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APPROACHES TO MITIGATING AND MANAGING NATURAL CATASTROPHE RISK: H.R. 2555, THE HOMEOWNERS' DEFENSE ACT

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND
COMMUNITY OPPORTUNITY

AND THE

SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE, AND
GOVERNMENT SPONSORED ENTERPRISES

OF THE

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APPROACHES TO MITIGATING AND MANAGING NATURAL CATASTROPHE RISK: H.R. 2555, THE HOMEOWNERS' DEFENSE ACT

Wednesday, March 10, 2010

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND
COMMUNITY OPPORTUNITY, AND
SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE, AND GOVERNMENT
SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittees met, pursuant to notice, at 2:23 p.m., in room 2128, Rayburn House Office Building, Hon. Paul E. Kanjorski [chairman of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises] presiding.

Members present: Representatives Kanjorski, Waters, Sherman, McCarthy of New York, Baca, Green, Cleaver, Klein, Foster, Carson, Adler; Bachus, Royce, Manzullo, Biggert, Capito, Hensarling, Garrett, Campbell, Putnam, Posey, and Jenkins.

Chairman KANJORSKI. This joint hearing of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises and the Subcommittee on Housing and Community Opportunity will come to order. I yield myself 4 minutes for the purpose of making an opening statement.

I would like to thank Chairwoman Waters, our ranking members, other members of our two subcommittees, and our invited witnesses for joining us today for this hearing to explore approaches to mitigating and managing natural catastrophe risk and to examine H.R. 2555, the Homeowners' Defense Act.

Introduced by Congressman Klein of Florida, H.R. 2555 tackles the complex issue of how to address the growing problem of the availability and affordability of homeowners' insurance around the country in the wake of ever-bigger natural catastrophes. This hearing represents the second time our subcommittees have met to consider a version of this bill. Last year, the Oversight Subcommittee also reviewed these matters.

Natural catastrophes can produce devastating effects for the affected people and communities. Within our hemisphere, we most recently experienced considerable damage as a result of earthquakes in Haiti and Chile. We also know that such earthquakes could, at any time, strike the United States.

In addition to earthquakes, hurricanes are another form of natural catastrophe that threatens American citizens and businesses, and which could lead to severe losses and sizeable rebuilding costs. In Northeastern Pennsylvania in 1972, Hurricane Agnes ruined more than 25,000 homes, damaged nearly 3,000 businesses, and destroyed 5 major bridges. At the time, then-President Richard Nixon called the event, "the greatest natural disaster in U.S. history."

Since then, Americans have experienced even greater natural catastrophes, which have cost the Federal Government billions of dollars. The Government Accountability Office estimates that the Federal Government, in response to the Gulf Coast storms of 2005—Hurricanes Katrina, Rita, and Wilma—made about $26 billion available to homeowners who lacked adequate insurance. Even with this aid, many of the affected communities are still struggling to rebuild.

In constructing any program to mitigate the structural and financial damages that natural catastrophes can cause, we need to ensure that those who benefit bear the costs. The approach taken in Mr. Klein's bill aims to do just that.

Specifically, the consortium proposed in the legislation would encourage States with insurance funds to voluntarily pool their exposures and cede the risk to the capital markets. I look forward to learning more about the increased role our capital markets can play in covering the insured losses of natural disasters. To the greatest extent possible, we should maximize the risk-bearing capacity of the private sector before calling on the government to assist.

H.R. 2555 would also provide a Federal guarantee on the debt issued through the consortium. While the guarantee approach is slightly different than the loan program proposed in similar legislation 2 years ago, the U.S. Treasury is still entitled to recover any payments it makes. Thus, the bill aims to protect taxpayers.

Mr. Klein's legislation also includes a Federal reinsurance fund structured to provide capacity above and beyond private market reinsurance. Lastly, but very importantly, the legislation includes a grant program to help develop, enhance, and maintain programs to prevent and mitigate losses from natural catastrophes. I view these mitigation reforms as a key part of the bill. The implementation of effective mitigation plans will help to lower long-term costs.

In sum, proper planning—both structurally and financially—can help to lessen the devastation caused by natural catastrophes. It is in this spirit that Mr. Klein has put forth his important legislation. Questions have been raised about the need, cost, and potential success of these programs. I look forward to a productive debate on these matters.

I would now like to recognize Ms. Capito of West Virginia for her opening statement.

Mrs. CAPITO. Thank you, Mr. Chairman. And I would like to thank Chairwoman Waters and Chairman Kanjorski for holding this joint Housing Subcommittee and Capital Markets Subcommittee hearing.

The legislation before us today is not new. This committee has debated this issue for the past two Congresses, and there is by no means a consensus that this is the best approach to address the

availability and affordability of catastrophe insurance for residential property owners in Florida as well as in other States faced with risk management challenges presented by major hurricanes and other potentially catastrophic natural disaster threats.

The Homeowners' Defense Act creates new Federal programs to guarantee the catastrophe—I am having trouble with that word—catastrophe debt obligations issued by eligible State catastrophe insurance programs, offer reinsurance coverage to eligible State catastrophe insurance programs, and provide for mitigation grants to State and local governments. These programs would be established by the Treasury and the Department of Housing and Urban Development.

Before we obligate the United States to hundreds of billions of dollars of potential liabilities, we should first have a better understanding of the current marketplace and the need for this legislation. And the chairman alluded to this in his opening statement.

Many States and private markets can already address the concerns brought forth by this legislation. For example, risks are already spread globally through the reinsurance marketplace, and States have struggled with how to balance risks more narrowly among a smaller number of participants.

Furthermore, States already can and do purchase reinsurance and sell catastrophe bonds through their risk pools and funds. Finally, if there is an implicit Federal guarantee or assumption of risk, this legislation would create a massive potential exposure for the taxpayer.

It is important to note that opposition to this legislation spans a wide spectrum, including private industry, taxpayer advocates, and environmental groups. These entities raise legitimate concerns about the effect this legislation will have on the ability of private markets to function efficiently, the environmental impact on coastal areas, and most important, the risk passed to the taxpayer.

I look forward to hearing from our witnesses today. And again, I would like to thank Chairwoman Waters and Chairman Kanjorski for holding this hearing.

Chairman KANJORSKI. Thank you very much.

We will now hear from Mr. Klein for 4 minutes.

Mr. KLEIN. Thank you, Mr. Chairman. I thank the chairman, the ranking member, and all the others who have made this hearing possible today. This is a chance to hear from many people on this committee as well as the experts in the field, and the American people as well.

Reducing the skyrocketing cost of homeowners' insurance is one of my top priorities, and I appreciate this committee's work to stand up for families and other owners of property who have to deal with what has become a major cost of homeownership.

It has been more than 15 years since Hurricane Andrew crashed into south Florida, but homeowners are still feeling its impact, not only in Florida, but other places as well. Since that storm, my constituents have seen their insurance premiums increase dramatically every summer, storm or no storm.

As too many Florida homeowners know firsthand, some insurance companies cherry-pick their customers and their risk, refusing

to write policies or limiting the scope of coverage. That is simply wrong, and the time for change is now.

Yet this issue clearly extends far beyond the borders of the State of Florida. An alarming number of families across the country have also had their homeowners' insurance coverage dropped or are currently slated for nonrenewal by their insurance company, including homeowners in Massachusetts, New York, North Carolina, South Carolina, Alabama, and Texas. In Delaware, New Jersey, and Connecticut, in some cases, property insurance companies have stopped writing new policies for residents.

When families are priced out of the market, they face enormous risk. In earthquake-prone California, 88 percent—88 percent—of homeowners have no earthquake insurance at all. Increasingly, insurance companies are treating homeowners across the country like they have been treating Floridians for years, canceling policies and doubling or tripling rates in the wake of a single claim.

That is why I have worked with my colleagues, Democrats and Republicans alike, to address and craft a common-sense solution that works for Americans in every corner of the country. Through a lot of hard work, we have built a coalition that includes more than 70 cosponsoring Members representing over 30 States, coming together to fight for a solution that works for families in each of our diverse districts.

Our legislation, the Homeowners' Defense Act, harnesses the power of the private market to pool the risk of all kinds of natural disasters, from hurricanes to earthquakes, wildfires, winter storms, tornadoes, and more.

For millions of Americans, the question of a natural disaster hitting their home is not a question of if, but when. By spreading the risk, we can make sure that insurance is working like it is supposed to do, to bring down costs for homeowners across the country and still allow insurance companies to have a reasonable return on their investment.

With this legislation, we take a proactive approach that allows States to responsibly plan for disasters ahead of time—and I am sure our witnesses will talk about that—while encouraging strong mitigation, which I also believe is important, to minimize the cost of natural disasters. By planning ahead, States can reduce their losses and get homeowners back on their feet as quickly as possible following a disaster.

It is also very important to note that our program is completely voluntary. Once we have set up the pool to spread the risk, States make the choice whether they want to participate or not. If you don't participate, no responsibility, no involvement in your insurance policy. States are free to join the pool or not depending on what is best for each of them individually.

The reason our bill is so urgently needed and that it is so strongly supported by disaster experts, senior citizens, and families is that unfortunately, in many parts of the country, the system is broken. As things now stand, natural disasters, no matter where they happen, impact Americans in all 50 States. Ask taxpayers.

Cleanup in the aftermath of Hurricane Katrina cost American taxpayers nationwide—every single one of us—a total of nearly $100 billion. These days, you can't pick up a newspaper or turn on

the TV without seeing scenes from the most recent natural disaster.

The current system is nothing more than a constant cycle of bailouts at taxpayers' expense. I won't personally—as I think many others won't—stand for it any more. I believe it is time to focus on local responsibility and let the private market do the heavy lifting rather than the taxpayers.

I want to stress that this strategy is a private market solution. Although it has become clear in recent weeks that big offshore insurance companies who oppose this bill in many ways are saying lots of different things which are misleading the debate here, I am here to set the record straight. I believe strongly in the power of the free market, and we have no intent to eliminate or subvert the insurance industry.

The fact of the matter is in many parts of the country, the homeowners' insurance market right now is not working. People have been paying premiums for 20 years; they make one claim, see their rates shoot up, or they are canceled. This is why this legislation is so important at this time.

So in conclusion, I would just like to say, Mr. Chairman, that I think that this committee has come together at a crucial moment. This bill did pass in a similar form a year and a half ago, with overwhelming bipartisan support. At that time, President Bush did not support it. He felt that the market somehow would figure this out. It has not, as we expected. So we are now in the position of having the opportunity to bring smart minds together from all walks of life—and I certainly welcome everybody's perspectives—to make sure we have a bill that will accomplish this goal.

A common-sense solution like the Homeowners' Defense Act will bring real relief to American families, provide structure to the insurance market, and be a key part of a broader economic recovery. And I thank the chairman.

Chairman KANJORSKI. Thank you very much, Mr. Klein.

We will now hear from the gentleman from New Jersey, Mr. Garrett.

Mr. GARRETT. I thank the Chair, and I thank the sponsor of the bill for trying to address this important issue. But I must respectfully disagree with the approach.

At first blush, I believe that the underlying legislation, quite candidly, will not solve the major problem of trying to manage natural catastrophic risk but, rather, really could exacerbate the problem that we face today.

This legislation also potentially will create additional moral hazard for people to build and live in these catastrophe-prone areas, and subsidize risky homeowners by—well, how does it do that? Reallocating and spreading the risk to less risky taxpayers.

When you think about it, we sort of see the same thing going on right now with the cross-subsidy in the National Flood Insurance Program. There you have people who are paying higher rates on flood insurance, basically to cover the losses sustained by those living in the high-risk area.

I would also point out I am a little bit disappointed that Chairman Frank would endorse this legislation, considering the good bipartisan efforts we have made in the past in trying to phase out

these types of subsidies within the Flood Insurance Program. But here we do the opposite.

I know the coalition of supporters of this legislation have made a really good attempt to try to frame the debate as a nationwide debate. It is really a debate, basically, about Florida and, to a lesser extent, California. Florida citizens currently have an underfunded disaster insurance liability of around $20 billion. California needs about $5 billion for earthquake protection. And conveniently, the legislation before us allows for multi-peril coverage for $20 billion, and earthquake coverage for $5 billion. Coincidence? Maybe not.

So it seems to me that every day—I know they wouldn't say this is a bailout, but every day, we seem to wake up in this country to someone else getting bailed out. First, it was the banks. Then, it was irresponsible homeowners. Then, it was Fannie Mae and Freddie Mac. Then, it was the unions. Then, it was the States. And just earlier this week, we heard reports that the entire European continent is now planning one massive bailout for European countries.

I heard someone suggest that perhaps what is going on here is we are going to come to the day when the Federal Government is going to need a bailout. And when that happens, perhaps Chairman Frank will have to rethink his efforts and his opposition to the space program, as we may need some other planet to come back here and to help bail out this country and this Earth.

But more to the point. The main reason that we are in this situation is because the governor and a number of elected officials in Florida have not had the political will to charge actuarial rates on residents living in these disaster-prone areas.

Now, I have heard some make the argument that we need to do this because, well, the Federal Government is on the hook anyway, and we will wind up footing the bill when disasters inevitably come. But I respectfully disagree.

In most cases, the Federal Government picks up the tab on infrastructure and other related costs, but not specifically on the homeowners' insurance policies. An example that Director Witt highlights in his testimony, the $10 billion that went to homeowners in Katrina, well, that really happened in large part because of the mistakes by the Federal Government with their own mitigation programs, not building the levees in the correct way.

So this idea that the Federal Government needs to add this burden now to prevent it from more later is really a red herring. There are many other positive solutions to this problem, such as further increased mitigation efforts and additional regulatory reform. And I believe that Mr. Ellis is going to discuss the South Carolina and the Virginia way to handle this situation much better and more responsibly than perhaps Florida has.

So in the end, I will conclude by saying I think it is a safe bet that we should be addressing these issues, and we can come up with solutions to the problems. And I do look forward to ways to try to tackle these problems of mitigation and managing natural disaster risk.

With that, I yield back.

Chairman KANJORSKI. Thank you very much, Mr. Garrett.

Now we will hear from the gentlelady from California, Ms. Waters.

Chairwoman WATERS. Thank you, Chairman Kanjorski, for joining me for this joint hearing on approaches to mitigating and managing natural catastrophe risk, H.R. 2555, the Homeowners' Defense Act. I am delighted to see all of our panelists here today.

But I am especially pleased to see Mr. James Lee Witt, former Director of FEMA, who will be testifying here today. I had the opportunity to work with him on one of the biggest earthquakes we had in California. He did such a magnificent job, I am sure he is able to share with us a lot of information that will be helpful to us.

In the wake of Hurricane Andrew almost 18 years ago, 11 insurers became insolvent and another 63 announced plans to withdraw or limit their insurance-writing ability in the State. But the costs associated with Hurricane Andrew pale in comparison to those of the 2005 hurricanes, Katrina, Rita, and Wilma. Insured losses from those storms total over $56 billion.

Although only one insurer became insolvent as a result of paying claims resulting from those storms, following Katrina, some insurers began pulling out of areas along the Gulf Coast. Those who haven't left yet have raised rates on homeowners, with some families seeing a 600 percent increase in their insurance premiums. In the meantime, the capacity of wind and earthquake insurance companies has declined by 61 percent and 22 percent, respectively.

As we all know, much work is still needed to rebuild the Gulf Coast. However, without affordable and available homeowners' insurance, many families will either never return to this region or will risk losing everything in another storm.

The bill introduced by Mr. Klein seeks to address the reinsurance crisis facing the Nation's insurers by creating a consortium to encourage risk transfer into the capital markets, a new Federal reinsurance program for State catastrophe funds, and allowing the Federal Government to guarantee loans to State catastrophe insurance programs.

I am especially interested in how this bill would increase the availability of earthquake insurance. The California Earthquake Authority, CEA, is the sole provider of earthquake insurance in the State of California. However, only 12 percent of Californians have earthquake insurance.

Moreover, since its inception 11 years ago, CEA has been unable to accumulate the amount of capital it projects it will need in the event of catastrophic earthquake. I am looking forward to hearing Mr. Pomeroy's testimony on how this legislation will allow the CEA to reduce its claims-paying costs and accumulate more capital.

Thank you, Mr. Chairman, and I yield back the balance of my time.

Chairman KANJORSKI. Thank you very much, Ms. Waters.

And now, we will hear from the gentleman from Texas, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman.

By any honest accounting standards, the President's push on his health care agenda is going to cost the Nation $2 trillion. Already,

the President has submitted to us a budget which will double the national debt in 5 years, and triple it in 10 years.

According to the latest Congressional Budget Office baseline, at the end of the 10-year budget window, our Nation will be paying $916 billion a year, over $8,000 per household, in interest alone on the national debt. Half of our national debt is now owned by foreign interests, mainly China.

When you look at our Nation's spending patterns, it has caused Congressional Budget Director Elmendorf to state, "The outlook for the Federal budget is bleak. U.S. fiscal policy is on an unsustainable path." Economist Robert Samuelson says this spending could "trigger an economic and political death spiral."

Former Comptroller General David Walker has said that our spending patterns represent a "fiscal cancer that threatens catastrophic consequences for our country." And we recently read where Moody's has announced that America's bond offerings may soon lose their AAA rating.

On top of that, we now have H.R. 2555, which creates new Federal guarantees, a new Federal reinsurance program, and a new Federal grant program: Title 1 authorizes $100 million for a national catastrophic risk consortium; Title 2, $25 billion for catastrophic obligation guarantees to the States; Title 3, up to $200 billion for reinsurance coverage to eligible State programs; and Title 4, $75 million for a mitigation grant program.

I ask the question: How much more money are we going to borrow from the Chinese and send the bill to our children and our grandchildren?

This bill simply represents a bad idea whose time has not come. Our Nation is currently on the road to bankruptcy. If we do not change our spending ways, then we are looking at a massive tax increase, up to 60 percent by the end of this decade, which will crush jobs, or massive inflation, which will make us look longingly and nostalgically upon the Carter era.

I know there are those who maintain that the taxpayer has nothing to lose. But we heard these same voices about Fannie and Freddie. And now, over a trillion dollars of taxpayer exposure later, we know how wrong those opinions were.

We have gone from bank bailouts to beach condo bailouts. What is next? And I haven't even mentioned the wisdom or the fairness of forcing my constituents in Dallas to subsidize someone else's constituents in Daytona.

In a free society, how people choose to risk their money is their business. How they choose to risk the taxpayer money is my business. H.R. 2555 is unwise, unfair, and unaffordable.

I yield back the balance of my time.

Chairman KANJORSKI. The gentleman from Texas, Mr. Green, is recognized.

Mr. GREEN. Thank you, Mr. Chairman. I thank the chairwoman of the Subcommittee on Housing, Chairwoman Waters, and I also thank Ranking Member Capito.

In response to something that was said about the chairman of the full committee, Chairman Frank, it is no secret that he is not shy when it comes to expressing his opinion. It is also equally as true that he will listen to others, and while he may not agree, he

does allow differing opinions to be heard. And I salute the chairman for his willingness to hear from other persons.

With reference to the statement about the amount of money, the $3 trillion, CBO seems to differ with the $3 trillion estimate that was called to our attention. There may be many who are reviewing these numbers, but CBO seems to be the gold standard that we all rely on and refer to. And their number is decidedly different from the $3 trillion number that was called to our attention.

With reference to Title 1 of the Homeowners' Defense Act, it is voluntary. I think it is important to note that it is voluntary, that States may or may not participate. Usually, States will do what is in their best interest. If it does not benefit a given State, then the people of that State will not participate. If it does, then it bodes well for what we are trying to accomplish, and the people do participate.

I think it is worth our consideration. I look forward to hearing from the witnesses. I believe that this consortium, a national catastrophic risk consortium, is something worthy of review. I look forward to hearing the witnesses, and I yield back the balance of my time.

Chairman KANJORSKI. Thank you very much, Mr. Green.

We will now hear from the gentleman from California, Mr. Campbell.

Mr. CAMPBELL. Thank you, Mr. Chairman.

As has been mentioned, after Katrina, the Federal taxpayer sent tens of billions of dollars to help reconstruct things in Louisiana. Whether it is a hurricane, an earthquake, a tsunami, as we have heard about recently, tornado, flood, land subsidence, whatever—if a similar natural disaster hit any of our States here, does any of us reasonably believe that we are not going to come here to the Federal Government and say, "You helped out Louisiana; help us out, too."

Of course, we are. But that is not the best way to finance this stuff. That is not the best way to deal with this. And as has also been mentioned, only 12 percent of homeowners in California have earthquake insurance, and it is less than that for businesses. Why? In part, because everyone expects the Federal Government will come bail them out because, look, they did it over there.

What this bill attempts to do is to replace that very broken, wrong way of dealing with natural disasters and enable a government-supported and assisted, yes, but private insurance market so that people can have private insurance for these things. We can build up insurance around the States.

Now, I know some people have problems, as has been expressed, with the specific mechanisms used in this bill. Fine. Let's debate those. But we need something other than what we have because this is just not going to work, either for the taxpayer or for homeowners and residents.

Thank you. I yield back.

Chairman KANJORSKI. Thank you very much, Mr. Campbell.

We will now hear from Mr. Posey.

Mr. POSEY. Thank you, Mr. Chairman. I would like to echo the comments of my colleague from California and express my appre-

ciation to my colleague from Florida for bringing forth this legislation.

Whether people know it or not, or whether they like it or not, major parts of nearly every State are merely one natural disaster away from catastrophe. And you can sit around and do nothing and bury your head in the sand, and wait for that to happen, and then come crying to the Federal Government for help; or you can try and be a little bit forward-thinking, as the proponent of this bill has done, and explore ways to prepare better for the future.

This concept has worked in many States, to the salvation of homeowners and some insurance companies. This is not perfect yet. It is not ripe. But we will never find the perfect solution if we don't take the time and give the necessary attention to exploring the various options that are out there.

Sadly, a lot of people, based on the comments I have heard, do not understand the concept of reinsurance. And maybe when they find out a little bit more about it, they will be supportive.

Thank you.

Chairman KANJORSKI. Thank you very much, Mr. Posey.

Are there any other members of the committee who seek recognition for an opening statement? The Chair seeing none—oh, I am sorry, Mrs. Biggert.

Mrs. BIGGERT. Mr. Chairman, I don't have an opening statement. But I would like to submit several statements from groups for inclusion in the hearing record: the National Wildlife Federation; an environmental groups joint letter; SmarterSafer; Cincinnati Insurance; RIAA; PCI/AIA; fiscal conservative groups joint letter; and NAMIC.

Chairman KANJORSKI. Without objection, it is so ordered.

I am pleased to welcome our distinguished panel here today. We want to thank you all for appearing before the subcommittee. Without objection, your written statements will be made a part of the record.

You will now each be recognized for a 5-minute summary of your testimony. Our first witness—I introduce him actually with pride because I had the experience of working with Mr. Witt on several occasions in several Administrations, and if all Federal leaders and managers were of his capacity, we would have a perfectly functioning government.

So Mr. Witt, we welcome you here as a former Director of the Federal Emergency Management Agency and on behalf of ProtectingAmerica.org.

Mr. Witt?

STATEMENT OF JAMES LEE WITT, FORMER DIRECTOR OF THE FEDERAL EMERGENCY MANAGEMENT AGENCY, ON BEHALF OF PROTECTINGAMERICA.ORG

Mr. WITT. Thank you, Mr. Chairman. Mr. Chairman and members of the subcommittees, I want to thank you for the opportunity to appear before you today to discuss ways to better prepare and protect American families from the devastation caused by natural disasters.

Congressman Klein, I also want to thank you for your leadership on this very important issue.

I was honored to serve as the Director of FEMA under the Clinton Administration from 1993 to 2001. Today, I will speak on these issues in my capacity as the co-chairman of ProtectingAmerica.org.

ProtectingAmerica.org is an organization formed in 2005 to raise national awareness about the important responsibilities we all have to prepare and protect consumers, families, and communities from natural catastrophes. My fellow co-chairman is Admiral James Loy, former Deputy Secretary of Homeland Security and Commandant of the U.S. Coast Guard (Retired).

Together, we have built a coalition and a campaign to create a comprehensive, integrated 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, and save money and lives.

There are over 300 organizations in our coalition, including the American Red Cross, the International Association of Fire Fighters, State Farm, Allstate, municipalities, small businesses, Fortune 100 companies, and more than 20,000 individual members. The membership is truly broad, diverse, and representative of virtually every State in the union.

We all believe that this hearing is timely. With headlines around the world relaying stories from recent tragedies in both Haiti and Chile, and on Monday in Turkey, many here at home are taking a harder look at whether or not we would be prepared if a similar catastrophic event were to happen in the United States.

A catastrophic event, whether an earthquake striking one of our great American cities, a massive hurricane making landfall near any of the metropolitan areas from New York to Houston, a wildfire spreading quickly through the western States, or a twister tearing through Tornado Alley, would cause such damage that our economy would be stunned, private resources quickly depleted, and an immediate Federal bailout of hundreds of billions of dollars could potentially be required. As a result, they would be far better served by a program that uses private insurance dollars to pre-fund coverage for the eventuality of a catastrophic natural event.

I believe that there are three key points critical to any comprehensive solution to a homeowners' insurance crisis.

First, a national reinsurance program will generate additional capacity, bring more stability to the market, make higher-quality insurance more available, and ensure that consumers realize significant cost savings on their homeowners' insurance. The best way to accomplish this is to enable and encourage more States to create well-structured, actuarially sound catastrophe funds to supplement the protection offered by the current State catastrophe programs in California and Florida.

Second, catastrophe obligation guarantees will provide helpful support to the debt issuance of State programs that could serve these programs well in distressed market conditions.

Finally, we believe that a hybrid approach to the prevention and mitigation provisions is important. This approach would keep the program under the Department of Housing and Urban Development, but incorporate a privately financed national catastrophe

fund that provides significant investment income to groups like the Red Cross and others.

Stated simply, the status quo is not acceptable. A 2009 report by Jonathan Orszag, an economist who formerly served on President Clinton's National Economic Council, found that the current system for post-catastrophe financial preparedness is riddled with inefficiencies, and there is a significant gap between the ability of the private insurance and reinsurance sectors to provide the protection that is required.

Specifically, Mr. Orszag found that the current system is an ad hoc, backward-looking program that makes the government and the taxpayers essentially the insurers of last resort. Further, his report suggests that a better approach would be one that not only ensures that resources are available to fund recovery, but also funds prevention, mitigation, and preparedness.

To that end, we support a comprehensive, integrated plan linking the national catastrophe fund with support to first responders, as well as strong education and mitigation provisions. A national catastrophe fund will create a privately financed, federally administered layer of reinsurance to complement and stabilize the private market reinsurance alternatives, and ensure greater availability and affordability for consumers of residential property insurance.

And let me close with this. The 8 years that I was Director of FEMA, 1993 to 2001, based on a 5-year average less the Northridge Earthquake—at that time one of the costliest disasters we had—the average cost was $3 billion a year in disaster supplemental recovery efforts. And that cost has escalated tenfold from those 8 years.

There are people for whom insurance is not available and not affordable, or who are underinsured. With these conditions, it will be a bailout every time one of these events happens. We have to make insurance available and affordable if we expect communities to recover and to replace the things that they worked all their lives for, and help their economies recover faster.

So I thank you, and any questions you may have, I will be happy to answer.

[The prepared statement of Mr. Witt can be found on page 73 of the appendix.]

Mr. KLEIN. [presiding] Thank you, Mr. Witt. We appreciate your leadership on behalf of FEMA, and you have been a great resource in the consideration of this issue, most particularly as understanding the before, the during, and the after, which is a comprehensive approach here.

Our next witness: We would like to invite Mr. Glen Pomeroy, chief executive officer of the California Earthquake Authority, to share with us your thoughts.

Mr. Pomeroy?

STATEMENT OF GLENN POMEROY, CHIEF EXECUTIVE OFFICER, CALIFORNIA EARTHQUAKE AUTHORITY (CEA)

Mr. POMEROY. Thank you very much, Congressman Klein, and subcommittee members.

On a Monday morning in January 1994, the Northridge earthquake struck southern California. Many lives were lost, and homes

and businesses were destroyed. It remains one of the most expensive natural disasters in our Nation's history.

In its wake, most private insurers were desperate to shed their California earthquake exposure, but State law still required them to offer it as long as they were selecting homeowners' policies in the State. So most companies stopped writing homeowners' insurance altogether, and California had a crisis on its hands.

That is when the State created the California Earthquake Authority, a publicly managed, privately financed, not-for-profit enterprise with the public purpose of making earthquake insurance broadly available.

So, fast-forward 14 years. Today, the CEA insures over 800,000 homes. We are the largest earthquake writer in the United States, and one of the largest in the world. But even though we know another Northridge-sized event will strike within 30 years, only about 12 percent of California homes have earthquake insurance.

Some may be hoping that the next "Big One" will miss their home, or that the Federal Government will help them rebuild and recover following a disaster. We know that there are many others who believe they simply cannot afford earthquake insurance, especially given its high cost and high-deductible structure.

After almost 14 years in this business, and knowing that seven out of eight California homes have no quake insurance, it is in the interest of everyone—the homeowners in harm's way and the taxpayers of our State and our Nation—to find a way for more Californians to be able to insure their homes. Otherwise, families and communities will not recover when the "Big One" happens.

Government aid can't be the only solution, and no one should have to surrender their home to foreclosure. The reality is this: We are hitting a brick wall in insuring more people because we depend too much on expensive reinsurance.

Reinsurance makes up only one-third of our claim-paying capacity, but it is two-thirds of our overall expenses. Forty percent of every premium dollar we collect goes right out the door as reinsurance premium, paid to reinsurers in Europe and London and Bermuda. Since 1996, we have paid $2.6 billion for reinsurance, and we have made reinsurance claims of $250,000. And despite that history, our reinsurance rates shot up 15 percent last year.

It is time for CEA financing to become more efficient, and in the process, less dependent on expensive reinsurance. Title 2 of H.R. 2555 is an innovative tool that will allow us to do just that, and we are grateful to Congressman Klein for including this provision in the bill.

It is not a bailout. It is not a giveaway. It is not an expensive government program. It is none of those. In fact, Title 2 simply provides a limited Federal guarantee so qualified, creditworthy State programs like the CEA have guaranteed access to private debt markets.

This year, CEA will spend $224 million on reinsurance. With the Title 2 guarantee, we could save about $150 million each year, and we would pass these savings directly to our policyholders by cutting rates and slashing deductibles. We will still use reinsurance in the structure, just less of it.

And we will maintain our financial strength to handle anything Mother Nature may throw in our way. Lower prices, better products, more choices—with those ingredients, we think we can double our policyholder count in 5 years.

We are not seeking to push off our risk on others. Just the opposite: We want to manage our capacity better and more efficiently, continue to rate the risks appropriately, and ask Californians to bear the risk of loss from California earthquakes.

There is a less than 1 percent chance we will need to borrow using the guarantee. But in an event such a magnitude happens and we do need to borrow money in the private debt markets, we will repay that debt from premium income going forward.

We believe, based on discussions between CBO staff and a Senate sponsor of a similar measure, that the CBO score of this approach will be minimal, perhaps as low as $25 million over 10 years.

And so the bottom line is this. Today, we ask the CEA policyholders every year to pay in full for huge events that almost never happen. There is a better way. Finance a structure using our capital and financial tools like reinsurance in reasonable amounts for the ready funds to pay for all the more expected events, and use the powerful certainty that if that huge and unlikely event occurs, we would have guaranteed access to the private debt markets to ensure that we could pay all policyholder claims.

Ending our overdependence on expenditure reinsurance means that more Californians can get the protection they need. And they won't have to pay in advance over and over again for that mega-catastrophe California has never experienced.

Title 2 of this bill is a new approach. It will be effective, and it can be a real game-changer. But we need your help, and we thank you for your consideration.

[The prepared statement of Mr. Pomeroy can be found on page 60 of the appendix.]

Mr. KLEIN. Thank you very much, Mr. Pomeroy. I appreciate your involvement today, and your experience in this.

Our third witness is Mr. Steve Ellis, vice president of Taxpayers for Common Sense.

Mr. Ellis, please proceed.

STATEMENT OF STEVE ELLIS, VICE PRESIDENT, TAXPAYERS FOR COMMON SENSE

Mr. ELLIS. Thank you very much. Good afternoon, Congressman Klein, Ranking Member Garrett, and members of the subcommittees. Thank you for inviting me to testify. I am Steve Ellis, vice president of Taxpayers for Common Sense, a national, nonpartisan budget watchdog.

Unfortunately, Taxpayers for Common Sense believes H.R. 2555 is fundamentally flawed, and strongly opposes the legislation. The bill would actually end up putting taxpayers at risk, and subsidizing people to live in harm's way. Americans across the country would be forced to pay for a narrow bailout that primarily helps the well-off. It doesn't make sense.

We are joined in our opposition by SmarterSafer.org; Allied Groups, which run the gamut from American Rivers to Americans

for Prosperity; the National Association of Professional Insurance Agents; and the National Wildlife Federation.

The breadth and depth of the taxpayer, environmental, and industry groups opposed underscores the broad-based concerns with H.R. 2555. Much of the argument for the programs under the bill relies on a "pay me now or pay me later" approach. Essentially, by providing reinsurance and debt guarantees, taxpayers will avoid fiscally messy and expensive bailouts of State programs in the aftermath of large disasters.

Unfortunately, we have heard that seductive siren song before with the National Flood Insurance Program. Cheap Federal flood insurance helped fuel the coastal development boom. Although intended to provide only limited, short-term subsidies and encourage responsible construction, it actually served to increase subsidies.

Today, a program that takes in roughly $2 billion in premiums annually is $20 billion in debt to the taxpayer. It is extremely likely that most, if not all, of that debt will be forgiven.

We walked down that primrose path decades ago, and we are now stuck with Federal flood insurance. But today, staring into a budgetary abyss, with predicted average deficits of $1 trillion a year over the next 10 years, we cannot afford to make that costly mistake again.

Let's be clear about a few points. This bill does not pre-fund response. In any major disaster like Katrina, taxpayers will still have to pay for infrastructure repair, debris removal, emergency relief, and services. Furthermore, nothing in this legislation forces States to use the subsidies to help lower-income homeowners obtain insurance.

The three major components of H.R. 2555 are all directed at accomplishing the same thing: shifting the cost and risk from bad decisions by a few to the rest of the country. And in so doing, they would enable continued subsidized insurance rates, which promotes unwise development and increased risk.

The bill creates a Federal reinsurance program for eligible State programs. Currently, only Florida and California qualify, although others could join. Curiously, the bill stipulates that the program not compete with private markets, and that prices be actuarially sound.

First, reinsurance is available, so it will compete. And second, at actuarial rates, the program would be more expensive because it would be forced to sell reinsurance to a very narrow pool of high-risk States, whereas the private market could distribute the risk worldwide.

The debt guarantee program would put taxpayers on the hook to back State programs that insure earthquake losses at $5 billion or other perils at $20 billion. The $20 billion figure fits fairly closely with the gap between the total liabilities faced by the Florida Hurricane Catastrophe Fund, the State reinsurance program, and the fund's available hard assets.

Beware of Federal guarantee programs. They are presented as having little or no cost to taxpayers. But if the Federal Government picks up the tab for enormous State losses, particularly those of politically powerful States such as Florida and California, much of that amount could be forgiven.

H.R. 2555 creates a National Catastrophe Risk Consortium chaired by the Secretary of the Treasury. Although the legislation stipulates that the consortium is not part of the U.S. Government, it is pretty clear that with board membership and a Federal charter, it will be viewed as such. And its financial actions will be viewed as activities with the backing of the Federal Government, similar to what occurred with Fannie Mae and Freddie Mac.

H.R. 2555 notes that natural disasters are going to continue to damage and destroy homes, and that the United States needs to be better prepared for and better protected against catastrophes. We agree. We have long supported efforts to mitigate or eliminate impacts associated with natural disasters. A few ideas:

Eliminate the parochial earmarks that have littered FEMA's predisaster mitigation program in recent years. Separately, little of the $5 billion in stimulus funds that was given to States for weatherization has been spent. Some of these funds should be redirected to catastrophe mitigation efforts.

Florida should look slightly north to South Carolina and Virginia for examples of good policy. South Carolina's programs have let risk, not politics, determine rates in coastal areas, and the State has helped residents mitigate their homes. In Virginia, the FAIR plan provides a true last-resort coverage for those who can't get coverage elsewhere, and the State has private reinsurance to cover claims.

The major provisions in H.R. 2555 would actually serve as an impediment to a better way forward, expanding subsidies to high-risk development and removing market incentives to mitigate future storm damages and move people out of harm's way.

Higher insurance premiums are never popular, and politicians are in the business of being popular. This is a key reason why government-run insurance programs are fraught with fiscal peril.

Taxpayers for Common Sense's mission is about making government work. Sometimes, the best way for government to work is to not make matters worse. H.R. 2555 would pile subsidy on top of subsidy to preserve an insurance house of cards. In these difficult budgetary times, we cannot afford to bail out one State for politically expedient decisions of the past. Thank you very much.

[The prepared statement of Mr. Ellis can be found on page 46 of the appendix.]

Mr. KLEIN. Thank you.

And our final witness will be Mr. Charles McMillan from Coldwell Banker Residential Brokerage, Dallas-Fort Worth, and immediate past president of the National Association of Realtors. Congratulations on your leadership on the Board of Realtors, which is a very important organization in all of our communities. And we appreciate your testimony today. Mr. McMillan?

STATEMENT OF CHARLES McMILLAN, COLDWELL BANKER RESIDENTIAL BROKERAGE, DALLAS-FORT WORTH, AND IMMEDIATE PAST PRESIDENT, NATIONAL ASSOCIATION OF REALTORS (NAR)

Mr. MCMILLAN. Thank you, Congressman Klein. I also want to thank Chairwoman Waters, Chairman Kanjorski, Ranking Members Capito and Garrett, and the members of the subcommittees

for inviting me to present the views of the more than 1.2 million members of the National Association of Realtors on approaches to managing natural catastrophic risk.

Recent earthquakes in Chile and Haiti should remind all of us of the need for a comprehensive, forward-looking national natural disaster policy. However, as it stands today, U.S. policy toward natural catastrophic risk is largely reactive rather than proactive.

For example, when Hurricane Katrina struck, the Federal Government paid for much of the cleanup, all with taxpayer dollars. Of the total provided, $26 billion went directly to underinsured property owners, according to the Government Accountability Office. That money would not have been paid to taxpayers had a proactive Federal policy been in place to make property insurance more widely available as well as affordable.

NAR believes that a comprehensive natural disaster policy should include property owners, the 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 a comprehensive approach to addressing future catastrophic natural disasters.

Specifically, we support the creation of a Federal policy to address catastrophic natural disasters that: ensures the insurance coverage is available and affordable; acknowledges the personal responsibility of those living in high-risk areas to mitigate, which includes adequate incentives; acknowledges the importance of building codes and smart land use decisions; 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 reinforces the proper role of all levels of government for investing in critical infrastructure, including levees, dams, and bridges.

Several pieces of legislation that would accomplish many of these goals are currently pending before you. Your bill, Congressman Klein, H.R. 2555, which has been mentioned several times during the testimony, the Homeowners' Defense Act, would offer the most comprehensive solution, in our opinion, by providing access to Federal reinsurance and a guarantee for State loans.

It provides stable funding sources so there is more consistency in insurance availability, as well as affordability. Key components of the bill have also been introduced as stand-alone measures by Representatives Ginny Brown-Waite and Loretta Sanchez.

Others have introduced legislation which provides tax incentives, including H.R. 308 by Representative Gus Bilirakis for property mitigation, and H.R. 998 by Representative Tom Rooney for insurance company reserve funds to pay claims arising from catastrophic events.

All of these ideas could work together as critical elements of a comprehensive solution. Not only would such measures protect the private market from collapse, but they also ensure that resources are available to rebuild after the next mega-catastrophe.

Simply stated, these ideas would create a national policy to proactively address the inevitable rather than waiting for the next crisis to occur and rely upon taxpayer-funded bailouts.

Realtors thank Representative Klein for your efforts, sir, and we urge the committee to hold a markup at the earliest opportunity. NAR believes that all reasonable proposals should be considered as a part of a comprehensive solution to address future catastrophes, and we look forward to working with you on such measures in the months ahead.

Thank you again for inviting me to present the views of the National Association of Realtors, and I will be happy to answer any questions that you or other members of the subcommittees may have.

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

Mr. KLEIN. Thank you very much, Mr. McMillan. And I would like to thank all of you for coming today and being part of this discussion. This is something I think all four of you understand, although some of you had some different opinions on how to approach this, it is not if, it is when.

And we understand that whether it is maybe 50 States, maybe 45 States, maybe 30 States, but there will be natural disasters over the next number of years. We have had an ad hoc approach for a long time.

So I think what we will do is, I would like to thank you. I am going to just reserve 5 minutes for myself for asking some questions, and then we will move it along to other members.

First of all, as I said, I know the question is: How do you manage the risk? And what I have been most intrigued by in working on this for the last number of months, and with a lot of input from people who like some of the ideas, we really molded something that ended up being a good bipartisan consensus.

But I think the most important thing, and Mr. Witt, maybe you mentioned this, and I think Mr. McMillan as well: It is the view of a comprehensive approach. Before understanding, there is planning, whether it is mitigation, whether it is building codes, all the things that take place before, and the management of insurance in a way that will help homeowners manage one of the most expensive pieces of homeownership.

Secondly, it is how you deal with an event during and then after. We also know that there are a lot of expenses that occur right after major natural disasters. And those can even be mitigated with proper State planning.

And again, we are not here to say to each State, you have to do it a particular way, because each State will be dealing with it differently. But the eligibility for participation in this does require a great amount of mitigation, a great amount of responsibility for planning properly.

Mr. Witt, you were FEMA Director for a number of years, and I think you handled, in my notes here, over 360 disasters, which is extraordinary. If you could just discuss with us how this notion of a prefunded system created by the bill—how that is better than a system on the back end, in which we are just cutting a check after the fact.

Mr. WITT. Thank you, Congressman Klein, for the question. First, let me just say that when I was Director of FEMA, we created what we will call a public/private partnership with the private

sector. We had over 2,500 core business partners in a program called Project Impact.

It worked. The funds were leveraged to mitigate the risk in these communities, 250 communities across the United States. This program is a pre-funded catastrophe fund. And if a State wants to join, pass, and create the fund, it is a partnership from the private sector industry. By creating this fund, the Federal Government then would be the backstop if it was so catastrophic that the fund was depleted.

But the idea of trying to create a cost-effective insurance homeowners' premium in today's world is difficult. We have to do better. This is not a bailout. If you look at every event, the 360 disasters I responded to, who funded that? The taxpayers, in every single event; and not only the response, but also in the longer-term recovery.

If you were a homeowner and your home got destroyed, or it was minimally damaged and you were underinsured, that family, if they could make it habitable, was eligible for up to a $10,000 FEMA grant to make it liveable, or 18 months of temporary housing, all funded by the taxpayer.

Now, I think that a pre-funded, private sector catastrophic fund at the national level, with funding from each State as they come on board, is a smarter way to go.

And you talked about mitigation and prevention. We did a cost/benefit analysis on mitigation and prevention after the Midwest floods in 1993, and we found that every dollar spent saved $4 to $5 in future losses.

The mitigation, prevention, public awareness, and education is a really important part of this because we can continue to minimize the risk and the loss, and continue to drive down the premiums so more people can afford to buy them.

Mr. KLEIN. Thank you. And if I can ask Mr. McMillan: You and your colleagues are in the business of selling homes. Can you tell me how, in many places around the United States, the lack of available or affordable homeowners' insurance is affecting the overall recovery and our general economy?

Mr. MCMILLAN. Absolutely. I would be delighted to. One of the myths that is often fueling the divisiveness in this debate is that this is about a bailout for luxury homeowners in Florida and California. And the final exhibit, I have from 2005 to 2008, a number of instances within which a tornado took a turn from Florida and went into Indiana and Illinois and what have you, tornadoes and hurricanes and things of that nature.

The bottom line is, whereas there is a statistical probability that there are areas that might be more affected, we have found in the past 5 years, that the entire Nation is at risk at some point or another for things that are happening that statistically haven't happened in the last 100 years.

So I am in agreement that we must have a comprehensive policy. And past discussion was to leave it on those homeowners so affected. The result of that is that the homeowners in the entire infrastructure of the Nation have been left ill-prepared because of the lack of availability of homeowners' insurance when these catastrophes occur.

Mr. KLEIN. Okay. Thank you very much. I will turn it over to Mr. Garrett for 5 minutes.

Mr. GARRETT. Thank you.

First, a question to the panel, and anyone can answer. In Florida, you have a couple of programs right now. Right? You have the Florida Hurricane Catastrophe Fund, which provides reinsurance to insurers on hurricane losses. And you have the Florida Citizens Property Insurance fund as well. Both, to my understanding, are underfunded in terms of being able to meet their potential claims to going forward.

So before we were to implement this legislation, before we set up a Federal backstop for any State catastrophe fund, shouldn't we make sure that those funds are already properly capitalized and funded? Mr. Ellis, it seems like you are grabbing the microphone.

Mr. ELLIS. Yes. Thank you very much, Ranking Member Garrett.

You are correct that—well, one is that the Citizens Insurance, the State insurance fund in Florida is the largest insurer, and the rates are artificially low. They buy reinsurance from the State reinsurance fund.

The State reinsurance fund, and it is hard to tease out exactly what the numbers are, but when you look at it through both some other documents and then you look out from their annual report or their audit, it looks like there is about a $20 billion gap between assets and total liabilities.

Total liabilities, basically there is about $4 billion in assets, and then plus $20 billion gets to the total liabilities. Obviously, it is unlikely that the full $20 billion would be called upon at any one moment. But certainly, you are looking at—potentially, if there was a large natural disaster, an enormous bond issue would have to come out from the State of Florida to actually try to fill that gap.

So certainly Florida—and they are taking steps. They are looking at—Citizens has agreed to—or the State legislature has indicated that they want to have a 10 percent increase in homeowner insurance rates each year for the next several years.

And so they are doing work to close that gap. And I think that is certainly something that Florida needs to be looking at as one of our concerns about this overall program, stepping in, that it will actually be a disincentive to trying to do those measures.

Mr. GARRETT. Okay. Mr. Witt, it looks like you were—were you going to grab the microphone?

Mr. WITT. Yes. Thank you.

Mr. GARRETT. Sure.

Mr. WITT. Really, the problems with the Florida CAT fund are actually an indication of the need for a national backstop. The Florida CAT fund actually worked in 2004 and 2005. It paid out $37 billion that the taxpayers across the country didn't have to pay out. So it actually worked.

Also, I think that a few comments made earlier about this was a bailout for property on the coast or helping to build up the coast—let me tell you something. If you can afford to build a house on the coast, on the oceanfront, you probably don't need to worry about insurance. You probably can afford it. So I don't think this is going to enhance that.

But the Florida CAT fund actually worked. And it paid out almost $10 billion in hurricane funds in 15 years.

Mr. GARRETT. But the rates on these funds, to date, have not been actuarially sound. Is that correct?

Mr. WITT. They are actuarially sound in Florida on the CAT fund that they have.

Mr. ELLIS. I don't know how exactly they could be if it is tremendously underfunded compared to the liabilities. But—

Mr. GARRETT. Yes. I have never heard anybody make that assertion before, that they are actuarially sound rates. I have always heard that they have not been soundly set, that they have been set too low that it is basically that they have not been able to get the wherewithal to change that.

Mr. ELLIS. But even beyond that, Ranking Member Garrett, I would just point out that in 2007, there was a change done by the State of Florida under Governor Crist that actually expanded Citizens Insurance.

So even though the CAT fund responded well in 2004 and 2005, in 2007, under Governor Crist, they expanded the ability to get coverage under the Citizens Insurance, which then dramatically increased the risk. And that is also what catapulted Citizens to being the largest home insurance company in the State.

Mr. GARRETT. And it looks like I only have 1 minute left, so I will throw this out quickly. I wanted to get to Mr. McMillan's comment with regard to mitigation and enforcement of State laws. And I think you said it should be done on the State level, that is a really good way to make sure of building codes and what have you.

I don't have time to get to that, but I think that is a good point that you made in your testimony. That is the way to get it done, and unfortunately that is not being done. And I think that is to the chagrin and to the detriment of both the municipalities, the counties, and the States, and also the homeowners there.

Would you just agree with that, in short?

Mr. MCMILLAN. I would agree with that.

Mr. GARRETT. I thank you, and I think that is a point that we need to make. I appreciate that.

If I have 30 seconds left, one major point that was made, and maybe it is conflicted on, is whether or not—what the Federal Government actually pays out. The Federal Government right now pays our temporary assistance and infrastructure assistance in these cases when you have these things.

Katrina was a little bit different because, hey, the Federal Government messed up there—oh, there is a light on this one—and does anybody want to just quickly say whether or not we are—are we really subsidizing the insurance in these situations, or will that be an added subsidy once these plans go into place? Mr. McMillan, do you want to respond?

Mr. MCMILLAN. If I might, briefly, I think this is one of the areas where we talk about reinsurance. Without this government backstop, we have to depend on the open market. And one of the things that is making this reinsurance—and subsequently the insurance to the homeowner—unaffordable is that they have to work with extremely fluctuating market rates. With this backdrop, there would be much more stability. And I would dare say, in California and

Florida and throughout, we would have many more participants in that pool.

Mr. KLEIN. Ms. Waters, for 5 minutes.

Chairwoman WATERS. Thank you very much.

Mr. Pomeroy, even though Mr. Klein started this work and has worked diligently because of the hurricanes and floods, you and I are a little bit more focused on earthquakes because of where I come from and where you come from.

I would like to just take a moment to explore, given that you have been insurance commissioner of North Dakota and you are now head of the largest provider of earthquake insurance in California, can you explain in greater detail how the mechanisms in this bill make good risk management sense to States like California and North Dakota, that are exposed to such very different natural catastrophe risk? What can this do for us?

Mr. POMEROY. Thank you. Thank you very much, Congresswoman Waters. Actually, my strong opinions as to why this is absolutely the direction we need to be heading to in terms of risk management were formed by my time as an insurance commissioner in North Dakota from 1992 to the year 2000, commissioner during a time, during 1997, when we had a horrible disaster in Grand Forks, North Dakota.

The City entirely evacuated, entirely flooded. A horrible disaster. And fortunately, James Lee Witt was the FEMA Director at that time, and marshaled an incredibly impressive Federal response to come into that community, help it recover, help it get back on its feet. And North Dakotans forever are grateful for not only Mr. Witt's leadership, but for the response of the United States Government.

Well, now we are talking about California, and California earthquakes. If there is a similar but different natural disaster in our State, and you have a massive earthquake with massive destruction, most of which is uninsured, of course, there will be a similar Federal relief effort, as Californians will then look to North Dakotans and others for the kind of help that they have been providing other States during their times of disaster.

It just makes more sense to get more people to take the steps to privately insure their own homes so they can quickly recover, and get their families back in their homes, and get their communities moving again without having to go stand in line to try to seek assistance from various agencies.

It is better for folks to take the responsibility up-front, and insure their properties. The problem is, it is hard to do right now because it is expensive. So what we are trying to do is make it more affordable, thereby making it more available.

Chairwoman WATERS. In your testimony, you mentioned the goal of the California Earthquake Authority through this legislation is to double the percentage of Californians who have earthquake insurance from 12 percent to 25 percent in 5 years, as I understand your position. The CEA believes that this goal can be achieved with the $5 billion debt guarantee provided in Title 2 of the bill.

Please explain how the $5 billion debt guarantee in this bill can double the number of Californians with access to earthquake insurance following the next inevitable California earthquake.

Mr. POMEROY. Thank you, Congresswoman. Yes. We are currently limited today by the fact that we are dealing with a risk that the private sector basically walked away from. And yet we need to figure out a way to manage it and provide coverage for Californians who wish to obtain it.

Yet the financing that is available to us makes it tough because we really have no choice today other than to acquire a tremendous amount of our claims-paying capacity from the global reinsurance markets. It is very expensive, and prices do fluctuate.

And so 40 percent of everything we collect from our policyholders goes right out the door by way of reinsurance premium. Almost zero dollars have been paid back to us over time, despite the fact that we have paid $2.6 billion for that coverage since we opened our doors.

And so by moving into this new and innovative approach that is called for in this bill, we will be able to lower our costs substantially. We will still obtain reinsurance. We will still have claims-paying capacity. We will still have our financial strength. But we will make our coverage more affordable, so we will get more people covered. We will grow our capital base during the process, lower premiums, we will lower our deductibles, and therefore have a policy that is going to be more meaningful as earthquakes actually do occur because we are going to be able to pay for claims.

By creating a better value proposition for consumers, we are going to get more homes insured.

Chairwoman WATERS. That makes good sense. Thank you very much. I yield back the balance of my time.

Mr. KLEIN. The gentlelady yields back.

Mrs. Biggert?

Mrs. BIGGERT. Thank you, Mr. Chairman. I would ask unanimous consent to submit the testimony of Nationwide Insurance to the hearing record.

Mr. KLEIN. Without objection, it is so ordered.

Mrs. BIGGERT. Thank you. It really is a shame that our environmental groups and the reinsurance industry and any regulator, State regulator, are not represented here today. And Mr. Chairman, I think it is important that we have, with such a bill, which could cost many of our constituents, taxpayers who are not residents of Florida or California—that we hear from all sides of this debate. And so I would request of the committee that we hold another hearing on this bill so we can hear from these other stakeholders.

And then my question to the panel is: Do Florida and California allow insurance businesses to charge actuarially sound risk-based rates? And I guess, Mr. Pomeroy, maybe you could answer that for me.

Mr. POMEROY. Yes. Thank you, Congresswoman. The answer is absolutely, yes. And in fact, the California Earthquake Authority is required by law to charge actuarially sound rates for the coverage that we write.

Mrs. BIGGERT. Are there price controls and caps?

Mr. POMEROY. There is State regulation of insurance, obviously, and the California Earthquake Authority is a regulated entity. We submit our rates to the department for their review. There are not

price caps; however, there is the appropriate State oversight, as there is throughout the country.

Mrs. BIGGERT. Do you think that there—it seems like in some of these States that competition—it really drives out competition and leaves the consumer with fewer choices and higher rates. If Florida and California—and that happens in Florida and California. Is that true?

Mr. POMEROY. If I may, Congresswoman, what drove companies out of California in terms of earthquake coverage was the Northridge earthquake. Companies were devastated by the losses that far outstripped premiums that they had collected or sought to collect. And companies really wanted nothing more to do with that risk.

And so the State was left with having to have homeowners go it alone and shoulder their own risk, or put together some creative solution, which has been in existence and operating successfully for 14 years. It is just that we want to take it to the next level and make coverage more affordable, and therefore get more homes within the program.

Mrs. BIGGERT. And do you think that, for example, my constituents in Illinois should provide a subsidy for the State of Florida and California or the consumers of those States?

Mr. POMEROY. Congresswoman, I think that is an excellent question. And we are not here seeking any subsidy. We don't believe a subsidy is necessary. The California Earthquake Authority stands on its own. It is just that as we seek to put our financing structure in place, we have the ability to borrow money currently; it is just that after a huge and devastating event, we don't currently have the certainty that the private debt markets would be responsive.

We can pay the debt back. We just have to make sure that we have access to the debt in the first place. And so our request is give us this little assistance in the form of the Federal guarantee. Allow us to get more homes properly protected. We will pay the claims when they occur so that the State will be less in a position of having to come out to you all after a devastating event, when we have all this uninsured loss.

Mrs. BIGGERT. I guess I just have to put in a plug for Illinois, which has been kind of a model State for insurance. And one of the reasons is because there are no price controls or rate control, and that we get more competition because more insurance companies are willing to come to the State.

Mr. ELLIS. Congresswoman Biggert?

Mrs. BIGGERT. Yes, Mr. Ellis?

Mr. ELLIS. There are, in Florida, some challenges there as far as—it is part of the reason why many of the companies have left the State. The State is trying to force more companies to come back in through a variety of means.

And then I would just point out that in the testimony of the California Earthquake Authority, there was a lot made about how there is no State money that is going into the California Earthquake Authority. It is under the auspices of the State government.

But essentially, what we are asking here is that the Federal taxpayer back the bonds there for the California Earthquake Author-

ity, and actually to then make it so that they are less reliant on reinsurance.

And I would just point out that, unfortunately, I have not made a claim on my car insurance for many, many years, but I have paid my car insurance every single year. That is unfortunately the way insurance works—or fortunately that's the way it works.

And so the idea that they have paid a lot of money to reinsurance and haven't gotten any return, well, thankfully. That means that there hasn't been an earthquake. They haven't actually had to tap it. That is part of what insurance is about.

Mrs. BIGGERT. Well, what about—let's turn to Florida. And Florida doesn't allow risk-based pricing. Right?

Mr. ELLIS. I am not—I have never lived in Florida. I would have to look exactly to get to that level of detail. But my understanding is is that there is not—that they are not able to charge commensurate with risk such that—and are actually undercut. And it is probably more that they are undercut by low prices from Citizens.

Mrs. BIGGERT. Okay. Just one other quick question. And I understand that the—

Mr. KLEIN. You are out of time.

Mrs. BIGGERT. I yield back.

Mr. KLEIN. Okay. Let's see. I now recognize Mrs. McCarthy from New York for 5 minutes.

Mrs. MCCARTHY OF NEW YORK. Thank you.

Mr. Ellis, I think that you just made a case on why we need to have some sort of catastrophe insurance, basically saying the insurance companies wouldn't come into the States. I know we are hearing about California and I know we are hearing about Florida.

But I just want to ask the experts out there, like New York, most of our insurance companies have moved out even though we haven't had a major hurricane since maybe the 1960's. I'm not sure. But they have all pulled out, mainly because they think we are going to get a hurricane soon.

But I guess the question I really want to ask is: How many States do you think will actually partake in this? Because, obviously, the more States that would take it, the better.

But the other thing is, too, the government right now doesn't—I need to know exactly why the government should back the States on these issues because we don't do anything on guaranteed municipal bonds now for local areas. And during this time of recession and our States, our cities, are having a hard time just paying their bills, how do we know that they will be able to pay us back, the Federal taxpayer back?

I guess those are the concerns I have. And I will just pick up one thing that Mrs. Biggert had said, too. If we are going to rebuild in areas that have hurricanes, earthquakes—I know California, they have their codes. But some States are still building on hurricane areas along the coastline and not taking the proper precautions of putting the correct piles, I guess, the house on the piles and things like that.

If we are going to do something like this, shouldn't we have language in there that, to be covered, that you have to have the best technology out there? Anyone can answer that.

Mr. WITT. Let me first answer part of it, and I know that Mr. McMillan wants to say a few words.

First of all, it is not—this is not just about California and Florida. This is about the whole country. This is about those high-risk States where we have events frequently and more often than others.

New York, in 1938, was hit with a very large nor'easter hurricane. New York has an earthquake fault. And when you get in the middle United States, you start out from Tennessee, Arkansas, Indiana, Illinois, all with the New Madrid earthquake fault, which had an 8.0 earthquake in 1811, 1812; had two of them that rang the church bells in Boston. It just wasn't inhabited at that time as much as it is today.

So the risk that we face today is nationwide, not just Florida and California. And I think the most important—I was the CEO of the International Code Council for 3 years in building codes, building standards, electrical, plumbing. And the State of Florida at that time, when Governor Jeb Bush was down there, they did not have statewide building codes in all of Florida. But they do now.

After Katrina, the State of Louisiana did not have statewide building codes, and it was just along the coast. But Governor Blanco and the legislators passed a statewide building code.

So it is really important that part of this, and the funding from this, goes for the support of statewide building codes, the enforcement of them, and the mitigation and prevention side of it. It is very important because we can mitigate a lot of these losses.

Mr. ELLIS. Congresswoman, I would just point out that in my testimony, I talked about South Carolina and how South Carolina has allowed prices of insurance to be commensurate with risk along the coast. And they have actually seen insurance companies coming into the State.

And so certainly that is one of the things, that you can move insurance out of the State by having more restriction or underpricing them, like Citizens has done; or you can do things that will try to encourage that.

And then secondly, absolutely other regulatory measures and other means and building codes and everything else along those lines are critically important. I don't think anybody here has indicated that we don't need to be doing something more. We are just saying, not this.

Mrs. MCCARTHY OF NEW YORK. Just to follow up on that, it just so happened my brother-in-law was talking to me about this the other day. He does live in North Carolina on the coast. He bought the property and built a house probably 15 or 20 years ago.

His insurance for that area was close to $8,000 a year. North Carolina just came in with their own fund, and I think he is paying $3,000 a year now. That is quite a big difference. And I think, knowing my brother-in-law, if there was another insurance company around that would have given him a cheaper price, believe me, he would have.

So I think that we still have a problem with people. And I am one of those who believed if you were going to take an FHA loan out for a house, and if you were anywhere near—whether it is a

flood coast or an earthquake, that you had to have the right insurance behind that. I still believe in that.

I think this is a debate, but I think it is a debate that we need to have because I think the Federal Government ends up paying an awful lot of money for any of the national—we call emergency funding around here. But it still comes out to a lot of money.

Thank you.

Mr. KLEIN. Thank you. And just to reserve myself 1 minute here, just to clarify. On Florida's issue, for example, Florida by law has to be actuarially sound. I am not here to tell you what risk-based pricing is, Mr. Ellis. Maybe you can define it. What is risk-based pricing?

Mr. ELLIS. Well, certainly. For instance, the Flood Insurance Program is supposed to be actuarially sound. It is stipulated in law. But it never took into account catastrophic losses, which is why, even though it was dipping along and basically being able to pay out its losses, borrowing from the government and paying it back, we ended up with a program that takes in $2 billion a year and is $20 billion in debt.

Mr. KLEIN. Well, I understand that. What is risk-based pricing? How do you—

Mr. ELLIS. Well, risk-based pricing is going to be about characterizing the actual risks to that property, that area, and then being able to pay out that price over a long term in a macro sense.

Mr. KLEIN. How is that different from being actuarially sound?

Mr. ELLIS. It is not necessarily different than being actuarially sound.

Mr. KLEIN. All right. And just also to clarify, I think the gentlelady from New York was talking about the fact that we talk about property on the coast, not on the coast, as it relates hurricanes.

I will just tell you from our experience, in the four hurricanes that did hit Florida after not having any hurricanes in my area for 50 years, people paying their premiums in every year, the four hurricanes, although people on the coast were paying more—and should pay more; I am all for the recognition that people who live in high-risk areas should pay more, and that is appropriate—most of the damage took place inland because the hurricanes came from the west inland.

So it was very interesting. I used to call it the I-95 mountain range. That was how they used to charge one price on one side of—I-95 is a road; I know you know that. It has nothing to do with any topography, no mountains, no nothing. It is just sort of an arbitrary point, which was a little interesting the way it was handled.

I will now recognize Mr. Campbell from California for 5 minutes.

Mr. CAMPBELL. Thank you, Mr. Chairman. And I first want to thank Mr. Witt for mentioning that this isn't just a Florida and California thing. In fact, but for circumstances that didn't quite turn out, we could have been talking about a tsunami in Hawaii and Oregon today, from last week, perhaps.

And another thing: We talk about big disasters, but just another little thing that can happen. In my district about 6 or 7 years ago or so, there was a landslide that was just caused by a lot of rain.

A hillside gave way. Twelve houses were destroyed. Not hundreds, not thousands; 12 houses were destroyed.

But in checking into it, I found no one was insured. And the reason no one was insured is there is no insurance for that available, period, anywhere. And these people not only lost their homes, they lost the land because the land disappeared. So these 12 families were destroyed, absolutely devastated. There was no insurance available, and it was not a big enough disaster to get any attention for anything here.

So I think part of what we are talking about here is that there are disasters of one sort or another that can occur—I think Pennsylvania has insurance for this, by the way, because I think it is required because they have land subsidence issues there frequently.

But there are natural disasters like this that can occur in small groups or big groups all over the country, in all kinds of different places. Some are insurable. Some are not. Some have expensive insurance. What we are talking about is trying to figure out a way to provide something for all of those people in all 50 States.

I would like to spend the rest of the time talking about California and earthquakes, because I am from California, and because Mr. Pomeroy is here. But I actually want to address the questions to the other 3 of you because we have talked about the fact that only 12 percent of homes in California have earthquake insurance.

A few other facts you may or may not know. California law requires that everyone who is shopping for or who is offered homeowners' insurance be offered earthquake insurance. So everyone has to be offered it.

Someone earlier said the California Earthquake Authority is the only insurer of earthquake insurance. That is not true. I am insured in my house with earthquake insurance not from the CEA. And there are various other insurance companies that offer earthquake insurance in California. But 12 percent is the total, not just the CEA.

Now, Mr. Pomeroy has said that given one of the proposals in this bill, he thinks perhaps we could double it to 25 percent of total. That is still not enough.

Let me ask the rest of the three of you because there is all this talk about high risk and so forth. Earthquakes in California, unless you want to eliminate San Francisco, Los Angeles, and just about everything in between, this isn't about people building in high-risk areas. This isn't about only expensive homes or whatever. This is about everybody, "everybody" representing 1 out of every 12 people in the United States, just in California.

So what can we do? What else can we do? What other ways are there to get this thing up? You heard Mr. Pomeroy say some people just say, oh, the Federal Government will bail me out. I'm not going to buy this insurance because they'll come in and take care of me. And we have to break that cycle, certainly. And as Mr. Pomeroy suggested, right now it's relatively expensive. The deductibles are high. And so there is that as well.

Ideas from the rest of you, please, because I think it could—it is not just about California. This sort of thing, it is so broad and so diverse that it is a lesson for the whole country, I think.

Mr. McMillan?

Mr. MCMILLAN. I would like to make a quick comment, Congressman Campbell, and that is the next thing that we can do is to have a national comprehensive disaster preparedness plan. As I see the balking in the discussion about whether to approve or jump on certain sections of H.R. 2555, it is that the taxpayer will pay for this.

The taxpayer is paying for it now, without a plan. And I think it is so important, as we have suggested in our testimony, that we be proactive as opposed to reactive. Now a disaster happens, it is declared a Federal disaster, and the taxpayers pay it without any discussion about repaying it. At least that will be in the discussion with the comprehensive Federal plan.

Thank you for the privilege of sharing that.

Mr. CAMPBELL. Other thoughts? Mr. Ellis?

Mr. ELLIS. Yes, sir. Certainly, we certainly agree with preparedness. And actually, there has been some stuff on wildfires in the last decade or so that has dealt with preparedness and trying to figure out communities to have wildfire plans and figure out what is going to burn, how they are going to deal with this, and all these type of issues. And certainly that is important.

I will just point out that unfortunately, no matter what we do, the taxpayer is going to pay after a natural disaster. It has done that. It will do that. There is critical infrastructure that is going to be rebuilt that is either going to be paid for by the State taxpayer or, even more likely, the Federal taxpayer.

But beyond that, unfortunately we are talking about human nature here that we are trying to adjust. And there are people who don't buy health insurance. There are people who don't buy flood insurance who live in the flood plain, who are in the 100-year flood plain. And so these are issues that we have to deal with.

Some of it is education. Some of it is trying to do—in building codes to make communities less resistant. And some of it is about the fact that we have to have some tough love sometimes when people don't actually—don't pay, and how much we are willing to bail them out.

Mr. CAMPBELL. Mr. Witt?

Mr. WITT. Thank you, Mr. Chairman. It is interesting. I don't know how many people in this chamber have ever been through an event of any magnitude. But I have. I lost our home and everything in it when I was 12 years old with a fire. A tornado blew our house off of the foundation when I was 6. My wife says I am a disaster.

[laughter]

Mr. WITT. But let me just say, when you talked about the mudslides in California—and I remember them really, really well, several of them, particularly after the Laguna Beach fire and the Malibu fire and others—those 12 homes, that was a catastrophic event to those 12 families. Whether it is 1 home or 5,000, it is a catastrophic event to that family.

I think that we can do more, and we can do it better, and we can put less burden on the taxpayers by supporting the private funded catastrophic fund and have more people insured. This is really, really critical in this day and age, with the economy the way

it is right now. And it just really frustrates me to no end when I see these type of losses.

I was just in Haiti. I made three trips to Haiti with President Clinton. Those people there make $2 max a day in labor. They don't have anything. We are blessed with everything. And it is time to make the change in giving people an opportunity to not only protect themselves, but to protect the things that they have worked so hard for all their life. And a lot of these people don't have that ability because they can't afford it and it is not available.

California has probably done more than any State in the country in seismic building codes, retrofit, particularly of critical care facilities, schools, nursing homes, and hospitals. Every country around the world looks at California's seismic building codes as a model for their own country. Japan does. Everybody does.

So the mitigation, preparedness, and a public/private partnership in developing a catastrophe fund is really critical in this time of our lives. And I just hope that everyone listens to this and everybody looks at it this way: it is not about any one. It is about everyone. And we need to make a difference here.

Mr. CAMPBELL. I thank the gentleman. Thank you. I yield back.

Mr. KLEIN. Thank you, Mr. Campbell.

Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

Mr. Ellis, thank you for being here, first. Thank all of your for the generosity of your time.

Mr. Ellis, in your prepared remarks, you mention that the FEMA pre-disaster mitigation program has been littered with earmarks. What earmarks?

Mr. ELLIS. What earmarks? I think, the last time I looked, out of the $100 million program, about a quarter of that was earmarked. I would have to get you the exact numbers, sir, but—

Mr. CLEAVER. No. I'm not asking for numbers. What—and maybe the disconnect is the definition of an earmark. So, I am not sure—

Mr. ELLIS. Congressionally defined earmarks, sir. It is—in the DHS bill, under FEMA's pre-disaster mitigation program, in the last couple years there has been a growth of earmarks in that particular program to individual projects.

It is not completely earmarks, but it is one of the areas that we are concerned about because it is a competitively awarded program, and it has earmarks scattered through it.

Mr. CLEAVER. So members are designating money to that area—

Mr. ELLIS. To some project in their particular district.

Mr. CLEAVER. —because, if they don't, badly needed mitigation won't occur. Is that—

Mr. ELLIS. I don't know if that is necessarily the case, sir. What I am saying, Congressman Cleaver, is that this is a merit-based program. There are parameters that are established by FEMA to try to award the funding under the pre-disaster mitigation program.

But in some cases, lawmakers are earmarking funding. They are jumping the line. And so, essentially, some other community that also has critical—

Mr. CLEAVER. Jumping the line?

Mr. ELLIS. Jumping the line, meaning that FEMA gets a pot of money to assign out to various things. They have a bunch of parameters that communities need to meet to qualify.

Mr. CLEAVER. Yes, sir.

Mr. ELLIS. They award the funding to these various entities.

Mr. CLEAVER. Yes, sir.

Mr. ELLIS. Some of these, Congressman, are now, because lawmakers are getting earmarks, are going ahead of other communities that don't have as powerful of a lawmaker to get the earmark into that program and designate it to go to their particular project.

Mr. CLEAVER. So they should wait on a bureaucrat to do it?

Mr. ELLIS. No, sir. Essentially, this comes down to the whole issue of earmarks. But, Congress should bring the bureaucrats in front of them and work with them to develop the program to make sure that it is done correctly. And if they don't do it right, haul them back the next year and hold them accountable, sir.

Mr. CLEAVER. Okay. I wish you were a Member of Congress. I hate to say that is completely unrealistic. It sounds good on the evening news or something like that. But it is not real. And I think even my colleagues on the other side will tell you the same thing.

Congress has only a few responsibilities, and one of them is spending the money.

Mr. ELLIS. Absolutely, Congressman.

Mr. CLEAVER. And so, I hate to give that responsibility to some guy in the basement of some building—I live in Kansas City, Missouri—who has never crossed the Mississippi and wouldn't know Kansas City, Missouri, from Milwaukee, Wisconsin.

But the other point here is that you suggested that our money should be used to do this, on page 5. You say, under the American Recovery and Reinvestment Act—

Mr. ELLIS. Correct. Yes, sir.

Mr. CLEAVER. —the stimulus, nearly $5 billion has been given to States. And you go on to say, "Maybe this money should be taken."

Mr. ELLIS. Not taken, sir. I am suggesting that essentially—just recently the Inspector General came out with a report saying that an alarming amount of money—I think it is like $4.7 billion out of the $5 billion that has gone out for weatherization—has not actually been spent by the States, mostly because the States' weatherization programs are incredibly overwhelmed. I think Connecticut got 16 times what it had in the past.

And so all I am saying is here is a place where we could redirect some of that funding, still as stimulus still going out in this—I am not trying to reclaim it—and still saying the States should use that money, but allow it to be used in mitigation efforts as well as weatherization.

Mr. CLEAVER. Okay. Two points and I am through, Mr. Chairman.

The first point is—well, I am assuming you supported the statement?

Mr. ELLIS. We did not come out one way or another. We were mostly for making sure the money was spent accountably and transparently.

Mr. CLEAVER. So you were neutral on the stimulus?

Mr. ELLIS. We did not take a position one way or another, no, sir.

Mr. CLEAVER. So you were neutral on the stimulus?

Mr. ELLIS. Correct.

Mr. CLEAVER. Okay. The last part of it is, I agree with the slowness with which the money has gone out, but that is a statement about running that program more effectively. And one of the things that we are elected to do is to try to deal with problems in the districts from which we come. And that is why they have been using any pot of money that they can in order to address problems.

That is what we are supposed to do. And I would not criticize a Republican or a Democrat or an independent or an Oakland Raider for—I am from Kansas City—

Mr. ELLIS. I know, sir. So is my dad.

Mr. CLEAVER. —to remind you—but to try to deal with problems. I wish a Republican, could get as much money as there might be needed to deal with problems in New Orleans. And so I guess we may have a philosophical difference about what Members of Congress are supposed to do.

But I do agree with you that the money has gone out slowly, and it means we have to do a better job of getting that money out, not necessarily transferring it to another agency.

Mr. ELLIS. I certainly agree that it needs to be dealt with better. Yes, sir.

Mr. KLEIN. Okay. I thank the gentleman from Missouri.

And now the gentleman from Florida, Mr. Posey, for 5 minutes.

Mr. POSEY. Thank you, Mr. Chairman.

I am a free market guy. But experience has shown me that unregulated insurance markets do not mean they are free markets as people are taught in academia. They are manipulated. You can talk about all the availability of reinsurance. I know, in Florida, every single reinsurance company had the exact, identical, same rate. That is a free market. What a coincidence. Just what a coincidence.

Comparing South Carolina's exposure to Florida's exposure doesn't pass the straight-face test in front of anyone that knows the difference between the Florida coastline and the South Carolina coastline.

And I think it ought to be stated for the record that when Florida did expand its catastrophe fund, much to the chagrin of many insurance companies, big insurance companies, it brought in—it was responsible for bringing in—the only new business that we had.

The big insurance companies were allowed at one time to have pup companies in Florida, so that means your home office in Bloomington or wherever was no longer responsible for paying claims in Florida. It would be the new company that was founded with no more than the minimal amount of capital. And if it blew away in the next storm, it was just too bad for all the policyholders. And the CAT fund was to guard against that.

And because we have an expanded CAT fund, we have new business, new companies coming into Florida, hopefully that will stay there and will continue to invest there and not just reap the year's profits and cry when the storms come later.

I have been an accountability wonk for many years. I am a former ALEC, National Legislator of the Year, for passing account-

ability legislation ALEC called the best to come out of any capital in over a decade. But I have never heard of Taxpayers for Common Sense.

And I wonder—you keep referring to "we." Who is that? Who is "we?"

Mr. ELLIS. Taxpayers for Common Sense? We are happy to celebrate our 15th anniversary. We are a national, nonpartisan budget watchdog. We are based here in D.C. I have been with the organization for 10 years. I would be glad to answer any other questions.

My colleague is the person who dubbed the "Bridge to Nowhere" the "Bridge to Nowhere." I don't know exactly what you are—we have some members. We have mailing lists for our products. We do advocacy work on budget issues.

I don't know exactly, Congressman, what else—

Mr. POSEY. Well, I just—I know Mr. McMillan's group and I know the other people's groups and I have had experience with them. I have never seen you before or heard of your organization before. So I just wanted some information for my own—

Mr. ELLIS. Absolutely. I would be glad to come by and talk to you about us any time at your leisure, sir.

Mr. POSEY. Okay. Thank you, Mr. Chairman. I yield back.

Mr. KLEIN. I thank the gentleman.

Mr. Sherman from California?

Mr. SHERMAN. Thank you.

Mr. Witt, I represent Northridge. People all over the San Fernando Valley thank you again and again every day for the help FEMA extended to us in 1994.

Mr. Pomeroy, thanks for your work to try to prepare us to recover from the next earthquake.

Mr. Ellis, I want to thank you for your tireless efforts to move this country away from democracy and toward empowering bureaucrats, bureaucracy or bureaucratocracy. Your hard work has not gone unnoticed.

There are those who say that, oh, we shouldn't provide better disaster insurance because that will just encourage people to live where we don't want them to live. And if you are talking about a few areas near rivers that flood every year, that may be; maybe we shouldn't build there.

But if you want to say that nothing should be built near an earthquake fault, you lose your largest State, or at least your most populous State. I think Mr. Pomeroy would agree with me that well over half the population of California—I see him nodding—lives near an earthquake fault.

And if you wanted to vacate every area that might be hit with a hurricane—Mr. Klein, is that your whole State or just two-thirds of it?

Mr. KLEIN. Probably a good two-thirds, if not the whole State. Every county.

Mr. SHERMAN. So those who support vacating areas subject to hurricanes and earthquakes ought to tear some stars off the flag as their symbol of their position.

We have to encourage people to buy earthquake insurance. Either you can help me now, or you can pay me later. That is to say, if nobody in California buys earthquake insurance, when we are

hit, we are coming to Washington, and we are coming for everybody who is uninsured.

Right now, you have to be offered earthquake insurance when you buy a house. The only problem is enormous deductible, enormous premium, and I know Mr. Campbell buys it; I don't know anybody else who does. The reason is that the reinsurance is so expensive that is passed on to consumers.

And so we need a system in which we can provide reasonable insurance even if the Federal Government undertakes some slight risk, or you can live in a world where you believe the Federal Government isn't at risk as long as we have no program because God knows there is no risk of an earthquake in California and there is no risk that Californians would come here to try to collect their uninsured losses from the Federal Government.

Neither of those is a significant possibility. The only thing that is an actuarial risk to the United States is if we pass a bill. Then, we acknowledge that there is some possible risk to the Treasury, a diminished risk, I might add, but then we would have to acknowledge it.

Mr. Pomeroy, does the CEA operate on an actuarially sound basis? Title 2 of Mr. Klein's bill creates a conditional guarantee program like CEA, in effect a CEA for CEA. What are the chances that the CEA would need to borrow more money? Could you handle another Northridge earthquake without access to Title 2?

Mr. POMEROY. Thank you, Congressman. That is an excellent question. And yes, the answer is clearly yes, the CEA does charge actuarially sound rates, which is why it is so expensive and most people feel they can't afford it.

Moving to this more efficient structure, we would maintain our financial strength. We would be able to pay the claims of all of the earthquakes that we are going to see. We would not need to borrow—and I should have emphasized this more in my testimony—we would not need to borrow, in the vast majority of any scenario we can imagine.

All of our modeling, our scientific-based modeling, indicates that the probability of our needing to borrow, if H.R. 2555 becomes law, is between .5 and 1 percent, a minuscule probability of the need to borrow.

We look back over history, we have had earthquakes in California going back to 1906: the great San Francisco shake; Northridge; the famous World Series earthquake back in the 1980's, Loma Prieta. We could handle any one of those without the need to borrow.

Mr. SHERMAN. Let me try and squeeze in one more question.

Mr. Ellis, your testimony in opposition to this bill is largely premised on comparisons to the National Flood Insurance Program. Since the National Flood Insurance Program is in the jurisdiction of another subcommittee, I wanted to make the differences clear between this bill and the NFIP.

Isn't it true that the rate subsidies you reference when discussing the NFIP are written in as part of the National Flood Insurance Act, and that there are no similar subsidies or grandfathering in the bill that we are considering today?

If Mr. Klein's bill doesn't include provisions like the subsidies specifically written into the National Flood Insurance Act, wouldn't you agree that Mr. Klein's bill—or how can you argue, rather, that Mr. Klein's bill will lead to the same subsidized insurance rates that you blame on the NFIP? You are comparing apples and oranges—

Mr. ELLIS. No, sir. There is an explicit subsidy in the NFIP for pre-firm properties before the flood insurance rate maps were created. Separately—

Mr. SHERMAN. And is there such a subsidy—

Mr. ELLIS. There is separately—in the Flood Insurance Program, there is a subsidy that exists because they did not take into account catastrophic risks, which is why you end up with a $2 billion-a-year program having $20 billion in debt to taxpayers.

Clearly, properties other than flood—other post-firm properties are flooded. You have cases of repetitive losses within that program. You have a variety of different characteristics of that which are replicated. And I think at this is still—

Mr. SHERMAN. Excuse me. You mentioned the grandfathering. Is there any grandfathering in Mr. Klein's bill?

Mr. ELLIS. No, sir. There is no grandfathering. But that is not the only subsidy in the Flood Insurance Program, sir.

And on the democracy issue, I would just argue that we are about democracy and democratizing the budget. That is why we publish a variety of objective documents, to make the budget more transparent and more accountable to the American taxpayer.

Mr. SHERMAN. Sir, reclaiming my time, you have a point of view. You are not just a library. And you work every day to try to diminish the power of elected officials—

Mr. ELLIS. No, sir.

Mr. SHERMAN. —and increase the power of bureaucrats. I yield back.

Mr. ELLIS. No, sir.

Mr. KLEIN. Our last member, Mr. Royce from California, for 5 minutes.

Mr. ROYCE. Yes. I guess I will ask Mr. Ellis some questions as well from Taxpayers for Common Sense. One of them has to do—I take it part of his concern, perhaps, is with the liability issue here, really, because if we consider the current liabilities that taxpayers face, we have $104 trillion in unfunded liabilities for Social Security. That might give this organization pause. It certainly seems to give our Federal Reserve Chairman a lot of worry.

We have that $104 trillion I mentioned in Social Security and Medicare liability. We have $12 trillion in debt. We have $1.6 trillion in deficit this year. Obviously, there is a concern that taxpayers might be overextended.

But I think the real worry on the part of the Federal Reserve Chairman is that when Moody's made that call—what was that, 3 weeks ago—where they said we might have to downgrade; they warned they might have to downgrade the AAA rating of sovereign debt, of our U.S. Treasuries—that, in tandem with the comments by the Fed Chairman that we are on an unsustainable path, when he testified to the Financial Services Committee, I think that probably gives some organizations a reason to wonder how much

weight, how much of a burden, can you add without it breaking the back and creating a reaction over at Moody's or just in the public in terms of all of the liabilities we have taken on.

We have double-digit increases in the Federal appropriations bills this year. We have the argument, on the new health care entitlement program that it is going to break even, but I think a lot of people are somewhat suspicious that an entitlement program is going to break even. So eventually we have to take a step back. And I would ask Mr. Ellis if I could get his thoughts.

Mr. Ellis, are you concerned with the broader implications this bill will have in terms of setting a precedent that cannot easily be reversed when it comes to guaranteeing State and municipal debt?

Mr. ELLIS. Well, certainly this would be the first time that I am aware of that we would be starting to back—well, not the first time, but it certainly would be a big step towards backing State debt and then potentially, yes, moving towards the municipal debt. It would be one of the only ones today that is doing that. Yes, sir.

Mr. ROYCE. So your best judgment when you look at this, you see a government program that is going to guarantee State and municipal debt, probably grow, and probably have liabilities there that are going to add eventually to the debt and the pressures on the dollar, I would suspect, and on our Treasuries?

Mr. ELLIS. Well, certainly, at least right now, it is going to be State debt, at least under this program. And $25 billion is where it is capped right now, $5 billion in earthquake, $20 billion for other losses.

Clearly, programs like this, if it becomes more popular, could grow and it could mushroom. Yes, sir.

Mr. ROYCE. So we would set a precedent if we passed it. The one aspect of this that I'm a little encouraged about, unlike previous drafts, this attempts to go beyond simply cleaning up the mess Citizens Insurance created in Florida.

But I think the overriding concern has to be our current fiscal situation, especially at the Federal level, and the message that we are sending, and how that translates out of the market.

And I don't know how—after the words of warning we got from the Federal Reserve Chairman here, I don't know why we would want to stampede down this road because it would be one more signal to Moody's and to others, to the credit rating agencies, that we are taking on additional risks. And those would be my observations, Mr. Chairman.

Mr. Ellis, would you like to close with any other observations?

Mr. ELLIS. No. I think that certainly sums it up, Congressman Royce, very well. And thank you for your comments.

Mr. ROYCE. Thank you.

Mr. KLEIN. I would like to thank the gentlemen and the members of the committee. Just if I can reserve 1 minute here, just to make a point.

The discussions about the debt, obviously, everyone in Congress and every American is concerned about debt, our national debt. And again, what we have tried to think through very carefully, and we will look forward—as a work in process, we will look forward to continuing to make this bill better, is to reduce that national ex-

posure, which I think is very open-ended at this moment and has been for many years.

And if we can manage this in a way in which we can hopefully reduce that amount of liability and underwrite it through private insurance, I think that seems to be a better model.

But again, we thank Mr. Witt, Mr. Pomeroy, Mr. Ellis, and Mr. McMillan for taking time out of your very busy days and your professions to be here today. We appreciate that. I will note that some members may have additional questions for this panel, which they may submit in writing.

Before we adjourn, the written statements of the following organizations will also be made a part of this record of this hearing: the testimony of Congresswoman Loretta Sanchez; the American Red Cross; International Association of Fire Chiefs; National Multi-Housing Council and National Apartment Association; National Catastrophe Policy Coalition; Association of State Flood Plain Managers; and Independent Insurance Agents and Brokers of America.

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.

The panel is now dismissed and the hearing is now adjourned.

[Whereupon, at 4:17 p.m., the hearing was adjourned.]

A P P E N D I X

March 10, 2010

OPENING STATEMENT OF
CHAIRMAN PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

JOINT HEARING ON APPPROACHES TO MITIGATING AND MANAGING NATURAL CATASTROPHE RISK: H.R. 2555, THE HOMEOWNERS' DEFENSE ACT

WEDNESDAY, MARCH 10, 2010

Good afternoon. I would like to thank Chairwoman Waters, our Ranking Members, the other Members of our two Subcommittees, and our invited witnesses for joining us today for this hearing to explore approaches to mitigating and managing natural catastrophe risk and to examine H.R. 2555, the Homeowners' Defense Act.

Introduced by Congressman Klein of Florida, H.R. 2555 tackles the complex issue of how to address the growing problem of the availability and affordability of homeowners insurance around the country in the wake of ever bigger natural catastrophes. This hearing represents the second time our Subcommittees have met to consider a version of this bill. Last year, the Oversight Subcommittee also reviewed these matters.

Natural catastrophes can produce devastating effects for the affected people and communities. Within our hemisphere, we most recently experienced considerable damage as a result of earthquakes in Haiti and Chile. We also know that such earthquakes could, at any time, strike the United States.

In addition to earthquakes, hurricanes represent another form of natural catastrophes that threaten American citizens and businesses, and which could lead to severe losses and sizable rebuilding costs. In Northeastern Pennsylvania in 1972, Hurricane Agnes ruined more than 25,000 homes, damaged nearly 3,000 businesses, and destroyed 5 major bridges. At the time, then-President Richard Nixon called the event the "greatest natural disaster in U.S. history."

Since then, Americans have experienced even greater natural catastrophes which have cost the federal government billions of dollars. The Government Accountability Office estimates that the federal government in response to the Gulf Coast storms of 2005 -- Hurricanes Katrina, Rita, and Wilma -- made about $26 billion available to homeowners who lacked adequate insurance. Even with this aid, many of the affected communities are still struggling to rebuild.

In constructing any program to mitigate the structural and financial damage that natural catastrophes can cause, we need to ensure that those who benefit bear the costs. The approach taken in Mr. Klein's bill aims to do just that.

Specifically, the consortium proposed in the legislation would encourage States with insurance funds to voluntarily pool their exposures and cede the risk to the capital markets. I look forward to learning more about the increased role our capital markets can play in covering the insured losses of natural disasters. To the greatest extent possible, we should maximize the risk-bearing capacity of the private sector before calling on the government to assist.

H.R. 2555 would also provide a federal guarantee on the debt issued through the consortium. While the guarantee approach is slightly different than the loan program proposed

in similar legislation two years ago, the U.S. Treasury is still entitled to recover any payments it makes. Thus, the bill aims to protect taxpayers.

Mr. Klein's legislation also includes a federal reinsurance fund structured to provide capacity above and beyond private market reinsurance. Lastly, but very importantly, the legislation includes a grant program to help develop, enhance and maintain programs to prevent and mitigate losses from natural catastrophes. I view these mitigation reforms as a key part of the bill. The implementation of effective mitigation plans will help to lower long-term costs.

In sum, proper planning -- both structurally and financially -- can help to lessen the devastation caused by natural catastrophes. It is in this spirit that Mr. Klein has put forth his important legislation. Questions have been raised about the need, cost and potential success of these programs, and I look forward to a productive debate on these matters.

CONGRESSMAN ALAN GRAYSON
STATEMENT FOR THE RECORD

Approaches to Mitigating and Managing Natural Catastrophe Risk: H.R. 2555, The Homeowners' Defense Act

I would like to take a moment to thank my colleague, and fellow Floridian, Mr. Klein, on his tireless efforts toward meaningful and effective natural catastrophe insurance reform. I am happy to be an original cosponsor of H.R. 2555, the Homeowner's Defense Act of 2009, because this legislation will help stabilize insurance markets, while concurrently reducing the costs and improving the availability of homeowner's insurance.

With nearly 50 percent of the total U.S. population living within 50 miles of coastline, it is essential that we identify how vulnerable much of the U.S. coastal populations have become. I come from a community, and a state, that is no stranger to frequently changing, increasingly intense, and unpredictable weather patterns. Florida, with a population of more than 15 million, and a coastline stretching 1,200 miles, has been the most vulnerable state in the country in regards to hurricane or tropical storm activity, nearly doubling any other state in the total number of hurricanes and major storms on record since 1851.

With insurance markets responding adversely to such catastrophes as hurricanes and flooding, adequate and affordable coverage is often lacking, and sometimes completely unavailable or unattainable for those who need coverage most. Take the citizens of Ocoee, Florida, a suburban and hard-working community in my district, for example. Just recently FEMA revisited the Ocoee area for mapping purposes, and found that an area previously mapped had changed in elevation by 1.5 feet. This 18 inch shift in topography effectively landed 2,400 Ocoee residents in the middle of a flood plain. Residents received notification of this newly acquired status not from FEMA, but from their various local mortgage companies when they informed homeowners that they had 45 days to come up with up to $5,000 to insure their homes. This is unacceptable.

By restricting the supply of natural catastrophe insurance and raising the price of the limited coverage that is available, far too many people are left exposed to potentially devastating damages and property loss. I believe that the Homeowners Defense Act will help provide an efficient and cost-effective solution to this problem. The Homeowner's Defense Act can be a vehicle of significant and necessary industry reform through efficient catastrophe risk transfer practices that will require States to maintain reasonable underwriting procedures, and make them eligible to pool their risk of natural disasters.

What I was especially pleased to see included in this bill, is the public education of mitigation strategies necessary to prepare and respond to natural catastrophes. As a Representative from Florida, I have remained dedicated to strengthened hurricane and flooding policy, and I believe that hurricane R&D and mitigation strategies are a necessary component in safety and the prevention of costly property damage. By increasing the focus on hurricane research, including the understanding of storm surges, rainfall, and flooding, we will become able to successfully track storms and improve our catastrophe preparation and response mechanisms.

As someone who understands the seriousness of natural catastrophes and the life altering damages and costs that they can incur, I am asking my colleagues to support H.R. 2555, which is an important step forward in providing the adequate and affordable coverage and education necessary to protect vulnerable homeowners.

STATEMENT FOR THE RECORD

THE HONORABLE ADAM H. PUTNAM

JOINT SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY AND SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES HEARING

Approaches to Mitigating and Managing Natural Catastrophe Risk:
H.R. 2555, the Homeowners' Defense Act

MARCH 10, 2010

Whether it is a hurricane inflicting a state in the Gulf Coast, an earthquake or wild fire wrecking havoc in California, a hailstorm in Colorado, flooding in the Midwest, a terrorist attack in the heart of our nation's economy, or a tornado in the central plains – the truth of the matter is that any catastrophe is a terrible ordeal for any state, business, or family to go through.

This is why Congress acted in 2002, 2005, and 2007, to create and maintain Terrorism Risk Insurance following the 9-11 terrorist attacks which resulted in a disruption in the insurance market. Due to a growing fear that a lack of insurance against terrorism loss would have a wider economic impact, the Bush Administration and Congress worked together to form a public-private partnership to ensure the capacity of the private sector to finance large-scale terrorism risk in the United States.

Prior to threats of terrorism that we are all too familiar with today, our nation long faced the threat of natural catastrophes. Not just any catastrophes, but mega-catastrophes that occur with minimal warning, and leave behind lasting impact; misplacing whole states and communities on months ends, if not years.

In 2007, the House passed similar legislation to that of today's hearing. The legislation established a National Catastrophe Risk Consortium to allow states to voluntarily pool their catastrophe risk diversified by type of peril and geography. It also supported mitigation efforts and created a Federal loan program to provide post-catastrophe financing for qualified State and regional reinsurance programs, rather than Catastrophe Obligation Guarantees, as proposed in H.R. 2555.

The legislation aimed to encourage states located in high-risk catastrophic areas to better prepare for the inevitable, rather than to rely on the federal government to save a state from such liability, which is what I believe Congressman Klein is working toward in the 111th Congress.

I recognize that some of my colleagues share the same concerns today that they did in 2007, but I do believe that we are all trying to find the right balance. We have witnessed first hand the amount of money that taxpayers are on the hook for when a natural disaster of such proportions occurs – it is enormous. In fact, according to the non-partisan Congressional Research Service (CRS), during the 20-year period from fiscal year 1989 to fiscal year 2008, Congress appropriated $250 billion dollars for disaster assistance.

Following the devastation of Hurricane Andrew in 1992, Florida took a series of regulatory and legislative actions to increase availability of hurricane insurance coverage and to prepare for the possibility of such future losses. Over time, availability crossed a fine line with affordability, as more and more homeowners continued to have absolutely no access to the private insurance market. There is a common misperception that this problem only affects mansions on South Beach and Siesta Key. This could not be further from the truth. I am speaking for middle-America families in Winter Haven and Ocala, and small business owners in Madison and Sebring who cannot find any other available source of property insurance.

I will not detail the financial challenges that hover over Florida's Citizens Property Insurance or Florida's Hurricane Catastrophe Fund; we have all been reminded plenty today. I will, however, take the time to let you know that we are not merely sitting by idly, waiting for the next big hurricane to hit.

- Florida continues to work toward ensuring the rates of Citizens Property Insurance and private insurers are actuarially-sound and to minimize the state's role in the homeowner's insurance market, so that should it fall victim to another mega-catastrophe, it is fiscally sound and prepared to manage post-disaster obligations.

- Florida residents with auto, residential property or commercial property insurance policies are already paying a 1 percent assessment to shore up the Hurricane Catastrophe Fund following the 2004 and 2005 hurricane season losses.

- Following the 2009 Legislative Session, legislation was signed into law that sets a "glide path" of steady annual premium increases of up to 10 percent, which would help Florida reduce its financial risk by increasing cash assets and decreasing the accountability in the state's Hurricane Catastrophe Fund.

- The Florida Office of Insurance Regulation (OIR) has also recently approved a number of appropriate rate increases for private insurers so that they are offering actuarially sound rates.

At the end of the day, even if you physically removed Florida from the continental United States, the coastal threat to that region would not disappear, or from any region for that matter. Instead it would pose a greater risk to those states in the region, such as Georgia, Alabama, South Carolina, North Carolina, and so forth.

So our options are to do nothing, and continue to add on to the $250 billion dollar Congressionally approved funding for disaster assistance, or to establish a public-private partnership that encourages states to plan and prepare in advance through actuarially sound rates and mitigation efforts so that they can properly manage fiduciary responsibilities during those times of extreme damage and ruin, when a state or the private market cannot meet the state or region's capacity.

To that extent, I look forward to working with Congressman Klein to ensure that the approaches proposed in this legislation strike the proper balance for a public-private partnership that will hold states accountable and protect taxpayer dollars against the threat of future catastrophic adversities.

Testimony of Steve Ellis
Vice President, Taxpayers for Common Sense

House Committee on Financial Services
Subcommittee on Housing and Community Opportunity and Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
hearing on
"Approaches to Mitigating and Managing Natural Catastrophe Risk: H.R. 2555, The Homeowners' Defense Act"

March 10, 2010

Good afternoon, Chairman Kanjorski, Chairwoman Waters, Ranking Members Garrett and Capito, members of the subcommittees. I am Steve Ellis, Vice President of Taxpayers for Common Sense, a national non-partisan budget watchdog. Thank you for inviting me here today to testify on H.R. 2555, The Homeowners' Defense Act.

Taxpayers for Common Sense believes H.R. 2555 is fundamentally flawed and strongly opposes the legislation. The euphemistically named Homeowners' Defense Act would actually end up putting taxpayers at risk and subsidizing people to live in harm's way. Taxpayers across the country would be forced to pay for a narrow bailout that primarily helps the well off. It doesn't make sense.

But don't just take our word for it. TCS works with SmarterSafer.org. These allied groups oppose H.R. 2555 and run the gamut from American Rivers to Americans for Prosperity. From the National Association of Professional Insurance Agents to the National Wildlife Federation. From PLAN!T NOW to the National Fire Protection Association.[1] The depth and breadth of the coalition of consumer, taxpayer, environmental and insurance industry groups underscores the broad-based concerns with H.R. 2555.

[1] Full list is available at www.smartersafer.org

The major elements of H.R. 2555 would establish a national catastrophe risk consortium for states to pool risk, create a new federal reinsurance program for state catastrophe funds, and make federal taxpayers guarantee potentially billions of dollars of debts incurred by state catastrophe insurance programs. I would like to take a few minutes to put the legislation in context and describe our concerns with the various elements of H.R. 2555. In addition, I would like to outline a better, more fiscally sound path forward.

The Primrose Path

Much of the argument for the programs under H.R. 2555 relies on a "pay me now or pay me later." Essentially, by providing reinsurance and debt guarantees, taxpayers will avoid fiscally messy and expensive bailouts of state programs in the aftermath of large disasters. Unfortunately, we have heard that seductive siren song before. And we know how it ends: instead of reducing the cost to taxpayers, we will have in fact forced the federal government to shoulder more of the burden and alleviate the financial incentives to properly manage risk.

You don't have to look any further than the National Flood Insurance Program to see how this song plays out. Part of the justification for the establishment of NFIP in 1968 was that the program's premium payments would reduce ad hoc post-disaster recovery costs. Claims were also made about the lack of availability of flood insurance, similar to the argument for federal reinsurance today.[2]

The sad reality is that the availability of cheap federal flood insurance over the last several decades made it financially attractive to develop in high risk areas. Along with other factors, NFIP helped fuel the coastal development boom that increased the program's risk exposure and losses. Though intended to provide only limited, short term subsidies and encourage responsible construction, the program actually served to increase subsidies. Before 1986, the program received nearly $2 billion in direct appropriations, and borrowed from (and repaid) the treasury in the 1990s.[3] But that was nothing compared to the present day. The huge storm year of 2005 (Hurricanes Katrina, Rita, and Wilma in particular) forced NFIP to borrow heavily from the Treasury. Now a program that takes in roughly $2 billion in premiums annually is $20 billion in debt to the U.S. taxpayer. It is extremely likely that most, if not all, of this debt will be forgiven.

The ability to borrow from the Treasury is an enormous subsidy that enabled NFIP to charge rates that, despite assertions to the contrary, were not actuarially sound and certainly didn't include catastrophic risk.

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[2] Pidot, Justin R. "Coastal Disaster Insurance in the Era of Global Warming: The Case for Relying on the Private Market. P18.

[3] National Wildlife Federation. "Higher Ground." July 1998. P 16-17.

We walked down the primrose path decades ago, and now we are stuck with the National Flood Insurance Program.

But today, staring into a budgetary abyss with predicted average deficits of $1 trillion a year over the next ten years,[4] we cannot afford to make that costly mistake again.

The three major components of H.R. 2555 are all directed at accomplishing the same thing: Shifting the cost and risk from bad decisions by a few to the rest of country. And in so doing, they would enable continued subsidized insurance rates which promotes unwise development and increased risk.

Taxpayers as a Backstop

A key part of H.R. 2555 is the federal reinsurance program for "eligible" state programs. Currently, only Florida and California have programs that would meet the criteria specified in the legislation.[5]

Curiously, the legislation stipulates that the program "shall not displace or compete with the private insurance or reinsurance markets or the capital market."[6] But that seems to be the whole point. Reinsurance is available in private markets, as illustrated by annual renewal prices declining this year, with record share repurchase by the private sector.[7] However it is not offered at the price the states want to pay. This leads me into the next odd assertion in the legislation: that the program should charge actuarially sound rates.[8] First, if this limited program's rates were truly actuarially sound, they would exceed the private market's rates because the program would be forced to sell reinsurance to a very narrow pool of high risk states, whereas the private market could distribute the risk worldwide. But, remember, the federal flood insurance rates were supposed to be actuarial as well.

The legislation stipulates that the maximum amount of contracts written under the federal reinsurance program would be capped at $200 billion per year.[9] But contracts written under the plan would kick in at a shockingly low level. It describes the attachment point as the loss level that would result from an event that has a .5 percent chance of occurring in any given year

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[4] Congressional Budget Office. "Preliminary Analysis of the President's Budget Request for FY2011." March 5, 2010. Available at http://www.cbo.gov/ftpdocs/112xx/doc11231/frontmatter.shtml.

[5] With slight modifications to their existing wind program Texas could also qualify.

[6] Section 302 (1)

[7] Guy Carpenter and Co. "Rates Retreat as Capital Rebounds: Global Reinsurance Renewals at January 1, 2010" January 3, 2010. http://www.gccapitalideas.com/2010/01/03/rates-retreat-as-capital-rebounds-global-reinsurance-renewals-at-january-1-2010/

[8] Section 303 (g)

[9] Section 304

(a 200-year event).[10] But that total would be aggregate for the year, so several small events would eventually trigger payments under this reinsurance.

Bailing Out Bad Decisions

Another section of H.R. 2555 creates a debt guarantee program for eligible state programs. Again, this appears to target California and Florida. These programs would put taxpayers on the hook to back state programs that insure earthquake losses at $5 billion (California) or other perils at $20 billion (Florida). In fact, the $20 billion figure fits fairly closely with the gap between the total liabilities faced by the Florida Hurricane Catastrophe Fund, the state reinsurance program, and the fund's available hard assets.[11]

TCS has long been skeptical of federal guarantee programs. They are almost always presented as having little or no cost proposals to federal taxpayers. But time and time again, from energy loan guarantees in the 1980s[12] to the Title XI shipbuilding program,[13] Uncle Sam has been left holding the bag. In these cases, it has been private companies that failed to repay loans. But it is easy to see that if the federal government picks up the tab for enormous state losses – particularly those of politically powerful states such as Florida and California – that much of that amount could be forgiven over the specified 30-year repayment period.[14]

In addition, the provision of this guarantee is a subsidy in and of itself. Explicitly promising the full faith and credit of the federal government behind the states' debts would enable them to borrow far more than they would otherwise, particularly in Florida, which doesn't have a income tax.

Fannie and Freddie Redux

H.R. 2555 envisions the creation of a National Catastrophe Risk Consortium. This consortium, at least initially, would be chaired by the Secretary of the Treasury, and the members would include the Secretary of Homeland Security, Secretary of Commerce and an appointee from

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[10] Section 303 (a)

[11] The actuarial firm AON Benfield reported that the total potential liabilities for FHCF were $28 billion in 2009, which should be roughly $26 billion in 2010. Available at http://fhcf.paragon.aonbenfield.com/pdf/09ratereportaddendum.pdf. Separately the FHCF audited statement includes $1.7 billion cash and $5 billion in pre-event bonds (although some have not been sold). Available at http://www.sbafla.com/fhcf/LinkClick.aspx?fileticket=U7k4ZIFZocM%3d&tabid=319&mid=1006. The difference of these two numbers is roughly $20 billion.

[12] Rudolph, Barbara. "Shattered Hopes for Synfuels." *Time Magazine*. April 18, 2005. Available at http://www.time.com/time/magazine/article/0,9171,1050485-1,00.html

[13] Government Accountability Office. Maritime Administration: Weaknesses Identified in Management of the Title XI Loan Guarantee Programhttp://www.gao.gov/products/GAO-03-728T

[14] Shapiro, Robert J. and Mathur, Aparna. "The Economic Effects of Proposals for Federal Natural Catastrophe Reinsurance and New Loan Programs: Who Pays and Who Benefits?" August 2008.

each State participating.[15] Although the legislation stipulates that the Consortium "is not a department, agency, or instrumentality of the United States Government,"[16] it is pretty clear that with high profile board membership and a federal charter, it will be viewed as such.[17] And as such, the provisions to have the Consortium "issue securities and other financial instruments linked to the catastrophic risks insured or reinsured through members of the Consortium in the capital markets" or "coordinate reinsurance contracts between participating, qualified reinsurance funds and private parties" will be viewed as activities with the backing of the federal government.[18]

You don't have to look any further than Fannie Mae and Freddie Mac to see how such arrangements were viewed by the public and markets. These government-sponsored entities were explicitly described as not being backed by the federal government. But everyone perceived them to be, and considering the federal takeovers, the public, not government protestations to the contrary, were right.

A Better Way Forward

The findings section in H.R. 2555 notes that natural disasters are going to continue to damage and destroy homes and that the U.S. needs to be better prepared for and better protected from catastrophes.[19] We agree.

We have long supported efforts to mitigate or eliminate (through buyout) the impacts associated with natural disasters. Several steps should be taken immediately. The Federal Emergency Management Agency's pre-disaster mitigation program has become littered with earmarks in recent years. This program is supposed to be about making communities more disaster-resistant and is too important to be treated like a parochial piggy bank. Separately, under the American Recovery and Reinvestment Act – the stimulus – nearly $5 billion has been given to the states for weatherization, but according to the Department of Energy Inspector General, an "alarming" amount of this funding has not been spent.[20] Congress could enable

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[15] Section 105. The Cabinet Secretaries could be represented by designees and the DHS and Commerce Secretaries are only members when there are less than two States participating in the Consortium.

[16] Section 101 (b).

[17] Testimony of Treasury Assistant Secretary for Economic Policy Phillip Swagel before the House Committee on Financial Services Subcommittees on Capital Markets, Insurance, and Government Sponsored Enterprises; and Housing and Community Opportunity. September 6, 2010. Available at http://financialservices.house.gov/hearing110/swagel.pdf

[18] Section 103 (2) and (3).

[19] Section 2(a)(3) and (5)

[20] U.S. Department of Energy Inspector General. Progress in Implementing the Department of Energy's Weatherization Assistance Program Under the American Recovery and Reinvestment Act. http://www.ig.energy.gov/documents/OAS-RA-10-04.pdf

some of these funds to be redirected to catastrophe mitigation efforts. Other available stimulus funds could help jumpstart this area.

In Title IV, H.R. 2555 authorizes $75 million over five years for mitigation measures. But that seems to be more of an afterthought than a real goal of the legislation. There are other several pieces of legislation that would provide for a more robust investment in mitigation without all the other baggage included in H.R. 2555.

Finally, Florida needs to only look slightly north to South Carolina and Virginia for examples of good policy. Simply put, South Carolina's programs have let risk, not politics, determine rates in coastal areas, and the state has used its own resources to encourage residents to mitigate their homes vulnerability to hurricanes. As a result, more insurance carriers are entering the state. And in Virginia, the FAIR plan (Fair Access to Insurance Requirements) provides true "last resort" coverage for those who can't get coverage elsewhere. In addition, the state has private reinsurance to cover claims.

The major provisions in H.R. 2555 would actually serve as impediment to a better way forward. These provisions would enable Florida, or other states, to continue to subsidize high risk development and remove market incentives to mitigate future storm damages or move out of harm's way.

Conclusion

Higher insurance premiums are never popular, and politicians are in the business of being popular. This is a key reason why government-run insurance programs are fraught with fiscal peril. Witness the federal flood insurance program. Or look at Florida. Program changes in 2007 shifted the state-run Citizens Property and Casualty Insurance Company from insurer of last resort to the largest insurer in the state by a wide margin.[21]

Taxpayers for Common Sense's mission is "making government work." Sometimes the best way for government to work is to not make matters worse. H.R. 2555 would pile subsidy on top of subsidy to preserve an insurance house of cards in Florida. The federal flood insurance program has already demonstrated where this will lead. In these difficult budgetary times, we cannot afford to bailout one state for politically expedient decisions of the past.

[21] http://www.floir.com/pdf/NumberPIF3Q2009.pdf

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HEARING BEFORE

THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
AND
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT-SPONSORED ENTITIES

ENTITLED

"APPROACHES TO MITIGATING AND MANAGING NATURAL CATASTROPHE RISK: H.R. 2555, THE HOMEOWNERS' DEFENSE ACT"

TESTIMONY OF

CHARLES MCMILLAN, CIPS, GRI

IMMEDIATE PAST PRESIDENT, THE NATIONAL ASSOCIATION OF REALTORS®

MARCH 10, 2010

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EQUAL HOUSING OPPORTUNITY

Introduction

Thank you, Chairs Waters and Kanjorski, Ranking Members Capito and Garrett, and Members of the Subcommittees for inviting me to testify here today before the Subcommittees on Housing and Community Opportunities and Capital Markets, Insurance, and Government Sponsored Entities, and to present the views of the National Association of REALTORS® (NAR) on approaches to managing natural catastrophe risks.

My name is Charles McMillan, and I am the Immediate Past President of the National Association of REALTORS® (NAR). I have been a REALTOR® for more than 20 years, and am Director of Realty Relations and Broker of Record for Coldwell Banker Residential Brokerage, Dallas-Fort Worth. Along with being a REALTOR®, I have been active in my community, serving as past chairman of the Community Development Council of Fort Worth, the Tarrant County Affordable Housing Task Force, the Housing Subcommittee of Fort Worth, and a past director of the United Way of Tarrant County and of the Fort Worth Chamber of Commerce.

NAR is America's largest trade association, representing more than 1.2 million members involved in all aspects of the residential and commercial real estate industries. NAR is the leading advocate for property ownership, affordable housing and private property rights.

Overview

Recent earthquakes in Chile and Haiti – occurring so close together and relatively close to the United States – should serve to remind all of us of the need for a comprehensive, forward-looking national natural disaster policy. Such a policy would recognize that property owners, the private insurance markets, and all levels of government must work together in order to successfully address the problems of not available and affordable property insurance currently plaguing many parts of the U.S. While we may not have experienced this level of devastation since the Northridge Earthquake in 1994 or Hurricane Katrina in 2005, we all know "the next big one" is not a question of if, but when. We cannot afford to wait any longer.

Today, U.S. policy toward natural catastrophe risk is largely reactive rather than proactive, case-by-case rather than comprehensive, and that has to change. The default approach of the federal government has been to wait and respond: wait for the next disaster and then respond by appropriating assistance to its victims. For example, when Hurricane Katrina struck the southeastern coastline, the federal government paid for much of the cleanup – all with taxpayer dollars. Of the total appropriated, $26 billion went directly to under-insured property owners according to the General Accountability Office. That is $26 billion that would <u>not</u> have been necessary or paid by taxpayers (including those not living near the U.S. coast) had proactive federal policies and programs been in place, to make property insurance more widely available and affordable. While we do not have a similar estimate for all U.S. natural disasters, the following table should offer a sense of the magnitude of the impact to taxpayers from continuing the current policy.

TOP U.S. NATURAL CATASTROPHES

Rank	Date	Peril	Location	Estimated Damages ($ Billions)	Estimated Damages Minus Insured Loss ($ Billions)
1	Aug. 2005	Hurricane Katrina	AL, FL, GA, LA, MS, TN	$90	$45
2	Aug. 1992	Hurricane Andrew	FL, LA	$51	$28
3	Oct. 2005	Hurricane Wilma	AR, IL, IN, KY, LA, MO, OH, PA, TX	$24	$13
4	Sept. 2008	Hurricane Ike	FL	$24	$12
5	Aug. 2004	Hurricane Charley	FL, NC, SC	$20	$11
6	Jan. 1994	Northridge Earthquake	CA	$29	$11
7	Sept. 2004	Hurricane Ivan	AL, DE, FL, GA, LA, MD, MS, NJ, NY, NC, OH, PA, TN, VA, WV	$16	$8
8	Sept. 1989	Hurricane Hugo	GA, NC, PR, SC, VA, Virgin Islands	$14	$7
9	Sept. 2005	Hurricane Rita	AL, AR, FL, LA, MS, TN, TX	$13	$6

(1) Property coverage only. Does not include flood damage covered by the National Flood Insurance Program. As of Sept. 2009.

(2) Adjusted to 2008 dollars by the Insurance Services Office, Inc.

(3) Data from National Hurricane Center 2006 data adjusted to 2008 dollars, except Northridge damage data from U.C. Berkeley

Sources: National Hurricane Center http://www.nhc.noaa.gov/pdf/NWS-TPC-5.pdf
Insurance Information Institute (www.iii.org)

Pending before Congress is legislation that would begin to shift taxpayer burden back to property owners by incentivizing state-government and private-insurance efforts to increase property insurance availability and affordability. NAR believes that a workable solution to the insurance problems now facing this country must also go beyond a discussion of property insurance and include a comprehensive natural disaster policy. A comprehensive natural disaster policy should take into account the responsibilities of multiple actors including property owners, the insurance companies and each of the different levels of government in preparing and paying for future catastrophic events. Consequently, 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

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. 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 any single region of the country. We have heard those concerns from REALTORS® in numerous states, including New York, New Jersey, South Carolina and North Carolina, as well as the Gulf Coast region. A witness at this hearing will testify about the significant challenges California is currently facing in preparation for the next mega-quake. As many of you are no doubt aware, the most recent earthquake and aftershocks were not limited to Chile; while the world waited for the Tsunami to hit Hawaii, central Oklahoma registered a 4.4-magnitude quake that approached the state record of 5.5 in El Reno in the 1950's. Also in February, CNN reported another quake that rattled northern Illinois and could be felt from Georgia, Tennessee, Kentucky, Ohio, Indiana, Michigan, Iowa and Wisconsin. Natural disasters are challenges facing more than just the coasts of the U.S. They are a problem for the interior of the country too, and it is not limited to earthquakes or hurricanes but also to other natural events such as tornados and ice storms. Insurance concerns extend beyond homeowners' insurance and include multi-family 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 could be 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 communities across the nation.

The inability to obtain affordable insurance is a serious threat to the real estate market, impacting not only single family detached homes, but condominiums, co-operatives and rental units as well. New real property purchases, resale transactions and affordability are affected in the following ways:

- **Property insurance is a necessary component in securing a mortgage and buying and selling a home or building.** If a potential buyer is not able to obtain or afford the required insurance, the sale will not be completed. As a result, potential buyers are excluded from the market.
- **The cost of owning property is directly tied to insurance costs.** Property owners are required by their mortgage lenders to maintain insurance, regardless of its cost. If the property owner is not able 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 property 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 and commercial property owners are ultimately passed on to tenants through higher rents. This affects housing affordability, particularly for low-income renters.

Many of NAR's commercial members have also reported problems with commercial insurance availability and affordability. For example, members in coastal areas 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, the landlord must absorb most of the increased costs.

Often it is the smaller property owner that suffers the greatest. These are the owners of America's small businesses that are the engine of job creation and innovation and backbone of their local community and economy. But due to size, these owners are not as able to 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 property no longer generates sufficient income to cover expenses. This problem can force owners to sell their properties. It can also lead to mortgage default and even foreclosure, especially during an uncertain economy when there are little-to-no buyers. Additionally, individuals and families who lease apartment space in multi-family structure could be severely affected.

Catastrophic Natural Disasters are a National Issue

Coupled with the recent reminders in Chile and Haiti, the catastrophic events of the past decade should serve as a wakeup call that highlights not only the importance of having insurance, but also the role that individual property owners, insurance companies, all levels of government, and taxpayers have in preparing for and recovering from future catastrophic events. The ongoing recovery from these events shows that all taxpayers in the country have a stake in a federal natural disaster policy because their tax dollars are funding recovery efforts.

While as a result of the 2004 and 2005 hurricane seasons, much attention has focused on the Gulf Coast states, 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. I already referenced recent quakes in northern Illinois and central Oklahoma – yet another reminder that fault lines are not limited to California alone. While it is true that not all areas of the country are as susceptible to the next major

hurricane; earthquakes, tornados, winter, ice and hail storms, tsunami, draught, wildfire, lighting storms – the effects of and costs of cleaning up after all of these potentially devastating events certainly are felt by taxpayers nationwide.

Elements of a Comprehensive Natural Disaster Policy

NAR encourages Congress to develop a comprehensive natural disaster policy that encourages personal responsibility, promotes mitigation measures, ensures insurance availability, and strengthens critical infrastructure such as levees, dams, and bridges. NAR supports the creation of a federal natural disaster policy that will promote available and affordable property owners' insurance.

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 access to affordable property insurance. The lack of a U.S. natural disaster policy has had a measurable direct impact on property insurance availability in many parts of the country; the inability to obtain affordable insurance is a serious threat to the entire real estate market and thus, our economy.

Homeowners and commercial property owners need insurance to protect themselves, their families, their tenants and property in case of catastrophe. However, if insurance is not affordable, many make the unfortunate, but understandable, decision to purchase only the minimal amount or type of insurance required. As others will testify, 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 when "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 and insurance rate reductions) to encourage 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] Experts point to Chile's preparation and mitigation efforts, and more specifically the stringency of the country's building codes, as one of the central reasons why the vast majority of the buildings there continue to stand after an earthquake that released 500 times the energy as the 7.0-magnitude quake that struck Haiti.

However, while an essential component of any workable solution to managing natural disaster risk, mitigation measures alone would not address the taxpayer burden for cleanup of under-insured properties – i.e., billions of dollars that would no longer be necessary if there were proactive federal policies and programs in place to make property insurance more widely available and affordable.

NAR strongly believes that 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 simply too large or unpredictable for states and the private market to deal effectively with the resulting damage. There is an "adverse selection" issue: too few are able to insure so the companies are not always able to collect the premiums necessary to cover the losses. At some level, there is 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 market forces.

We believe that it is in the best interest 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 2010 or any future years will be as benign for natural catastrophes as 2009. 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. NAR supports the efforts of members of Congress who have introduced and co-sponsored legislation to address this critical issue.

Legislation introduced in the 111th Congress to date takes different approaches to managing natural disaster risk. Representative Ron Klein (D-FL) has proposed to address the risk by offering more stable financing alternatives to and thereby reducing state reliance on an increasingly volatile global reinsurance

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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.

market. His H.R. 2555, the Homeowners' Defense Act would provide pre-qualified state insurance programs with access to federal reinsurance that supplements and smooth out the market-rate fluctuations over time. The bill would provide for a Catastrophe Obligation Guarantee, also the subject of S. 886 by Senator Bill Nelson (D-FL) and H.R. 4014 by Representative Loretta Sanchez (D-CA). Guaranteeing post-disaster state loans would encourage lending during a time of heightened market uncertainty. H.R. 2555 would also establish a National Catastrophe Risk Consortium, to allow state insurance programs to voluntarily pool and further spread the risk by issuing catastrophe bonds. Finally, the bill includes a mitigation grant program to reduce taxpayer exposure by preparing and dedicating significant resources to local building code enforcement, preparedness initiatives by the American Red Cross and others, and first responder needs.

All of H.R. 2555's provisions work together to offer a comprehensive federal backstop and guarantee for state insurance programs, not only to protect the private market from collapse but also to ensure that resources are available to rebuild after the next mega-catastrophe. The bill would succeed in creating a national policy to proactively address the inevitable, rather than waiting for the next crisis and then needing to rely upon taxpayer funded bailouts. We thank Representatives Klein for his efforts, and urge the Committee to hold a mark up at the earliest opportunity and consider this legislation the starting point for a responsible solution to the problem of decreasing availability and affordability of property insurance.

NAR would encourage consideration of additional proposals, for example, H.R. 308 ("Hurricane and Tornado Mitigation Investment Act") by Representative Gus Bilirakis (R-FL) to provide tax incentives for property mitigation. A separate bill by Representative Tom Rooney (R-FL), H.R. 998 (the "Policyholder Disaster Protection Act of 2007") would encourage disaster reserve funds by insurance companies to pay policyholders' claims arising from future catastrophe. We also support Representative Gene Taylor's (D-MS) H.R. 1264, the "Multiple Peril Insurance Act," which would expand the National Flood Insurance Program (NFIP) to include windstorms, although we expect that measure to be considered as part of the Committee's NFIP reform debate later this year. 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®. We urge Congress to develop a comprehensive approach to natural disaster preparedness that encourages personal responsibility, promotes mitigation measures, ensures insurance availability and affordability, and strengthens critical infrastructure.

Passage of an appropriate comprehensive national disaster policy is a top legislative priority for REALTORS® nationwide. We stand ready to work with you, the leadership of these subcommittees as well as others on the Committee on Financial Services and in Congress to develop a responsible natural disaster policy that addresses the needs of consumers, the economy and the nation.

Testimony of
Glenn Pomeroy
Chief Executive Officer, California Earthquake Authority

Before the
House Committee on Financial Services
Subcommittee on Housing and Community Opportunity
Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises

Hearing on
"Approaches to Mitigating and Managing Natural Catastrophe Risk: H.R.2555, The Homeowners' Defense Act"

March 10, 2010

I would like to express my appreciation to Chairman Frank and the Committee, as well as Subcommittee Chairs Congressman Kanjorski and Congresswoman Waters, for the opportunity to be here today and speak on behalf of the California Earthquake Authority.

My name is Glenn Pomeroy, and I am Chief Executive Officer of the CEA. The CEA is California's not-for-profit, public/private partnership that offers residential earthquake insurance in a voluntary market, throughout California.

H.R.2555, specifically in its Title II, would enable the CEA to lower insurance rates and policy deductibles, allowing many more California consumers to have broader access to earthquake insurance that is both more affordable and more valuable.

As a result, we believe many more Californians would insure their homes against the potential catastrophe—and certain occurrence—of large, damaging earthquakes in our state.

I have divided my testimony today into four parts:

1. **California residential earthquake insurance, Northridge, and the CEA**
2. **The CEA today**
3. **The problem: The high-cost of earthquake insurance puts the coverage out of reach for most California homeowners**
   - **CEA's financial capacity is reinsurance-based**
   - **The high cost of CEA's reinsurance is passed on to policyholders in higher rates**
4. **The solution: COGA – the Catastrophe Obligation Guarantee Act**
   - **Big cost-savings and more choices for consumers**
   - **Lower rates, lower deductibles, and much greater value**

1. California residential earthquake insurance, Northridge, and the CEA

Residential earthquake insurance has been available in California for many years, but since the 1980s California law has required homeowners insurers to make a "mandatory offer" of earthquake insurance.[1] Simply put, as a condition to selling a policy of residential-property insurance to a consumer, the insurer must also offer an opportunity to buy earthquake insurance.

Under this system, consumers don't have to buy earthquake insurance, but they must be offered the opportunity to do so. Thus, earthquake insurance in California is historically a

[1] The CEA offers "residential" earthquake insurance — as defined in California's mandatory-offer law, that includes insurance for renters, condominium-unit owners, manufactured homes (mobilehomes), residential buildings of up to four units, and single-family dwellings. References to CEA "earthquake insurance" in this testimony do not refer to insurance for commercial structures or enterprises.

totally voluntary market — indeed residential quake coverage has never been mandatory in California — and the only mandate is the insurers' offer, made at inception of the homeowners policy and every two years thereafter.

Many observers believe insurers generally did not correctly price the residential earthquake coverage they sold, even under this mandatory-offer system, which led to "competitive" rating and too-low premiums collected for the earthquake coverage sold. This practice, and the entire earthquake-insurance market, changed dramatically in the wake of the 1994 Northridge earthquake.

On January 17, 1994, at 4:31 a.m., a magnitude 6.7 earthquake struck California's San Fernando Valley, 20 miles northwest of downtown Los Angeles. While the strong shaking lasted only 20 seconds, the earthquake produced enormous ground acceleration, with devastating results: 30 lives were lost, and residential insured losses exceeded $12 billion, making it one of the costliest natural disasters in our nation's history.

As insurers assessed their huge Northridge losses, their representatives lobbied hard to repeal the mandatory-offer law — put another way, insurers strongly wanted to stay in the homeowners-insurance market, which was profitable and well understood, but most insurers thought that earthquake-insurance risk was too high, threatening profits and (in extreme cases) company survival.

California policymakers were highly concerned that mandatory-offer repeal could spell the end of earthquake insurance, so the mandatory-offer law was retained to preserve availability of quake coverage. Frustrated in their efforts to control their earthquake exposure, insurers responded by severely restricting, or simply refusing to offer, sales of homeowners insurance in the state, and with those efforts eventually reaching some 94% of the market, their actions threatened to deprive Californians of homeowners insurance altogether.

To respond to this residential-insurance market crisis, the Legislature in 1995 began considering the CEA framework but imposed three tough conditions on the CEA's becoming operational:

- Insurers representing 70% of the homeowners insurance must commit to CEA participation — that participation level would bring the CEA at least $700 Million in start-up capital;
- The IRS must declare the CEA exempt from federal income tax; and
- The CEA was obligated to obtain in reinsurance protection twice the level of initial insurer contributions — this $1.4 Billion (or more) in initial reinsurance was to require an unprecedented reinsurance buy for a single entity writing a single risk.

All of the benchmarks were met, and the CEA opened its doors and accepted its first risks on December 1, 1996. From that day forward the CEA has served a statewide, voluntary residential-earthquake market that private insurers had largely abandoned.

2. The CEA Today

Today, the CEA is the largest monoline writer of earthquake insurance in the United States. With 800,000 policies in force, $600 Million in annual premium revenue, and almost $10 Billion in claim-paying capacity, the CEA now writes 70% of all residential earthquake policies sold in California.

The CEA is organized as a **unique, public-private entity**:

- It has public management.
  - Its Governing Board is composed of the Governor, Insurance Commissioner and State Treasurer (as voting members) and the two leaders of the State Legislature (as non-voting members).
- It is privately financed.
  - Because it is not an agency or department of government, it uses no tax money.
  - It is wholly outside California's state budget.
  - When it incurs debt, it does so without California's "full faith and credit."
  - Its primary revenue is its investment income and its premium receipts.
  - Private-insurer contributions formed the CEA's seed capital, and all participating insurers retain a further responsibility to pay assessments in the event of large earthquakes.

The CEA Governing Board and staff manage the CEA's business activities, but the insurance companies that are the CEA's participating insurers play a central role in the conduct of the CEA's insurance business.

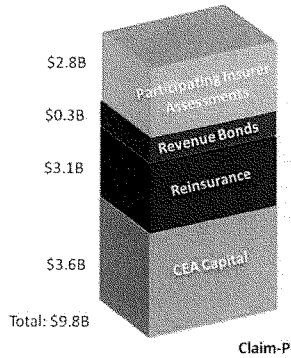
- The first step of the CEA's business process is the (still mandated by law) offer of earthquake insurance that CEA participating insurers retain – California's homeowners insurers still must make the offer, but those that under the CEA Act[2] have committed funds to and participate in the CEA are authorized to offer a CEA policy.
- If an earthquake-insurance offer is accepted, the CEA participating insurer (using its own agents and sales channel) bills and accepts the premium and remits it to the CEA, less a service charge.
- While the policy is in effect, the participating insurer has a continuing responsibility to service the policy, handling policy changes, re-rating, and the like. There is no separate charge to the CEA for handling these matters.
- After an earthquake that CEA determines is likely to produce claims, the CEA advertises widely in affected areas to direct CEA policyholders to report their earthquake-insurance claims directly to their participating homeowners insurer.
  - Recognizing the CEA's expertise in all matters pertaining to earthquake insurance, California law requires all adjusters of earthquake-insurance claims to be trained and accredited under CEA claim-adjusting standards. This requirement applies to both CEA participating insurers and non-CEA insurers.

[2] The CEA Act can be found at sections 10089.5 through 10089.54 of the California Insurance Code.

- CEA participating insurers have primary responsibility to handle CEA claims through their own adjusters, whether employed or under contract.
- The insurers generally pay the claims that are determined eligible, with the CEA providing reimbursement and a claim-handling fee.

The CEA today has $9.8 Billion in claim-paying capacity. The components of this capacity, and the order in which these funds would be accessed to pay claims following an event, are as follows:

1. CEA capital: $3.6 Billion
2. Reinsurance: $3.1 billion
3. Revenue bonds: $0.3 Billion
4. Participating insurer assessments: $2.8 Billion



Claim-Paying Capacity: 1-in-545 Years

3. The problem: The high cost of earthquake insurance puts the coverage out of reach for most California homeowners

California is home to about two-thirds of our nation's earthquake risk. About 2000 known faults criss-cross the state, and although California's strong land-use rules strictly determine conditions for building or living very near a fault[3] or where soil liquefies or is subject to landslides[4], the sheer number of faults means that a majority of Californians live within 20 miles of at least one of them.

With so much earthquake risk within the state, and with a majority of California's large population living near faults, the subject of how to prepare for and recover from the next big earthquake is critical to California policymakers. There is broad consensus in the scientific community that a 6.7 earthquake somewhere in California within the next 30 years is a virtual certainty – this, of course, means that questions of how best to prepare and protect lives and homes against earthquakes is front and center, framed with urgency.

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[3] For an excellent official account of the landmark Alquist-Priolo Earthquake Fault Zoning Act, please see: http://www.consrv.ca.gov/CGS/RGHM/AP/Pages/Index.aspx.

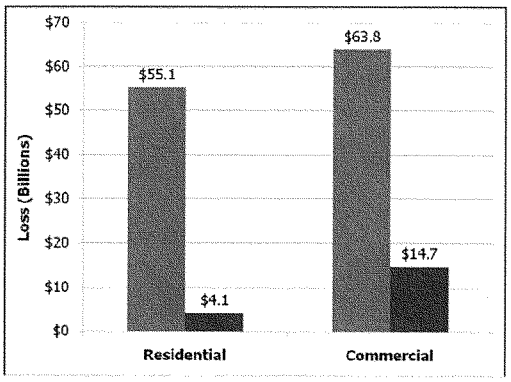
[4] A further, important refinement to the Alquist-Priolo Act was the Seismic Hazards Mapping Act, which addresses seismic hazards not related to surface faults, such as liquefaction and landslides. Please see: http://www.consrv.ca.gov/cgs/shzp/Pages/shmpact.aspx.

As occurs everywhere in the United States, most California homes have mortgages and therefore are covered by fire insurance—that is a mortgage-related requirement. But no homeowners policies cover damage from earthquakes, even though most people believe that a cornerstone of earthquake preparedness *should* be earthquake insurance for homes.

In fact, only 12% of California homes (just one-in-eight) with a fire policy are covered for earthquake shake damage (this 12% number is called a penetration rate or a take-up rate). To flip that coin and focus that statistic on the real public-policy problem, 88% of homes covered for fire (fully seven out of eight) are *un*insured with respect to earthquake risk.

The consequences of such a large uninsured population could be devastating following a large, damaging quake.

For example, if a 7.2 magnitude earthquake occurred on the Peninsula segment of the San Andreas fault (which runs along the peninsula, up and through San Francisco), it is estimated that residential losses would be approximately $55.1 billion. ***At current take-up rates, only $4.1 Billion of these losses would be covered by insurance, while $51 Billion would be uninsured.***



Total economic damage (blue) and insured loss (red) to the residential and commercial lines of business as a result of a M7.2 earthquake on the Peninsula segment of the San Andreas Fault in 2009. Source: Risk Management Solutions, Inc., *Catastrophe Modeling and California Earthquake Risk: A 20-Year Perspective* – copyright 2009 – used with permission.

Barriers to Purchase of Earthquake Insurance. There are two primary barriers that prevent more California householders from buying earthquake coverage:

1. The policy is considered too expensive.
2. The policy requires a deductible that is considered too high and too restrictive.

There is no doubt earthquake insurance can be expensive – especially in high-risk areas – often exceeding the price of the homeowners/fire insurance. And a 15% deductible does mean that a dwelling must sustain considerable damage before a claim can be paid.

In high-risk regions where earthquake insurance is expensive, the higher predicted loss in such areas is an obvious, but only partial, explanation for the pricey coverage. The other, and often predominating, reason is that an insurer's expenses is the other determinant of rates—high expenses drive higher insurance rates. In the case of the CEA, its overhead and operating expense is well *below* industry averages, but its reinsurance costs are simply *massive*.

To explain further:

An insurance company establishes its rates by applying some variation of the following formula and then distributing its rate needs over its exposures, using a rating plan:

projected loss + expenses + profit = insurance company rate

Because the CEA is a nonprofit entity, it collects no profit – for CEA, therefore, the formula is more like this:

projected loss + expenses = CEA rate

It bears emphasizing that CEA rates are required – by law – to be actuarially sound: not excessive, not inadequate, and not unfairly discriminatory.

- The CEA determines its projected losses through sophisticated earthquake-loss modeling and dynamic-financial analyses. In fact, the CEA is recognized in the seismic-science and earthquake-engineering communities as among the most sophisticated, responsible users of modeled-loss outputs.
- In addition, California's property-insurance rates are regulated by a highly professional Department of Insurance, which takes a strong interest in ensuring that rates are set correctly and appropriately distributed over CEA risks.

The bottom line is that CEA earthquake-insurance rates are accurately set and appropriately regulated so that they are appropriate for the risks insured, given the expected losses and the CEA's expense load.

The expense part of the rate formula is the only rate variable over which the CEA has significant control. Fully two-thirds of the CEA's expenses consist of what it spends each year, every year for the reinsurance we place in our claim-paying capacity. Any effort to make the CEA's capital deployment more efficient by reducing its expenses, thus attracting more policyholders, must begin with a careful examination of its reinsurance program.

CEA's heavy dependence on reinsurance. Since the CEA opened its doors in 1996, it has depended heavily on reinsurance coverage for a significant portion of its claim-paying capacity — that heavy reliance is still true today and the purchases are larger, even as CEA capital has grown: nearly one-third of CEA's claim-paying capacity (which today totals $9.8 billion) is provided through reinsurance.

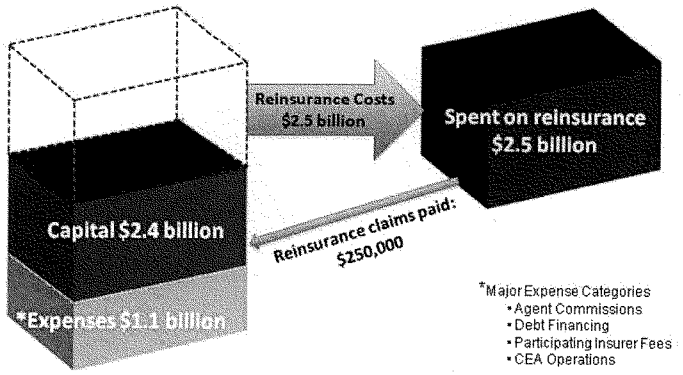
High cost of reinsurance. While reinsurance allows critical risk transfer for the CEA, there have not been suitable alternatives to it, and so the reinsurance protection has come at a huge cost. Over the years, CEA has collected a total of $6 Billion in premium from its policyholders. Of that amount, $2.5 billion – *40% of the CEA's premium revenue over 13-plus years* – has been paid by CEA to the global reinsurance market as reinsurance premium. And of the $2.5 billion paid in reinsurance premium, the reinsurers have paid to the CEA $250,000 in reinsurance claims paid.

The CEA is clear on the benefits of good reinsurance in a financial structure and has obtained important capacity from reinsurance over almost 14 years. The CEA's highly conservative capacity levels have allowed CEA to write very safe and secure insurance policies for its policyholders, but only for those who can afford it and choose to purchase it.

In the absence of a more efficient financing model, however, the CEA has had no alternative but to commit 40% of its policyholder premium to pay in advance, in full and for each and every such year, for the capacity to withstand events of extremely unlikely probability.

For example, in 2010 the CEA's capacity calculations indicate that only once in every 545 years would earthquake events cause CEA to be unable to pay 100% of all its claims. Reinsurance protection in this financing capacity would not even begin to kick in until the CEA had exhausted nearly all of its capital and revenue bond proceeds, a total of almost $4 Billion — for some perspective, $4 Billion is substantially more than the CEA would expect to pay in a repeat of the 1994 Northridge earthquake, and the CEA's total capacity today of $9.8 Billion exceeds what the CEA would expect to pay in a Northridge repeat <u>and</u> a repeat of the 1906 San Francisco earthquake, combined.

1997-2009: Total policyholder premiums $6 billion



If such mega-catastrophes do not occur in 2010, CEA's reinsurers will once again have no losses to pay, whether from capital or from CEA premium received, which might lend them the ability and the desire to negotiate a similar (and similarly beneficial) contract with CEA next year. We won't actually know, however, until we are in the reinsurance market later this year.

In short, CEA customers, each and every year, are asked to pay a premium sufficient to ensure CEA has full, reinsurance-based claim-paying capacity for a huge, almost unprecedented earthquake in California. And when each year rolls by and no such mega-catastrophe occurs, the CEA's reinsurers realize generous profits for the risk they assumed for a year, and then the cycle repeats.

The slides below are from a December 2008 Swiss Reinsurance Company (Swiss Re) presentation to analysts and investors and seem to demonstrate how one reinsurer, at least, regards the CEA business as large, attractive, and profitable. The CEA is listed as the number-one example under the heading "Large Attractive Transactions." The summary take-away of this slide is "Swiss Re deploys capital to large, profitable deals."

Swiss Re

Annual results 2008

Analyst and investor meeting – Zurich, 19 February 2009

Swiss Re

Large attractive transactions

Some examples

- **California Earthquake Authority**
  USD 1.5bn gross reinsurance cover for publicly managed, privately funded earthquake insurance for homeowners
- **Liberty Mutual**
  Substantial property quota share
- **Australian insurer**
  Longevity swap providing protection against adverse longevity developments in client's annuity book

→ Swiss Re deploys capital to large, profitable deals

Slide 29

So again, for the past 14 years the CEA has obtained important catastrophe cover from the reinsurance industry. And while this cover has served its purpose, its placement has been highly profitable for reinsurers but has come at an extremely high cost to CEA policyholders.

A final note about the high reinsurance costs that pose such a challenge to the CEA: Despite the huge disparity between the premium paid by CEA for reinsurance and reinsurance claims that have been paid, last fall, in establishing the reinsurance contracts for 2010, the CEA was forced to pay a 15% overall rate ***increase*** for its reinsurance package, despite a claim-free 2008 and 2009.

4. The Solution: COGA – the Catastrophe Obligation Guarantee Act

Title II of H.R.2555 would create a committed, but strictly limited, federal guarantee for post-event borrowing for certain qualified state programs, as determined by the US Treasury Secretary.

Many states face catastrophic natural-disaster risk so large that private markets won't or simply can't insure it. And, of course, the cost of natural-disaster insurance is so high that many consumers can't afford it.

To bridge these availability and affordability gaps, a number of states have created public insurance or reinsurance programs to help property owners insure their homes against natural disasters. These programs need substantial post-catastrophe capital to pay their claims, but for public entities, the only available form of external capital is debt capital. In severely disrupted credit markets, however, even the most creditworthy public entities face challenges when seeking to raise the debt capital necessary to fully fund their program needs.

Established programs in California, Texas, Florida, and Louisiana came together in 2009 to formulate a common-sense and innovative proposal designed to address their common needs for reliable, adequate private-debt financing.

- This concept was originally embodied in a standalone bill in the U.S. Senate, S.886 (COGA, or the Catastrophe Obligation Guarantee Act), now co-sponsored by Senator Bill Nelson (Florida), Senators Dianne Feinstein and Barbara Boxer (California), and Senator Mary Landrieu (Louisiana).
- A similar concept has been introduced as a standalone bill in the U.S. House of representatives (H.R.4014 – Congresswoman Loretta Sanchez, with a number of co-sponsors).
- And we are grateful to Congressman Klein for his inclusion of the COGA concept as Title II of H.R.2555.

Focusing on the COGA provisions in Title II of H.R.2555, the bill would authorize (<u>only</u> for qualifying state catastrophe-insurance programs) a federal guarantee of private-market debt

incurred to pay insured losses from natural catastrophes. Each of the programs that today qualify for the Title II guarantee provisions has actuarially sound rates, and each has both experience in, and high ratings for, debt issuance.

Upon application by a qualifying state program, the Treasury Department would provide a three-year rolling commitment to guarantee private-market debt, re-affirmed each year, but in amounts limited by law: $5 Billion in guarantees would be available for public earthquake programs and $20 Billion available for public wind programs.

A three-year COGA guarantee commitment would give each State program the vital certainty it needs when planning its claim-paying capacity.

Unlike reinsurance, which requires advance payment of premium for all coverage that might be needed, the COGA guarantee would be issued only *after* an event, when the state program would go into the private debt markets, and it would be issued only for such borrowing as is needed for event-related claim payment. On that basis, it would be available to ensure that programs relying on authorized debt have the market access they need in difficult times, such as might occur after a large event or during demanding economic times.

A federal guarantee, as helpful as it may be, should only be available through programs such as COGA that are sensitive to a central factor: no guarantor — private or government – wishes to provide a guarantee that is certain to be exercised. Good business sense demands that guarantees be issued only to responsible borrowers, lest the guarantor become a "co-signer."

That is why under COGA and Title II of H.R.2555, only state catastrophe programs that meet stringent criteria qualify to receive committed guarantees:

- The program must fulfill a public purpose and be a public organization, governed by a board composed of or appointed by public officials.
- The public program must be exempt from paying federal income tax.
- The program must have a proven ability to repay debt.
- Rates and rating structures for the program must be actuarially sound.
- States with qualifying programs should have strong building codes, support good land-use principles and goals, and have effective loss-mitigation measures in place.

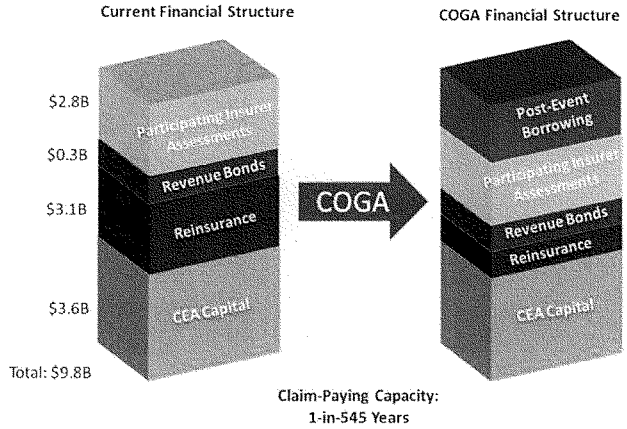
This combination of factors is calculated to ensure that COGA-program benefits support good public policy, and that COGA borrowers are responsible, managed with transparency, and are safe and suitable candidates for a guarantee of debt by the U.S. Treasury.

The CEA would use the new COGA tool to reduce reliance on expensive reinsurance, replacing part of that cover with the certain ability to borrow money in the private capital markets, incurring that debt only after an event, and repaying the debt as required.

This would be a paradigm shift, a true game-changer for the CEA. The CEA could significantly reduce its rates, charge its policyholders less and lower their deductibles, while at the same

time enhancing and enlarging coverage choices. All this would be accomplished in a highly responsible and transparent manner, within a proven, actuarially sound rating structure. It would be a win-win-win situation: the U.S. Treasury, the State, and the CEA's customers would all be beneficiaries of the new system.

Federally guaranteed post-event borrowing capability



The illustration above shows that COGA would create a new layer of CEA claim-paying capacity, allowing CEA to reduce its customary reliance on prepaid, expensive reinsurance, and providing the certainty of being able to borrow after a catastrophic event. The CEA would continue to obtain a layer of reinsurance protection, but it would no longer be forced to spend 40% of its policyholder-premium revenue on this expensive form of risk transfer.

CEA modeling indicates that once the new COGA tool becomes available to the CEA and the financial structure is modified, the CEA's odds of borrowing under COGA would be extremely remote – between 0.5% and 1%. Put in practical, scenario terms, the CEA could pay all policyholder claims from **any** of the following events ***without*** any borrowing using COGA:

- Repeat of San Francisco 1906 earthquake (M 7.8).
  - Projected CEA losses: $5 – 6 billion.
- Repeat of 1989 "World Series Earthquake" (M 6.9).
  - Projected CEA losses: $0.5 billion.
- Repeat of Northridge earthquake (M 6.7).
  - Projected CEA losses: $3.2 billion.
- 2008's Great California Shakeout Scenario (M 7.8).
  - Projected CEA losses: $7 billion.
- Hayward Fault Scenario (M 7.2).
  - Projected CEA losses: $3.9 billion.

Big cost savings for consumers: Since fully two-thirds of all CEA's expenses are in the cost of its reinsurance program, COGA cost-savings will be passed directly on to policyholders as reduced premium. We estimate that we would be able to implement an across-the-board premium-rate decrease of about 35%.

More choices for consumers – lower deductible and greater value
In addition to making earthquake insurance more affordable, COGA would enable the CEA to offer greater choices of coverage – and greater value – as well.

- Most CEA policies are sold with a 15% deductible. This means that the insured dwelling must be damaged in an amount equal to 15% of the CEA structure limit before CEA can pay a claim. And a CEA policyholder with contents coverage receives no contents-damage payout until the dwelling deductible is met.
- COGA would enable the CEA to slash the dwelling deductible in half – cutting the typical 15% deductible to just 7.5%. This would create CEA coverage that is much more likely to result in claims paid. And the CEA could create a new *contents-specific* deductible and for the first time pay contents losses if just the insured contents suffer a 15% loss.

More insured California homes helps homeowners, which can mean less financial pressure on the Federal government following a mega catastrophe:

The CEA strongly believes that by offering a more affordable, more valuable earthquake-insurance policy, many more Californians could and would decide to insure their homes for earthquake loss. After all, we know that in California's voluntary residential-earthquake-insurance market, price and deductible level are the declared barriers to purchase – and COGA goes straight to the heart of lowering those barriers.

Indeed, our goal would be to double the take-up rate of earthquake insurance in California within five years of COGA's enactment.

Scientists and citizens alike know that it is clearly a matter of when, not if, the next damaging earthquake will strike in California. By your taking favorable action on H.R.2555 today, and in the process providing qualifying state programs with COGA benefits, you can help ensure that this nation is better supported – and better protected – when that big earthquake occurs.

Conclusion.

The CEA is grateful for the opportunity to be here today, to be a part of informing the Committee's and Subcommittees' process on these critical preparedness and recovery challenges for the States. We thank you for your great interest in this subject, which to those of us on the front lines is so important.

If there is any matter on which you would like follow-up or more information, please let us know – I'm more than happy to offer you, and the Committee and Subcommittee staff members, the expertise and technical assistance of the CEA staff.

Admiral James M. Loy, National Co-Chair
Former Deputy Secretary, Department of Homeland Security
Commandant, U.S. Coast Guard (Retired)

James Lee Witt, National Co-Chair
Former Director, Federal Emergency Management Agency
Former Chief Executive Officer, International Code Council

STATEMENT OF

JAMES LEE WITT
FORMER DIRECTOR, FEDERAL EMERGENCY MANAGEMANT AGENCY

NATIONAL CO-CHAIRMAN
PROTECTINGAMERICA.ORG

Before the
House of Representatives Committee on Financial Services
Subcommittee on Housing and Community Opportunity
and
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

March 10, 2010

Statement for the Record

Mr. Chairman, Ranking Member Bachus, and members of the committee, I want to thank you for the opportunity to appear before you today to discuss ways to better prepare and protect American families from the devastation caused by natural disasters. Congressman Klein, I also want to thank you for your leadership on this very important issue.

As you know, I am no stranger to the field of disaster management and emergency preparedness. I was honored to serve as the Director of FEMA under the Clinton Administration from 1993 until 2001. Today, I will speak to these issues in my capacity as co-chairman of ProtectingAmerica.Org, an organization formed in 2005, to raise the national awareness about the important responsibility we all have to prepare and protect consumers, families, businesses, and communities from natural catastrophes.

My fellow co-chairman is Admiral James Loy, former Deputy Secretary of Homeland Security and Commandant of the U.S. Coast Guard (Ret.). Together we have built a coalition and campaign to create a comprehensive and integrated 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, and save money and lives. There are over 300 organizations in our coalition including the American Red Cross, the International Association of Fire Fighters, State Farm, Allstate, municipalities, small businesses, Fortune 100 companies, and more than 20,000 individual members. The membership is truly broad, diverse, and representative of virtually every state in the nation.

We all believe that this hearing is timely. With headlines around the world relaying stories from the recent tragedies in both Haiti, Chile and on Monday, Turkey , many here at home are taking a harder look at whether or not we would be prepared if a similar catastrophic event were to happen in the U.S.. Unfortunately, recent experiences, such as the aftermath of Hurricane Katrina in 2005, as well as the continuing economic troubles in our housing and lending sectors prove that we have a lot of work to be better prepared.

A catastrophic event, whether an earthquake striking one of our great American cities, or a massive hurricane making landfall near any of the metropolitan areas from New York to Houston, would cause such enormous damage that our economy would be stunned, private resources quickly depleted, and an immediate federal bailout of hundreds of billions of dollars could potentially be required. This Committee is very familiar with the fact that the American taxpayers have lost their appetite for bailouts. As a result, they would be far better served by a program that uses private insurance dollars to pre-fund coverage for the eventuality of a catastrophic natural catastrophe.

I believe that there are three key points critical to any comprehensive solution to the homeowners' insurance crisis.

First, a National Reinsurance Program will generate additional capacity, bring more stability to the market, make high-quality insurance more available, and ensure that consumers realize

significant cost-savings on their homeowners insurance. The best way to accomplish this is to enable and encourage more states to create well-structured, actuarially-sound catastrophe funds and to supplement the protection offered by the current state catastrophe programs in California and Florida.

To deliver meaningful premium savings for consumers and to allow for the maximum use of the reinsurance by differing programs in multiple states, the reinsurance provisions of the national program should allow flexibility on the attachment point. In addition, the Committee may wish to consider alternative means to fund the reinsurance program other than upfront appropriations of the entire potential liability since the odds of incurring this liability are very small. This is one area of the bill we believe can be improved by placing a lower federal catastrophic attachment point to provide a seamless level of protection for policy holders.

Second, Catastrophe Obligation Guarantees will provide helpful support to the debt issuances of state programs that could serve those programs well in distressed market conditions. The guarantee or loan concepts should be constructed to work together seamlessly with the reinsurance program. They should complement each other, with the guarantee and/or loan option covering a certain layer of loss and the reinsurance option another.

Finally, we believe that a hybrid approach to the prevention and mitigation provisions is important. This approach would keep the program under Housing and Urban Development (HUD) but incorporate a privately financed National Catastrophe Fund that provides significant investment income to groups like the Red Cross and others. We are pleased to have been working with the Committee to strengthen this particular piece of the legislation.

To state it simply, the status quo is not acceptable. A 2009 report by Jonathan Orszag, an economist who formerly served on President Clinton's National Economic Council, found that the current system for post-catastrophe financial preparedness is riddled with inefficiencies and there is a significant gap between the ability of the private insurance and reinsurance sectors to provide the protection that is required. Specifically, Mr. Orszag found that the current system is an ad hoc, backward-looking program that makes the government and the taxpayers, essentially, the insurers of last resort. Further, his report suggests that a better approach would be one that not only assures that resources are available to fund recovery, but also funds prevention, mitigation, and preparation.

To that end, we support a comprehensive, integrated plan linking a national catastrophe fund with support to first responders as well as strong education and mitigation provisions. A national catastrophe fund will create a privately financed and federally-administered layer of reinsurance to complement and stabilize private market reinsurance alternatives, and ensure greater availability and affordability for consumers of residential property insurance. It will do so by acting as a backstop for state catastrophe funds, which will protect the private market from collapse and ensure that resources are available to rebuild after a major catastrophe. In addition, it will save your constituents money on their homeowners' insurance and help states better manage the risk associated with mega-catastrophes, which are essentially uninsurable in the private market due to the timing risk.

Qualified state funds would also be able to purchase reinsurance from the national program. Rates for this coverage would be actuarially based and would only be available to state programs that have established the mandatory prevention and mitigation funding. In the event that a catastrophe strikes, private insurers would be required to meet all of their obligations to their policyholders. Should catastrophic losses exceed those obligations, the state catastrophe fund would be utilized. 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 a 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 in the areas that are most exposed to catastrophe. This approach is far preferable to the de facto bailout we have witnessed with natural disasters in recent memory. Following the devastation caused by Hurricane Katrina, a Brookings Institution study found that after-the-fact recovery funding resulted in an enormous taxpayer subsidy for effected uninsured and underinsured properties – of the first $85 billion in taxpayer dollars spent more than $10 billion funded losses for families lacking coverage.

ProtectingAmerica.org believes that a national catastrophe fund would also buffer the already fragile housing and lending markets during this time of economic downturn. The approach proposed in H.R. 2555 would reduce the threat of insurer insolvency and enhance the industry's capacity to pay claims. This in turn would create an important measure of stability to the catastrophic insurance industry and mitigates the shock to the U.S. economy that a major natural disaster might otherwise produce.

We recognize that not all areas of the country face equal threats of exposure to natural catastrophe. A recent report by Protecting America.org analyzed the demographic profiles of residents of counties that have been significantly affected by hurricane damage in recent years. The report found that persons who are most likely to be impacted by catastrophic events are disproportionately African American, poor, and living in homes with values well below state and national averages. This further reinforces the need for strong, complementary readiness, preparedness, and mitigation provisions. Ideally, the plan would require the national and state catastrophe fund to dedicate a significant portion of its investment income to local communities and non-profits to support efforts like building code development and enforcement, improved preparedness education and training, and additional equipment and personnel for first responders.

When catastrophe strikes, our response programs, such as those through the American Red Cross, do a remarkable job of getting victims into shelters and mobilizing emergency supplies and personnel so that the situation does not get worse.. All Americans, regardless of whether or not they have been victimized by catastrophe, owe our first responders an enormous debt of gratitude. Their service is invaluable. Clearly, programs that would improve preparedness, increase public education, enhance prevention and mitigation programs, and augment support for first responder programs would improve our national capability to prepare and protect those of us who live in harm's way.

I truly believe that this needs to continue to be a top national priority. It reflects strong leadership to act before the next crisis. It is time for the federal government to take action on this important issue and with your assistance, we can, together, get this critical legislation passed into law. Congressman Klein, thank you again for your leadership and continued persistence on this important issue, and thank you again to the Committee for this opportunity to testify. I would be happy to answer any questions that you may have.

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The Honorable Paul Kanjorski, Chairman
Subcommittee on Capital Markets, Insurance,
and Government Sponsored Enterprises
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Maxine Waters, Chairwoman
Subcommittee on Housing and Community
Development
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Scott Garrett, Ranking Member
Subcommittee on Capital Markets, Insurance,
and Government-Sponsored Enterprises
B371A Rayburn House Office Building
Washington, DC 20515

The Honorable Shelly Moore Capito, Ranking Member
Subcommittee on Housing and Community
Development
B317A Rayburn House Office Building
Washington, DC 20515

March 9, 2010

Dear Chairman Kanjorski, Chairwoman Waters, Ranking Member Capito, and Ranking Member Garrett:

As your Subcommittees begin to consider the Homeowners' Defense Act (H.R. 2555) and its impact on the homeowners insurance markets, I want to share our views on this legislation. This is an important issue and we commend you for taking a proactive approach to addressing the complex problem of insuring natural catastrophes. The American Insurance Association (AIA), the nation's leading trade association for property and casualty insurance companies, remains committed to working with you to find solutions designed to provide both long-term stability in the private insurance markets and greater certainty to insurance consumers.

Following the historic 2004 and 2005 hurricane seasons, AIA again under took an extensive review of America's response to catastrophes and ways to improve the insurance industry's ability to serve homeowners and businesses in catastrophe-prone areas. In particular, we looked at positive system changes that will allow private markets to manage natural catastrophe risk without establishing new government programs or a bail-out from taxpayers living in less-risky areas.

With maximizing private market capacity as a guiding principle, AIA developed a reform agenda that includes federal and state initiatives that could provide short- and long-term benefits. This agenda, a summary of which we have enclosed, consists of four major components:

Protective measures, including improving mitigation efforts and strengthening building codes, to keep people out of harm's way and increase the ability of homes and businesses to withstand future catastrophes;

Regulatory and legal reforms to improve the stability of insurers' operating environment;

Tax incentives to encourage residents to take more responsibility for catastrophe preparation and response; and,

National Flood Insurance Program (NFIP) reforms to assure that the NFIP continues to play a vital role in protecting the nation from the generally uninsurable risk of flood.

These reforms should be implemented as quickly as possible. While some of the reforms are clearly targeted at windstorms, they could be modified to address other natural catastrophes. We believe that these proposals would preserve the critical role of the private insurance markets in providing financial protection from natural catastrophes. For your information, I am enclosing a copy of the executive summary of AIA's reform agenda.

As we have noted, mitigation must be a key component to any comprehensive reform effort, and we appreciate the inclusion of a mitigation grant program in the Homeowners' Defense Act. However, the core components of the legislation do not meet the objective of maximizing the private sector's ability to manage risk. Although well-intended, H.R. 2555 will not generate new private sector insurance, reinsurance or capital market capacity. Instead, it is more likely to encourage the development of state programs that will displace the private market and require a federal government bailout in the event of a catastrophe.

As introduced, H.R. 2555 establishes: (1) a "consortium" or pooling mechanism that would enable states to purchase natural catastrophe reinsurance and sell catastrophe bonds to private investors; (2) a federal guarantee for the debt issued by eligible state programs; and (3) a federal reinsurance program allowing the Secretary of the Treasury to sell reinsurance to eligible state programs. To varying degrees, we have concerns with each of these components.

Regarding Title I's consortium, states already have the option to pool their risk with other states, but have chosen not to do so. This is because a lower-risk state receives no benefit in pooling its risk with a relatively higher-risk state. In fact, when lower-risk states pool risks with higher-risk states, the lower-risk states are effectively subsidizing insurance costs in higher-risk states. Second, individual state programs can access capital markets today, without being part of a consortium and without the need for federal legislation.

Next, the federal "Catastrophe Obligation Guarantees" in Title II (which pledges the "full faith and credit" of United States to pay the debt in the event that an eligible state is unable to meet its obligation to bond holders) is also of concern. This guarantee mechanism incentivizes a state to under-fund its state program in the expectation that it can simply issue additional debt guaranteed by the federal taxpayer. Moreover, when insurance rates are artificially suppressed by the government, it generates moral hazard by encouraging people to build and locate in more catastrophe-prone areas.

Title III's federal reinsurance program appears to be based on the notion that large-scale natural catastrophes are uninsurable in the private sector. We respectfully disagree with this premise. While the devastating storms of 2004 and 2005 certainly impacted earnings, the private property and casualty insurance industry remains strong and resilient. Similarly, private reinsurers and capital markets continue to assume catastrophe risk.

We are particularly concerned with these proposals since they are likely to encourage the growth of existing state programs, and the establishment of new ones. State programs displace private market insurance and reinsurance, and encourage a state to warehouse its catastrophic risk within the state, rather than spread risk through global reinsurance markets.

Importantly, the bill does not require a state program to charge risk-based premiums, maintain adequate reserves, establish a solid, private-market reinsurance program, or manage its finances to an acceptable level of risk. In other words, the legislation does not require that the state program to have any "skin in the game."

Finally, subsidies are not fair to federal taxpayers who do not live in catastrophe-prone states, but would nonetheless bear the costs of these proposals.

For.all these reasons, AIA opposes the Homeowners Defense Act.

Thank you for the opportunity to present our views on this important policy matter. We stand ready and are willing to work with the Subcommittees to develop a comprehensive set of reforms designed to maximize the ability of the private insurance markets to manage better the risk of natural catastrophes.

Sincerely,

Leigh Ann Pusey
President and CEO

[Enclosure]

cc: Barney Frank, Chairman, House Committee on Financial Services
Spencer Bachus, Ranking Member, House Committee on Financial Services
Members of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
Members of the Subcommittee on Housing and Community Development

American Insurance Association
Natural Catastrophe Agenda

- To Reduce Loss and Promote Stability -

EXECUTIVE SUMMARY

Hurricane Katrina and the other devastating 2004-05 storms focused renewed attention on the role of private sector insurers in managing natural catastrophe risk. Fortunately, despite last year's record-breaking losses—and predictions of higher-than-average hurricane activity levels for the foreseeable future—insurers are well positioned financially to manage this risk. However, to do so effectively, insurers must have the tools to measure and reduce catastrophe risk, and the insurance regulatory system must allow rates to reflect the real costs of coastal exposure.

AIA and many other insurers believe that new government programs are no panacea for natural catastrophe risk, and can lead to inefficient allocation of capital, unfair subsidization, and increased (and unwise) building in catastrophe-prone regions. The best solution rests in improving, not displacing, the private sector's ability to serve homeowners and businesses in the path of potential storms.

AIA's reform agenda includes both federal and state initiatives, as well as both short- and long-term measures consisting of four major components:

I. **Protective measures** to keep people out of harm's way and strengthen their ability to withstand future hurricanes;
II. **Regulatory reforms** to improve the stability of insurers' operating environment;
III. **Legal reforms** to provide insurers confidence that the insurance policies they write will be upheld following a major catastrophe;
IV. **Tax incentives** to encourage residents to take more responsibility for hurricane preparation and response; and,
V. **National Flood Insurance Program (NFIP) reforms** to assure that NFIP continues to play a vital role in protecting against the generally uninsurable risk of flood.

I. Protective Measures

- **Building Codes** – Establish and enforce strong building codes to help reduce deaths, injuries, and property damage from natural catastrophes and more routine property losses.
- **Land Use Planning** – Create and implement "smart growth" land use planning policies to help make communities more disaster resistant.

- **Disaster Awareness and Preparedness Plans** – Design and use disaster awareness and preparedness plans to mitigate the negative personal and financial impact of a catastrophe.

II. Regulatory Reform

- **Risk-Based Pricing** – Property insurance rates must be predicated on risk-based pricing, utilizing the best possible scientific information, which will encourage loss prevention, thus reducing the individual and societal costs of disasters.
- **Computer-Based Disaster Models** – Models must be improved and refined to help insurers measure catastrophe risk and reduce likelihood of insurer insolvency.
- **Higher Deductibles and Tax Incentives** – Higher deductibles can make insurance more affordable, while tax incentives can help policyholders pre-fund their deductible obligations.
- **Post-Event Regulatory Mandates** – States should not implement broad-ranging and shifting post-event regulatory mandates that increase insurer uncertainty and divert attention needed to respond to claims.
- **Post-Event Claims Adjustment** – States should facilitate post-event claims adjustment.

III. Legal Reform

- **Contract Inviolability** – The legal system must preserve the sanctity of contracts.
- **Statutes of Limitations** – Statutes of limitations should not be extended.

IV. Tax Incentives

- **Tax-Deferred Catastrophe Reserves** – Amend U.S. tax laws to permit insurers to establish tax-deferred catastrophe reserves.
- **Tax-Exempt Catastrophe Savings Accounts** – Enact federal legislation to establish tax-exempt Catastrophe Savings Accounts (CSAs) for individuals (similar to health savings accounts).
- **Income Tax Credits** – Provide federal/state income tax credits (similar to tax credits formerly provided to encourage energy efficiency) to encourage homeowners and business owners to invest in protective measures that go beyond building code requirements (e.g., hurricane-resistant garage doors, hurricane shutters).
- **Sales Tax Holidays** – States should create state sales tax holidays for hurricane mitigation and preparedness purchases, or exempt certain items from state sales tax.

V. National Flood Insurance Program (NFIP) Reforms

- **Risk-Based Pricing** – Introduce risk-based premiums.
- **Expansion** – Expand program mandates to cover more homeowners in more locations.
- **Financial Enhancement**– Increase maximum coverage limits and deductibles.
- **Policy Terms** – Use policy terms that are more consistent with private insurance.
- **Map Modernization** – Complete NFIP map modernization initiative as soon as possible.

Updated 2010

Testimony

The Cincinnati Insurance Companies

Approaches to Mitigating and Managing Natural Catastrophe Risk:
H.R. 2555, the "Homeowners Insurance Defense Act of 2009"

The House Subcommittee on Housing and Community Opportunity
The House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

United States House of Representatives

March 10, 2010

The Cincinnati Insurance Company, a national property casualty insurer headquartered in the Cincinnati, Ohio area, and the 25th largest publicly traded property casualty insurer in the United States, offers the following testimony in opposition to H.R. 2255, the Homeowners' Defense Act of 2009.

This bill is another in the long line of ill-conceived federal proposals that would interfere with private insurance markets by providing federal support and assistance to state-sponsored catastrophe insurance and reinsurance programs.

Specifically, H.R. 2255 would provide a $325 billion federal backstop to state-sponsored catastrophe insurance and reinsurance programs. First, the bill would permit state-sponsored catastrophe insurance and reinsurance programs to purchase risk-linked securities and reinsurance through the "National Catastrophe Risk Consortium," an ambiguously conceived facility that would provide state-sponsored catastrophe insurance and reinsurance programs with up to $100 billion in bailout funding. Second, the bill would create a federal guarantee program for bonds issued by state-sponsored catastrophe insurance and reinsurance programs with a price tag of $25 billion. Third, the bill would create a federal reinsurance program for state-sponsored catastrophe insurance and reinsurance programs with annual liabilities of up to $200 billion per year.

Before Congress jumps into this fiscal sinkhole, it should take a long, hard look at the dysfunctional nature of state-sponsored catastrophe insurance and reinsurance programs and the manipulation of private insurance markets by state governments which forced state-sponsored catastrophe insurance and reinsurance programs into existence. To these points, we encourage you to review the attached materials which describe the problems with these "government run amok" catastrophe insurance programs:

- Protecting Our Homeland from Natural Catastrophe Risk: The Private Market Approach & The Role of Congress
- The Dysfunctional Nature of State Catastrophe Funds
- State Catastrophe Funds Do Not Work

These materials also document the dirty little secret that the supporters of this bill don't want to discuss: that had state governments allowed private market insurers to charge rates for catastrophe insurance that were commensurate with the risk being taken on, so-called "risk-based rates," and had state governments allowed private market insurers to spread their insured-risks to avoid geographic concentrations, the need for state-sponsored catastrophe insurance and reinsurance programs never would have arisen.

Instead, supporters of H.R. 2255 would have you believe that this legislation is needed to keep these government run amok programs in business since the private insurance market does not have the capacity to cover its catastrophe insurance obligations. Nothing could be further from the truth. Last year was the 4th worst year for natural catastrophe losses on record yet the home insurance business continued to be safe and sound without the need for government bailouts. While the bill sponsors talk about 1992 (Andrew) and 1994 (Northridge), those are ancient history for the marketplace. In 2004 and 2005 the industry dealt with loss payouts of $23.5 billion and $62.5 billion respectively while keeping the marketplace solvent and stable. The private industry is now clearly able to address the "high severity, low frequency" event. Yet in those same years, and in 2008 (following Ike), the Florida, Louisiana, Mississippi and Texas state-sponsored catastrophe insurance programs went under and became insolvent.

The federal government should not encourage the development or continued existence of dysfunctional state-sponsored catastrophe insurance and reinsurance programs. But that is the primary objective of the trifecta of federal bailout programs provided under H.R. 2255. This "trifecta of trouble" will also destroy any incentive for state insurance regulators and state legislators to consider common-sense alternatives to underfunded and overexposed state-sponsored catastrophe insurance and reinsurance programs, e.g., market-driven solutions premised upon two of the most essential principles of insurance: spreading of risk and risk-based pricing.

We therefore urge members to oppose H.R. 2255.

Submitted by:

Scott A. Gilliam
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Protecting Our Homeland from Natural Catastrophe Risk:
The Private Market Approach & The Role of Congress

While it is appropriate for Congress to review and consider the proper role of the federal government in ensuring that Americans are provided with appropriate insurance protection for losses arising from hurricanes, earthquakes and other natural catastrophes, any federal role must be crafted with these precepts in mind:

- The federal government should not compete with or supplant the private market's ability to insure Americans against the risks of natural catastrophes.
- The federal government should not provide taxpayer-funded bailouts for insurers who overexpose themselves in catastrophe-prone areas.
- The federal government should encourage effective mitigation and land use planning.

Failure to abide by these precepts doomed a federal reinsurance proposal in 2000 (H.R. 21, 106th Congress), which drew opposition from a coalition which included insurers, business groups, taxpayer groups, consumer groups and environmental groups. As Congress prepares to consider these issues again in 2006 and industry opposition to federal reinsurance for natural catastrophes continues to grow, it is incumbent that several basic principles and concerns be kept at the forefront of the debate.

Maximize private insurance markets. With very few exceptions, natural catastrophe remains an insurable risk, which private insurers can manage with the appropriate tools including a private reinsurance market. From 1995 to 2004, insurers managed to pay $124 billion in U.S. catastrophe losses (in 2004 dollars). In 2005, the industry will pay close to $60 billion in U.S. catastrophe losses. Any federal catastrophe reinsurance program must be designed to prevent competition with the private sector and must not provide coverage for events well within private market capacity. The private sector's role should be maximized and such financing mechanisms fully exhausted before any government capacity is provided.

Let the private markets work: flexible pricing and underwriting. Under the concept of risk-based rating, insurance companies rate risks at their proper levels based on the degree of risk. Those choosing to live in high risk areas pay rates which match their higher risk of a catastrophe loss. Those living in lower risk areas pay rates which match their lower risk of suffering a catastrophe loss. The ability of an insurer to shed excess catastrophe exposure goes hand-in-hand with risk-based rates: private insurance markets only work when insurers are permitted to exercise underwriting flexibility to avoid risk concentration. When insurers are allowed to engage in flexible pricing and underwriting, availability is enhanced. Unfortunately, many states suppress risk-based rates and prevent insurers from shedding excess exposure in catastrophe-prone areas because of political pressures, making insurers more reluctant to market insurance in these areas. Federal policy on natural catastrophe insurance should encourage private market flexibility in the pricing and underwriting of catastrophe insurance.

Focus on solvency-threatening events. Congress should focus its efforts on mega-catastrophes: those events which threaten the solvency and claims-paying ability of the insurance industry. As demonstrated by the 2004 and 2005 hurricane seasons, the industry can readily handle a series of events with insured damages as high as $60 billion. Some reinsurance experts believe the industry can handle a single insured event approaching $100 billion in claims. Previous proposals would have permitted federal reinsurance payouts for events with as little as $2 billion in damages. Some in the industry advocate a trigger as low as $20 billion. At such a low levels, the federal government would become a risk bearing entity for exposures that are adequately and appropriately served by the private sector. Congress should reject any legislation that would trigger federal reinsurance for events within the industry's capacity.

Federal policy should not favor one segment of the insurance industry over another. Most insurers act responsibly, avoid large concentrations of risk, and purchase adequate reinsurance or otherwise develop adequate resources to absorb large catastrophe losses. Unfortunately, some insurers follow business strategies which produce high concentrations of risk and overexposure in catastrophe-prone areas. Federal policy should not favor these irresponsible insurers with a taxpayer-funded bailout at the expense of responsible insurers who spread their

catastrophe risk. Competition in the insurance marketplace should be based on market forces, not on government policies that favor poor risk management.

Avoid ambiguous coverage triggers. The "trigger" for any federal reinsurance program must be clear and unambiguous. Previous proposals for federal reinsurance have used return times (the amount of damages likely from an event expected to occur once over a specified period of years, e.g., 1/100 year event) to specify the level of losses at which federal reinsurance becomes available to pay claims. Using return times to trigger coverage is disingenuous and subject to manipulation. Ask five catastrophe modelers to estimate the amount of damages likely to be caused by an event with a specific return time and you will get five different answers. Congress should reject any legislation that does not include specific "hard damage" trigger levels for federal reinsurance.

Market-based pricing for federal reinsurance contracts. To avoid anti-competitive impact, it is imperative that the prices established for reinsurance under any federal reinsurance program be insulated from political pressures and be commensurate with rates that would be charged by the private sector for similar coverage. The pricing approach for federal reinsurance contracts under H.R. 4507 (109th Congress) is encouraging in this regard: "[an] amount that is one percent greater than the lowest amount for which a private insurer with an equivalent risk portfolio can obtain equivalent coverage in the private reinsurance market."

Discourage state catastrophe insurance funds. State catastrophe funds were created for the ostensible purpose of ensuring the availability of residential insurance coverage for persons in areas at high risk for natural disasters. Quite often the availability problem sought to be addressed by state catastrophe funds is a problem that was created by the states themselves by not allowing insurers to charge risk-based rates in catastrophe-prone areas (insurers are reluctant to market insurance when they cannot charge rates which reflect the level of risk being assumed). Federal reinsurance for state catastrophe insurance programs should not be made available in states which do not allow insurers charge risk-based rates in catastrophe-prone areas (the approach taken H.R. 4507, 109th Congress).

Allow insurers to accumulate tax-deferred catastrophe reserves. Instead of creating government insurance programs, Congress should look at ways to empower the private markets to handle natural catastrophes without government involvement. One way would be to allow insurers to accumulate tax-deferred catastrophe reserves to pay for future mega-catastrophes. The current U.S. tax/accounting system only allows insurers to look backwards – insurers can set aside consumer premiums in reserves to pay for past disasters but not for future, predicted events. As a result, consumers' insurance payments are taxed up front as profits, discouraging insurers from providing insurance in high-risk areas and reducing capacity to deal with catastrophes. Congress should correct this flaw, as many other industrialized nations have, and allow insurers to set aside part of the premiums they receive for catastrophe insurance in special tax-deferred catastrophe reserves under strict regulation and oversight. This would empower and encourage insurers to serve markets in disaster-prone areas, to remain in those markets after a catastrophe, and result in fewer insurer insolvencies after a major catastrophe.

Encourage catastrophe mitigation and effective land use planning. Any federal policy on natural catastrophe insurance should promote effective catastrophe mitigation, including the development and enforcement of strong building codes and sensible land use planning that does not encourage inappropriate coastal development.

Natural catastrophe insurance for low income consumers. The private marketplace should not be called upon to provide catastrophe insurance to low income insurance consumers at less than market rates. The inability of some Americans to afford catastrophe insurance is a societal issue that is best left to government to resolve.

For more information contact:
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(September 25, 2007)

The Dysfunctional Nature of State Catastrophe Funds

State catastrophe funds were created for the ostensible purpose of ensuring the availability of residential insurance coverage for persons in areas at high risk for natural disasters. However, in most instances the availability problem sought to be addressed by state catastrophe funds is a problem that was created by the states themselves by not allowing market forces to operate.

Under the concept of risk-based rating, insurance companies rate risks at their proper levels based on the degree of risk. Those choosing to live in high risk areas pay rates which match their higher risk of a catastrophe loss. Those living in lower risk areas pay rates which match their lower risk of suffering a catastrophe loss. Under such an approach, the competitive insurance market would keep rates in check since market-priced insurance correctly tells a homeowner that owning a home in the path of a hurricane can be an expensive proposition. Unfortunately, many states have suppressed risk-based rates in catastrophe-prone areas, making insurers more reluctant to market insurance in these areas at prices which do not reflect the level of risk being assumed.

As a result, it is our view that the availability problem sought to be addressed by state catastrophe funds is a problem that was created by the states themselves by not allowing insurers to charge risk-based rates in catastrophe-prone areas.

To further complicate the situation, state catastrophe fund programs are also subject to enormous political pressure to keep rates low while providing coverage beyond the funding capacity of the funds' reserves. As a result, the state catastrophe funds themselves have become dysfunctional since they are: (a) dramatically underfunded; and (b) overexposed with only the undesirable and unprofitable risks. As a result, state catastrophe funds have primarily become concentrations of risks the insurance industry avoids because it is impossible to charge proper rates for those risks.

If insurers in states with catastrophe funds were permitted to offer insurance at **risk-based rates** and were permitted to shed excess exposure **(spread their risk)**, there would be no availability problem and no need for state catastrophe funds.

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State Catastrophe Funds Do Not Work

State cat funds are ***not a long-term solution***. Cat funds most likely will become insolvent after either a series of events or the mega-catastrophe that is well within the range of probability as predicted by scientific experts.

The track record of state-managed insurance funds is dismal: it includes insolvencies, mismanagement, political suppression of rates, bad investment, and diversion of earmarked funds for other uses.

There is no free lunch; someone will pay for catastrophic losses. The question for policymakers and insurers is should those exposed to catastrophic risk pay an appropriate risk based premium up front or should all taxpayers subsidize those exposed to the risk by paying for catastrophic losses after the fact via taxes and assessments? The Cincinnati Insurance Companies believe that public subsidies are not the answer.

Public subsidies and cross-subsidies in the property insurance market ***lead to inappropriate economic and political decisions*** by homeowners and government officials. Decisions regarding land use, building codes, disaster preparation and loss reduction will be significantly impacted by these subsidies.

State Cat Funds Interfere with Private Market Responses

State cat funds eliminate the incentive for private market investment, such as the investment that occurred after Hurricane Andrew, 9/11, and the 2004 and 2005 hurricanes and will be ineffective because it does not add new capacity to the market place. It simply diverts existing available resources. It will not encourage companies to remain in or enter the insurance market and, in fact, may be a deterrent to entry into the homeowner's market.

State Cat Funds Reward Irresponsible Insurers

State cat funds benefit the largest and wealthiest insurers in a state and disadvantage smaller insurers operating in a state. Since an insurer passes its catastrophe risk to a catastrophe fund, there are no incentives for the company to maintain underwriting controls to appropriately underwrite the risk. It rewards companies that are overexposed to catastrophic risk at the expense of those prudent companies that have a balanced, diverse, spread of risk within the state.

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AMERICAN RIVERS * AUDUBON * CERES * DEFENDERS OF WILDLIFE * ENVIRONMENTAL DEFENSE FUND * LEAGUE OF CONSERVATION VOTERS * NATIONAL WILDLIFE FEDERATION * NATURAL RESOURCES DEFENSE COUNCIL * REPUBLICANS FOR ENVIRONMENTAL PROTECTION * SIERRA CLUB

February 25, 2010

The Honorable Barney Frank
Chairman, Financial Services Committee
U.S. House of Representatives
2129 Rayburn House Office Building
Washington DC 20515

Dear Chairman Frank:

We understand that the Financial Services Committee may soon take up H.R. 2555, the Homeowners' Defense Act. Our organizations have significant concerns with this legislation and respectfully request that you defer its consideration until it or other measures are proposed that would better protect people, property, the environment and the interests of taxpayers all across the country.

We have no doubt that Representative Klein's efforts to ease Floridians' insurance rates are well intended, but we are extremely concerned that providing a federal insurance subsidy will create incentives for more development in environmentally sensitive coastal areas and increase exposure to hurricane-related risk. This could leave people more exposed to harm and at the same time increase, rather than decrease, adverse impacts to the environment.

The effects of climate change and the projections that climate scientists have made about the future form a critical backdrop for this legislation. A recent report from the federal government, Global Climate Change Impacts in the United States, paints a sober picture of the future that scientists anticipate in Florida and other southeastern states. An increase in average sea level of up to two feet or more is expected. For the Southeast, the report notes that "Sea-level rise and the likely increase in hurricane intensity and associated storm surge will be among the most serious consequences of climate change." (p. 114)

If coastal state and local governments allow development to continue as usual – with little regard to natural hazards – then federal backstop guarantees or reinsurance will almost certainly result in more development in high-risk areas. With the risks of rising sea levels and stronger hurricanes as a result of climate change, state and local governments will have to make much better land use decisions to avoid risk. Unfortunately, HR 2555 would perpetuate ill-conceived or unwise development decisions.

In 2008 the Florida Coastal and Ocean Coalition issued a report, Preparing for a Sea Change, which found that the general availability of property insurance through Citizens Property Insurance Corporation (CPIC) "...results in a subsidy for ill-advised coastal construction in coastal high hazard areas fronting vulnerable and eroding beaches...CPIC coverage is provided to builders, investors, and homeowners along the coast regardless of the historical erosion rates, storm history, or frequency of repeat claims."(p. 18). The report recommends restrictions in CPIC coverage and calls on Congress to oppose efforts to expand federal subsidies for wind insurance and natural catastrophe insurance in coastal high hazard areas.

In addition to what has occurred in Florida, four decades of experience with the National Flood Insurance Program has served as a critical laboratory and powerful reminder to all that the federal role in insurance has had serious unintended consequences. While the program has kept consumers' flood insurance costs low, it has done too little to reduce risk, and in fact it has been a major factor in increasing risk. Through the NFIP the federal government has repeatedly supported building or rebuilding of high-risk properties, and the program is now nearly $20 billion in an insurmountable debt to the Treasury. The NFIP offers a cautionary tale about how government action to reduce insurance costs provides a negative signal about the need to reduce risk.

In contrast to a federal insurance subsidy, which is the focus of H.R. 2555, hazard mitigation programs are a well-established, cost-effective means to reduce the impact of natural disasters. For example, in 2007, the Congressional Budget Office found that projects funded through the Pre-Disaster Mitigation program between 2004 and June 2007 resulted in a reduction of future disaster spending of approximately $3 for every $1 spent on these projects. Similarly, in 2005, a Congressionally-mandated study by the Multihazard Mitigation Council (an advisory body of the National Institute of Building Sciences) concluded that cost-effective mitigation saves an average of four dollars for every dollar spent.

We appreciate that the bill adds a small, $15 million/year mitigation authorization. However, because mitigation both protects lives and property and cuts insurance costs, the fundamental focus of the effort to address the risks that communities face should be to pursue mitigation at a much greater scale. As it stands, the scale of the mitigation program has a virtually insignificant effect and is dwarfed by the scope of the bill's insurance provisions and their incentives for risky development. There is far less incentive to mitigate when the cost of insurance is subsidized.

In conclusion, we believe that a strategic commitment to encourage mitigation is the best approach to protecting communities from natural hazards and urge Congress to follow that path. This would discourage risky development, protect environmentally-sensitive areas to buffer communities from hazards, emphasize actuarial, risk-based insurance that sends appropriate signals regarding risks. This strategy would do the most to safeguard people, protect property, reduce insurance rates and protect the environment. We would welcome an opportunity to work with you and your staff, Congressman Klein and other members of the committee toward an approach that better protects people, property and the environment.

Thank you for considering our views.

Sincerely,

Andrew Fahlund
Senior Vice-President Conservation Programs
American Rivers

Brian Moore
Legislative Director
Audubon

Vivian Buckingham
Director of Government Relations
Ceres

Mary Beth Beetham
Director of Legislative Affairs
Defenders of Wildlife

Paul Harrison
Senior Director - Rivers and Deltas
Environmental Defense Fund

Tiernan Sittenfeld
Legislative Director
League of Conservation Voters

Adam Kolton
Sr. Director, Congressional and Federal Affairs
National Wildlife Federation

Scott Slesinger
Legislative Director
Natural Resources Defense Council

David Jenkins
Vice President for Government and Political Affairs
Republicans for Environmental Protection

Debbie Sease
National Campaign Director
Sierra Club

Americans for Tax Reform – Institute for Liberty – Americans for Prosperity – American Consumer Institute American Civil Rights Union – Center on Risk, Regulation and Markets

March 2, 2010

Honorable Barney Frank
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Honorable Spencer Bachus
Ranking Minority Member
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Frank and Ranking Member Bachus:

We understand that H.R. 2555, the Homeowners' Defense Act, will be scheduled for action by the Committee on Financial Services as early as next month. As representatives of organizations concerned about taxes, budgets, and federal spending, we strongly believe that such a federal effort to subsidize insurance companies and properties in risky locations would be a step in the wrong direction for the nation.

H.R. 2555, introduced by Representative Ron Klein of Florida on May 21, 2009, imposes nearly unlimited potential liabilities on American taxpayers. While it makes certain concessions in the direction of budget neutrality and fiscal responsibility, H.R. 2555's major provisions make it clear that it will ultimately insert the federal government into previously private insurance and reinsurance marketplaces at enormous costs to taxpayers. The bill, as you know, establishes a federally facilitated consortium of states to pool their natural catastrophe risks; provides federal reinsurance for state natural catastrophe funds (which currently exist only in Florida and California) and offers federal guarantee of state bonds related to catastrophes. In the long term, such "backstop" measures will result in wasteful spending, larger deficits, and, eventually, higher taxes. They are not good ideas.

Quite simply, whatever money the federal government devotes to such efforts would be wasted. Insurance and reinsurance, by their very natures, work best when risk is managed across a broad pool of events unlikely to happen at the same time. International reinsurance markets can pool the risk of American windstorms with those of United Kingdom floods and Japanese earthquakes. A government run national consortium or guarantee capacity could not realize the benefits of international risk pooling and would thus have to charge *higher* rates than the private sector in order to break even. We strongly suspect that, rather than charging actuarially indicated rates, however, a government-run fund would under-price coverage and provide an enormous subsidy those choosing to build and write insurance in dangerous places.

The liabilities of any federal "backstop" capacity, furthermore, would eventually become liabilities of the Treasury. Even if the federal government decides to move them "off balance sheet"--as it did with the liabilities of Freddie Mac and Fannie Mae—federal taxpayers would implicitly remain on the hook for billions of state debt, catastrophe fund payouts and, ultimately, primary insurance policies on many homes located in dangerous areas. Our nation does not need a larger federal debt.

Since Rep. Klein's proposal cannot, under any circumstances, produce enough revenue to cover its costs, keeping any such facility on an even keel will ultimately require significant, broad-based tax hikes to cover the billions of dollars in liabilities it will eventually impose. Even by the standards of the federal budget, these liabilities will be quite large: Florida's Hurricane Catastrophe Fund alone has $4 billion in hard assets to pay claims that could total more than $25 billion in a bad year. A national consortium might well require tax increases totaling more than $100 billion to bail it out after a major disaster.

In short, we are deeply troubled by H.R. 2555, the Homeowners' Defense Act and believe that you should carefully consider its manifest flaws in deciding how to vote on it.

Sincerely,

Grover Norquist
Americans for Tax Reform

Steve Ellis
Taxpayers For Common Sense

Andrew Langer
Institute for Liberty

Phil Kerpen
Americans for Prosperity

Steve Pociask
American Consumer Institute

Susan Carlson
American Civil Rights Union

Eli Lehrer
Center on Risk, Regulation and Markets

cc: Honorable Nancy Pelosi
Honorable Steny Hoyer
Honorable John Boehner
Honorable Eric Cantor

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March 9, 2010

Honorable Barney Frank
Chairman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Honorable Spencer Bachus
Ranking Minority Member
House Committee on Financial Services
B371A Rayburn House Office Building
Washington, DC 20515

Dear Chairman Frank and Ranking Member Bachus:

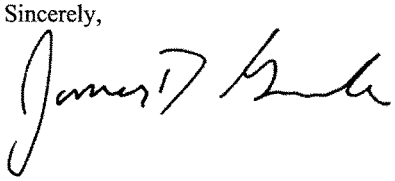
On Wednesday, March 10, 2010, the House Financial Services Subcommittees on Capital Markets and Housing will hold a hearing on the Homeowners Defense Act, H.R. 2555. While the National Association of Mutual Insurance Companies (NAMIC) is encouraged that Members of Congress are working to develop a comprehensive natural disaster plan to address concerns about coastal insurance affordability and availability, we are concerned that this legislation would expand the federal government's role to a point that the private insurance market could be crowded out. The result would likely be to encourage unwise residential and commercial development in high-risk coastal regions, such as the Atlantic and Gulf coasts of Florida.

The high costs of recent natural disasters combined with credible projections of future catastrophes have led to restricted homeowners' insurance coverage, reduced availability, and affordability issues in disaster-prone regions. The Homeowners Defense Act attempts to address these issues, but NAMIC believes it fails in this attempt. We believe it would instead artificially and unnecessarily alter private insurance markets and create a federal backing that would place taxpayers at risk for paying catastrophe losses through an implicit federal guarantee, thereby potentially adding billions of dollars to the federal deficit.

NAMIC strongly believes that we should build on the incentives to avoid and mitigate risk that the private sector provides through supply, demand, and price. A variety of other approaches would establish a proper balance between the roles of the private insurance sector and governments. This end result can be accomplished through sending proper signals to discourage development and/or mitigate its effects in dangerous areas and also by addressing affordability issues for low-income people already living in areas prone to natural disasters.

In sum, this legislation would create a permanent federal role in the private insurance markets that would be detrimental to people living in catastrophe-prone areas. NAMIC opposes this approach. We urge you to oppose the Homeowners Defense Act in the upcoming hearing and subsequent markup and, instead, support proposals that would couple private sector signals with government incentives to encourage proper uses of catastrophe-prone lands.

Sincerely,



Jimi Grande
National Association of Mutual Insurance Companies
Senior Vice President, Federal and Political Affairs

cc: Members of the House Financial Services Committee

NAMIC®

NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

SUBMITTED TESTIMONY
ON BEHALF OF
THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

JOINT HEARING

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GSEs

OF THE COMMITTEE ON FINANCIAL SERVICES

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"APPROACHES TO MITIGATING AND MANAGING NATURAL CATASTROPHE RISK: H.R. 2555, THE HOMEOWNERS' DEFENSE ACT"

MARCH 10, 2010

Founded in 1895, NAMIC is a property and casualty insurance association, whose 1400 members underwrite over 40 percent of the property/casualty insurance premium written in the United States. NAMIC is grateful for the opportunity to submit testimony on a subject that poses an enormous challenge to the insurance industry and our nation as a whole.

It is widely acknowledged that property insurance has become more expensive and somewhat less available in the coastal regions of the U.S. While the private sector and government can and should work together to address problems of insurance availability and affordability in these areas, government intervention should not supplant the economic principles affecting the complex relationship between supply, demand, and price.

Understanding the Nature of the Problem

To understand the problem, we must begin with three simple facts:

1. The exposure of densely concentrated, high-value property to elevated levels of catastrophe risk in certain geographic regions means that property insurance in these regions will be relatively expensive compared to the regions that lack these attributes.

2. As population growth and commercial development in catastrophe-prone regions increases, the number of people and businesses faced with relatively high insurance costs will naturally increase as well.

3. The Atlantic and Gulf coastal regions of the U.S. have experienced significantly increased population growth and commercial development at a time when the frequency and severity of catastrophic storms in these regions is increasing.

Simply put the availability and affordability of property insurance in coastal regions is mainly a function of risk. But other variables, including actions taken by governments and *post hoc* reinterpretations of insurance contract language by courts, can also affect the supply and cost of insurance.

Frequency and Severity of Major Coastal Storms

Higher property insurance prices in coastal areas have come in the wake of the three 2005 Gulf Coast hurricanes that killed more than 1,400 people and cost more than $180 billion in insured losses and federal disaster relief. But the trend was not caused by those hurricanes *per se*. Rather, insurance prices have increased because of what the 2005 hurricane season portends for the future.

Coastal Development and Population Growth

Greater frequency and severity of coastal storms would matter less if the affected areas were sparsely populated and contained few valuable assets. But in fact the areas most at risk of increased storm activity contain a disproportionate share of the nation's population, as well as its most valuable real estate. What is more, the movement of people and wealth from interior regions with relatively little catastrophe risk to coastal regions with the highest levels of catastrophe risk is increasing even as the likelihood of severe coastal hurricane activity increases. 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 21 years. In 2015 —just five years from now—Florida is projected to surpass New York as the nation's third most populous state.

Consider one dramatic example. The Great Miami Storm of September 18, 1926, a Category 4 hurricane with 145 mile per hour winds, caused $42 billion in economic damages in today's dollars, according to the web site www.icatdamageestimator.com. Because of the enormous growth in population and wealth of Miami since then, were a

similar storm to strike Miami today, the web site estimates that it would cause $180,890,000,000 in damages, or 2,380 times the amount of damages caused in 1926.

State Regulation

Many states in catastrophe-prone coastal regions, including Florida, impose rating and underwriting restrictions on property insurers that act as price ceilings on coverage. Many state officials believe that insurance rate suppression, which allows high-risk property owners to pay artificially low premiums, is the answer to the property insurance "affordability problem" in catastrophe-prone areas.

While rate suppression lowers the cost of insurance in the short term, it has long-term consequences that are far worse for insurance consumers. First, rate suppression lowers prices for people living in high-risk regions at the expense of insurance buyers in low-risk regions, forcing people living in low-risk regions to pay inflated prices in order to subsidize the insurance costs of those in high-risk regions.

Second, rate suppression removes a powerful disincentive – namely, higher insurance prices – to further population growth and economic development in disaster-prone areas. That may seem like a good thing to those that thrive on growth and development. But unfortunately, government rate suppression distorts the public's perception of risk, thus encouraging—rather than discouraging—the very phenomenon that created the problem in the first place – the growing concentration of people and wealth in high-risk regions.

Federal and state governments then end up bearing the cost of the economically irrational decisions that result from rate suppression by paying for disaster aid to repair properties that might have never 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.

Rate suppression and underwriting restrictions are also largely responsible for insurance availability problems in coastal areas. Like any other business enterprise,

insurers must charge a price that covers the cost of the good or service they provide and allows them to make a profit. Historically, profit margins in the highly competitive property/casualty insurance industry have been quite modest compared to other business sectors. But if government rate regulation prevents insurers from covering their claim costs, replenishing surplus reserves to pay future claims, and making a profit, they may have no choice but to exit the market or dramatically reduce exposure, as we have seen recently in Florida.

At the same time, NAMIC is not insensitive to the affordability issue, particularly for long-time, low-income residents and businesses of catastrophe-prone areas that have seen dramatic increases in their premiums related to new development and not to their behavior. NAMIC suggests that the best way to address the affordability issue is through direct governmental subsidies to needy individuals and businesses. Government programs for risk mitigation may also help. Such approaches would increase insurance affordability and availability without distorting the insurance mechanism that sends valuable signals as to the relative level of risk of living in a particular geographic area.

The Tide Is Beginning to Turn in Florida

In 2009 Florida lawmakers passed, and Governor Charlie Crist signed into law, HB 1495, allowing Citizens Property Insurance Corp. to increase premium rates by 10 percent for individual policyholders each year until actuarially sound levels are attained. Additionally, this bill also increases rates and lowers coverage amounts over time for the Florida Hurricane Catastrophe Fund. The changes HB 1495 brings are encouraging. Not only does it put Florida Citizens Property Insurance Corp., the state-run insurer, on a glide path to more appropriately matching rate to risk, it puts the entire state at the beginning of a path to better financial preparation for future storms.

A separate bill, HB 1171, would have allowed Floridians the option to choose between rate-regulated property/casualty insurers and a select group of well-capitalized, mostly nationally recognized carriers exempt from price controls. The bill would not have

affected the state's ability to regulate against unfair discriminatory practices, insolvency, and insufficiency. The measure also included transparency, disclosure, and consumer provisions. The bill, which passed overwhelmingly, represented a greater understanding by legislators of the importance in keeping a vibrant marketplace that provides choices for consumers. As reported in the *Tallahassee Democrat*, "New capital and new companies are important, because the state's insurer of last resort, Citizens, is so underfinanced that it couldn't possibly pay off claims in the event of major storm damages." Unfortunately, the governor chose to veto HB 1171 despite consumer and insurer support.

NAMIC would have preferred that this bill be applied to all insurers, and the 2010 versions – HB 447 and SB 876 - do just that. It remains to be seen if this year's session, which began in earnest just last week, will see success with consumer choice legislation in particular, but we have hope that the positive movement from last year will continue.

The Lack of Federal Backing Has Been an Incentive for States to Make Improvements

The likelihood that Florida and other disaster-prone states will move forward on the path toward more prudent catastrophe risk management depends in no small measure on the structure of incentives that Congress creates. If Congress enacts legislation that encourages coastal states to adopt and enforce stronger building codes, and to curtail further development of ecologically-sensitive coastal areas, it can slow the growth in coastal catastrophe risk exposure. The relatively small amount of damage caused by the huge earthquake in Chile, and in contrast the vast degree of damage caused in Haiti, are good examples of how natural catastrophe damage can be limited through stronger building codes. On the other hand, if Congress enacts legislation such as the Homeowners Defense Act, it will remove incentives for coastal states to adopt sensible risk mitigation and avoidance policies by creating mechanisms for spreading coastal zone catastrophe risk to insurance policyholders and taxpayers in other states.

Consider North Carolina, whose legislature and insurance commissioner worked together in 2009 to reform the state's troubled disaster insurance facility known as the "Beach Plan." A new law enacted in 2009 caps the insurance industry's non-recoupable assessment level for losses incurred by the Beach Plan at $1 billion, and lowers the plan's coverage limit from $1.5 million to $750,000.

Having the HDA in place would have discouraged these needed reforms. Under the HDA, bonds issued by the Beach Plan would be guaranteed by the federal government, and the plan would be eligible to participate in a new $200 billion federal reinsurance program. The discipline that state officials needed to enact the necessary reforms of the Beach Plan would have evaporated with the HDA's promise of a federal bailout.

If Congress enacts the HDA in 2010, the same dynamic will work to halt or even reverse the limited progress that other coastal states are making in better managing their catastrophe risk exposures. Indeed, the HDA would create a powerful incentive for coastal states that currently lack state-sponsored disaster insurance programs to create such mechanisms, potentially leading to a proliferation of state programs that artificially mask risk at the expense of federal taxpayers and insurance policyholders in states without such programs. Does the federal government and taxpayers in general, really want to be liable for paying huge sums of money for the failures of disaster-prone states to address their own problems?

The Commission Approach

The complexity associated with the issue of disaster-related legislation does not lend itself to a quick political fix. NAMIC supports a more measured approach through the creation of a commission to study the various facets of catastrophe risk management.

A number of proposals have been introduced in Congress aimed to reduce America's vulnerability to natural disasters. While some proposals have merit, each would benefit from the kind of rigorous, objective study that only an impartial commission of experts could provide. Moreover, there may be promising natural catastrophe-related measures

that the federal government could undertake that have not yet been identified by Congress.

The commission approach would allow the development of a full menu of policy options that Congress could pursue and would bring together experts on catastrophe-related issues who would be given adequate time to study the issues in-depth and hold public hearings around the country to gather information from a host of constituencies affected by natural disasters.

Furthermore, several independent research organizations are currently engaged in major research projects whose purpose is to gather and analyze relevant data to allow policymakers to make informed decisions on these issues. Rather than rushing to vote on currently pending catastrophe bills, Congress should tap the growing body of knowledge and expertise that is available.

NAMIC is not seeking to be dilatory, just responsible. With all the work that has been done already in the private sector and that is in process, NAMIC believes a commission would probably only need nine-12 months to propose the best possible solutions. That time frame would leave ample time for the Congress to act swiftly.

We encourage the Congress to follow the measured approach of establishing a commission with a deadline that would facilitate prompt congressional action. NAMIC stands ready to work with Congress on such an approach and believes this would produce the best possible combination of private and public sector efforts to minimize the costs of addressing natural catastrophe risks for people who live in catastrophe-prone areas, for the states, and for the federal government and taxpayers.

Taking the Affordability Problem Seriously: A Different Approach

Last year, MIT Press published an important new book, *At War With the Weather: Managing Large-Scale Risks in a New Era of Catastrophes*, which has been hailed by Terri Vaughan, CEO of the National Association of Insurance Commissioners, as "essential reading for anyone searching for solutions to the problem of financing large-

scale catastrophes." Authored by a team of distinguished insurance scholars from the Wharton School and Georgia State University, the book identifies "two key principles" that should guide insurers and policymakers as they grapple with natural disaster insurance availability and affordability issues. NAMIC believes that these principles provide Congress with a solid foundation from which to develop innovative solutions and avoid costly mistakes. As stated in the book, the two principles are:

- *Risk-based Premiums:* Insurance premiums should be based on risk to provide signals to individuals as to the hazards they face and to encourage them to engage in cost-effective mitigation measures to reduce their vulnerability to catastrophes.

- *Dealing with Equity and Affordability Issues:* Any special treatment given to lower income residents in hazard-prone areas who cannot afford the cost of living in those locations should come from general public funding and not through insurance premium subsidies.

The book's authors recognize, as does NAMIC, that 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. We agree with the recommendation that in lieu of cross-subsidization through rate suppression and taxpayer-funded government insurance schemes, policymakers should consider creating programs to provide direct government assistance, funded from general revenue, to particular consumers based on criteria established through a transparent decision-making process.

This should not be all that difficult. The federal government has a long history of designing and administering programs that provide grants and other forms of direct financial assistance to individuals on a means-tested basis for the purchase of essential goods such as food and shelter. For example, government responds to the inability of some individuals to afford basic food staples, not by capping the price of groceries or creating government-run food stores, but by providing food stamps to low-income

individuals that can be used to purchase food items from private vendors. There is no reason why Congress could not provide a similar form of aid to selected property owners for the purchase of insurance. Such an approach would have many advantages over the current system of generalized rate suppression and cross subsidization, not the least of which is that the assistance could be targeted to particular individuals based on financial need. Moreover, its availability could be limited to those currently residing in disaster-prone areas, and would thus avoid creating incentives for people not currently living in those areas to move into harm's way.

Conclusion

The problems that natural catastrophes pose for the property/casualty insurance industry are not insoluble. The work that an impartial commission could do to bring needed clarity to some of these issues would surely benefit this discussion. We recommend that the next step be the creation of such a commission.

NAMIC believes that the surest way to increase the supply of insurance in catastrophe-prone coastal regions is to remove government restrictions on pricing and underwriting, immediately making the market attractive for new entrants. Also, the best approach to the affordability issue is through direct governmental subsidies to needy individuals and businesses as described above. Such an approach would increase insurance availability without distorting the insurance mechanism that sends valuable signals as to the relative level of risk of living in a certain area.

Statement of Adam Kolton

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National Wildlife Federation

Before the

Subcommittee on Housing and Community Opportunity

and the

Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises

of the

House Committee on Financial Services

U.S. House of Representatives

For hearings on

Approaches to Mitigating and Managing Natural Catastrophe Risk:

H.R. 2555, The Homeowners' Defense Act

March 10, 2010

Washington DC

Good morning, Chairwoman Waters, Chairman Kanjorski, and Ranking Members Capito and Garrett and Members of the Financial Services Committee. My name is Adam Kolton. I serve as Senior Director for Congressional and Federal Affairs for the National Wildlife Federation. We appreciate the opportunity to provide the views of the National Wildlife Federation on H.R. 2555, the Homeowners' Defense Act.

The National Wildlife Federation is the largest national conservation education and advocacy organization, with more than 4 million members and supporters and affiliate conservation organizations in 47 states and territories across the nation. The Federation has a long history of active involvement with natural resources conservation and management, especially dealing with water-related areas that are often critical for supplying environmental services – providing key habitat for wildlife, as well as human enjoyment, and areas that are subject to natural hazards and climate change that can adversely impact the built environment, sometimes catastrophically.

For many years, in particular, the Federation has been a leader in the nation's conservation community on issues related to the National Flood Insurance Program (NFIP) and disaster assistance programs as they relate to environmental quality. We believe our experience is especially relevant to the subject at hand: legislation to create a financial backstop and federal reinsurance for catastrophic storms and natural hazard-related disasters – especially from hurricanes and wind-related damage which has increased over the last several decades. While it is not the legislation's stated intent, the Federation is extremely concerned that H.R. 2555 could ultimately work to encourage increased development and redevelopment in many of the most risk-prone and environmentally-sensitive areas of the nation – the very areas that will be hit the hardest as climate change causes further sea level rise, more intense storms and flooding. In the long run we believe the overall effect of the legislation would be to exacerbate natural hazard risks and costs to homeowners and ultimately to the U.S. taxpayers. As a result, the National Wildlife Federation opposes H.R. 2555 in its current form. We favor alternative approaches to reduce risk to people and communities including aggressive hazard mitigation measures and incentives for smart land use planning.

H.R. 2555 Would Incentivize Development and Redevelopment in Coastal Areas and Floodplains

H.R. 2555 consists of three major components: It 1) establishes a federally-facilitated consortium of states to pool natural catastrophe risks, 2) provides federal reinsurance for state natural catastrophe funds and 3) provides federal guarantees of bonds issued by state catastrophe funds. The effect of providing federal reinsurance and federal guarantees would be, essentially, to shift resources from all 50 states to benefit an individual state. The practical effect of such mechanisms would be to provide a federal backstop and guarantees that would result in substantial federal subsidies to reduce insurance costs – essentially off-loading some of the risks

and costs from States and individuals ultimately onto federal taxpayers. Establishment of consortia for pooling of natural catastrophe risks can already be accomplished under existing laws; however, it is mostly not done, because lower-risk states generally do not want to subsidize high-risk states and their homeowners' insurance.

It is well understood that the genesis for this legislation principally has been as a federal backstop to assist Florida's far over-extended Florida Citizens Property Insurance Corporation and the State's Hurricane Catastrophe reinsurance fund. According to insurance industry reports, the Citizens program is at least 40% underfunded on average for residences and "as much as 140 percent on wind-only commercial property policies to reach proper funding for its exposure, which is about $405 billion for its 1,040,000 policies."[1] Rates in the past by Citizens were originally based on private market rates; however, in 2006, the Citizens' Board of Directors voted to freeze rates, which resulted in an enormous underfunding and soaring risk exposure for the State's insurance program.

When the risks and costs of natural hazards are shifted away from those taking the risks, much of the incentives for controlling those risks are removed. In Florida, especially, conservation organizations have witnessed enormous development pressures that are damaging some of the state's most environmentally-sensitive areas, such as coastlines, wetlands and floodplains.

Federal Coastal Barrier System Specifically Sought to Remove Development Subsidies on Undeveloped Barrier Islands

In 1982, Congress recognized the potential for insurance and other subsidies to serve as a powerful incentive for unwise and risky development when in it established the Coastal Barrier Resources Act and System (CBRA and CBRS). The CBRA specifically barred direct federal subsidies, including availability of federal flood insurance in designated, undeveloped portions of coastal barrier islands.

In March 2007, the GAO reviewed the development status of CBRA lands and found an estimated 84 percent of these lands remain undeveloped, principally, according to GAO, from a range of factors such as state or local laws discouraging development or lack of lands suitable for development.[2] In a 2002 study, however, by the U.S. Fish and Wildlife Service, which manages the CBRA program, the Service recognized the prohibition on availability of federally-subsidized flood insurance for these areas was "without a doubt the most important deterrent to development in the System."[3] There are many areas that are beyond the presently designated

[1] http://www.insurancejournal.com/news/southeast/2009/07/09/102084.htm.

[2] Coastal Barrier Resources System: Status of Development That Has Occurred and Financial Assistance Provided by Federal Agencies," Government Accountability Office, March, 2007, GAO-07-356. GAO notes in recent years that increasing NFIP enforcement and increasing private insurance costs may have an increasingly discouraging effect on development in the future, p. 15.

[3] "The Coastal Barrier Resources Act: Harnessing the Power of Market Forces to Conserve America's Coasts and Save Taxpayers' Money," U.S. Fish and Wildlife Service, August, 2002, p. 28.

units of the CBRS that are vitally important for natural resources protection and, yet, are highly subject to natural hazards such as hurricanes, flooding and storm surge and which need protections. We are concerned that legislation such as H.R. 2555, acting especially in states and communities which lack strong protections, would only increase the pressures to develop risky and sensitive environmental areas.

In addition, we are concerned that H.R. 2555 would create incentives for other states to create Florida-like state CAT funds, sending a signal that states could begin to move away from more sound policies toward higher risks and subsidies such as Florida has. To the extent this would happen, we also foresee the institution of even greater development pressures, which, in turn could be predicted to promote development where both the environment would be damaged and ultimate disaster costs would continue to rise.

Insurance Subsidies Have Spurred Coastal Development that Harms Threatened Species and the Environment

The Federation's experience with the National Flood Insurance Program (NFIP) makes it clear that federally-subsidized insurance in sensitive, disaster-prone areas increases development in those areas, impacting species that depend on such areas. The negative impacts of coastal and floodplain development on species are well recognized.

Coastal and floodplain areas provide breeding grounds, foraging grounds and other essential habitat to countless species, many of which are endangered or threatened. Not only does development directly destroy habitat, it can impact species in countless other ways such as altering hydrological cycles, impacting species food sources, introducing light and noise that disrupt species, and causing human and pet activity that harm species or their nests.[4]

The Courts have found that the NFIP enables development that impacts threatened and endangered species. The Eleventh Circuit Court of Appeals – which has jurisdiction over Florida, Georgia and Alabama – recently ruled in a case concerning the Key Deer and seven other ESA listed species in the Florida Keys that "[FEMA's] administration of the NFIP is a relevant cause of jeopardy to the listed species [in the Florida Keys]. … because development is encouraged and in effect authorized by FEMA's issuance of flood insurance."[5] A federal court in Washington similarly found that "development [of the floodplain] is 'reasonably certain to

[4] *See, e.g.*, National Marine Fisheries Service and U. S. Fish and Wildlife Service, Green Sea Turtle (*Chelonia mydas*) 5-Year Review: Summary and Evaluation (2007), p. 48-49, 65; National Marine Fisheries Service, Endangered Species Act – Section 7 Consultation Final Biological Opinion And Magnuson-Stevens Fishery Conservation and Management Act Essential Fish Habitat Consultation Implementation of the National Flood Insurance Program in the State of Washington Phase One Document – Puget Sound Region (Sept. 22, 2008), p. 54 (stating that "Degradation of riverine, estuarine, and near shore habitat [largely from coastal and floodplain development] has resulted in the loss of an average of 83 percent of the potential production of the 42 steelhead populations assessed in Washington.").

[5] *Florida Key Deer v. Paulison*, 522 F.3d 1133, 1144 (11th Cir. 2008) (citation omitted).

occur' as a result of [NFIP implementation]".[6] That case resulted in a 2008 Biological Opinion from the National Marine Fisheries Service finding that the NFIP is causing jeopardy to salmon in the Puget Sound and that FEMA must make changes to the NFIP to be protective of those species.[7]

Impacts to Sea Turtles and Beaches

Sea turtles also are an apt example of species that are particularly vulnerable to coastal development. Five species of sea turtles – the loggerhead, green, hawksbill, leatherback, and Kemp's Ridley – are found in Florida. Unlike other marine animals, sea turtles nest on shore. Although they have outlived the dinosaurs, they are now threatened with extinction due to development impacting their habitat.

Nowhere are these threats more evident than on Florida's beaches. The largest loggerhead, green, and leatherback nesting colonies in the continental United States rely on Florida's beaches. In fact, 90% of all sea turtles in U.S. waters nest in Florida. This critical nesting habitat is threatened in large part by poorly sited coastal development. Because 60% of Florida's beaches are eroding, and 46% are "critically eroding," upland structures are under eminent threat.[8] To protect against this erosion, increasingly strong storms, and rising sea levels due to climate change, sea walls are often constructed,[9] which in turn, leads to more development. Moreover, tall buildings shade beaches while human removal of beach vegetation reduces shade, affecting crucial nest temperatures. Increased artificial light from development may discourage females from nesting and disorient hatchlings.[10] Nevertheless, public subsidies – including federal flood insurance – continue to encourage development along even the most erosive beaches. Further subsidies, such as wind insurance, will only increase development, threatening the diminishing number of areas sea turtles may successfully breed and ultimately dooming these wonderful creatures to extinction.

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[6] *Nat'l Wildlife Fed'n v. Fed. Emergency Mgmt. Agency (NWF v. FEMA)*, 345 F. Supp. 2d 1151, 1176 (W.D. Wash. 2004).

[7] National Marine Fisheries Service, Endangered Species Act – Section 7 Consultation Final Biological Opinion And Magnuson-Stevens Fishery Conservation and Management Act Essential Fish Habitat Consultation Implementation of the National Flood Insurance Program in the State of Washington Phase One Document – Puget Sound Region (Sept. 22, 2008).

[8] National Marine Fisheries Service and U. S. Fish and Wildlife Service, Recovery Plan for the Northwest Atlantic Population of the Loggerhead Sea Turtle (*Caretta caretta*) (2008), p. I-38.

[9] *See, e.g.*, National Marine Fisheries Service and U. S. Fish and Wildlife Service, Recovery Plan for the U.S. Population of Atlantic Green Turtle (*Chelonia mydas*) (1991), p. 3 (attached) ("Where beachfront development occurs, the site is often fortified to protect the property from erosion. Virtually all shoreline engineering is carried out to save structures, not dry sandy beaches, and ultimately results in environmental damage.").

[10] *See*, National Marine Fisheries Service and U. S. Fish and Wildlife Service, Status Reviews of Sea Turtles Listed under the Endangered Species Act of 1973 (1995), p. 7-8, 48, 85 (attached); *see also* Listing Notices (attached); National Marine Fisheries Service and U. S. Fish and Wildlife Service, Loggerhead Sea Turtle (*Carreta caretta*) 5-Year Review: Summary and Evaluation (2007), p. 23.

H.R. 2555 Follows in the Mistaken Path of the National Flood Insurance Program.

The NFIP offers a cautionary tale about how government action to reduce insurance costs provides a negative signal about the need to reduce risk.

National Wildlife Federation has become increasingly concerned about the multitude of unintended adverse consequences that have accompanied the NFIP, the nation's principal experiment to date with a government-managed natural hazards insurance system. This program is now entering its forty-second year. The NFIP currently is carrying an insurmountable $18.75 billion debt to the U.S. Treasury. It has no catastrophic loss reserves and overall the rates are not actuarial and many of the policies are sold at heavily subsidized, grandfathered rates, often with the greatest levels of subsidy going to the wealthiest Americans. Enforcement and compliance with NFIP requirements are poor, and often safety standards for new development and redevelopment are extremely weak, leading even to new buildings being built with high flood risk. While some improvements are being made, many NFIP special flood hazard maps remain out of date and inaccurate. Major improvements are needed or else the program may ultimately collapse. In the face of global climate change, and more powerful storms, sea-level rise, and substantial land use conversions and urbanization, which are literally changing the natural hydrology and exacerbating flood risks across the nation, the NFIP stands as an object lesson in the challenges posed by any natural catastrophe legislation, such as H.R. 2555.

In 1998, the Federation issued a three-year study entitled *Higher Ground*,[11] where we reviewed the history of repetitive loss properties in the NFIP and the successful experience of the use of voluntary property buyouts for properties damaged by floodwaters after the 1993 Great Midwest Flood. We found, shockingly, that approximately 2 percent of the NFIP properties – those with two or more losses in a rolling ten year period – were generating twenty-five percent of total claims and forty percent of the total losses paid. At the time, in the total of 18 years of NFIP data that was available, some 74,501 repetitive loss properties had generated $2.581 billion in NFIP payments.

Today, twelve years later, these trends essentially continue. The number of repetitive loss properties has nearly ***doubled*** and the total cost of repetitive loss properties to the NFIP is ***now over $10.1 billion***.[12] Two-thirds of these repetitive loss claims costs have been experienced in Gulf Coast States, often in the areas subject to substantial tropical storm and hurricane risks.

Among the most troubling of findings in the Federation's *Higher Ground* report was the fact that large numbers of these properties were subject to substantial rate subsidies that appeared to have

[11] D. Conrad, B. McNitt and M. Stout, *Higher Ground: A Report on Voluntary Property Buyouts in the Nation's Floodplains, A Common Ground Solution Serving People At Risk, Taxpayers and the Environment*, National Wildlife Federation, Washington D.C., July, 1998.
[12] Source: FEMA, Repetitive Loss State Summary, Data as of 2/28/2009.

discouraged homeowners and businesses from making investments to mitigate their flood risks. In most instances, homeowners and businesses simply used flood insurance payments after disasters to rebuild in the same location without reducing their risk, only to be flooded again in the next disaster. Many properties already had cumulative flood losses far exceeding, sometimes multiple times, their property values. Thus, subsidized insurance worked as a clear disincentive to reduce risk, and the program as a whole failed to incentivize risk mitigation.

With this experience, and witnessing over two decades of Congress' mostly unsuccessful attempts to bring more actuarial soundness to the NFIP, and to strengthen NFIP risk reduction efforts, along with witnessing an enormous buildup of new development and redevelopment in coastal and floodplains areas, we believe that providing such government guarantees and reinsurance - as contemplated in H.R. 2555 - is only likely to fuel similar development pressures in many of the same types of locations. When disasters occur, we will likely see the same investments and reinvestments in areas such as barrier islands, along key shorelines and beaches, in and nearby wetlands and important wildlife habitat and areas otherwise prone to the same or greater repeated disaster costs as we have experienced in the past. Recent experience with flood hazard mapping and levees is demonstrating that such programs virtually always become quite political, which complicates our ability to manage the programs in a fiscally sound and environmentally responsible manner.

Nearly fifty years ago, in the mid '60's, when the NFIP was first proposed by some of the nation's most preeminent scientists and natural resources policy analysts, the scientists repeatedly warned the Executive Branch and Congress not to stand up such a program on a national basis, without extensive study and testing first in local areas and states. Their concern was precisely that such a program would likely have many serious and unforeseen impacts – a concern we can now see was clearly warranted. Congress, however, failed to heed these warnings and stood up the program nationwide almost immediately. We have similar concerns for a program such as H.R. 2555.

Impacts of Climate Change on Gulf States Require a Fundamentally Different Approach – A Massive Mitigation Effort

The nation's leading scientists continue to refine their models and predictions regarding hurricanes and storms. Climate change will make the Gulf and Atlantic coast states even more vulnerable to damages from hurricanes, tropical storms, and increasingly heavy rainfall associated with other storms. Furthermore, continued global sea-level rise associated with warming ocean waters and melting glaciers and ice caps will likely further exacerbate the risk of storm surge damages.

Scientists have been gaining confidence in projections for more intense hurricanes and tropical storms in the future, even as they continue to debate whether they can detect the signal of climate

change in the records of past storms. A recent assessment by the world's top experts on tropical cyclones concluded that the wind speeds and rainfall rates of future storms are likely to increase, and that storm surge damages will increase due to rising sea levels.[13]

The mean maximum wind speed of tropical cyclones is likely to increase by +2 to +11% globally by the end of the century if climate change continues unabated. The biggest changes may occur for the most intense storms, with the wind speeds of these storms increasing by a significantly larger percentage.[14] While these changes in wind speed may seem small, they can translate into large increases in damages. Yale economist William Nordhaus finds that hurricane damages are correlated with the eighth power of wind speed.[15]

All climate models project more rainfall from tropical cyclones in a warmer climate. The average increase by the late 21st century is about 20% within 62 miles of the storm center.[16] The increase in rainfall amounts will not only happen during hurricanes and tropical storms. In fact, climate change is already increasing rainfall totals in heavy downpours across the nation. Since 1958, the Southeast United States has experienced a 20% increase in the amount of precipitation falling during the heaviest events (excluding tropical storms). This trend is expected to increase: by the end of the century, the 1-in-20-year heavy downpour will be 10 to 25% heavier than it is now.[17]

Sea-level rise will even further increase the vulnerability of states along the Gulf and Atlantic costs to storm-surge flooding. When a tropical storm hits, higher sea-level translates into bigger storm surges that can cause flooding further inland. Sea-level rise will also endanger coastal wetlands and barrier islands that form a first line of defense and help buffer coastal areas against hurricanes and storm surges. Even if the unlikely circumstance that the characteristics of tropical cyclones do not change, scientists are highly confident that sea level is rising and that coastal areas will have a greater risk of damaging storm surge. A recent analysis of the potential economic costs of sea-level rise and associated storm damage in six Florida counties found that severe storm events and associated damage costs are likely to increase significantly during this century, with coastal property losses likely to double under a sea-level rise scenario of 2 feet by 2080.[18]

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[13] Knutson, T.R., et al., 2010. Tropical cyclones and climate change. *Nature Geosciences* Advance Online Publication on February 21, 2010, DOI: 10.1038/NGEO779.
[14] Knutson et al., 2010.
[15] Nordhaus, W.D., 2006: *The Economics of Hurricanes in the United States.* National Bureau of Economic Research (NBER) Working Paper, Cambridge, MA, 46 pp. Available at http://www.nber.org/papers/w12813
[16] Knutson et al., 2010.
[17] U.S. Climate Change Science Program (CCSP), 2008a. *Weather and Climate Extremes in a Changing Climate. Regions of Focus: North America, Hawaii, Caribbean, and U.S. Pacific Islands.* A Report by the U.S. Climate Change Science Program and the Subcommittee on Global Change Research. [Thomas R. Karl, Gerald A. Meehl, Christopher D. Miller, Susan J. Hassol, Anne M. Waple, and William L. Murray (eds.)]. Department of Commerce, NOAA's National Climatic Data Center, Washington, D.C., USA, 164 pp.
[18] Harrington, J. and Walton, T.L., Jr. 2007. Climate Change in Coastal Areas in Florida: Sea-level Rise Estimation and Economic Analysis to Year 2080 (Tallahassee, FL: Florida State University).

In 2007, the Intergovernmental Panel on Climate Change projected that sea level would rise 7 to 23 inches by 2100.[19] More recent studies indicate that sea level could rise much more rapidly; for example, Martin Vermeer and Stefan Rahmstorf projected 2.4 to 6.2 feet of sea-level rise over the same time period.[20] To put this in perspective, a two-foot rise in sea level would mean regular inundation for 2,200 miles of major roads and 900 miles of railroads in Maryland, Virginia, North Carolina and the District of Columbia.[21]

Ideally, coastal wetlands (and their ability to buffer storm surge impacts) would survive by migrating inland as sea levels rise. However, a recent study of land-use plans for states and local areas along the U.S. Atlantic coasts found that less than 10% of land within about 3 feet of the current sea level has been set aside for conservation.[22]

Florida's coastal management and coastal development policies currently do not proactively take sea-level rise and other climate change impacts into consideration. There is no mention of climate change or sea-level rise in Florida's 2007 Strategic Beach Management Plan. Similarly, there is an immediate need to reassess the state's Coastal Construction Control Line (CCCL) program, the foundation of Florida's coastal management policies.

Defying long term planning needs in the face of climate change, Florida continues to encourage, allow, and subsidize high risk coastal development in several ways. For example, the Department of Environmental Protection (DEP), in accordance with state law, regularly issues permits for beach-front construction at risk of damage by erosion. While the CCCL regulatory control program generally prohibits construction seaward of a line equal to where annual wave events are projected to reach in 30 years, loopholes often render this sensible setback ineffective, such as by allowing development on the frontal dunes of the most erosive beaches in the state.[23] Exemptions for building seaward of the 30-year erosion line are mandated for single family homes on lots platted before 1985 and are routinely granted if there is an existing line of construction or a pending beach nourishment project. In addition, the CCCL program does not account for the potential for extreme erosion associated with hurricanes.

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[19] Intergovernmental Panel on Climate Change (IPCC), 2007. Climate Change 2007: The Physical Science Basis. Contribution of Working Group I to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change [Solomon, S., D. Qin, M. Manning, Z. Chen, M. Marquis, K.B. Averyt, M. Tignor and H.L. Miller (eds.)]. Cambridge University Press, Cambridge, United Kingdom and New York, NY, USA, 996 pp.

[20] Vermeer, M., and S. Rahmstorf, 2009. Global sea level linked to global temperature. *Proceedings of the National Academy of Sciences.* 106(51): 21,527–21,532.

[21] CCSP. 2008b. Impacts of Climate Change and Variability on Transportation Systems and Infrastructure: Gulf Coast Study, Phase I.A Report by the U.S. Climate Change Science Program and the Subcommittee on Global Change Research [Savonis, M.J.,V.R. Burkett, and J.R. Potter (eds.)].Department of Transportation, Washington, DC, USA, 445 pp.

[22] Titus, J.G., et al., 2009. State and local governments plan for development of most land vulnerable to rising sea level along the US Atlantic coast. *Environmental Research Letters* 4: 044008 (7pp).

[23] Levina, E., et al. 2007. Policy Frameworks for Adaptation to Climate Change in Coastal Zones: The Case of the Gulf of Mexico (Paris, France: Organisation for Economic Co-operation and Development and the International Energy Agency).

The general availability of the state-financed Citizens insurance also results in a subsidy for ill-advised construction in coastal high hazard areas fronting vulnerable and eroding beaches. Insurance coverage is provided regardless of whether development is thousands of feet from the shore or adjacent to the most seaward line of dunes on eroding beaches. In addition, Citizens coverage is provided to builders, investors, and homeowners along the coast regardless of the historical erosion rates, storm history, or frequency of repeat claims.

As we have indicated, we believe such trends argue strongly for a much enhanced mitigation approach to assist homeowners and businesses, and especially to assist low and moderate income individuals on a needs-tested basis, rather than creating conditions whereby the incentives for risk mitigation are effectively reduced through government backstop subsidies.

A Much Greater Commitment to Mitigation Is a Better Solution

The National Wildlife Federation believes that a strategic commitment to encourage mitigation is the best approach to protecting communities from natural hazards and we would urge the Congress to follow that path as a clear and effective alternative to the kind of approach proposed in H.R. 2555. This would discourage risky development, protect environmentally-sensitive areas and buffer communities from hazards, provide for important habitat for wildlife, and emphasize actuarial, risk-based insurance, which sends appropriate signals regarding risks. Such a strategy would do the most to safeguard people, protect property, reduce insurance rates and protect the environment. We would welcome an opportunity to work with the Financial Services Committee leadership, Representative Klein and other members of the Committee toward an approach that better protects people, property and the environment.

A long-term strategy for managing and reducing insurance rates should be founded especially on wise land-use and mitigating risks.[24] While we understand that H.R. 2555 includes authorization for a minimal $15 million per year for five years for grants to promote mitigation, this, first, would be subject to the vagaries of annual appropriations, and, second, would be completely dwarfed by the scope of the bill's insurance provisions and the incentives for risky development whose disaster-related costs would ultimately be borne by the U.S. taxpayers in events where catastrophic levels of costs cannot be repaid.

A strategy to support substantially expanded mitigation would include establishment of comprehensive reforms for the National Flood Insurance Program, emphasizing actuarial soundness and reducing subsidies, improved flood hazard identification and risk communication to the public, and integration of protection and restoration of natural and beneficial floodplain functions and ecosystem health with strengthened land use and building controls to improve public safety. Congress should also expand programs such as the Coastal Barrier Resources

[24] Note: A major study of hazard mitigation measures typically supported by FEMA programs by the Multi-Hazard Mitigation Council found that "a dollar spent on mitigation saves society a average of four dollars," Multi-Hazard Mitigation Council, *Natural Hazard Mitigation Saves: An Independent Study to Assess the Future Savings From Mitigation Activities*, National Institute of Building Sciences, Washington DC, 2005, p. 5.

System potentially to other sensitive areas and expand the range of ecosystem restoration programs to better protect coastal and other wetlands, vegetated stream corridors, barrier islands and critical beaches and dunes that serve as nature's buffers from extreme events as well as provide necessary habitat areas for fish and wildlife.

Additional measures would include support for strengthening pre- and post-disaster mitigation programs, including support for H.R. 3377, the Disaster Response, Recovery and Mitigation Enhancement Act, already reported by the House Transportation and Infrastructure Committee to expand investments in pre-disaster mitigation, modernize public warning systems and provide incentives to states to adopt and enforce improved building codes. We also urge support for strengthened disaster planning and to expand federal weatherization grant programs, especially to assist low income homeowners to strengthen their homes against damages from hurricanes and major storm events.

Finally, and most importantly, we again urge Congress to pass comprehensive climate legislation to help stave off the worst effects of climate changes from the buildup of greenhouse gasses in the Earth's atmosphere.

Conclusion

The National Wildlife Federation once again greatly appreciates the opportunity to provide our views on H.R. 2555, the Homeowners' Defense Act. I would be happy to respond to any questions the Members of the Committee may have.

TESTIMONY FROM NATIONWIDE INSURANCE
W. CRAIG ZIMPHER, V.P. GOVERNMENT RELATIONS
IN SUPPORT OF
THE ENHANCED HOMEOWNERS INSURANCE POLICY PROPOSAL
PROVIDED MARCH 10, 2010

Thank you, Mr. Chairman, Nationwide Insurance is very pleased and honored to submit testimony before your committees regarding the proposed "Enhanced Homeowners Insurance Policy Act", which Nationwide has developed and disseminated for your consideration. EHIP has two principle purposes: (1) To provide a practical way for homeowners and their insurers to include flood insurance within a homeowners insurance policy, while neither requiring homeowners to buy such a policy nor insurers to sell one; and (2) potentially minimize the uncertainties, expense, and litigation that arise from homeowners insurance policies not including flood insurance within them.

Following hurricane Katrina and other related wind flood natural disasters in the recent past, public policymakers, including Congressmen, state legislators, and state insurance regulators admonished the industry to attempt to formulate feasible and workable public policy alternatives. Nationwide, as a responsible corporate citizen, seriously listened to those admonitions and has attempted to formulate a proposed insurance policy that would respond to the interests of public policy makers and, most importantly, the well being of our insurance consumers. It is that response to the concerns we heard expressed by various public policy makers that brings us here today to discuss EHIP.

With few exceptions, insurers today do not provide flood insurance coverage as part of their homeowner's insurance policies. The financial risk is just too great to do so. But while their decision to exclude flood coverage is financially appropriate, their inability to "conveniently" include this coverage as part of the homeowner policy results in millions of homeowners being dangerously uninsured.

This critical lack of insurance arises in two circumstances. The first is flooding that arises from the accumulation of ground water from heavy and persistent rains or from a body of water overflowing its banks. The second arises in relation to a hurricane. In the first circumstance, there is little doubt that the damage has been caused by the floodwaters. In the second circumstance, however, disputes can arise about whether the house was damaged by hurricane winds, which then made the water damage possible, or whether the water damage had been caused by flooding unrelated to any wind damage. If the damage was caused by hurricane winds, that damage will be covered by a homeowner's insurance policy or a separate wind policy, typically purchased through a state Windpool Association. If the water damage did not have its origin in damage to the house from hurricane winds, however, the damage will not be covered by a homeowner's policy. In either case, millions of homeowners will not have insurance protection.

This lack of insurance further results in a critical need for enormous post-flooding federal expenditures to help the uninsured rebuild their homes and their lives after the catastrophe. Even after the floodtide recedes, a litigation tide often comes crashing ashore. This litigation tide brings expensive, acrimonious lawsuits with it that pit insurers and their policyholders against each other, arguing about whether a specific customer's loss was covered by that customer's policy.

This problem has been well known for decades, which is the reason that Congress created a separate federal flood insurance program in 1968 through the enactment of the National Flood Insurance Act. The NFIP provides stand-alone government subsidized flood insurance policies that customers can buy separately from their homeowner's policy. There is no doubt that NFIP stand-alone insurance has made flood insurance available for millions of homeowners who otherwise would not have been able to obtain it. But it is also true that the

lack of a convenient consumer process to buy separate flood policies has resulted in many other homeowners not obtaining the coverage they need.

Most of these issues can be described in shorthand fashion as the "wind-water" dichotomy. If the cause of loss is "wind," then the loss will be covered by the homeowner's insurance policy or a wind insurance policy. If the cause of loss is "water," then the loss will either be covered by an NFIP stand-alone policy, or it will not be covered at all because the homeowner has not bought an NFIP policy. Most homeowner's insurance policies also have "anti-concurrent cause" provisions which, as a general matter, state that if a loss is caused by both wind and water, the loss will not be covered by the policy. Although sometimes criticized, these anti-concurrent cause provisions have been upheld in litigation arising out of Hurricane Katrina.

These problems have festered for decades. Now they have become acute, both because of changing weather patterns across the United States seemingly making the country more prone to hurricanes and flooding in recent years, and because the population in hurricane and flood prone areas has increased dramatically. Until now, however, no workable resolution of these problems has been proposed. Now there is a proposal to do so: the Enhanced Homeowners Insurance Policy (EHIP) decisively addresses this deadlock by making it possible to attach the established NFIP flood coverage to homeowners policies, while enhancing options for homeowners and insurers, alike, and ameliorating the problems that have defied solution for so long.

The EHIP proposal provides a practical answer to a critical problem for millions of homeowners and for their insurers. For the first time, homeowners insurance policies will be generally available to the public with flood insurance included within them, thus potentially minimizing the confusing and expensive coverage gap that exists today.

This general availability of the Enhanced Policies will almost certainly increase—perhaps dramatically—the number of homeowners who obtain protection from flood losses. At the same time, it has the potential to dramatically decrease the amount of litigation between homeowners and their insurers based on the question of whether the loss came from "wind" or "water"—because both "wind" and "water" will be covered in the policy.

Allow me to now briefly discuss the core principles and key operational aspects of EHIP.

EHIP is built on three core principles:

First, EHIP provides a workable national mechanism for insurers to voluntarily sell – and consumers to voluntarily buy -- a homeowner's insurance policy that would include flood insurance, by reinsuring the flood coverage through the Treasury Department.

Second, EHIP would leave all current homeowners' insurance options alone, so homeowners could continue to purchase insurance that does not include flood coverage, at all, or to add the flood coverage currently sold separately through the National Flood Insurance Program.

Third, EHIP incorporates principles of creative federalism by establishing a regulatory partnership between the states and the federal government, pursuant to which each state would be authorized and encouraged to assure consumer protections for EHIP customers in the state, while the Treasury Department manages the reinsurance program and regulates the EHIP policy in a uniform, national way.

Building on these three core principles, here is how EHIP would operate:

EHIP policies would be homeowners' insurance policies that have been extended to include flood coverage. That flood coverage would be exactly the same as an NFIP stand-alone policy for that same home, with the premium for the flood portion of the EHIP policy being exactly the same as the premium for a stand-alone NFIP policy. Insurers and customers could, of course, arrange for additional flood coverage, but that additional coverage would not be part of the EHIP program.

The non-flood coverages under the EHIP policies would be priced by insurers individually in the marketplace based on their own loss experience, in addition to the existing prices of the stand-alone NFIP policies, thus enhancing both competition and price discipline in the homeowners' insurance market.

When a claim was filed under an EHIP policy, the insurer would handle it in the same way that it would handle any other claim under that policy, thus eliminating the need for multiple claims adjusters – one for flood, one for everything else – potentially minimizing the arguments and litigation over whether the damage had been caused by wind or water.

The flood coverage of EHIP policies would be reinsured by the Treasury Department through a statutorily established mechanism that prohibited EHIP insurers from earning any profit on the flood portion of the EHIP policy while, at the same time, shielding EHIP insurers from assuming any financial responsibility or loss on the EHIP program, including flood claims. Any disagreement between an insurer and the Treasury Department would be decided, if necessary, through arbitration.

The EHIP insurance policy would be regulated nationally by the Treasury Department to assure uniform treatment of the policy from state-to-state and to

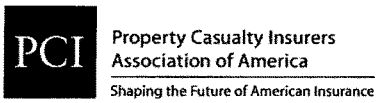
enable EHIP insurers to sell the same policy in multiple states or nationally. To protect the financial integrity of the EHIP program, each EHIP insurer would be required to establish a separate account on its books where all EHIP flood-related premium would be deposited and which could only be used to pay for flood claims and related costs and the Treasury reinsurance premium.

Important state consumer protection laws would continue to apply in each state where EHIP policies were sold, and each state would be authorized to continue to regulate EHIP insurers on all consumer protection and market conduct matters. States that agreed to undertake consumer protection and market conduct responsibilities would get the financial benefit receiving premium tax on the sale of each EHIP policy.

Mr. Chairman, we believe that the EHIP legislation provides an opportunity to resolve enormous problems that have proven intractable over many decades. I am attaching a copy of the legislation to this testimony, so that the Committee may study it in greater detail. We would be delighted to further discuss the proposal with the Committee and respond to any questions the Committee might have.

Additionally, Mr. Chairman, we appreciate the Commmittee's interest in natural disaster issues, and possibile public policy solutions to assuring adequate consumer protection before and after natural disasters occur. A number of legislative proposals have been introduced and are under consideration. Nationwide has been actively engaged in these issues and I wish to add our support for efforts to modernize residential and commercial building codes, incentives to adopt effective land use and zoning requirements as well as residential retrofitting to more adequality protect against natural catastrophe losses.

Thank you.



Testimony
Property Casualty Insurers Association of America (PCI)

Approaches to Mitigating and Managing Natural Catastrophe Risk:
H.R. 2555, the "Homeowners Insurance Defense Act of 2009"

The Subcommittee on Housing and Community Opportunity and the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
Committee on Financial Services
United States House of Representatives
March 10, 2010

The Property Casualty Insurers Association of America (PCI) is pleased to offer testimony on H.R. 2555, the Homeowners Insurance Defense Act of 2009. PCI is the leading property-casualty trade association representing more than 1,000 insurers, the broadest cross-section of insurers of any national trade association. Our members are leading providers of home, auto and business insurance.

Over the years, the Congress and states have considered various solutions to the issue of availability and affordability of natural catastrophe insurance. Most are premised on the idea that natural catastrophe insurance is one monolithic problem that needs a monolithic government solution. PCI invites the sub-committee to look at natural catastrophe insurance issues from a different perspective. There are a number of discrete issues that collectively contribute to availability and affordability issues. By carefully focusing on those specific problems, most of which have more easily achievable targeted solutions, PCI believes that Congress and the states can take a series of positive steps to minimize the economic and market impact of homeowners insurance premiums in high-risk areas and ease burdens on those who can least afford to bear those high risk costs. Our Natural Catastrophe Guidebook, attached to this testimony, discusses these more discrete solutions that would reduce losses, ensure a competitive marketplace and result in limited additional federal exposure. A healthy market where government tools are used effectively to solve problems and create desired behaviors benefits everyone. We would be happy to discuss our suggested tools with you in greater detail as part of our continuing constructive engagement on this important issue.

PCI shares the concerns expressed by taxpayer, environmental, and other groups. The bill would broadly shift taxpayer resources from the entire country to benefit specific catastrophe-prone areas through the proposed federally subsidized bond guarantees and the reinsurance catastrophe fund provisions. That approach is costly to all taxpayers, and threatens to displace the private market. Moreover, by providing government subsidies to artificially suppress costs for coastal properties, the bill fosters significant moral hazards that encourage building and development in

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high-risk and environmentally sensitive areas. (The record of the National Flood Insurance Program, which has incurred huge debt and encouraged construction in flood-prone areas, suggests that lawmakers should tread cautiously when considering a new government catastrophe insurance program.)

To achieve a meaningful consensus on natural catastrophe insurance, policymakers must identify approaches that address real world needs while avoiding politically tempting approaches that deny the laws of economics. While there is no magic solution to bring insurance premiums down in catastrophe-prone areas, affordability is a particular concern for some lower-income individuals and fixed-income seniors in primary residences. Government subsidies (*e.g.,* tax credits to offset premium costs) can be narrowly targeted to provide assistance where it is needed most.

Price volatility is another specific concern, but that can be partly tempered through changes in the tax codes. Mitigation can be encouraged through a carrot-and-stick regulatory approach. Responsible land use and construction of stronger homes and businesses are key components of any effort to address natural catastrophes. According to the 2007 Congressional Budget Office report on projects funded through the Pre-Disaster Mitigation program, for every $1 spent to mitigate loss, $3 was saved in post-event spending. The differing impacts of recent earthquakes in Haiti and Chile have demonstrated that mitigation not only works, it saves lives. The earthquake in Chile registered an 8.8 magnitude and ranks as the world's fifth largest earthquake on record. While 720 people lost their lives, countless others were saved due to strong building codes. The Haiti earthquake, by comparison, registered 7.0 but claimed more than 200,000 lives.

Our Guidebook includes specific targeted solutions for particular types of risk (earthquake, hurricane, wildfire, etc.) and locations (along the coast, inland, near a fault, etc.). Specifically, the Guidebook provides suggestions on how policymakers can encourage mitigation, by: limiting development in risky areas, providing Federal grants to assist state mitigation programs, or considering sales tax relief on the purchase of mitigation supplies. These are just some of the many positive steps that government can take at the federal, state and local levels.

Risk has a cost! There is no getting around it. That's why properties in catastrophe-prone areas are costly to insure. But there are responsible ways to mitigate those costs, especially for those who can least afford them. We believe that practical solutions like those we have suggested would minimize the economic and market impact on high-risk areas and ease the burden without further government intrusion into the private sector. Those practical solutions are much preferable

to the approach taken in H.R. 2555, which would unfairly shift the risk costs in catastrophe-prone areas to all taxpayers and create potential moral hazards that encourage over-building in risky and environmentally sensitive areas. We commend our Guidebook to you, and invite you to consider catastrophe insurance in a new and different way, focusing on discrete needs and targeted solutions rather than overarching federal government subsidies. We welcome the opportunity to discuss our proposals in greater detail and we look forward to working constructively with the subcommittee as it considers the critical need for a well functioning private natural catastrophe insurance market for consumers.

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March 12, 2010

Honorable Barney Frank
Chairman
Honorable Spencer Bachus
Ranking Minority Member
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Frank and Ranking Member Bachus:

We understand that the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises and the Subcommittee on Housing and Community Opportunity will soon be considering the Homeowners' Protection Act of 2009 (HR 2555). We believe the proposed legislation is ill advised and unwarranted.

Although this Committee approved natural catastrophe funding legislation sponsored in the last Congress, it is important to note that H.R. 2555 is a very different bill. Under the terms of the proposed legislation, the Federal government would guarantee municipal obligations of state sponsored and quasi-state sponsored municipal bonds and, for the first time, create a federal reinsurance program which would engage directly in offering reinsurance for insured properties.

The legislation is primarily designed to address the underfunded state insurance facilities in Florida. Additionally, it encourages other states to change from pre-funding their insured property catastrophe exposure through insurance premiums and assessments on insurers (such as the California Earthquake Authority) to a reliance on post-event funding with federal guarantees of debt issuances. This is certain to add billions of dollars to the federal deficit. For example, the Florida Hurricane Catastrophe Fund has approximately $4.5 billion in cash, $3 billion in outstanding loans and total statutory obligations of $26 billion. Florida Citizens, the state insurer, has $4 billion in surplus, $17 billion in claims paying capacity (including $10 billion recoveries from the Florida Catastrophe Fund) and $410 billion in insured exposures. The California Earthquake Authority has approximately $10 billion in claims paying capacity and $277 billion in insured exposures.

The private reinsurance market has demonstrated that it can serve property catastrophe insurance markets under the most extreme scenarios. In 2005, Hurricanes Katrina, Wilma and Rita caused $72.7 billion of insured losses of which 61 % were ultimately paid by the global reinsurance market. In 2001, the events of 9/11 caused $32 billion in insured losses of which the reinsurance market paid two thirds. In addition to its dependability in paying its claims, the added value of relying on the private market is that, unlike public insurance programs, it prices for catastrophe risk. This ensures that recovery by homeowners and businesses from extreme events are pre-funded and that resources are set aside to meet obligations when they occur. As with Florida, where both the state's insurance program, Citizens, and the state reinsurance facility are underfunded, intentionally underpriced and

dependent already on debt, the Federal government has seen what happens with government programs that unrealistically price risk. The National Flood Insurance Program is $20 billion in debt as a result of the same extreme weather events where the insurance industry paid $72 billion of losses without notable insurer failures.

HR 2555 marks an extraordinary departure in Federal policy. By providing special interest federal guarantees to a small number of underfunded state insurance programs, the legislation would provide a preference over the municipal obligations of all other entities for which the Federal government provides no current bond guarantees: cities, states, quasi- governmental entities such as water districts and highways, and private institutions such as hospitals and universities.

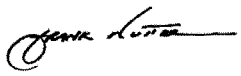
No valid Federal policy goal is achieved by giving a few state insurance funds this priority. In fact, the states most likely to rely on these federal guarantees (California and Florida) do not themselves guarantee, backup with state full faith and credit or provide funding for their own state insurance programs. Yet, they would offload the insured risk of their state sponsored entities on to Federal taxpayers through the proposed reinsurance program and bond guarantees.

Proponents routinely argue that the Federal government is already committed to support citizens after a natural catastrophe. Indeed, the federal government has been generous in these moments. However, the proposed legislation would do little, if anything, to relieve the government of its post disaster role. HR 2555 would only provide financial support for insured losses through state sponsored insurance programs. It would not address the vast bulk of federal spending post-event for emergency relief, such as temporary housing, evacuations, and Defense Department support. That obligation would continue without diminution as a result of HR 2555 which would only add to emergency federal spending when such natural catastrophes occur.

HR 2555 provides a reward for state sponsored insurance programs which have failed to adequately collect premiums for their insured property risk for natural catastrophes. It incentivizes other states to replicate this approach. By doing so it would expose the Federal government to financially support states which would "game" the system to transfer the cost of natural disaster insurance to Federal taxpayers instead of funding catastrophe risk by those living in risk prone areas.

The private reinsurance market continues to offer robust capacity for property catastrophe risk. HR 2555 would shift the risk of loss from the private sector to the federal government, thus exposing federal taxpayers to the parochial prerogatives of state insurance programs. We urge you to reject the proposed legislation.

Sincerely,



Franklin W. Nutter
President

Cc: Members of the House Financial Services Committee

February 24, 2010

Honorable Barney Frank
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Honorable Spencer Bachus
Ranking Minority Member
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Frank and Ranking Member Bachus:

We understand that H.R. 2555, the Homeowners' Defense Act, will be heard in the House Financial Services Committee next month. As a coalition of leading environmental groups, taxpayer organizations and insurance interests, we strongly oppose H.R. 2555. If enacted, the Homeowners' Defense Act would cost taxpayers billions of dollars, discourage the insurance and reinsurance private market, and result in incentives to build in unsafe and environmentally fragile areas.

H.R. 2555, introduced by Representative Ron Klein of Florida on May 21, 2009, creates a federal bailout program principally designed to benefit hurricane-threatened Florida at the expense of taxpayers in all 50 states. The legislation supports a Florida system that is based on artificially low premiums. Such a system encourages risky development behavior. It is a cost the federal government and taxpayers cannot afford.

H.R. 2555 consists of three major components: (1) a federally facilitated consortium of states to pool their natural catastrophe risks, (2) federal reinsurance for state natural catastrophe funds, and (3) federal guarantees of bonds issued by state funds. All three of these components are problematic. Federal reinsurance and federal guarantees used in this way shift resources from all 50 states to benefit a single state—a state that could fix its insurance problems without federal intervention. And while the consortium approach would not significantly burden taxpayers, it is a fatally flawed concept. States can already create pools for insurance. States have not done so, however, because low-risk states and their taxpayers do not want to subsidize high-risk states and their homeowners.

We understand the significant risks that Florida faces as a result of natural disasters. We agree that all US residents, including Floridians, should have access to adequate insurance so they can responsibly rebuild after a storm. We oppose, however, any effort to shift the costs of insuring Florida residents to taxpayers across the United States. The state of Florida has established a public insurance system instead of relying on the private sector. This public system is deeply flawed. Unlike private insurance and reinsurance, which maintain proper liquidity and reserves to pay claims, Florida's state insurance and reinsurance funds are severely under-capitalized and will not be able to pay claims in the event of a large hurricane.

The state of Florida is well aware that its public insurance system is flawed—under the state program, Citizens Property Insurance Corporation, homeowners who live on the coast pay only a

fraction of actuarial rates. These subsidies are not means tested—affluent homeowners with beachfront property are being subsidized by those who live in less risky, and in some cases less wealthy, areas of the state. While Florida could make changes to ensure its system is on solid financial footing, including purchasing reinsurance or floating catastrophe bonds in the private market, the state has chosen to continue its under-capitalized system in hopes that the federal government, and all taxpayers, will bail them out.

We strongly believe that Florida has made the wrong choice in seeking a federal bailout instead of looking to the private market. Private reinsurance and capital markets are robustly assuming catastrophe risk, while federal insurance programs struggle to deliver on their commitments. The private insurance sector has met its obligations arising from recent disasters, including Hurricanes Katrina, Rita, Wilma, Ike and Gustav, thus ensuring that families across devastated areas were quickly able to rebuild and re-start their lives. This is in stark contrast to federal programs, such as the National Flood Insurance Program, which is now more than $20 billion in debt in large part due to inadequate rates. When rates are disconnected from risk, more development occurs in flood prone areas, which increases insured and economic losses caused by hurricanes. Further, this inappropriate development puts individuals in harm's way and threatens lives. In short, such action perpetuates and exaggerates the problem and does nothing to solve it.

In addition to shifting significant costs onto federal taxpayers, a fundamentally unfair and, in this era of spiraling federal deficits, a fiscally irresponsible request, H.R. 2555 encourages development in unsafe and environmentally fragile areas. While we agree that there may be actions that need to be taken to help lower-income families afford insurance when they already live in harm's way, subsidizing development in environmentally sensitive areas primarily benefits those who least need assistance. Encouraging this development directly harms this nation's residents and communities by eroding our natural barriers to storms and their impact.

We strongly believe that instead of acting favorably on the fundamentally misguided and fiscally irresponsible Homeowners' Defense Act, the Financial Services Committee should focus its natural catastrophe efforts on smart mitigation legislation that helps property owners—particularly lower and moderate income families—make their homes safer. Federal efforts to strengthen state-level mitigation programs will better protect those living in at-risk areas and it gets at the root of the problem. The Klein legislation, on the other hand, does nothing to solve the underlying issues. Instead, it would create a system that perpetuates a flawed and costly approach.

H.R. 3026, the Hazard Mitigation for All Act, for example, was introduced by Representative Bennie Thompson of Mississippi last year and was referred to the Financial Services Committee. H.R. 3026 recognizes that public housing, Section 8 rental units, and publicly-assisted housing all would benefit from comprehensive retrofit mitigation projects to harden them against natural catastrophes. Such an approach is fiscally responsible because it would reduce long-term taxpayer costs by reducing the need for post-disaster reconstruction. H.R. 3026 would provide for funding for such mitigation efforts for the benefit of those at-risk and in-need populations.

In addition, we support efforts to encourage all property owners to make needed resiliency improvements to their homes. We have been working with Congress to include resiliency in legislation designed to encourage energy efficiency retrofits, and we would welcome the opportunity to brief you and your staff on these efforts and their benefits.

Finally, we also strongly support H.R. 3377, Disaster Response, Recovery and Mitigation Enhancement Act, which has been reported favorably by the Committee on Transportation and

Infrastructure and awaits action by the House. This vitally important legislation authorizes critical new investments in pre-disaster mitigation, would help to modernize our Nation's public warning systems, and provides incentives to the states to adopt and enforce improved building codes.

Thank you for this opportunity to present you with the views of the SmarterSafer.org coalition in opposition to H.R. 2555, the Homeowners' Defense Act.

Sincerely,

SmarterSafer.org

(List of Coalition Members and Allied Organizations Attached)

cc: Honorable Nancy Pelosi

Honorable Steny Hoyer

Honorable John Boehner

Honorable Eric Cantor

MEMBERS

Environmental Organizations

American Rivers
Ceres
Defenders of Wildlife
Environmental Defense Fund
National Wildlife Federation
Republicans for Environmental Protection
Sierra Club

Emergency Preparedness Group

National Flood Determination Association

Consumer and Taxpayer Advocates

Americans for Prosperity
Americans for Tax Reform
Center on Risk, Regulation, and Markets—The Heartland Institute
Competitive Enterprise Institute

Insurer Interests

Allianz of America
Association of Bermuda Insurers and Reinsurers
Chubb
Liberty Mutual Group
National Association of Mutual Insurance Companies
National Association of Professional Insurance Agents
Reinsurance Association of America
Swiss Re
USAA

ALLIED ORGANIZATIONS

National Fire Protection Association
Taxpayers for Common Sense

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