American Insurance Association

UNITED STATES SENATE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

"AN EXAMINATION OF THE AVAILABILITY AND AFFORDABILITY OF PROPERTY AND CASUALTY INSURANCE IN THE GULF COAST AND OTHER COASTAL REGIONS"

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

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

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

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

Recent Experiences

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

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

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

The Need for Meaningful Reform

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

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

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

I am here today to urge appropriate restraint as this Committee sorts through the various federal legislative proposals that have been introduced in the 110th Congress. The reality is that there are no quick fixes or easy answers to the very difficult challenges we face. Moreover, punitive measures directed at insurers, including recently introduced bills to repeal the McCarran-Ferguson Act's limited antitrust exemption for the business of insurance, while couched in the language of the current natural catastrophe insurance debate, are wholly unrelated. They will do nothing to improve the availability or affordability of coastal insurance and instead will have a serious and detrimental effect on the markets they purport to assist.

AIA's Reform Agenda

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

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

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

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

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

Recent State Activity

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

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

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

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

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

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

Federal Approaches

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

S. 928 - The Homeowners Insurance Protection Act: This legislation would create a federal reinsurance mechanism to encourage states to establish catastrophe funds (Cat Funds) for homeowners insurance. We believe this is based on the premise that large-scale natural catastrophes are uninsurable by the private sector, and that the government should step in to provide capacity.

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

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

Tax legislation: Although such a change may not precipitate substantial capacity in the short term, amending U.S. tax laws to permit insurers to establish tax-deferred catastrophe reserves, if designed properly, would have a positive impact on present and future recovery efforts. There are also other ways that federal tax policy can enhance affordability and encourage the use of protective measures. These include: legislation to establish tax-exempt catastrophe savings accounts (CSAs) for individuals (similar to health savings accounts) as introduced by Senator Bill Nelson, S. 927; and federal income tax credits to encourage homeowners and business owners to invest in protective measures as introduced by Senator Mel Martinez, S. 930.

S. 1061 - The Homeowner's Insurance Non-coverage Disclosure Act: This legislation would require insurers to restate the terms of their property insurance policies in “plain language” that may be at odds with the actual contract language, thus increasing complexity and the likelihood of litigation, while discouraging homeowners from reading their policies. The overwhelming majority of states, including those in the Southeast and along the Gulf, subject companies to regulatory review of their policy language and conditions. This process recognizes the importance of technical accuracy over language that is so simple as to be misleading to the consumer. Simplifying and re-characterizing existing language would undercut the regulatory process and long-standing judicial interpretations of contract terms.

Moreover, imposing new regulatory requirements, and increasing the litigation risk facing insurers, is counterproductive to the goal of encouraging the growth and development of private sector capacity to manage catastrophe risk. There are ample safeguards in state systems, including market conduct regulations and unfair claims practices laws, to make sure that insurers do not mislead their policyholders or shirk their responsibilities to pay covered claims. The addition of new disclosure requirements that are at odds with existing contract terms will make catastrophe exposures more difficult to measure and add to the cost of providing coverage.

Conclusion

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