrina losses alone were an estimated $45 billion, even greater than the projected $35 billion in 9/11 losses. The 27

named hurricanes and tropical storms in 2005 set a new record, an aggregate total of $80 billion in insured losses. The Big Three: Katrina, Rita and Wilma produced losses estimated to be as high as $60 billion. The reinsurance industry once again played a critical role, providing stability to the insurance market, by paying approximately one-half of all of these losses. Even with these unprecedented losses there were no resulting reinsurer insolvencies.

Notwithstanding that 2005 was the worst year on record for insured natural catastrophe losses in the U.S., the insurance industry reported its best ever profitability which can be attributed in large part to the industry's reliance on reinsurance to moderate the losses. In fact, the U.S. insurance industry surplus grew from $356 billion at December 31, 2003 to $439 billion at December 31, 2005. As of December 31, 2006 the industry's claims paying ability and capital base have never been better.

Despite the resilience of the reinsurance industry to respond to these record breaking financial losses, a few primary insurance companies in the industry are suggesting the 2005 hurricane season has demonstrated the need for a federal reinsurance program for natural disasters. The RAA does not believe market conditions warrant the creation of a federal program.

Indeed the capital markets have greatly enhanced reinsurance catastrophe capacity following hurricane Katrina. As they did in 1993 after Hurricane Andrew and in 2002 after the terrorism losses of 9/11, 2001, the capital markets promptly provided new reinsurance capital and capacity in response to the 2005 hurricanes. Since late fall 2005, approximately $32 billion in new capital has been raised and committed to the reinsurance market. Of that capital, $10.4 billion was invested in new start up reinsurance companies; $10.3 billion replenished the capital positions of existing reinsurers; and an additional $5.6 billion was invested in special purpose vehicles, whose

investors collaborate to provide extra underwriting capacity to existing reinsurers for property and catastrophe retrocessions and short tail lines of business. Thus over $26 billion in new capital has been raised in the reinsurance industry since Hurricane Katrina. An additional $5.3 billion was raised in the capital markets in catastrophe bonds for U.S. catastrophe risk.

So what does that mean for actual reinsurance capacity to provide natural disaster protection for primary insurance companies for 2007? Despite the unprecedented losses in 2004 and 2005, private market reinsurance capacity increased in 2006 by approximately 30%. The reports of January 2007 renewals indicate reinsurance capacity for 2007 has grown by 14% even in a moderating price environment. The private reinsurance market is financially strong and diverse. Reinsurance capacity is adequate even for peak catastrophe markets. Thus, RAA does not believe a federal role is appropriate.

Looking back at 2006 and the issues raised by some regarding reinsurance market dynamics, several factors external to the reinsurance market affected the market. Demand increased in some peak zones at a greater rate than the supply increased due to: rating agencies (such as AM Best and Standard & Poors) requiring more capital of insurers and reinsurers to support catastrophe risk; reinsurance modelers increasing loss predictions; and insurance company managements' desire to purchase more protection. Rating agencies determined that companies with catastrophe exposures needed additional capital or needed to buy more reinsurance to support their ratings. Insurance catastrophe modelers revised their models due to new data following 2005 and a belief that the country is entering into an era of increased hurricane frequency and severity. Insurance company managements also have reacted to a changed perception of risk. Such managers have seen the impact of increased hurricane frequency and severity on their losses and

want to purchase more reinsurance protection. At the same time as demand was increasing, reinsurers were re-evaluating the losses that their ceding insurers could suffer. The confluence of these events resulted in reinsurance prices increasing in some peak catastrophe zones dramatically.

In classic supply/demand economics, this period of re-evaluation and re-underwriting by reinsurers and the addition of new capital sources appears to have moderated the market. In 2006 testimony before this Subcommittee, the RAA stated that it believed the imbalance between demand and supply of reinsurance was temporary. As the events after Hurricane Andrew suggest, typical insurance and reinsurance cycles involve temporary spikes in pricing, followed by new market participants, leading to increased competition and price moderation. Ultimately, free markets will create a more diversified insurance and reinsurance market that will spread risk widely, increasing capacity and price competition.

The process we predicted would occur appears to be well underway. Capacity is adequate and reinsurance rates for January 1, 2007 renewals are below the market highs at July 1, 2006 according to reinsurance brokers.

> **"Reinsurance capacity at the end of 2006 was more than adequate, even for most peak exposures** ... Strong earnings were driven by low catastrophe losses. Normal dividend payments were maintained, and capital was boosted during the year. **New entrants were eager to join."**
> *Benfield, "Global Reinsurance Market Review Pick 'n' Mix," January 2007*

> **"[R]ates** at January 1, 2007 renewals for US property catastrophe **were below** the levels of July 1, 2006 renewals. Given that nearly all other lines are experiencing rate decreases or renewing at expiry, **we can now conclude that the U.S. reinsurance market overall has entered the soft phase of the cycle.** If history is a guide, **we can expect soft market conditions to persist for many years.** This will be the 'normal' state of the market."
> *Guy Carpenter, "U.S. Reinsurance Renewals at January 1, 2007 Smooth Sailing Ahead?"*

RAA's Position on State and Federal Catastrophe Funds

Some have called for the creation of a federal catastrophe reinsurance fund. At the core of these proposals is the creation of federal catastrophe funds to provide reinsurance to state catastrophe funds. The state catastrophe funds would then sell reinsurance to insurance companies. The stated intent is that this would result in insurance companies providing more homeowners with insurance in high-risk areas.

The RAA believes that there are many flaws with state catastrophe funds. There is no evidence that they result in greater availability or affordability of homeowners' insurance. Insurers must still manage their accumulated catastrophe exposure and in some cases, limit writings, cancel existing policies or seek premium increases. It is an essential element of solvency regulation and financial management that insurers (or those required to subsidize them) maintain adequate resources to cover losses. Politically charged rate setting does not affect the underlying risk of loss. Premiums (or in the case of Florida, premiums combined with later assessments on policyholders) must still cover catastrophe losses.

The RAA believes that natural disaster risks are insurable in the private insurance and reinsurance market and that state catastrophe funds significantly displace the private market. State catastrophe funds are not a long-term solution. The catastrophe fund concept as applied in Florida for example is one that relies on public subsidies or cross-subsidies from other insurance lines to pay for natural disaster risk, rather than relying on affected property policyholders paying the costs of their own risk exposure.

Florida's Catastrophe Reinsurance Fund meets the standard of proposed legislation, therefore it seems appropriate to examine its structure and its experience. The Florida Hurricane Catastrophe Fund does not rely on its premiums to pay its

hurricane losses. The model of the Florida Catastrophe Fund is one that offers insurers inexpensive reinsurance premiums up front, because it is back loaded. When a hurricane occurs that requires the Florida Catastrophe Fund to pay losses in excess of its cash balance (as in 2004 and 2005), the Catastrophe Fund issues bonds. The bond debt is not paid by the insurance companies who received the cheap reinsurance. Instead, it is paid by assessing/taxing Florida policyholders of other lines of insurance, such as automobile insurance and commercial insurance such as municipalities, daycare centers, school districts and small businesses. The effect is that insurers have off loaded a substantial part of their property risk to a government catastrophe fund, and that government fund assesses its citizens to make up for the revenue shortfall caused by the low upfront catastrophe fund reinsurance premiums. Policyholders from all lines of insurance, including those at low risk to catastrophes are being required to insure insurance companies. In essence the Florida Catastrophe Fund has disintermediated the reinsurance market and in its place, put the insured public, commercial and residential.

State catastrophe funds also violate one of the fundamental tenets of insurance-spreading the risk among various risk bearers. Government funds concentrate risk. The Florida Hurricane Catastrophe Fund, for example has $1.8 trillion of insured values with $1 billion of cash and $980 million of expected 2007 revenue. Private insurance and reinsurance however spreads the risk globally. Of the losses caused by Hurricanes Katrina, Rita and Wilma, reinsurers paid approximately 50% through markets in London, Bermuda, Europe and the U.S. Through bond indebtedness a state catastrophe fund concentrates risk in one jurisdiction and shifts the financial cost of paying catastrophe losses from the private sector insurers to insurance buyers including those not covered by the fund itself. Effectively low risk policyholders insure high risk policyholders.

State funds like the Florida Hurricane Catastrophe Fund do not reduce the vulnerability of people to natural catastrophes. They are not a proactive, disaster planning approach. Rather, they are a cost shifting mechanism. There is no free lunch-someone will pay for the losses. Private reinsurance is a proactive, "pay for the risk up front" by those insured at risk. The "pay me later" approach of state catastrophe funds costs homeowners and businesses, not insurers, since policyholders are essentially obligated to pay insurers for any shortfalls in the state catastrophe fund claims paying ability. For example the Florida fund is currently assessing policyholders for the 2004-2005 hurricane seasons.

The irony of Florida is that the people who vilified insurers are, together with other policyholders, now their reinsurers. State catastrophe funds also create cross-subsidies. First, coastal properties are subsidized by policyholders that have a lower risk to catastrophes, cannot afford or choose not to live in such hazard zones. In addition to property policyholder subsidies, the catastrophe funds rely on cross-subsidies to pay for hurricane risk rather than relying on current affected property policyholders paying those costs. For instance in Florida, car owners, small businesses, school districts, day care centers, churches, hospitals, renters, professionals, and business owners – anyone with a property and casualty insurance policy (other than medical malpractice and workers' compensation) – is required by law to pay the billions of dollars in bonds authorized for the Florida Hurricane Catastrophe Fund due to its shortfalls. These policyholders, even those far from the coast, will pay annual assessments needed to pay off the hurricane bonds that will benefit the coastal property owners.

The experience with state catastrophe funds is that they are susceptible to suppression of insurance rates for those at risk. The effect of this is to mislead high risk insureds about the financial consequences of living in high risk areas, encourage

continued development in those areas and shift the cost of disaster losses to others who may be less at risk and equally less willing to pay the subsidy.

The current Florida fund is riddled with debt and is likely to become worse. What incentives do states have to be fiscally responsible if a Federal fund were to provide financial backing? We urge Members of the Committee to take a serious look at the inherent problems with state catastrophe funds and whether they would actually create an improved homeowners' insurance market. We strongly suggest that such funds do not.

RAA's Concerns with Federal Catastrophe Funds

Over the last 15 years, the RAA has worked with Members of Congress and their staffs on many different legislative proposals to create federal reinsurance programs. We believe that natural catastrophe risk is insurable in a free market. We do not believe the creation of a federal reinsurance program solves the homeowners' insurance availability problem. It ignores the many constraints that are now imposed upon the private market. We believe public policymakers should make it their top priority to remove regulatory constraints from the private insurance market's ability to willingly insure risk. By removing regulatory constraints policymakers will maximize private sector risk bearing. These regulatory constraints include: price controls, coverage mandates, and involuntary residual market facilities and associated assessments. If policymakers follow competitive, free market principles, a federal natural disaster reinsurance fund is unnecessary.

The RAA offers the following observations regarding federal catastrophe funds:

1. Often, the proposed trigger levels for the federal reinsurance program are too low and will interfere with the private marketplace. These are levels of losses where

the private reinsurance marketplace is currently providing capacity. If the federal fund had provided reinsurance at low attachment points as some have proposed, rather than the private insurance and reinsurance markets paying for the insured losses associated with Katrina, Rita and Wilma, the federal government through its reinsurance fund would have paid for these insured losses.

2. There is no assurance that a federal reinsurance program will result in more availability of homeowners' insurance. Unlike the Terrorism Risk Insurance Act where the quid pro quo for the federal reinsurance is that insurers must offer terrorism insurance on the same terms and conditions as they offer other lines, there is no requirement that insurers who benefit from the federal reinsurance of state funds offer more homeowners' insurance. The experience of Florida is that cheap reinsurance has not resulted in greater private sector insurance.
3. To be fiscally responsible any federal reinsurance must include a requirement that the federal government and the state fund add a risk load reflecting the true cost of catastrophe exposure when pricing the reinsurance. In the private insurance and reinsurance market a catastrophic risk load is required on all pricing. Without such a requirement the private reinsurance and insurance market would be further disenfranchised from the market it now serves.
4. It has been suggested that a federal program is necessary because reinsurance prices are too high. The RAA believes that a free market should be allowed to work and that it is totally inappropriate to create a federal program simply based on complaints by some insurers over reinsurance prices at a single point in time. The concepts of supply and demand are playing out in the free market. As we learned following Hurricane Andrew in 1992, after 9/11 terrorism losses and now post-hurricane Katrina, reinsurance markets adjust. They are resilient, they attract

capital and capacity after major events and the supply/demand equation will come back into balance.

5. A federal fund that sells reinsurance to state catastrophe funds concentrates all of the risk associated with natural disasters in government. A private market diversifies this risk, spreading it globally. A classic example of the importance of a diversified insurance/reinsurance market occurred in 2005. Of the total reported losses, U.S. insurers paid (all approximate) 41%: U.S. reinsurers paid 11%, Bermuda reinsurers 24%, European reinsurers 13%, Lloyds 9%, and all others 1%. If H.R. 91 were to become law, most of this risk would no longer be spread across the global insurance/reinsurance market; instead it would be concentrated in the State and Federal governments.

Would a Federal reinsurance program replace government disaster assistance? Some have suggested that a Federal program is appropriate because "we all pay for disaster recovery now" implying that Federal taxpayers are on the hook for disaster losses. First it must be understood that, while natural "disasters" may occur in all states, most are modest potential costs compared with a few regions. Because of unusual risk exposures and concentrative of insured values, 97% of all earthquake losses have occurred in California and since 1900, 75% of all hurricane losses have occurred in Florida, Louisiana and Texas. The natural disaster related losses in other states are notably less and paid for by insureds based on their own risk premium. Secondly, an analysis of Federal disaster assistance indicates that it primarily goes to immediate and temporary shelter and food, infrastructure repairs and emergency responses. These losses would not be covered by a proposed Federal reinsurance program and therefore it would be expected that taxpayers would continue to support them. Third, a high percentage of

catastrophe loss occur to commercial businesses, none of which are covered under existing programs or by any proposed Federal program.

The Role of Government

Government does have a critical role related to natural catastrophes. States should impose appropriate hazard mitigation through sound building codes and land use. With respect to insurers, state government should ensure sound financial management of insurers by seeing that premiums are appropriate for the risk and that insurers remain financially vibrant and solvent. At the Federal level government provides appropriate disaster assistance in times of need. It also provides financial support for research and repair of infrastructure damage such as rebuilding of levees, dams, bridges and roads.

Conclusion

The reinsurance industry has responded well to every major catastrophe in the United States over the past decade. Reinsurers have served a vital purpose in providing insurers with the necessary capacity to ensure that homeowners are able to obtain insurance. A federal reinsurance program created to enhance state reinsurance programs would displace the vibrant private reinsurance market to the detriment and cost of the U.S. taxpayers. The RAA believes that natural disaster is an insurable risk in the private sector if the free market is allowed to work. A free market will give insurers the tools they need to better provide homeowners' insurance at an appropriate risk-based cost.

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STATEMENT OF

ROBERT W. PORTER

EXECUTIVE DIRECTOR
PROTECTINGAMERICA.ORG

Before the
Subcommittee on Housing and Community Opportunity
Committee on Financial Services
U.S. House of Representatives

March 27, 2007

Thank you Madam Chairwoman, Ranking Member Biggert and members of the subcommittee. My name is Bob Porter and I am the executive director of ProtectingAmerica.org. I appreciate the opportunity to appear before you today.

ProtectingAmerica.Org is a non-profit organization committed to finding better ways to prepare and protect American families from the devastation caused by natural catastrophes. Our organization was formed in the summer of 2005, right before the onslaught of hurricanes Katrina, Rita and Wilma, and is chaired by James Lee Witt, the former director of the FEMA, and Admiral James Loy, the former deputy secretary of Homeland Security and former commandant of the US Coast Guard.

ProtectingAmerica.Org's more-than 200 members include the American Red Cross and other first responders, emergency management officials, insurers, municipalities, small businesses, Fortune 100 companies along with thousands of private citizens.

ProtectingAmerica.org was formed to raise the national awareness about the important responsibility we all have to prepare and protect ourselves from the ravages of massive natural disasters. We support the creation of a comprehensive, national catastrophe management solution that protects homes and property at a lower cost, improves preparedness, and reduces the financial burden on consumers and taxpayers – all in an effort to speed recovery, protect property, save money and save lives.

The simple fact is that catastrophe can and does occur virtually anywhere in this country. The unfortunate reality is that tens of thousands of our fellow citizens are not able to pick up their lives where they left off before these catastrophes occur.

Let me give you some quick facts:

- 57% of Americans live in areas prone to catastrophes like major hurricanes, earthquakes or other natural disasters. While opponents of a comprehensive program to assure the safety of these American families glibly say that "people shouldn't move to those areas," the fact is that better than half of the American

public already lives in catastrophe-prone areas like New York, Miami, Galveston, Los Angeles and St. Louis.

Would those critics propose that we evacuate some of America's greatest metropolitan areas?

- Seven of the 10 most costly hurricanes in US history have occurred in the last 5 years.

  Every national and international forecasting agency has predicted that the worst of these storms is yet to come. Even Max Mayfield, the recently retired director of the National Hurricane Center has said that he wished that Katrina was the worst storm he would ever see.

- Last week, the London-based forecasting agency "Tropical Storm Risk," issued the coming hurricane season's first prediction – that the new hurricane season is likely to bring 17 tropical storms, of which nine will strengthen into hurricanes, with four of those expected to become more destructive, "intense" hurricanes.

  They said that current and projected climate signals indicate that U.S. hurricane activity this year will be 75 percent above the 1950-2006 average.

  This prediction is in line with the long term forecasts of the National Hurricane Center which has said that we are in a cycle of increased hurricane activity that will last for a decade or more and include hurricanes of substantially increased frequency and ferocity.

Notwithstanding the well-documented problems with the response to Katrina, when catastrophe strikes, Americans have historically done a remarkable job responding. All Americans owe our first responders an enormous debt of gratitude and thanks.

While little can be done to completely eliminate the actual catastrophe, we must break the cycle of build, destroy and build again in the same way and in the same place.

Programs to improve preparedness, increase public education, enhance prevention and mitigation efforts, and augment support for first responders are the keys to improving our national capability to prepare and protect those who live in harm's way.

- Public education programs will help homeowners make plans and be prepared in advance of an emergency.

- Mitigation programs such as strong and enforceable building codes and retrofitting programs will improve the integrity of catastrophe-prone structures so that damage is minimized when catastrophe strikes.

- An increase in first responder funding will help finance the critical programs that too often get shortchanged in the give-and-take of local budgeting decisions.

ProtectingAmerica.Org believes that we should reduce the enormous taxpayer subsidy of recovery efforts that exists under our response scheme. Florida Insurance Commissioner Kevin McCarty has estimated that every America family paid $881 in federal tax dollars responding to the storms of 2004/2005! Despite what some will say, taxpayers from Maine to Montana are already paying for the nation's natural catastrophe response. We believe that the time has come to break that cycle once and for all.

ProtecingAmerica.Org supports the establishment of a stronger public-private partnership as part of a comprehensive, integrated solution at the local, state and national levels.

The solution would include privately financed state catastrophe funds, established by the legislatures in catastrophe-prone states, to provide more protection at lower cost to consumers. These state level CAT funds would serve as a backstop to the private insurance and re-insurance markets and would generate investment earnings that, in

addition to helping to pay claims, would be used for mitigation, prevention, preparation and first responder programs.

We also support the creation of a national catastrophe fund that would serve as a backstop to participating state funds in the event of a mega-catastrophe, such as Katrina or the Northridge earthquake.

These state catastrophe funds would be financed through mandatory contributions by insurance companies in each of those states in an amount that reflects the risk of the policies that they write in each state. Actuarially sound premiums – not tax dollars – would support those funds.

Qualified state funds would be required to set aside a minimum of $10 million up to a maximum of 35% of investment income for first responder, for prevention and for mitigation programs.

Qualified state funds would be able to purchase re-insurance from the national backstop program. Rates for this coverage would again be actuarially based and would only be available to qualified state programs that have established the prevention and mitigation funding.

How would this work?

In the event of a major catastrophe, private insurers would be required to meet all of their obligations to their policyholders. Should catastrophic losses exceed those obligations, the state CAT fund would kick in. In the event of an extraordinary catastrophe, the national backstop program would provide benefits to the state and help pay remaining claims.

Because this is an opt-in, state-by-state program based entirely on each state's risk, the likelihood of a taxpayer subsidy is virtually eliminated. This approach requires pre-event

funding and relies on private dollars from insurance companies in those states that are most exposed to catastrophe.

Madam Chairman, all the elements I've mentioned are contained in legislation currently before the Congress. These bills have strong bi-partisan support and the support of members from across the nation.

That support, and your hearing today, is indicative of a renewed concern in Congress that protection and preparation for massive natural catastrophe must be a national priority.

Our organization commends you and Chairman Frank for making this national priority a priority of this committee.

The hurricane seasons of this new century have been devastating wake up calls for American families. ProtectingAmerica.org hopes to raise the national awareness and advocate for a national solution. This committee is the right venue to craft that solution and offer America a better, more comprehensive national catastrophe management program.

Thank you, Madam Chairman, for holding this hearing today. I would be happy to answer any questions that you may have.

American Insurance Association

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

"PERSPECTIVES ON NATURAL DISASTER INSURANCE"
MARCH 27, 2007

GOVERNOR MARC RACICOT, PRESIDENT
AMERICAN INSURANCE ASSOCIATION

Good afternoon. My name is Marc Racicot. I am president of the American Insurance Association (AIA). AIA represents major property and casualty insurers doing business across the country and around the world.

I appreciate the opportunity to testify this afternoon on a matter of utmost importance to AIA and the nation as a whole: insuring natural catastrophe risk. I commend the Committee for your leadership in examining proactive approaches to the management of this risk.

Hurricane Katrina and the difficult rebuilding in its aftermath focused renewed attention on the role of the private sector insurance industry in managing natural catastrophe risk. To effectively manage this risk, insurers must have the tools to measure, reduce, and fund these exposures. Those tools include protective measures, legal reforms, and regulatory reforms at the state and federal level. There are no shortcuts to addressing these problems, and all of us must remain committed to solutions that guarantee long-term stability in the private markets to protect our economy and, more importantly, to provide certainty to the nation's insurance consumers.

As a nation, we must make sure we are prepared for, and can respond quickly to, the spectrum of losses that may flow from a major catastrophe. Insurers are fully committed to working with local, state, and federal policymakers to make this happen. Thank you for the constructive role you are playing in the search for solutions.

Recent Experiences

Hurricane Katrina was the largest, most expensive insured disaster in our nation's history. Approximately 1.75 million claims were filed across six states. Some 15,000 insurance claims adjusters were called in from across the country to begin the process of recovery. To date, claims payments to restore homes, businesses, and vehicles have totaled about $40 billion.

As of the first anniversary of Katrina in August 2006, more than 95 percent of the 1.1 million homeowners' claims in Mississippi and Louisiana had been resolved, with fewer than 2 percent of such claims disputed. Approximately half of these disputed claims were referred to no-cost mediation programs established by the Mississippi and Louisiana insurance departments, leading to successful resolution of approximately 80 percent of the cases heard. Across the Gulf, less than one percent of homeowner's claims have resulted in lawsuits. Yet, these are the claims that have received most of the public attention.

Beyond the industry's response mechanism, we must also consider the role of mitigation and land use planning in reducing the tangible and intangible losses that occur after a major catastrophe. Additionally, the planning process, in terms of logistics, communications, and coordination with relevant government agencies and private groups, must be significantly improved.

The Need for Meaningful Reform

In the aftermath of Hurricane Katrina, AIA began the process of identifying ways to improve the insurance industry's ability to serve homeowners and businesses in the path of potential storms, in particular, positive system changes that will allow markets to manage natural catastrophe risk without establishment of new government programs or a bail-out from taxpayers living in less-risky areas. Beyond their benefits to the insurance system, many of these reforms will help prepare individuals and communities for future catastrophes, educate them about the benefits of risk management, and, most importantly, reduce the personal and economic toll of hurricanes and other natural catastrophes.

I have testified before this Committee about AIA's reform agenda on two previous occasions and also have shared our perspectives with southern governors meeting under the auspices of the National Governors Association. On each occasion, I have urged policymakers to act carefully. Thankfully, last year's hurricane season was remarkably mild. But hurricane experts are calling for another active season in 2007, and each year, more and more people populate our nation's most vulnerable coastal communities.

I have consistently cautioned against short-term fixes that create long-term problems for states or the national economy. Unfortunately, that was the approach taken by Florida in its recent short and chaotic special session—a deeply flawed bill aimed at lowering property insurance rates by transferring billions of dollars of hurricane risk from private sector (re)insurers to "post-event" bonding that will be paid for by assessments on policyholders and, ultimately, taxpayers throughout the state.

I am here today to urge appropriate restraint as this Committee sorts through the various federal legislative proposals that have been introduced in the 110th Congress. The reality is that there are no quick fixes or easy answers to the very difficult challenges we face. Moreover, punitive measures directed at insurers, including recently introduced bills to repeal the McCarran-Ferguson Act's limited antitrust

exemption for insurers, while couched in the language of the current natural catastrophe insurance debate, are wholly unrelated. They will do nothing to improve the availability or affordability of coastal insurance and instead will have a serious and detrimental effect on the markets they purport to assist.

AIA's Reform Agenda

Although the property insurance market currently is under stress in several Atlantic and Gulf Coast states, the solution rests in improving, not displacing, private sector ability to serve homeowners and businesses in the path of potential storms. The challenge is to identify and advance positive system changes that will allow markets to manage natural catastrophe risk without establishment of new government programs or a bail-out from taxpayers living in less-risky areas. Beyond their benefits to the insurance system, many of these reforms will help prepare individuals and communities for future catastrophes, educate them about the benefits of risk management, and, most importantly, reduce the personal and economic toll of hurricanes and other natural catastrophes.

AIA's reform agenda includes both federal and state initiatives that could provide short- and long-term benefits. All should be put in place as quickly as possible. The agenda we have developed consists of four major components:

- *protective measures* to keep people out of harm's way and strengthen their ability to withstand future hurricanes;
- *regulatory and legal reforms* to improve the stability of insurers' operating environment;
- *tax incentives* to encourage residents to take more responsibility for hurricane preparation and response; and,
- *National Flood Insurance Program (NFIP) reforms* to assure that NFIP continues to play a vital role in protecting the region from the generally uninsurable risk of flood.

Although some of these reforms relate specifically to hurricanes, many of the tools described here can be modified to address earthquake risk and other natural perils.

In addition to the ideas that we already have developed, we are working to identify other measures that can be put in place at the federal or state level to address concerns expressed about the availability and affordability of natural catastrophe insurance. These measures would be designed to preserve the essential role that the private insurance sector plays in response and recovery, while at the same time recognizing the post-Katrina challenges that are still facing some coastal communities.

Recent State Activity

In addition to Florida's special session legislation, natural catastrophe insurance issues are on the agenda this year in almost every coastal state from Texas to Maine. They cover a spectrum that includes regulatory reform (under consideration in Louisiana); restructuring of residual market mechanisms (enacted in Mississippi and under consideration in Massachusetts and Texas); tax incentives to encourage mitigation (under consideration in South Carolina); quasi-governmental Catastrophe Funds (introduced in Louisiana, New Jersey, New York, Connecticut, and Massachusetts); and anti-insurer regulatory mandates (under consideration in various forms in several states).

I would like to call the Committee's attention to two recent and very promising developments.

Last week, Mississippi enacted legislation reforming the state's wind pool, which had been under stress since Hurricane Katrina resulted in a $545 million deficit, paid by private insurers in the state. The new legislation allows these deficits to be recouped through a surcharge on property insurance policyholders throughout the state and gives the wind pool the authority to issue bonds if the amount assessed is not sufficient to pay claims. There is also a four-year, $20 million-a-year subsidy to the wind pool to reduce policyholder premiums, thus providing immediate relief without endangering the program's claims-paying ability.

In South Carolina, the goal of Governor Sanford's coastal insurance relief plan is to encourage, rather than discourage, insurers to write policies along the coast. The proposal includes a number of tax incentives, such as deductions for catastrophe savings accounts established by homeowners who choose to carry large deductibles or create accounts to "self insure," disaster mitigation measures, lower-income property owners who pay more than five percent of their incomes towards insurance premiums; and tax credits for insurance companies who write full coverage for property owners along the coast.

Less positively, as I noted earlier, Florida's special session legislation will result in much higher costs when hurricanes happen, which is inevitable in Florida. According to a report just released by the Associated Industries of Florida, per household, total assessment costs to finance the deficits resulting from this legislation could range from $1,700 after a moderate hurricane to $14,000 following a major hurricane, in comparison to average savings this year of $265. Thus, the long-term cost of this legislation could be more than 50 times the short-term savings for the average Florida household.

Moreover, the punitive regulatory restrictions imposed on insurers, while striking a populist chord, only add to the cost of providing insurance and send another message that Florida is a hostile business environment for insurers. Despite its flaws, the legislation did include several important provisions on mitigation, which is an essential part of the long-term solution.

Federal Approaches

As this Committee is well aware, several bills have been introduced this year to address different aspects of the natural catastrophe issue. I would like to take a few minutes to comment on two of these bills.

H.R. 91- The Homeowners Insurance Protection Act: This legislation would create a federal reinsurance mechanism to encourage states to establish catastrophe funds (Cat Funds) for homeowners insurance. We believe this is based on the premise that large-scale natural catastrophes are uninsurable by the private sector, and that the government should step in to provide capacity.

AIA respectfully disagrees with this premise. Even after Katrina, private sector capacity for dealing with natural disasters has grown – with approximately $28 billion in new capital entering this market last year – and is adequate to spread and manage this risk. Even the leading insurance industry proponents of Cat Funds have secured significant amounts of private reinsurance coverage. Ironically, the single greatest threat to private sector risk transfer mechanisms is not the force of hurricane winds, but legislation and regulations that displace available private capital, or make it economically unfeasible for private companies to operate in coastal markets.

Despite their seeming promise of short-term relief, Cat Funds are no panacea for natural catastrophe risk, and such programs can encourage and lead to generational inequities among policyholders, unfair geographic subsidization, and increased (and unwise) building in catastrophe-prone regions. Insurance mechanisms should not mask the true cost of living in risky coastal areas, although some bridge mechanisms (such as the recently enacted subsidy to the Mississippi wind pool) might be necessary for the immediate future.

H.R. 920 - The Multiple Peril Insurance Act of 2007: This legislation would expand the coverage offered by the deficit-laden National Flood Insurance Program (NFIP) from flood-only policies, to policies that include flood and wind coverage. The bill is an apparent response to the complications in purchasing and claims-adjusting that arise between the current federal flood program and private homeowners insurance coverage (which generally covers wind damage). While the bill promotes the concepts of risk-based pricing and local government mitigation—concepts we support—it displaces available private market financial capacity and claims handling capabilities and expands, rather than fixes, an already costly federal program.

As an alternative, we believe there are better ways to resolve disputes about wind versus water claims. For example, the existing NFIP program can be amended to require the NFIP to participate in state-sponsored mediations to determine the extent of damage caused by wind versus water. It is also possible to reexamine the process through which NFIP coverage is sold and marketed to see if there can be better coordination between federal flood and private homeowners insurance. We would be happy to work with you in exploring these concepts.

Conclusion

Thank you very much for giving me the opportunity to appear before you today. On behalf of AIA and our members, I appreciate this opportunity to continue to engage with you to address the challenges facing the insurance industry, and our nation as a whole, in preparing for, and responding to, natural catastrophes.

TESTIMONY OF ANN W. SPRAGENS
ON BEHALF OF
THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA
BEFORE THE
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

MARCH 27, 2007

My name is Ann W. Spragens and I am Senior Vice President, Secretary and General Counsel for the Property Casualty Insurers Association of America (PCI). PCI is a trade association representing over 1,000 property/casualty insurers that write almost 40 percent of the homeowners insurance sold in the United States. Because of that, PCI has a deep interest in natural disaster issues and the ways in which we can better prepare our industry and our nation to respond to future natural disasters. Thank you for the opportunity to appear before you today and to present our thoughts on these issues.

Introduction

PCI testified before this Subcommittee in June and September of 2006 on natural disaster issues and as we have stated previously, PCI believes that developing effective public policy solutions regarding natural catastrophes is one of the most significant issues facing the nation and the insurance industry today. Climate experts agree that America faces the prospect of more frequent and severe natural disasters in the coming decade. Moreover, significant property development, population growth, and rapidly rising real estate prices in areas prone to natural disasters exacerbate the potential for larger human and economic losses, requiring stronger loss prevention and mitigation and greater financial resources for recovery.

We commend you and your colleagues for your attention to and leadership on this issue and for your continued efforts to find innovative solutions to the problem of catastrophe risk. Just since the 110th Congress has convened, members have introduced several important legislative proposals, including H.R. 91, the Homeowners Insurance Protection Act, introduced by Rep. Brown-Waite; H.R. 164, the Policyholder Disaster Protection Act, introduced by Rep. Jindal; H.R. 330, the Homeowners Insurance Availability Act, introduced by Rep. Brown-Waite; H.R. 537, the Commission on Catastrophic Disaster Risk and Insurance, introduced by Rep. Meek; H.R. 913, the Hurricane and Tornado Mitigation Investment Act, introduced by Rep. Bilirakis; H.R. 920, the Multiple Peril Insurance Act, introduced by Rep. Taylor; as well as several companion and other bills introduced in the Senate. You have also passed last year, H.R. 4973, the Flood Insurance Reform and Modernization Act of 2006 that would reform the National Flood Insurance Program, for which we commend you. While that legislation was not enacted in 2006, we would urge you to pass flood reform legislation in 2007 and pledge to work with you and your colleagues in the Senate in this effort.

Comments on the Catastrophe Problem

PCI members play a pivotal role in protecting American homeowners and supporting our nation's housing markets by providing the products and services needed to protect homeowners, lenders, businesses, and communities against exposure to natural catastrophes. Our members are proud of the work they do in these markets.

In 2004 and 2005, property insurance markets have been tested as never before. Catastrophe losses in 2005 totaled some $61.9 billion, nearly doubling the previous record losses in 2001. Hurricane Katrina itself caused nearly $40 billion in insured losses, surpassing the roughly $32 billion from 9/11. The vast majority of claims from 2005's events have been paid and the insurance market has met its financial obligations. In PCI's view, the most important catastrophe issue facing us today is whether the market has, or is building, the capacity to pay for catastrophes the nation will face in the future.

Given the very serious catastrophe losses we've seen over the past several years and the significance of this issue for our membership, our organization has devoted considerable time and effort to develop sound public policy solutions that we can recommend.

There are several fundamental issues that have to be addressed:

- First, America clearly faces the prospect of increased frequency and severity of major hurricanes and the continuing threat of other major natural catastrophes including earthquakes, floods, tsunamis, and volcanic eruptions. Catastrophe modelers tell us that we are in a prolonged period of increased severe storm activity. Seven of the ten most costly natural disasters in U.S. history have occurred since 2004. We can't afford to ignore this reality.

- Second, America is experiencing significant development, population growth, and rapidly rising real estate prices in areas that are highly prone to natural disasters. AIR Worldwide, one of the leading risk modelers in this country, that there is currently some $7 trillion in property values exposed to catastrophe risk along America's coastlines; some $3 trillion of it is personal property, rather than commercial property. Even if storms were no more frequent or severe than in the past, this fact alone means that future storms will be more damaging and more costly to insure. As a result of migration and property development, the nation faces growing exposure to significant catastrophe losses and increasing costs of recovery.

- A growing number of Americans have a significant portion of their net worth exposed to catastrophic loss. The impact of future major natural catastrophes on the economy will be larger and will likely lead to significant public policy debates over how best to address this risk.

- As insurers, our members would like to rely on a free market environment to solve this problem whenever possible, with prices and products tailored to match the risks freely assumed. We think that such an approach would, over time,

establish appropriate economic incentives for those who live and work in catastrophe-prone areas and would attract badly-needed private capital for risk protection. However, we must also recognize that our industry does not operate in an unregulated market. Our members work in a world where prices and coverage terms are highly regulated and generally are not allowed to respond freely and in an immediate fashion to changing risks or conditions. For example, the Florida legislature, in a special session held just to address the affordability of property insurance, passed landmark legislation that rolled back appropriate rate changes for the state's largest insurer, Citizens Property Insurance Corporation, removed its "market of last resort" status, and required insurers to modify their pricing based on reductions in the cost of reinsurance resulting from changes to the Florida Hurricane Catastrophe Fund. According to our analysis, the legislation also lowers current residential property insurance rates by: providing reinsurance that is less expensive than commercial insurance, which includes provisions for risk load and taxes; deferring some of the risk of paying catastrophic losses to future years, and transferring risk currently borne by property owners to insured motorists and businesses. Clearly there is a problem in the availability and affordability of homeowners insurance in this state and we hope to work with Florida legislators to effectuate long-term solutions to this issue.

In sharp contrast to the highly-regulated structure governing direct writers, the world catastrophe reinsurance markets operate under a regulatory structure that allows free competition with respect to price, underwriting and product. The cost of catastrophe reinsurance is an economic reality PCI's members and their customers face, as they decide how much and where they can assume this risk.

We also recognize, as we must, that people do not simply pick up and move from one place to the next, irrespective of their homes, families, and community ties. Any set of realistic policy options must take this into account.

- Finally, with respect to preventing and reducing losses, states frequently have outdated and inconsistent requirements for building codes, code enforcement, and other prevention/mitigation tools in areas dangerously exposed to disasters. These weaknesses imperil lives, property, and policyholder resources.

In summary, we agree with you that this is a major public policy issue that must be addressed; we believe the problems posed by catastrophe risk are growing more severe, not less; and we believe a range of potential solutions must be considered, including market reforms, stronger loss reduction and prevention, and new approaches to financing catastrophe risk. We do not believe there is one "silver bullet" to solve this problem, but rather a full range of changes that will have to be made.

Policy Options to Consider

As we look at the issue, PCI suggests four major areas for consideration.

Reduce Exposure to Catastrophe Losses

First, we need to do more to control and reduce catastrophe exposure. PCI suggests the following:

- State and local governments should urgently and immediately review their building codes in catastrophe-prone areas. Wherever needed, they should upgrade their codes. Stronger building codes protect lives and significantly reduce property damage and repair costs. In a highly competitive insurance market, those savings will be passed directly back to consumers. Some have argued that it costs too much to rebuild to meet modern building code standards. Louisiana State University's Hurricane Center has estimated that the marginal cost of building a structure to meet higher wind-borne debris requirements in the International Residential Code is between 1.5 and 4.5 percent of additional cost. On a single-family home with a $100,000 mortgage, that works out to about $27 extra dollars per month. We think such investments are vital.

  PCI supported passage of minimum building code legislation in Louisiana and Mississippi this past year, as well as an unsuccessful effort to extend stronger building codes into the Florida panhandle. However, the Florida legislature realized that this delay in applying its strong statewide building code in the panhandle was inappropriate and, in the special session legislation mentioned above, eliminated this exception. Yet we still hear that there are those in Florida that still would oppose or delay implementation of this provision. PCI also applauds NCOIL in taking a leadership position in adopting a statewide building code model. As we look forward, we believe more work is needed to prepare an inventory of where our states' building codes are most in need of strengthening so that we can better target our efforts to strengthen the codes. And, finally, as much as we supported and are proud of our work to enact stronger codes in Louisiana and Mississippi, we know that much work needs to be done to implement and enforce these new standards, including making sure there is enough funding for the training of building inspectors.

- A second idea is the establishment by the federal government of incentives for greater investment in loss reduction and prevention. We suggest consideration of several ideas. First, the insurance industry's Building Code Coalition has recommended that enhanced disaster mitigation grants under the Stafford Act be provided for states that adopt stronger statewide building codes. This would address the funding issue mentioned above and PCI strongly endorses this approach and urge Congress to enact legislation for this purpose. Second, Rep. Feeney introduced legislation (H.R. 4836) in 2006 to create a special catastrophe savings account for purposes of allowing homeowners to build up, tax-free, funds for payment of qualified catastrophe expenses. Third, Rep. Bilirakis has introduced H.R. 913 this year, the Hurricane and Tornado Mitigation Investment Act that grant special tax credits for qualifying expenditures by homeowners to retrofit their homes to better protect against disasters, introduced by Rep. Bilirakis. Roughly one dollar spent to better protect a property results in four

dollars saved following an event. Clearly, one of the major limitations of any new building code enactment is the fact that it typically can't address improvements needed in the existing housing stock. This approach gives homeowners themselves additional incentives to make these improvements. This would save many dollars later in disaster assistance and other government programs.

- We believe state and local governments must take seriously the need to restrict development in catastrophe-prone areas. Max Mayfield, who recently left his position as director of the National Hurricane Center stated in a *Los Angeles Times,* January 3, 2007 article that he is more convinced than ever that U.S. residents of the Southeast are risking unprecedented tragedy by continuing to build vulnerable homes in the tropical storm zone and failing to plan escape routes. Professor Roger Pielke, Jr. of the University of Colorado at Boulder is on point when he says, "More storms like Katrina are inevitable. And the effects of future Katrinas and Ritas will be determined… by the decisions we make now about where and how to build and rebuild in vulnerable locations."[1] This is not only an issue for single family homes. Ongoing commercial development on our nation's barrier islands or in the wetland marsh areas also significantly increases these risks.

- We believe greater steps can be taken for preparedness. As a first step, PCI has completed and distributed to forty eight state insurance departments a PCI Regulators' Kit, containing recommendations for disaster preparation and response. This kit contains model regulations covering five critical areas, including: establishing an Insurance Emergency Operations Center; disaster claim reporting requirements; cancellation and non-renewal of insurance under disaster conditions; suspension of premium payments under disaster conditions; and mediation of disputed claims. When adopted, these regulations could improve the necessary coordination and communication after a catastrophe and help those whose lives and property are at stake.

Fix the Flood Program

Second, we believe Congress should complete its efforts to reform the National Flood Insurance Program (NFIP). PCI strongly endorsed your reform efforts last year and we continue to do so. The NFIP is a necessary policy response to an uninsurable peril and must be continued. However, the program needs numerous reforms, the majority of which are contained in the Flood Insurance Reform Act of 2007 introduced yesterday. As currently structured, the NFIP does little to discourage development in high risk areas, does not provide the level of protection needed by consumers and has not achieved the breadth of participation needed. We support efforts to pass a flood insurance reform bill this year and are willing to work with you to obtain passage of this important legislation.

[1] "Managing the Next Disaster," Roger A. Pielke and Daniel Sarewitz, The Los Angeles Times, September 23, 2005.

Expand Private Sector Capacity

Third, a key part of the long-term solution to natural catastrophe exposure is to expand private sector capacity to handle the risk. PCI strongly supports efforts to make markets more responsive to the risks we face. Prices and terms of coverage that are openly and freely established in competitive markets can create essential incentives for property owners and attract new capital to these markets. As you know, homeowners insurance markets are heavily regulated in virtually all aspects of their operations. We face significant regulatory constraints, particularly in rating, but also in other areas, that inhibit effective market responses and discourage capital from entering these markets. There are several things we think policymakers at several levels of government can do to address this problem:

- First, state legislators should give insurance markets greater freedom to respond to the exposures we face. In free markets, prices and terms of coverage tell consumers the true cost of insuring against catastrophes and are an efficient means of funding exposures. Regulators often fear that giving up regulatory control will make the problem worse and invite consumer backlash. However, based on the experience we've seen in states that have taken this approach, including South Carolina and New Jersey most recently, we believe the results would be just the opposite. Free markets encourage new capital to enter where insurance protection is needed and develop more capacity, not less. PCI will support state legislative initiatives intended to remove regulatory barriers to free markets for catastrophe insurance and will oppose enactment of new barriers.

We also encourage your review of two additional proposals:

- First we are very interested in, and in fact endorse, establishing voluntary, tax-deferred insurance company catastrophe reserves such as H.R. 164 introduced by Rep. Jindal. While there are provisions in this bill PCI believes should be modified, we urge your review and debate of this bill as well.

- Second, we will be examining specific steps that might be taken to remove regulatory, legal, accounting, or tax barriers to further growth in the catastrophe bond market. This market provides another outlet for catastrophe risk financing and introduces new sources of capital and competition. A report earlier this year from Guy Carpenter described the growing importance of this market for financing catastrophe risk. While we certainly don't see the cat bond market displacing traditional reinsurance, market participants tell us that bringing more of these deals "onshore" in the U.S. and reducing a variety of regulatory barriers would permit the market to grow. In principle, PCI strongly supports steps that will attract more private capital to address catastrophe risk and we are very interested in how this might be done in the catastrophe bond market.

State and Federal Government Involvement

Finally, with regard to state and federal government involvement:

- First, based on our review of this issue, we believe the growth in natural catastrophe exposures is of sufficient magnitude in some states that they may require consideration of state natural catastrophe funding facilities. Recent events show that the industry can respond to very severe catastrophe events, but private markets may not always have the capacity to fund increasingly more frequent exposure to "mega catastrophes" or to a series of very large events in a single season. Given this, our approach will be to look at specific conditions in each state to determine whether a catastrophe fund, or other financing mechanism, might be helpful.

  When we consider whether a state needs a catastrophe fund, we look also to see: (1) whether private markets have freedom to respond to market conditions; (2) whether care has been taken to prevent a catastrophe fund from damaging stable private markets or preventing new capital from entering the market; and (3) that the funding of the state program doesn't rely on cross-subsidies across lines of business. By their nature, cross-subsidies damage the ability of markets to provide strong price signals and incentives for behavior. Having said that, we believe there may be cases and states where a catastrophe fund can be part of a well-rounded solution and must be considered. PCI believes that the Florida Hurricane Catastrophe Fund, including its recent capacity expansion through the recently enacted special session legislation provides the basis for ongoing improvement to that program.

- Second, we would also suggest that there may be some mega-catastrophe exposures that are beyond the capacity of the private market and even of an individual state catastrophe fund to address. In these instances, it may be necessary for the federal government to offer liquidity protection to state catastrophe funds at a very high level, consistent with the maintenance of stable markets and avoidance of widespread insurer insolvencies. Federal involvement may also be essential if the nation suffers repeated mega-events within a short time period. Lest anyone thinks that scenario is impossible, we would remind you of how close Hurricane Rita came to hitting Houston last year, only a few weeks after Katrina devastated New Orleans and the Mississippi coast. It is not inconceivable that several of our major cities could be struck by Category 4 or 5 storms within a single season, or that a major earthquake could strike in the same year as a significant hurricane.

  There are many ideas for how a federal role could be structured, but we would recommend, as we have suggested before, serious consideration of establishing a federal catastrophe financing facility. Such a facility would optimally offer credit financing only to state catastrophe funds, intended to provide access to liquidity to meet immediate claim requirements in the event of a mega-catastrophe or a series of very large events. One key advantage of this approach would be to offer important financing benefits while limiting the offer to state catastrophe funds and thus helping to minimize any potential disruption in private markets.

We are very mindful of the need to be extremely careful in structuring any federal role and of the overriding need to attract new private capital to the market. Accordingly, we also believe that any federal financing role should include measures intended to promote freedom for markets to respond to these exposures, including support for greater rating freedom, support for actuarial soundness or private market rates, freedom for product innovations, use of sound underwriting tools, and lower market barriers. The point of connecting standards for market freedoms to the creation of a federal financing facility is to provide incentives for the states themselves to do everything they can to attract private capital before asking for federal assistance. In addition, we believe that any federal credit should be specified in advance, as private sector lines of credit are, in order to prevent political pressure from influencing what should be a market-based credit agreement. We have the same concern about the need for a federal program to avoid cross-subsidies and other negative design elements as we have for state programs.

However, PCI thinks there may be a role, properly structured, for the federal government to play in assisting the financing of mega-catastrophe risk and we believe it should be given serious consideration by Congress now - before the next crisis.

Conclusion

Again, let me thank you on behalf of PCI and its members for the opportunity to appear before you today, respond to your questions, and provide you with our input on possible solutions to the catastrophe problem. Let me thank you also for the work you are already doing to identify and explore constructive policy solutions. PCI believes this is one of the most serious public policy issues facing our nation and is deserving of your time and continued thoughtful attention. PCI and its members look forward to working with you in the future on this very important issue.

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STATEMENT OF GARY THOMAS ON BEHALF OF THE NATIONAL ASSOCIATION OF REALTORS®

Before the

The Subcommittee on Housing and Community Opportunity of the House Committee on Financial Services

"Perspectives on Natural Disaster Insurance"

March 27, 2007

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EQUAL HOUSING OPPORTUNITY

Introduction

Thank you, Chairwoman Waters, Ranking Member Biggert, and Members of the Subcommittee for inviting me to testify here today before the Subcommittee on Housing and Community Opportunity and present the views of the National Association of REALTORS® on the issue of natural disaster insurance.

My name is Gary Thomas. I am a REALTOR® from Aliso Viejo, California where I am CEO of RE/MAX Real Estate Services, one of the six largest RE/MAX brokerages in the nation. In 2001, I had the honor of serving as the President of the California Association of REALTORS®. Currently, I serve as Chairman of Real Estate Business Services subsidiary of the California Association and as Liaison to NAR's Public and Federal Issues Group.

The National Association of REALTORS® is America's largest trade association, representing more than 1.3 million members involved in all aspects of the residential and commercial real estate industries. NAR is the leading advocate for homeownership, affordable housing and private property rights.

Overview

The catastrophic events of 2004 and 2005 have shown the need for a comprehensive, forward-looking natural disaster policy. Such a policy would recognize that property owners, private insurance markets, and all levels of government must work together in order to successfully address the problems (e.g., lack of available and affordable property insurance) currently plaguing disaster-prone areas.

The availability and affordability of property insurance is, at its core, a consumer issue. The importance of available and affordable insurance to homeowners, commercial property owners and those who would like to own their own home or place of business cannot be

overstated. This is something that your constituents, Madam Chair, have long understood since Californians have dealt with problems of insurance availability and affordability numerous times, most recently after the Northridge earthquake. Unfortunately, it is also something that consumers nationwide – even those who are not in what have traditionally been considered "disaster-prone" areas – now know all too well.

The National Association of REALTORS® believes that any real solution to the insurance problems now facing this country must go beyond a discussion of natural disaster insurance and include a comprehensive natural disaster policy that addresses, but is not limited to, insurance availability and affordability. A comprehensive natural disaster policy should take into account the responsibilities of multiple actors including property owners, insurance companies and each of the different levels of government in preparing and paying for future catastrophic events. Consequently, although this hearing is titled "Perspectives on Natural Disaster Insurance," my testimony today offers suggestions for what REALTORS® believe must be a comprehensive approach to addressing future catastrophic natural disasters.

Residential and Commercial Properties at Risk

A strong real estate market is the linchpin of a healthy economy, generating jobs, wages, tax revenues and a demand for goods and services. In order to maintain a strong economy, the vitality of residential and commercial real estate must be safeguarded.

Today, insurance availability and affordability concerns are not limited to the Gulf Coast region. We have heard from REALTORS® in numerous states, including New York, New Jersey, South Carolina and North Carolina, expressing concerns about the availability and affordability of property insurance. Their insurance concerns extend beyond homeowners' insurance and include multifamily rental housing and commercial property casualty insurance.

Insurance is a key component to financing the purchase of real estate. Without property casualty insurance, lenders will not lend; without insurance, borrowers are typically in default of their mortgage terms. The limited availability and high cost of insurance, therefore, not only threatens the ability of current property owners to hold onto their properties, but also to slow the rate of housing and commercial investment in these communities. Either of these threats could, in turn, further delay the rebuilding of communities on our storm-ravaged coasts.

The inability to obtain affordable insurance is a serious threat to the residential real estate market, impacting not only single family detached homes, but condominiums, co-operatives and rental units as well. New home purchases, resale transactions and housing affordability are affected in the following ways:

- **Homeowners' insurance is a necessary component in securing a mortgage and buying and selling a home.** If a potential homebuyer is unable to obtain or afford the required insurance, the sale will not be completed. As a result, potential homebuyers are excluded from the market.
- **The cost of owning a home is directly tied to insurance costs.** Homeowners are required by their mortgage lenders to maintain homeowners insurance, regardless of its cost. If the homeowner is unable to afford the cost of that insurance, the mortgage is in default and the lender may foreclose. If disaster insurance coverage is required, potential buyers may choose not to purchase a home because the insurance they need is too expensive. If disaster coverage is optional but expensive, owners may choose to go unprotected.
- **Insurance costs impact rent levels.** Insurance costs incurred by multi-family property owners are ultimately passed on to tenants through higher rents. This impacts housing affordability, particularly for low-income renters.

Many of NAR's commercial members in the Gulf Coast and coastal regions have also reported problems with commercial insurance availability and affordability. Members have experienced large increases in premiums-- in some cases more than four-fold with concurrent increases in deductibles and decreases in coverage -- and in some cases, a complete lack of availability. These changes put the property owner at greater financial risk to recover from losses, while also affecting property values since dramatic insurance increases often cannot be passed on to tenants. For example, in the multifamily housing sector, the ability to pass on increased insurance costs in the form of higher rent is often limited by market conditions, rent stabilization laws and strict limits imposed on federally subsidized landlords. The commercial property owner faces similar problems because leases may cover more than one year and may include limitations on the amount of expenses that may be passed on to the tenant. Thus, when insurance costs rise from $0.10 to $0.50 cents per square foot, the landlord must absorb most of the increased costs.

Often it is the smaller property owner that suffers the greatest. Small owners cannot offset the increases in insurance costs for one property with lower insurance costs in other parts of the country; nor are they able to negotiate a lower multiple property rate. In commercial real estate, there is a point at which insurance becomes unaffordable -- when insurance expenses are so high that the property no longer generates sufficient income to cover expenses. This problem forces many owners to sell their property.

Catastrophic Natural Disasters are a National Issue

The catastrophic events of 2004 and 2005 should serve as a wake up call that highlights not only the importance of having insurance, but also that individual property owners, insurance

companies, all levels of government, and taxpayers have a role in preparing for and recovering from future catastrophic events. The ongoing recovery from these storms shows that all taxpayers in the country have a stake in a federal natural disaster policy because their tax dollars are funding recovery efforts.

As a result of the 2004 and 2005 hurricanes, attention has focused on Florida and the Gulf Coast states, but other areas of the country are also susceptible to large-scale natural disasters. Damage caused by any of the following events could be as great as, if not greater than, that caused by Hurricane Katrina: a repeat of the 1906 San Francisco earthquake, another 1938 "Long Island Express" hurricane, or a significant seismic event along the New Madrid fault, which extends from northeast Arkansas, through southeast Missouri, western Tennessee, western Kentucky to southern Illinois. While it is true that not all areas of the country are susceptible to the large-scale disaster scenarios above, the effects of these disasters certainly would be felt by all taxpayers.

Elements of a Comprehensive Natural Disaster Policy

The National Association of REALTORS® encourages Congress to develop a comprehensive natural disaster policy that encourages personal responsibility, promotes mitigation measures, ensures insurance availability, and strengthens critical infrastructure (e.g., levees, dams, bridges, etc.). NAR supports the creation of a federal natural disaster policy that will promote available and affordable homeowners' insurance in disaster-prone areas.

NAR supports the creation of a federal policy to address catastrophic natural disasters that:

1) Protects property owners by ensuring that transparent and comprehensive insurance coverage is available and affordable, with premiums being reflective of the risk involved;

2) Acknowledges the importance of personal responsibility of those living in high-risk areas to undertake mitigation measures, including the purchase of adequate insurance;

3) Provides property owners adequate incentives to undertake mitigation measures where and when appropriate;

4) Acknowledges the importance of building codes and smart land use decisions while also emphasizing that proper enforcement of both is best left in the hands of state and local governments;

5) Recognizes the role of States as the appropriate regulators of property insurance markets while identifying the proper role of federal government intervention in cases of mega-catastrophes; and

6) Reinforces the proper role of all levels of government for investing in and maintaining critical infrastructure including levees, dams, and bridges.

NAR believes that now is the time for Congress to address a comprehensive natural disaster policy that includes natural disaster insurance. The lack of a national natural disaster policy has had a measurable direct impact on the availability and affordability of property casualty insurance in many parts of the country. The inability to obtain affordable homeowners' insurance is a serious threat to the residential real estate market – and thus, our economy.

Homeowners and commercial property owners need insurance to protect themselves, their families and their property in case of catastrophe. However, if insurance is not available or affordable, many make the unfortunate, but understandable, decision to purchase only the

minimal amount or type of insurance required. I would point out that this is precisely the decision many Californians have made - buying the required property casualty coverage but foregoing earthquake insurance due to its high cost. The problem with this rational economic decision is that if "the big one" hits, and people are not insured for that type of catastrophe, then the American Taxpayer, that is to say everyone in the country, will pay. NAR believes that people who bear risk should pay a fair share – by obtaining and maintaining adequate insurance coverage.

Property owners should have confidence that their homes and businesses will survive future catastrophic events. Appropriate mitigation measures can help to create that confidence. Federal and state governments can provide incentives (e.g., tax credits, insurance rate reductions) to property owners to undertake appropriate mitigation measures for their homes and businesses. Research conducted by the Multihazard Mitigation Council of the National Institute of Building Sciences found that a dollar spent on mitigation saves society an average of four dollars.[1]

States are the appropriate regulators of property insurance markets, but there is a proper role for the federal government in addressing mega-catastrophes. Some disasters are just too large or unpredictable for the private market to deal effectively with the resulting damage. At some level, there may be an appropriate role for the federal government to intervene in insurance markets to prevent market disruption and insolvencies among insurance companies. The level of intervention, however, must be set at a level that will not interfere with normal market forces. The difficulty lies in determining the level at which such intervention would be appropriate

Finally, an essential part of a comprehensive natural disaster policy is the recognition of the basic responsibility of government at all levels to build and maintain infrastructure.

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[1] Multihazard Mitigation Council, "Natural Hazard Mitigation Saves: An Independent Study to Assess the Future Savings from Mitigation Activities, Volume 1 – Findings, Conclusions and Recommendations," National Institute of Building Sciences, Washington, D.C. (2005), p.5.

Hurricane Katrina was not the largest hurricane to ever hit the Gulf Coast, but the failure of the levees protecting New Orleans contributed significantly to the loss of life and property from that storm. USA Today reported on January 29, 2007, "The Army Corps of Engineers has identified 146 levees nationwide that it says pose an unacceptable risk of failing in a major flood."[2] According to the article, 42 of these levees are located in California.[3] The U.S. Army Corps of Engineers on February 1, 2007, released a list of 122 "Levees of Maintenance Concern" that includes 37 levees in California.[4] Moving forward, we believe that all levels of government must do a better job of shouldering their respective responsibilities.

To summarize, we believe that it is in the best interests of all Americans to have a comprehensive federal natural disaster policy that includes aggressive mitigation and appropriate assumption of risk so that affordable insurance for homeowners and commercial properties is available. Having a comprehensive natural disaster policy is essential in the coming years. There is no guarantee that 2007 or any future years will be as benign for natural catastrophes as 2006. The question is not whether there will be another Katrina-like event in size and scope of destruction, but when. As we have learned, it is far less costly to prepare ahead of time than to fund recovery efforts.

Proposed Legislative Approaches

Congress has, with varying levels of success, debated and voted on natural disaster policies since the 1990s. The National Association of REALTORS® encourages a healthy and vigorous debate during the 110th Congress that leads to sound and productive legislation. NAR

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[2] Peter Eisler, "146 U.S. Levees May Fail in Flood," USA Today, January 29, 2007. http://www.usatoday.com/news/nation/2007-01-28-levees_x.htm?POE=NEWISVA
[3] Ibid.
[4] *See*: U.S. Army Corps of Engineers, "Levees of Maintenance Concern," Feb. 1, 2007.

supports the efforts of members of Congress who have introduced and co-sponsored legislation to address this critical issue.

Legislation introduced in the 110th Congress to date takes different approaches to addressing the natural disaster insurance issue. For example, Representative Ginny Brown-Waite has introduced two bills that attempt to address the issue of reinsurance, H.R. 330, the Homeowners' Insurance Availability Act of 2007," and H.R. 91, the "Homeowners Insurance Protection Act of 2007." Representative Carolyn Maloney introduced a similar bill, H.R. 4507, the "National Catastrophe Insurance Act of 2005," in the 109th Congress.

Other legislation would create an incentive for insurance companies to increase reserves to help pay claims arising from future catastrophes. H.R. 164, the "Policyholder Disaster Protection Act of 2007," introduced by Representative Bobby Jindal, provides for the creation of disaster protection funds by property and casualty insurance companies that would be used to pay policyholders' claims arising from future catastrophic events.

H.R. 920, the "Multiple Peril Insurance Act of 2007," introduced by Representative Gene Taylor, would expand the National Flood Insurance Program to include coverage for windstorms.

H.R. 537, the "Commission on Catastrophic Disaster Risk and Insurance Act of 2007," introduced by Representative Kendrick Meek, takes yet another approach by seeking to create a bi-partisan commission on insurance reform.

In addition to the aforementioned proposals, NAR encourages the consideration of additional proposals that would provide incentives for property owners to undertake mitigation measures, allow individuals to establish catastrophe savings accounts to pay for losses resulting from catastrophic events, strengthen the nation's infrastructure, and ensure the long-term

viability of the National Flood Insurance Program. NAR believes that all reasonable proposals should be considered as part of a comprehensive solution to address future catastrophic events.

Conclusion

Thank you again for inviting me to present the views of the National Association of REALTORS® to the Subcommittee. The National Association of REALTORS® encourages Congress to develop a comprehensive approach to natural disaster preparedness that encourages personal responsibility, promotes mitigation measures, ensures insurance availability, and strengthens critical infrastructure (e.g., levees, dams, bridges, etc.).

Passage of an appropriate comprehensive national disaster policy is a top legislative priority for REALTORS® nationwide. We stand ready to work with you, Chairwoman Waters, the Committee on Financial Services and others in Congress to develop a responsible natural disaster policy that addresses the needs of consumers, the economy and the nation.

I would be glad to answer any questions that you or other members of the subcommittee may have.

Independent Insurance Agents
& Brokers of America, Inc.

TESTIMONY OF:

Mr. Andrew Valdivia

On behalf of the
Independent Insurance Agents & Brokers of America

Before the House
Financial Services Subcommittee
On
Housing and Community Opportunity

March 27, 2007

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Independent Insurance Agents
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STATEMENT OF ANDREW VALDIVIA
ON BEHALF OF THE
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA

BEFORE THE

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

March 27, 2007

Good afternoon Chairwoman Waters, Ranking Member Biggert, and Members of the Committee. My name is Andrew Valdivia, and I am pleased to be here today on behalf of the Independent Insurance Agents & Brokers of America (IIABA) to provide my association's perspective on efforts to reform how our nation insures against natural disasters. I currently serve as the California State National Director for the IIABA. I am also the President of White and Company Insurance Inc. in Santa Monica, CA, a full-service agency that serves clients in Santa Monica and the surrounding area with both commercial and personal insurance. White and Company employees over 45 insurance professionals in 5 separate departments.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, and we represent a nationwide network of more than 300,000 agents, brokers, and employees. IIABA represents independent insurance agents and brokers

who present consumers with a choice of policy options from a variety of different insurance companies. These small, medium, and large businesses offer all lines of insurance – property, casualty, life, health, employee benefit plans, and retirement products. It is from this unique vantage point that we understand the capabilities and challenges of the insurance market when it comes to insuring against catastrophic risks.

Background

In 2005, our country faced several devastating and record-setting natural disasters, including 28 named storms, seven of which made landfall in the U.S. These disasters roiled the insurance marketplace and our overall economy. Estimates for 2005 U.S. catastrophe losses are over $62 billion, greatly exceeding the previous record set in 2004 when 22 events caused $27.5 billion in insured losses. Six of the top 10 most costly catastrophes on record in the United States occurred in the 2004-05 hurricane seasons. In 2005, Hurricane Katrina alone generated $40.6 billion in insured losses and more than 1.7 million claims.

Although the 2006 hurricane season was relatively light in terms of hurricane activity, the tremendous costs of the 2005 season combined with the fear of future catastrophes have restricted homeowners' insurance availability in many markets. These multibillion-dollar events have created exposure and solvency issues for companies that write homeowners insurance in disaster-prone areas. As a result, many insurance companies have stopped writing new business in or withdrawn from at-risk markets, making it difficult for residents to find homeowners' coverage.

While our members and their consumers have experienced varying types of natural disasters across the country, this problem has been compounded by the fact that an ever-increasing number of people reside in areas where they are exposed to natural disasters. For example, in coastal areas alone we have seen tremendous growth in population. In fact, according to AIR Worldwide, a leading risk modeling and technology firm, in 2004 the value of insured coastal properties in the 18 East Coast and Gulf states exposed to hurricanes totaled $6.9 trillion, or 16 percent of insurers' total exposure to loss in the United States. Not unlike other disaster-prone areas, AIR also estimates that property values in coastal areas of the United States have doubled over the last decade.

IIABA Perspective

As a Californian and as your constituent, I first would like to thank you, Chairwoman Waters, for holding this important hearing on an issue that has impacted millions of Americans and many other communities across the country. The IIABA is extremely grateful for your work on this issue and for the opportunity to share its views on what we feel is a matter of critical importance.

Our members approach the issue of natural disaster insurance from a very simple perspective: we are here to serve consumers' needs, whether it is helping them secure coverage to protect their families and their homes prior to an event, or assisting consumers after an event to ensure that claims are paid quickly and fully. As the

intermediaries between consumers and their insurers, our members cannot and will not walk away from consumer needs as long as they demand coverage for these risks. We strongly believe our industry must come together with policymakers to find a common solution that will encourage participation in at-risk markets. For this reason, the IIABA is grateful to you, Madam Chairwoman, for calling this important hearing to explore these issues, and we look forward to working with the Committee in the future on this issue. We also thank the many other Members of Congress who have proposed legislative solutions to address these difficult issues.

In short, we welcome all proposals and support any and all reasonable ideas and plans that lead us to a healthy and competitive insurance marketplace in which consumers have choices and companies are vying for their business.

When natural disasters strike, independent insurance agents and brokers are on the front lines with devastated policyholders who need to rebuild their lives. In fact, our members live in the communities that they serve, and they and their families are also impacted by many of the same issues facing other consumers. As such, independent insurance agents and brokers understand the challenges that consumers face and their concerns about the availability of affordable coverage for losses from natural disasters.

Over the last several years, our members have witnessed how substantial insured losses from severe hurricane seasons have diminished the insurance industry's capacity, and more importantly their appetite for catastrophic losses in general. Meanwhile, the cost of coverage has increased. Insurers are currently under pressure from rating agencies to limit exposure, and they are reevaluating their exposure to all types of catastrophic losses. As underwriters continue to focus on the aggregation of losses, there is a definite strain on the insurance industry's willingness to cover catastrophic losses—whether they result from natural disasters, such as hurricanes and earthquakes, or man-made threats, such as acts of terrorism.

Any discussion concerning the solution to insuring against future natural disasters starts with admitting there is a problem. The IIABA believes it is no longer enough to say that the private market can handle catastrophic risks, when coverage is not sufficiently available at affordable rates. In fact, it is our experience that private market coverage is scarcely available at any rate in some areas – this is fast becoming an availability problem rather than an affordability problem. The reality is that many insurers have either stopped writing new homeowners' business in or withdrawn completely from at-risk markets.

The natural disaster insurance crisis currently threatening the marketplace is not an "insurance company issue." It is a consumer issue. As the largest trade association representing independent insurance agents, the IIABA feels it is our responsibility to deliver the message that there is a looming crisis facing consumers due to natural disaster risk. As the conduit to consumers, the IIABA recently joined the Natural Catastrophe Policyholders Coalition as an ex-officio member. The Coalition is an alliance of policyholders who have joined together to address issues related to the availability and

affordability of catastrophe insurance. The goals of the coalition are to create a forum to share information and to develop and promote policies to ensure the availability and affordability of catastrophe insurance to both homeowners and businesses. As an ex-officio member of the Policyholders Coalition, the IIABA will continue to be a leading advocate for a federal solution to this crisis. In fact, we are working with another witness here today, the National Association of Realtors, as part of this coalition.

National Problem

I would particularly like to stress that this issue is not simply a Gulf Coast problem – it is a national problem. Our members live across the country, serving and living in a wide variety of communities – large and small – and so many of them have been impacted by natural disasters. Certainly, the most devastating natural disasters in recent years have resulted from hurricanes, which have had the greatest impact on the homeowners' insurance market. However, hurricanes are only one of the many catastrophic risks our nation faces. According to the Insurance Information Institute, tornadoes, earthquakes, mudslides, blizzards, and other catastrophe events combined have accounted for over half of the U.S. catastrophe losses in the last 20 years. The 3rd most costly natural disaster on record was the Northridge Earthquake in 1994, with $16.5 billion in losses. Whether it is tornadoes in the Midwest, earthquakes in California, or ice storms in the Northeast, we all face some risk of natural disaster, and it often takes only one or two events in a particular area for the homeowners' insurance market to be dramatically affected.

In some cases, of course, states have set up entities in an effort to prevent insurance availability crises, such as the California Earthquake Authority (CEA) and the Florida Hurricane Catastrophe Fund (FHCF). The CEA was created in 1996 to offer a basic level of residential earthquake coverage to Californians. The FHCF was created in November 1993 after Hurricane Andrew to protect and advance the state's interest in maintaining insurance capacity in Florida. These programs are certainly useful, but ultimately, even if they are carefully constructed and managed they may not be enough to handle the particularly severe events. For example, even with the CEA, a A.M. Best 2006 study shows that only 12 percent of Californians bought residential earthquake insurance in 2005. Meanwhile, AIR Worldwide estimates that if there were a 7.9 Magnitude quake in San Francisco, CA, the losses could top $100 billion.

In the face of these enormous estimated losses, it is also worth noting that the commercial earthquake market in California has dropped precariously. While the CEA offers some earthquake protection for the residential market, it does not offer policies to the commercial market. Instead, the primary source of commercial earthquake coverage is the non-admitted market. With this market devoting additional catastrophic capacity to the windstorm states and reassessing its aggregate exposure in light of the natural disasters in the Gulf coast region, prices and retentions have skyrocketed. Quite simply, some commercial policy holders in California are unable to secure coverage at reasonable prices.

The plain truth is that some natural disasters will exceed the financial capacity of state catastrophe funds – only a program that is national in scope will be able to generate enough capacity to cover the most devastating events.

Put simply, insuring against natural disasters is a national problem that requires a national solution. Despite our longstanding position that the insurance market is best served by limited federal involvement, we believe that a federal solution to the issue of natural catastrophe insurance is necessary to help provide capacity and fill a void that the private market cannot and will not service. However, it is important that the day-to-day regulation of insurance remain at the state level, where state insurance departments are best equipped to serve the special needs of local consumers in local markets. As such, given the absence of affordable coverage and the exposure that both consumers and taxpayers face, we believe that there is a very limited and appropriate role for the federal government, and we are open to supporting proposals that increase insurance availability and affordability in catastrophe-prone areas.

IIABA is comprised of thousand of small businesses and as such, we always prefer market –driven solutions to problems and are suspect of new government programs. In short, we do not adopt a position like this lightly. We do so only because we so no other available course of action to resolve this availability crisis. There is currently a clear case of market failure.

National Solutions

In our view, a simple cost-benefit analysis suggests that it is more efficient and less costly for the federal government to address this issue in advance of a natural disaster in a way that maximizes private sector capacity, as opposed to through post-disaster relief on an ad-hoc basis. Members of this Committee are well aware of the GAO revelations regarding misuse of FEMA disaster funds disbursed following Katrina, and while we do not suggest that this would be a common occurrence, it does highlight some of the problems with ad-hoc relief efforts. The Big "I" believes the best solution is for a program to be in place before the events happen – to have a clear, well-structured mechanism that encourages the private sector to handle as much of the risk as possible, and only trigger federal involvement as a last resort upon private marketplace failure. We believe that such a structure will protect both consumers and taxpayers living in all areas across the country – especially when history has proven that more tax dollars are going to be spent on disaster assistance without such a structure to encourage the private sector to take on additional risk.

It is with these sentiments that we approach the legislative proposals pending in Congress. Specifically, we support H.R. 330, the Homeowners' Insurance Availability Act, sponsored by Rep. Ginny Brown-Waite (R-FL). The legislation would allow private insurers to purchase, at auction, reinsurance contracts directly from the U.S. Treasury to cover natural disasters that are equal to or greater than a one-in-100-year event. We believe this is a strong proposal because it will encourage more companies to enter at-risk

markets, thus increasing availability and market stability, while limiting federal involvement to only the most devastating catastrophes.

In addition to H.R. 330, the IIABA is examining other proposals that would create a federal catastrophe reinsurance program, such as H.R. 91, the Homeowners Insurance Protection Act of 2005, also introduced by Reps. Ginny Brown-Waite, and H.R. 4507, the Natural Catastrophe Insurance Act of 2005, offered by Rep. Carolyn Maloney (D-NY) in the 109th Congress. Under these proposals, states that have their own catastrophe funds could be eligible to purchase reinsurance from the federal government. Both bills seek to encourage states to establish catastrophic funds to protect against natural disasters and reduce costs to homeowners. Our association has not, however, taken a formal position on these bills at the present time.

IIABA is also looking beyond federal reinsurance proposals to other possible solutions, and in that vein we are encouraged by the introduction of H.R. 164, the Policyholder Disaster Protection Act, introduced by Rep. Bobby Jindal (R-LA). This bill would permit insurers to create tax-free reserve funds for natural disaster claims. We support the goal of this legislation, which is to build up insurance capacity in at-risk markets.

In addition to the above proposals, our members support exploring ways to reduce the costs of disasters, such as mitigation efforts. For instance, enhancing building codes and using financial incentives to mitigate risk must be explored in order to protect both consumers and taxpayers across the country. While it may be a difficult task, we believe that any solution to the natural disaster insurance crisis will likely need to be comprehensive in its approach and include a role for a federal backstop, tax-free reserves, and enhanced mitigation and building codes.

Along these lines, we thank Rep. Kendrick Meek (D-FL) for introducing H.R. 537, the Catastrophic Disaster Risk and Insurance Commission Act. H.R. 537 would help Congress address these issues by establishing a national commission to examine proposals and to make recommendations to help the federal government prepare for and manage natural disasters. We believe that such a Commission would be an important first step towards putting together a comprehensive solution, and we urge the Committee to consider this legislation.

We also recognize that Reps. Mahoney (D-FL), Klein (D-FL), Brown-Waite (R-FL), Jindal (R-LA), Melancon (D-LA), and Maloney (D-NY) are working in a task force to address the natural disaster insurance crisis. We commend these members for taking leadership roles in developing a solution and will be happy to work with them on identifying both the specifics of the problem and any potential solutions. In particular, we urge this task force to consider H.R. 330 as a starting point for legislative solutions. We believe any federal backstop proposal should encourage companies to enter at-risk markets, but should also have an appropriate "trigger" point to limit federal involvement. For the same reasons, we also urge the task force to consider Rep. Maloney's legislation (H.R. 4507) from last year's Congress, which has a $50 billion trigger point (a dollar amount consistent with the losses experienced in Katrina). Any trigger for program coverage should be set at a level appropriate to not impede market-driven efforts to

manage risk, while still encouraging insurers to enter the market. Finally, we urge the task force to consider supporting the Catastrophic Disaster Risk and Insurance Commission Act, which has support in both the House and Senate. A blue-ribbon commission that seeks broad input could lead to a comprehensive solution and could also create momentum necessary to enact legislative proposals.

We also urge you, the full Financial Services Committee, to again pass H.R. 1065, the Nonadmitted and Reinsurance Reform Act, introduced by Rep. Dennis Moore (D-KS) and Ginny Brown-Waite (R-FL). As evidenced by last year's 417-0 vote on the House floor, this legislation enjoys overwhelming support and it will allow us to better serve commercial policyholders, who are also beginning to feel the strain of limited capacity for natural disaster risk. Since many of the current natural disaster proposals primarily focus on homeowners insurance, we believe that H.R. 1065 is a good first step that will help provide efficiency to the surplus lines market that serves commercial policyholders throughout the country, including at-risk markets.

Finally, we are currently analyzing a proposal by Rep. Gene Taylor (D-MS), the Multiple Peril Insurance Act of 2007 (H.R. 920). We support the goals of this legislation, which is to increase the availability and affordability of windstorm coverage for both homeowners and commercial policyholders in areas of the country where coverage is either unavailable or cost prohibitive. However, we do have concerns that, by attaching a windstorm election to the National Flood Insurance Program (NFIP), the proposal may create an undue amount of financial exposure to U.S. taxpayers. Additionally, we are concerned that the proposal may have the unintended effect of crowding out the private marketplace in areas of the country where that marketplace is still vibrant. Finally, I'd like to comment that, as a Californian, this proposal does not help with the very real financial risks associated with earthquakes, mudslides, and other natural disasters that aren't associated with windstorm damage. The IIABA has not taken a formal position on this legislation, but we have and will continue to work with Rep. Taylor on his ideas for increasing the availability and affordability of windstorm insurance.

Congressional Attention Is Needed

Achieving a consensus within the insurance industry for a solution to this growing problem has proven elusive, which has complicated public and private efforts to address this issue. However, as some parties express concern with some of the above proposals, consumers still need and demand coverage to protect their homes, their families and their communities.

We thank this Committee and the Members of Congress mentioned above for their leadership on these issues, and we would strongly urge you to continue to shed light on this important topic. The sheer number of legislative proposals before Congress, as well as the Committee's decision to hold hearings on the issue, indicates to us that progress is being made towards a legislative solution.

We encourage Congress to be realistic, but also ask tough questions and demand responses. Congress can be very helpful in challenging the private sector to engage in this process. In our view, Congressional attention will spur greater insurance marketplace involvement in exploring potential solutions, perhaps leading to even more innovative proposals.

Conclusion

In conclusion, we commend you, Madam Chairwoman, for convening today's hearing, and we hope that the Committee will continue its thorough examination of legislative solutions for the catastrophe insurance availability crisis.

The Big "I" is committed to an open dialogue with all interested parties in the public and private sector to begin to address these important issues that consumers face. We are open to a number of potential solutions with limited federal involvement, including federal catastrophe funds, insurer tax-free reserving, enhanced building codes and mitigation.

We stand ready to assist your efforts in any way we can.

Questions of U.S. Representative Ron Klein

Twenty-Second District of Florida

Before the House Committee on Financial Services, Subcommittee on Housing and Community Opportunity

Hearing on "Perspectives on Natural Disaster Insurance"

March 27, 2007

(1) One major factor affecting the availability and affordability of property insurance in Gulf and Atlantic coast states is the manner in which the catastrophic insurance market is organized. Natural catastrophes tend to reduce private wealth just as other economic losses reduce the value of diversified portfolios of stocks and bonds held by individuals. A substantial portion of the losses from Hurricanes Katrina and Rita, and other 2004 and 2005 hurricanes, was borne by privately held reinsurance companies and small numbers of wealthy individuals — i.e., Lloyds of London.

- *Given the potential magnitude of the nation's exposure to a megacatastrophe, is this an efficient way to insure or reinsure catastrophic risk? Capital markets present both a major competitive opportunity and a threat to reinsurers. Given the present circumstances, would tapping into global bond and equity markets, worth more than a hundred times the insurance industry's equity, be an attractive option for your business?*

(2) Mr. Nutter, in the March 27, 2007, hearing you testified that natural catastrophic risk is insurable in a free market. You indicated that private market reinsurance capacity increased in 2006 by about 30%.

- *While it might be true that catastrophic risk is insurable in a free market and capacity has grown, the question is really whether you are providing enough insurance to meet the growing needs of American homeowners, businesses, and the national economy. The $26 billion in new capital raised in the reinsurance industry primarily derives from higher property insurance prices for consumers. Can you comment on proposals that would turn to financing mechanisms other than premium increases?*

(3) Some economists have observed that reinsurers apparently cannot diversify catastrophic risks, both because catastrophes appear to be correlated across risks and because estimates of the probable maximum loss (PML) from catastrophes have risen dramatically. National insurance markets, even those backed by international reinsurance catastrophe capacity, appear to be limited in terms of the total amount of risk that can be covered. In addition, insurance company managers apparently have changed their perception of risk. They are now cognizant of the significant risk of default by reinsurers

in the event of a mega-catastrophe, since the cost of such an event could exceed all known global reinsurance capital.

- *Is the total international catastrophic reinsurance capacity large enough to allow primary insurers to hedge their catastrophe risk adequately to meet society's growing needs?*

(4) The lack of affordably priced and available catastrophic reinsurance may force insurance companies to curtail important coverages in order to manage their exposure to catastrophic risk. This situation has led to insurance affordability and availability problems in Gulf and Atlantic coastal areas.

- *What options would you recommend to help Congress solve this problem? Are you in favor of the government's involvement in helping the private market securitize premium flows associated with catastrophic risks? The banking industry has proven to be a role model in this area with a successful record in mortgages and credit card receivables.*

(5) You stated that reinsurance capacity is adequate even for peak catastrophe markets.

- *What is a "peak catastrophe market?" Is a peak catastrophe the same as a mega-catastrophe that costs the insurance industry $100-$150 billion or more?*

(6) After Hurricane Katrina, reinsurance became expensive for insurers, who had to pass on higher costs to their customers. In an attempt to avoid insurer insolvency, some insurers have announced plans either to withdraw from selling insurance in high-risk areas, or to sell at such higher rates that my constituents may not choose to purchase or may not be able to afford insurance.

- *How would you respond to my constituents about the current insurance availability and affordability problem in Gulf and Atlantic coast areas?*

(7) Economics Professor Kenneth Froot at the Harvard Business School has observed that current institutional arrangements for allocating catastrophic risk may be inefficient because the lack of objective information acts as a barrier to reinsurance market entry. According to Professor Froot, when objective information is costly to assemble, a greater investment is required to get into the underwriting business. Froot points out that without objective information, markets tend to be organized around relationships and reputation. By contrast, when objective information is plentiful, markets tend to be organized around transactions, with the players being more interchangeable.

Because newcomers are discouraged from entering the market, the incumbents who specialize in underwriting catastrophic risk can charge high prices more easily.

- *How can Congress help you remove the information barriers that appear to exist in reinsurance markets? Would the removal of these barriers increase the reinsurance market's capacity for financing insurance against natural disaster losses?*

(8) You indicated that new capital sources appear to have moderated the market. But you also stated in the March 27, 2007, hearing that "reinsurance prices have increased in some peak catastrophe zones dramatically." I presume you are referring to Gulf and Atlantic coastal areas now experiencing dramatically higher pricing and capacity withdrawals.

- *When — if at any time — will this new capital flow into the disaster-prone areas, and when can we expect rates in these areas to decline? Will the capital flow result in savings to consumers? If not, why not?*

(9) The reinsurance business has been volatile over the past 20 years or so. We have witnessed an unprecedented series of major losses from natural and man-made disasters, together with much fiercer competition.

- *What can we do as Members of Congress to help you reduce volatility and improve capital efficiency in the insurance industry? Is this, or is it not, a market cycle issue that requires federal policy intervention?*

Statement for the Record

March 27, 2007

Submitted to the
Subcommittee on Housing and Community Opportunity
United States House of Representatives

By

Janice M. Abraham
President and CEO
United Educators Insurance, a Reciprocal Risk Retention Group
Chevy Chase, Maryland

Madam Chairwoman and Members of the Committee:

Thank you for the opportunity to participate in your "Perspectives on Natural Disaster Insurance". I am the president and Chief Executive Officer of United Educators Insurance. Created in 1987, United Educators is a risk retention group that, I believe, may be a model to consider as a part of the solution to providing adequate insurance coverage and capacity for natural disasters.

I would like, first, to provide a brief description of our company and its history. I will review what I understand to have been the Congressional purposes behind the 1986 Liability Risk Retention Act Amendments, and then I will explain why an expansion of the Risk Retention Act to include property and auto insurance will be a part of the solution to the challenges faced in meeting the needs of America's businesses and nonprofits in finding stable property insurance coverage.

A. About United Educators

United Educators Insurance, a Reciprocal Risk Retention Group, serves schools, colleges, universities, and related educational associations and groups. We cover all levels of education from pre-K, including Head Start programs, to post graduate, providing liability insurance to public, private, nonprofit, and for-profit education-related entities. Our main policies are Educators Legal Liability, which cover employment practices liability such as directors & officers and failure to educate, and general liability--both "first-dollar" primary general liability and excess general liability--at high limits. Our members include Rockefeller University, Marquette University, Abilene Christian University, Stonehill College, Marymount Manhattan College, Weill Cornell Medical College, Sacred Heart University, Stevens Institute of Technology, Washington University, and Wellesley College.

Our company owes its existence to the federal Risk Retention Act Amendments of 1986. Those amendments opened new options for entities that were struggling with then-skyrocketing insurance rates. A group of educational institutions, collaborating through a task force of the National Association of College and University Business Officers, decided to form their own insurance carrier.

Throughout this history our mission has been to:

- Meet the specific liability insurance needs of educational institutions on a long-term basis.
- Price coverage predictably and rationally based on education's own losses, avoiding the high-risk exposures of commercial insurance.
- Identify emerging liability issues and assist administrators in formulating sound policies and practices to manage risk and reduce loss.
- Handle claims fairly, quickly and proactively to support the cost-effective resolution of disputes.
- Partner with institutions and brokers to manage risk and catastrophic losses.

Today we are strong in terms of member loyalty, financial position, and, most importantly, expertise in the risks facing educational institutions.

B. The Goals of the Risk Retention Act Amendments of 1986

Congress passed the 1986 Amendments to the Risk Retention Act to address the challenges that municipalities, universities, small businesses, and other entities were then facing in obtaining liability insurance. The House Committee on Energy and Commerce vividly described the bleak national landscape for insurance:

> "During the 99th Congress, the country has been shaken by a crisis in the availability and affordability of commercial liability insurance. Congress has been besieged with complaints regarding huge rate increases, mass cancellations of coverage, and entire lines of insurance virtually unavailable at any price. Crucial activities and services have been hard hit. Such activities include, among others, those of municipalities, universities, child daycare centers, health care providers, corporate directors and officers, hazardous waste disposal firms, small businesses generally, and many others."

House Report 99-8655, page 7.

The 1986 Amendments built upon the 1981 legislation that permitted risk retention groups, which are groups of similarly situated entities in a common line of endeavor, to offer product liability insurance. The 1986 amendments were designed to allow such groups to offer all lines of liability insurance other than workers' compensation. It expanded the opportunity for groups of schools, businesses, professionals, and others to shape their own destinies in the insurance marketplace.

Supporters of the 1986 Amendments expressed the belief that allowing risk retention groups to provide all types of liability insurance would foster rational underwriting and insurance pricing. They anticipated a positive, overall increase in the nation's insurance capacity and some moderation of the painful cycles in the availability of insurance from commercial carriers.

The House Committee report explained the expected benefits of the proposed amendments:

> "Since a risk retention group is simply a group of businesses or others who join together to set up their own insurance company only to issue insurance policies to themselves, it was believed that by encouraging such groups, the subjective element in underwriting could be reduced. The risk retention group would know its own loss experience and could adhere closely to it in setting rates. It was also believed that the 1981 Act, by providing alternatives to traditional insurance, would promote greater competition among insurers to "encourage private insurers to set rates to reflect experience as accurately as possible."

House Report 97-190, page 4.

> "...the Committee believes that creation of self-insurance groups can provide much-needed new capacity. Additionally, according to the Department of Commerce, "[t]he knowledge that substantial insurance buyers can create their own alternative insurance mechanisms will be an incentive to commercial insurers to avoid sharp peaks and valleys in their costs."

July 17, 1986, Congressional Record, pages S9229-S9230, letter of Douglas A. Riggs, General Counsel, Department of Commerce, dated June 25, 1986.

> "With respect to purchasing groups, the Committee seeks to enable insurance markets to translate into lower rates and better terms the efficiencies gained from the better loss and expense experience that might arise from the collective purchase of insurance."

House Report 99-8655, at pages 7-8.

C. A new crisis

Now is the time for Congress to take the next step and help to solve a current insurance capacity problem by expanding the Risk Retention Act again to include property and fleet auto insurance.

Over the past twenty years, United Educators has grown to serve 1,200 schools, colleges and universities that educate over 16 million students. The federal Liability Risk Retention Act currently limits Risk Retention Groups (RRGs) to providing only liability insurance to its members. The ability to expand into property and automobile insurance,

using the principles of risk management, broad coverage, stable pricing and coordinated claims services would fill a significant need of educational institutions.

From the perspective of educational institutions, we describe the challenges of obtaining property, auto, and liability insurance. This case study covers the past, the present, and the future. We describe how educational institutions will benefit if risk retention groups are authorized to provide property and auto coverage.

1. The Past

In the 1980s, insurance premiums skyrocketed regardless of losses. Educational institutions became a casualty of this disaster. Schools and colleges had difficulty finding liability insurance, and what was available was astronomically expensive and ill-suited to their needs. In 1986, one typical university paid $800 for $5 million in coverage; the next year, bids ranged from $5,500 to $44,000 for a $1 million policy. Some institutions that could not purchase insurance had to promise to indemnify their trustees to keep them on the board.

For pricing purposes, insurance companies at that time lumped educational institutions in with a variety of diverse groups, though their needs and loss experience were critically different. An individual institution's loss experience played little role in determining its coverage.

Congress addressed the problems facing liability insurance at that time--reduced capacity, rising prices, and restrictive coverage--by passing the Liability Risk Retention Act of 1986. That law enabled a task force of universities and colleges to study the market and propose formation of a company they would own and operate. The next year, the group formed United Educators Insurance, a Risk Retention Group, and liability insurance became available, affordable, and responsive to education's needs. It has remained so through all market conditions.

The first coverage UE offered was Excess Liability, which offered the higher limits that were no longer available in the regular insurance market. Educational institutions could, at last, obtain liability coverage geared to their loss experience, what they do, and how they do it.

2. The Present

Today, through UE, liability coverage works for educational institutions. UE emphasizes stable pricing and risk management, and coverage aimed to members' needs. A standard liability package through UE covers risks often unavailable through other insurers but are basic to educational institutions, such as sexual harassment, sexual molestation, international study and sports injuries.

UE works with institutions to minimize risks through workshops, roundtable discussions, computer-based learning tools, and other types of training. Its risk management and education address campus topics including fire safety, sexual harassment training, safe driving practices, disaster planning, athletics, discrimination training, foreign study, and substance abuse.

That type of focused attention is not currently available in auto and property insurance, both of which, in 2007, look to many educational institutions much the way liability coverage did in the 1980s. The conditions faced by the some parts of the education community in obtaining stable property insurance, resembles closely those from the liability market of the 1980s.

Commercial carriers have suffered enormous property claims in certain geographic areas in the past years, and capacity has diminished as a result, but many carriers are seeking to recoup those losses almost overnight, through stunning increases, shrinking coverages, higher deductibles, lower limits and, in some cases, simply walking away. Even if a carrier wanted to work with the educational institutions, reinsurers are imposing severe limits on their ability to write policies under realistic conditions. We offer a few actual cases from the current market:

- A private college with good loss experience received a renewal quote from their insurance company raising the property annual premium from $637,000 to $2,200,000 while reducing the limits of coverage from $150 million to $25 million.
- A school's property insurance carrier ceased writing insurance for educational institutions and the school, again with good loss experience, was forced to accept dramatically reduced limits of insurance for its buildings.

If education in the U.S. is not to become an innocent victim of these forces, it must be put in a position to provide the self-help in property and auto markets that it has provided so successfully with liability coverages appropriate to its circumstances. UE has been successful in working with reinsurers and meeting the needs of education by demonstrating in-depth knowledge of the institutions and positive claims results.

In addition to UE's ability to design and implement sound, stable, and dependable coverages, we will also be able to realize other worthwhile goals in these areas:

A. ***Property***

Existing property coverage for educational institutions presents unique challenges. Property insurers don't understand the needs or processes of education. Conflicts commonly arise over issues such as these:

Budgeting: A property carrier may demand that certain changes be made within 90 days. If the demand, though, covers an issue such as retrofitting existing dormitories with sprinklers, the college's budget process and occupancy schedules generally cannot operate on so short a timetable.

Coverage: Existing Business Interruption coverage is generally ill-suited to tuition and state-supported educational institutions.

Property valuation: Many campuses have one or two historic buildings, for which property coverage at restoration value may be more appropriate than replacement cost.

Varying deductibles by department: Different academic departments use different types of equipment. The biology department, for example, would need a low deductible on its expensive laboratory equipment that would have to be replaced out of its own budget. Equipment in the English Department is very different.

B. ***Auto***

Educational institutions buy auto coverage from commercial carriers, which don't understand their unique driving practices. These can include:

- Student and faculty drivers, as well as professional drivers
- Long-distance trips over short periods of time, for example when a sports team plays an away game
- Campus bus systems that may operate only on campus or in the wider community
- Large and small passenger vans for student activities
- Fleet and rental cars for administrators, recruiters, and other staff (including rentals overseas for foreign study programs)

Educational institutions engage in more diverse transportation activities than most other entities. Auto insurers are unaccustomed to the wide range of drivers and driving that most institutions have. Their understanding of, and responsiveness to, educational institutions are severely limited.

Risk management: Guidance from commercial property insurers may focus on some important areas such as housekeeping practices, but it does not address research issues, student bonfires, libraries and other campus-specific property risks.

3. The Future

An expansion of the Risk Retention Act that enables United Educators to provide fleet auto and property insurance to educational institutions would make that coverage more affordable, available, and responsive to their needs. With an annual member renewal rate of 95%, United Educators' members clearly value the existing products and services.

Advantages of the expansion into property and auto would include:

Coordinated training and claims management: Liability risks are closely linked to property and auto risks. One insurance company could provide coordinated in-depth training and coverage for all risks that encompass liability, auto, and property claims.

Pricing: Educational institutions would be judged on their own experience, so costs would not reflect extraneous factors. An RRG offering property coverage will support sharing the risks across institutions throughout the country.

Loss control: United Educators would provide guidance specific to institutions regarding, for example, helping colleges establish mutual aid agreements to help each re-open and serve students as quickly as possible following a natural disaster.

Commitment: United Educators makes a long-term commitment to its members. It works with them to reduce their losses and doesn't drop them simply because there has been a major property loss. As a member-owned company, UE is committed to helping educational institutions and the members are committed to supporting their investment in the RRG.

Combined knowledge: UE members benefit from one another's experience. The company serves as an information clearinghouse so one institution's experience can help another prevent a loss.

Support for the expansion of the Risk Retention Act

A wide range of consumer groups, insurance brokers, state insurance commissioners, real estate investment trusts (REITs), and RRGs representing public housing authorities, educational institutions and businesses support the expansion of the RRA. It is also a bipartisan effort.

Government Accountability Office Report on Risk Retention Groups

The Government Accountability Office ("GAO") issued a report in August, 2005 entitled *Risk Retention Groups: Common Regulatory Standards and Greater Member Protections Are Needed.* The GAO found that while "RRGs have had a small but important effect in increasing the availability and affordability of commercial liability insurance for certain groups," "widely varying state standards" and limited governance protections against potential conflicts of interest created the potential for problems in the industry.

Prompted by the GAO Report, the National Association of Insurance Commissioners ("NAIC") has undertaken a two-year process that has resulted in creation of corporate governance standards and requirements for the accreditation of the RRG states of domicile. While United Educators has none of the problems reflected in the GAO's concerns, we heartily endorse these proactive actions by the NAIC and, further, believe that any amendment to the LRRA expanding the scope of permissible insurance could include similar provisions or an affirmation of actions that have been taken at the state level.

Conclusion

The genius of Congress' enactment of the Liability Risk Retention Act is vividly demonstrated by the successes of United Educators and other Risk Retention Groups, including the Housing Authority Risk Retention Group, ALPS and Nonprofit's Insurance Alliance of California They have succeeded because Congress recognized that commercial insurance purchasers know better than anyone else their own risks and needs. In requiring that Risk Retention Groups be owned and controlled by their policyholders, Congress also assured that the operation of the groups would consistently be in the best interests of their members.

Risk Retention Groups can not solve all of the problems that exist in the property insurance market in America today. It is not a solution for homeowners and will not instantaneously provide coverage for all coastal institutions. Nevertheless, expansion of the Liability Risk Retention Act to include property and fleet auto insurance will create additional capacity to deal with natural catastrophes. Appropriate underwriting, capital and risk management will need to be put in place to ensure long-term viability.

Having successfully addressed the hazards of a hard liability market, risk retention groups, if given the opportunity, can be counted on to find the best path to confronting the same conditions in much needed property markets of 2007 and beyond.

Thank you very much for the opportunity to address the committee on this important issue.

STATEMENT OF CHARLES CHAMNESS
ON BEHALF OF
THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES
BEFORE THE
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
COMMITTEE ON FINANCIAL SERVICES

"PERSPECTIVES ON NATURAL DISASTER INSURANCE"

MARCH 27, 2007

Thank you for giving me the opportunity to submit this testimony. Founded in 1895, the National Association of Mutual Insurance Companies (NAMIC) is the nation's largest property and casualty insurance association, underwriting more than 40 percent ($178 billion) of the property/casualty insurance premium written in the United States. NAMIC is pleased that Chairman Waters, Ranking Member Biggert, and Members of the Subcommittee on Housing and Community Opportunity are making an effort to understand the nature of catastrophic risk, and the role that insurance industry and the federal government can and should play to better prepare for and manage future large-scale natural disasters.

Introduction

We view today's hearing as part of an important national conversation that has been taking place among policymakers, residential and commercial property owners, academic researchers, and representatives of the insurance, banking, and construction industries since the fall of 2005, when three major hurricanes—Katrina, Rita, and Wilma—struck the Gulf Coast, killing more than 1,400 people and costing more than $180 billion in insured losses and federal disaster relief. The fact that no major hurricane made landfall in the United States in 2006, despite predictions of a highly turbulent hurricane season in the North Atlantic Ocean, should not diminish our resolve to identify and implement measures to reduce the risks associated with natural disasters, and to more effectively manage the economic consequences of future disasters.

We believe that private insurance, reinsurance, and capital markets can and should serve as the predominant source of risk management for natural disasters. To be sure, a genuine mega-catastrophe comparable to the 1906 San Francisco earthquake, or a high-category hurricane striking heavily populated areas such as Miami, Houston, or New York City, could potentially exceed private market capacity. To prepare for a disaster of this magnitude, it is appropriate for policymakers to consider whether government programs should be created to supplement the supply of private sector capacity.

Last fall, in testimony before the Subcommittee on Capital Markets, Insurance and Government Sponsored Entities, I noted that such programs must be carefully designed to avoid undermining the private insurance market and distorting public perceptions of the

risk associated with living and doing business in disaster-prone areas. Since that time, the legislature and governor of the state with the highest concentration of disaster-related risk—Florida—have adopted a series of measures that will almost certainly create the perverse effects that I and others had warned of.

Recent Government Action Affecting Natural Disaster Insurance: The Florida Example

In a special legislative session held last January, Florida lawmakers removed restrictions on the ability of the Citizens Property Insurance Corporation—originally conceived as the state-run property "insurer of last resort"—to compete with private insurers, while canceling rate increases that had previously been approved to reduce the disparity between the level of risk assumed by Citizens and the relatively low premiums it charges.

Lawmakers also doubled the risk-bearing capacity of the Florida Hurricane Catastrophe Fund from $16 billion to $32 billion, thus ensuring that the state's disaster reinsurance mechanism will become the predominant reinsurer for public and private insurers doing business in Florida. Although there is currently only $1 billion in the fund, it now has a legislative mandate to assume a level of catastrophe risk exposure more than 30 times that amount. Thus, if even one major storm hits the state this year, all Florida insurance consumers—not just property insurance policyholders—will face huge assessments and significant tax increases. A highly critical editorial in the *Washington Post* noted that in their misguided attempt to artificially reduce the cost of property insurance, Florida lawmakers "not only are gambling with the state's fiscal future but are also giving people an incentive to keep putting themselves in harm's way."

The *Post's* second point is often overlooked in discussions of what some have termed the property insurance "affordability crisis" in disaster-prone areas. When policymakers pursue "reforms" aimed mainly at lowering premiums, they not only reduce the cost of insurance for current residents of these areas; they also remove a disincentive to further population growth and economic development in these areas. According to the U.S. Census Bureau, Florida will experience significant population growth every year between now and 2030, by which time the state will have added more than 11 million new residents. That is equivalent to the entire current population of Ohio moving to Florida over the next 23 years.

To those who stand to profit from continued growth and development in Florida, this is a good thing. But given the risk involved, is it wise public policy? Does it make sense to encourage massive numbers of Americans to migrate from regions with relatively little exposure to disaster-related risk to the state with the most frequent and severe hurricanes? Policymakers should bear these questions in mind when considering proposals to create a federal disaster reinsurance fund to backstop state-run insurance and reinsurance mechanisms such as Florida's.

Congress might also encourage the movement of people and wealth to the country's most disaster-prone regions if it were to enact a measure to add wind hazard to the coverage available to purchasers of flood insurance through the National Flood Insurance Program.

Through its chronic failure to charge risk-based premiums for flood insurance, the NFIP has operated for decades in a manner that is both fiscally unsound and environmentally irresponsible. While the proposed legislation would make wind coverage contingent on responsible land use planning and zoning by state and local governments, it is questionable whether the standards developed by FEMA will be sufficiently stringent, whether enforcement will be sufficiently vigorous, and whether the premiums charged for wind coverage will be sufficient to pass the test of true actuarial soundness. A National Flood Insurance Program that was expanded to include wind coverage would need to build up a very large loss reserve very quickly to avoid the under-reserving problem that has plagued the NFIP. Otherwise, the plan would amount to little more than a massive risk transfer from private insurers to federal taxpayers.

Political Impediments to Achieving Realistic Goals

The question lawmakers ought to be asking is, What mix of policies will maximize the private sector's ability to provide property insurance in disaster-prone areas while minimizing the risk associated with living and doing business in these areas? Broadly speaking, the answer lies in removing impediments to private sector participation in disaster risk management, creating incentives for property owners in disaster-prone areas to invest in risk mitigation measures, and recognizing that regardless of who pays, managing and financing disaster risk in an economically-advance country such as the United States is inherently very expensive, and will become exponentially more expensive as the exposure of people and wealth to catastrophe risk increases.

Here are some specific observations intended to guide the committee as it considers policy options for meeting the challenges outlined above:

- It is an unfortunate but undeniable fact that state lawmakers and/or regulators sometimes impose rating and underwriting restrictions on property insurers that allow high-risk property owners to pay artificially low premiums, forcing low-risk property owners to subsidize the insurance costs of high-risk buyers. In my view, using the insurance pricing mechanism to create hidden cross-subsidies among risk classes is deceptive and unfair. NAMIC believes that a flexible regulatory environment, in which insurers are free to price coverage based on risk, will create incentives for property owners in high-risk areas to invest in loss mitigation measures.

- As I suggested above, government-imposed rate suppression can have the effect of distorting public perceptions of risk. Federal and state governments must bear the cost of the economically irrational decisions that result by paying for disaster aid to repair properties that should not have been built in the first place. Risk-based insurance pricing alleviates this problem by sending accurate signals to consumers about the relative level of risk associated with particular regions and types of structures.

- Managing catastrophe risk in coastal areas is not simply an insurance availability and affordability problem. Numerous studies suggest that property owners as well as

government officials tend to underestimate catastrophe risk and fail to prepare adequately for natural disasters. Other studies point to public misconceptions about the nature and purpose of insurance; for example, many consumers view insurance as a financial investment rather than as a protective measure, so that those who purchase insurance and do not collect on their policies over a period of time feel that their premiums have been wasted, leading them to discontinue coverage.

- The use of the term "actuarially sound" in discussions of insurance price regulation often lacks precision and can therefore be misleading. There is a tendency to use the term to refer to prices that reflect only the expected value of future loss costs. It is important to understand that "actuarially sound" pricing for catastrophe-exposed coverages must also include compensation for the unusually large "call on capital" that is required to pay catastrophic losses. The call on capital that results from the large-scale losses typically associated with extreme events may well be several times greater than the total annual "expected loss" of the coverage. In other words, the term "actuarially sound" should be understood to include an adequate "risk load" that takes into account the call on capital, rather than just the insurer's expected loss costs and expenses based on yearly averages.

- It is important for lawmakers, judges and the general public to understand the cyclical nature of property insurer profits, how profits relate to surplus, and the role of surplus in ensuring that insurers are able to meet their contractual obligations to policyholders. Economists who use return on equity as the universal benchmark for measuring company profitability have found that property/casualty insurance is less profitable than most other industries.

- Finally, the nation's courts must preserve the sanctity of contracts. With respect to insurance contracts, this often means deferring to the authority of the state insurance regulator that approved the contract language as part of the rigorous "form filing" process that insurers must follow in all 50 states. Insurers who relied in good faith on the decision of a state insurance department that their policy language was clear and unambiguous must not ordered by a judge to pay claims for which the insurer collected no premiums simply because, in the court's view, the insurance department erred in approving the contract language. If trial lawyers or others succeed in retroactively rewriting insurance contracts because of the supposed "ambiguity" in contract language that was approved by insurance regulators, they will have introduced a degree of legal capriciousness that will undermine the predictability upon which a healthy insurance system is based.

These observations aside, we believe there are several measures that Congress should consider immediately to address certain problems associated with natural disaster risk management and insurance.

Policy Proposals that Deserve Consideration

- NAMIC supports federal legislation that would create financial incentives to encourage states to adopt and enforce strong, statewide building codes. Strong building codes as well as responsible land-use planning have been shown to greatly reduce the level of property damage and human suffering caused by natural disasters. With respect to existing properties, we support government initiatives to create mitigation grant programs to enable homeowners in high-risk areas to invest in risk mitigation measures.

- We support the concept of amending the federal tax code to allow insurers to set aside a portion of premium income in tax-exempt policyholder disaster protection funds. We also support the concept of allowing homeowners to create tax-free catastrophic savings accounts similar to health savings accounts which could be used to pay hurricane deductibles and costs associated with retrofitting properties.

- A market-based insurance pricing system in which premiums reflect the actual cost of insuring against catastrophic risk could result in significant premium increases for some property owners in high-risk regions. Policymakers should therefore consider creating programs to provide direct government assistance, funded from general revenue, to low-income and other groups according to criteria established by the unit of government providing assistance. However, in designing such programs, care must be taken to avoid reducing incentives to mitigate risk.

- The National Flood Insurance Program should be subject to substantial reform. The current method for setting premiums, which is based on average annual losses, has been called "unsustainable" by the Congressional Budget Office. This approach has prevented the NFIP from accumulating the surplus necessary to pay claims during periods when loss costs are above average. We also support stiffer penalties to be imposed on financial institutions that either fail to require flood insurance coverage for mortgages on properties in flood-prone areas, or allow the policies to lapse. Greater effort should be made to ensure that more people are aware of the program and the benefits of having flood insurance coverage to protect their properties.

In conclusion, NAMIC realizes that property owners, insurers, mortgage lenders, realtors, and home builders that live and do business in catastrophe-prone areas will face serious challenges in the years ahead. We believe that the most effective mechanism for addressing these challenges is a private insurance market whose defining characteristics are open competition and pricing freedom. Congress can play a constructive role by reforming the National Flood Insurance Program, offering tax incentives for companies to reserve funds for future disasters, and providing incentives for states to enact and enforce effective statewide building codes.

Thank you for giving me the opportunity to submit this testimony on an issue of vital importance to NAMIC member companies and the U.S economy. I look forward to working with you to help consumers in disaster-prone areas meet the challenges involved in effectively managing the risk of natural catastrophes.

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