

# IS AMERICA'S HOUSING MARKET PREPARED FOR THE NEXT NATURAL CATASTROPHE?

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## HEARING BEFORE THE SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY OF THE COMMITTEE ON FINANCIAL SERVICES U.S. HOUSE OF REPRESENTATIVES ONE HUNDRED NINTH CONGRESS SECOND SESSION

—————  
JUNE 28, 2006  
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Printed for the use of the Committee on Financial Services

**Serial No. 109-103**



U.S. GOVERNMENT PRINTING OFFICE

31-532 PDF

WASHINGTON : 2007

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## **IS AMERICA'S HOUSING MARKET PREPARED FOR THE NEXT NATURAL CATASTROPHE?**

**Wednesday, June 28, 2006**

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

The subcommittee met, pursuant to notice, at 2:04 p.m., in room 212B, Rayburn House Office Building, Hon. Robert Ney [chairman of the subcommittee] presiding.

Present: Representatives Ney, Brown-Waite, Neugebauer, Waters, Lee, Cleaver, and Green.

Also present: Representatives McCarthy, Israel, Taylor, and Wasserman-Schultz.

Chairman NEY. Good afternoon.

The Subcommittee on Housing and Community Opportunity will be meeting to discuss the capacity of America's housing market to withstand future catastrophic events and the strain that natural disasters are having on the homeowner insurance markets.

For the past decade, the rising toll from natural disasters places significant strain on homeowner insurance markets in parts of the country that frequently experience catastrophic events.

In the aftermath of Hurricane Andrew in 1992, and the California North Ridge earthquake in 1994, many insurers stopped underwriting policies in these areas entirely, leaving many families with very little protection against catastrophic losses.

Insurers continue to be reluctant to enter coastal States that are at risk for severe earthquakes and hurricanes due to the increasing costs of paying for the damage that will be caused in a once-in-a-lifetime event.

Many factors that underlie why the U.S. coastal areas may have increased risk are related to an above-average cycle for large hurricanes as well as increased coastal development.

Up until the 20th century, most of the U.S. coastline was sparsely populated and protected from storms by marshy wetlands and sandy barrier islands, but for almost 60 years, there has been a surge in coastal development that has put more than half of the United States population within 50 miles of the sea.

During the 105th and 106th Congresses, the Committee on Banking and Financial Services, now of course the Committee on Financial Services, held four hearings to address the issue of preparing the housing market in the event of a natural disaster.

In those hearings, members discussed proposed legislation that would have created a Federal reinsurance program to protect insurance companies that would be unable to cover the costs of a large-scale natural disaster.

Due to the frequency and severity of natural disasters, the Federal Government has taken a greater interest in seeking to relieve the strain placed on public and private insurance pools engaged in catastrophic risk management and financing.

With focused public debating on whether to implement a comprehensive solution to the problem presented by the housing markets natural catastrophic exposure, the 109th Congress has several legislative proposals that addressed these issues. I'm certain today's discussion will focus on several of these initiatives.

While there may be competing philosophical views regarding the nature and role of the Federal Government, all parties would agree that the problem of insurance availability in disaster prone areas is a real and worthy issue that needs to be looked at by the Congress.

I hope today's hearing will raise important questions regarding the ability of American's housing market to withstand future natural catastrophic events, especially in light of the recent availability and affordability issues surrounding the homeowner insurance.

With that, I will yield to the ranking member, the gentlelady from California.

Ms. WATERS. Thank you very much, Mr. Chairman.

I'd like to thank you for holding this hearing today, and basically commend you not only for this hearing, but for all of the work that you have been doing relative to the great Katrina disaster and all of the work that you are doing to try and increase the ability of American citizens to own homes.

I need not remind you of a visit that we made to the Gulf Coast Region to conduct an assessment of the disaster that had taken place in the area and the time that we spent both in Louisiana and in Mississippi and what we learned.

First of all, we were able to view the terrific devastation of Hurricane Katrina and witness firsthand the loss of tremendous housing stock; but secondly, to hear from those citizens about their attempt to rebuild or to reconstruct their lives only to find that they were having tremendous problems with the insurance companies.

We learned that there were people who did not have insurance. The insurance was not required by the lender who provided the mortgage opportunity.

We learned that there were people who thought they were well covered only to find out about the debate between wind and water and which was responsible for the destruction.

We discovered that there were some issues with our own insurance program, the flood insurance program, and some changes that had to be made, and we went forward already with those changes. The bill was on the Floor yesterday.

We learned an awful lot about the mapping problem and the fact that the maps are outdated and really are not serving the purposes intended to be served.

So with all of that, this hearing today really does make a lot of sense, because we've got to figure out what we can do to protect the housing stock in the event of other disasters that are sure to visit themselves upon us in one way or another.

So I think that you have captured it pretty much in your statement, and I'm hopeful that we can hear information from our panel this afternoon about what we can and should be doing.

And with that, Mr. Chairman, I would like ask unanimous consent to just make sure that we allow for others who want to participate in this hearing to participate in a way that would allow them to have opening statements, and to question the witnesses.

I yield back the balance of my time.

Then, I would ask unanimous consent that the following members of the Financial Services Committee who do not serve on the Housing Subcommittee be permitted to participate in today's hearing by delivering opening statements and asking questions of the witnesses.

Chairman NEY. Without objection.

Ms. WATERS. Ms. Wasserman-Schultz, and Mr. Israel, and further, Mr. Chairman, I ask unanimous consent—I beg your pardon—and Mrs. McCarthy.

I further ask unanimous consent that the following members who do not serve on the Financial Services Committee also be permitted to participate in today's hearing by delivering opening statements and asking questions of the witnesses: the gentleman from North Dakota, Mr. Pomeroy, and the gentleman from Mississippi, Mr. Taylor should be included in that.

I yield back.

Chairman NEY. Without objection.

Ms. WATERS. Thank you.

Chairman NEY. And I have a statement for the record, a statement from the National Association of Realtors.

Without objection, it will be made part of the record.

And I'm going to yield to, and I want to thank, the gentlelady from Florida, Congresswoman Ginny Brown-Waite, who asked for this hearing, and has been spending quite a considerable amount of time addressing this issue.

The gentlelady.

Ms. BROWN-WAITE. Thank you very much, Mr. Chairman, for holding this hearing today.

I certainly want to thank the witnesses who have taken time out from their busy schedules to come here and deliver their statements.

We're obviously holding this hearing to determine whether the housing market is prepared for a major national catastrophe.

When we think of natural catastrophes, lately we think of hurricanes hitting Florida and other Gulf States as well as along the eastern coast, but hurricanes are not the only threats facing the United States.

In the last 2 centuries, there have actually been 24 tsunamis that have harmed the United States. In fact, there is a 10 to 14 percent chance that a tsunami comparable to that of South Asia will hit the West Coast in the next 50 years.

Over 75 million Americans live in metropolitan areas subject to moderate to high earthquake risk, and researchers are warning that a repeat of the 1906 San Francisco earthquake is very likely.

What I'm finding more startling is that the insurance industry might not be prepared.

In California, only 14 percent of homeowners actually have earthquake insurance, and if there was a repeat of the 1906 earthquake, it could cost up to \$500 billion in insured losses. If the 1938 Long Island Express hurricane hit today, it would cost tens of billions of dollars of insured losses.

Since policyholder surpluses for all lines, not just homeowners, only stood at \$370 billion in 2004, every Member of Congress needs to be concerned that the industry doesn't have the capacity to withstand a great natural catastrophe.

Floridians learned all too well what happens when the industry isn't ready for a catastrophic natural disaster.

When Hurricane Andrew hit in 1992, many insurers became insolvent. This is the largest number of insolvencies at one time in U.S. history. Sixty-three insurance providers pulled out of the State for fear of future excess losses, leaving homeowners with no insurance at all.

Many estimate that if Hurricane Andrew had hit a metropolitan area, like downtown Miami, the amount of insured losses would have bankrupted the entire industry nationwide.

Why does this Congress have to wait for a catastrophe to happen again before we act?

Floridians learned some valuable lessons after Hurricane Andrew. We made some changes to hurricane preparedness that were radical at the time but that now many States are emulating.

Florida enacted some of the strongest building codes in the Nation and set up forward thinking mitigation plans.

We established Citizens Insurance to insure that homeowners would never again be without coverage. Citizens is the insurer of last resort.

Most importantly, we also established a State catastrophic fund, the first of its kind in the Nation.

Florida's CAT fund is a tax exempt, low cost source of reinsurance to property owners. The CAT fund ensures that while reinsurance rates rise, a minimal affordable amount will always be available to insurers in the State.

This is really a safety net that has brought insurers back to the State of Florida and helped them remain solvent.

After the 2004 and 2005 season when five hurricanes ravaged Florida, only one company became insolvent. If this safety net worked for Florida, we really need to consider this nationwide.

That's why I've introduced the bill, H.R. 4366, the Homeowners Insurance Protection Act, which would create a national catastrophic fund.

To participate, States would have to have their own State catastrophic fund to handle hurricanes, earthquakes, tornadoes, or anything else. States are also encouraged to establish building codes and mitigation plans to prepare for natural disasters.

Chairman NEY. I'm sorry. I would note that the gentlelady's time has expired, if you would like to summarize.

Ms. BROWN-WAITE. I certainly will.

This bill has been around for many years, long before this committee ever discussed or considered TRIA. The fund it creates is a very unique program.

It's also categorically different from the Federal flood insurance program, and to compare the two is simply an indication that someone hasn't read the bill.

This bill guarantees that no longer would the Federal Government be the insurer of last resort.

I certainly appreciate the chairman holding this hearing and from the discussions with my colleagues both on this committee, and not on this committee; they believe that this bill is part of the solution nationwide.

Again, Mr. Chairman, thank you very much, and I yield back the balance of my time.

Chairman NEY. I thank the gentlelady, and I will give you notice when your time has expired, everybody.

We have some votes coming up and we have a lot of witnesses.

So, the gentlelady from California.

Ms. LEE. Thank you, Mr. Chairman.

Let me thank our witnesses for being here and our ranking member for convening this very important hearing.

I come from the Bay Area of California, and homeowners in my district are likely to be impacted by earthquakes, mudslides, and fires. We very seldom have floods and hurricanes, but that's really not the reality for all Americans, as we have witnessed in the past couple of years.

In 2005, for example, there were a total of 27 storms in the Atlantic region, including 14 hurricanes.

So on the first anniversary of last summer's devastating Hurricane Katrina, and as this anniversary approaches, I think we need to reflect on how all facets of housing, public and private, renters and homeowners, the lender and the insurer, how the entire, really, country has been impacted.

There are hundreds of thousands of people who remain displaced and dozens of communities that will never be rebuilt.

With an estimated cost of about \$200 billion in damages to the Gulf region, the cost of homeowner insurance has skyrocketed and left many homeowners to take on very dangerous risk.

For example, also, going back to the Bay Area, where I'm from, all homeowners are required, at least insurers are required to offer earthquake insurance, and only about 14 percent of California homeowners have purchased earthquake insurance, quite frankly, because it's just too expensive. There's no way the majority of Californians can afford earthquake insurance.

So we need a national natural disaster insurance plan really in order to prepare communities across the country for these natural disasters.

So while many of us come from disaster prone areas, as it relates to hurricanes and floods, some of us also are impacted by these disasters such as earthquakes and mudslides.

And so we're all in this together and we have to figure out how the entire country can move forward and not be devastated a sec-

ond time around as a result of the devastation by a natural disaster.

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

Chairman NEY. Does the gentleman have a statement?

The gentleman from Missouri, Mr. Cleaver.

Mr. CLEAVER. Thank you, Mr. Chairman.

I express appreciation to you and Ranking Member Waters for scheduling today's hearing and to the witnesses for joining us.

I have a different direction that I would like to travel with regard to dealing with this subject, is America's housing market prepared for the next natural catastrophe?

We have been rather active under the leadership of Chairman Ney since the hurricanes of the Gulf Coast. It was clearly the worst natural disaster in my lifetime, and perhaps in North America in the last 200 or 300 years or more.

My perspective about preparing for the next natural catastrophe is a little different, because I am very much concerned that American citizens believe that they're paying for the rehabilitation of the Gulf Coast, just like they think they're paying for the war, and they're not.

Most Americans don't realize we're borrowing every single penny we use to rebuild the Gulf Coast. That ought to cause the American Government to drop its head in shame. We're borrowing money from China to rebuild New Orleans. That is absolutely unacceptable.

One of the things that I'm hoping that we can get some of the Congressional leadership to do is to try to enter into some kind of agreement with China so that, if we should have to go to war with them, that we could sign an agreement now that they would finance it, because if we wait until that time comes, I don't think they're going to finance it, and we'll be in trouble.

So I think that we are going to go into a catastrophe and everything is impacted by the fact that we're not prepared.

Whatever you say, we're still not prepared, because we don't have the dollars to deal with it and if we have another catastrophe at the level of Katrina and Rita, the insurance industry is going to be decimated as well as those who are making investments with housing.

So it comes back on the government, and this government is irresponsible. We're almost \$9 trillion in debt. We're almost \$150 billion in debt to China, \$100 billion in debt to Japan. We are even in debt to the Caribbean islands. And I don't know how we're going to discuss this issue in the wake of the fact that we don't have any money and we're borrowing every penny we use today.

Chairman NEY. Time has expired.

Mr. CLEAVER. Thank you, Mr. Chairman.

Chairman NEY. The gentleman from Texas, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman, and I thank the ranking member as well, for this hearing, and I thank you, the members of the panel, for giving us this very valuable portion of your time. I assure you we greatly appreciate your attendance and we look forward to hearing from you.

I'm not sure that I was supposed to be next, now that I'm looking at all of these members.

Thank you.

When you're a neophyte, you learn quickly that you wait your turn.

But Mr. Chairman, while the hearings may focus on a number of things, one of the great issues that we will ultimately have to confront that is causing a great amount of consternation across the Nation happens to be this question of wind versus water and whether or not I really do have a right to have my house receive some attention from an insurance policy that I have been paying on for a long period of time.

People are greatly concerned about the language in the policy, and hopefully, notwithstanding our needs today and our concerns today, at some point we will focus on this so that people can have policies that they can understand and policies that will make it conspicuously clear as to whether wind or water is going to be the factor and how a layperson will know, as opposed to having someone say, "Your house was covered, but by the way, the house next door, which suffered the same damage, is not."

I yield back the balance of my time. Thank you.

Chairman NEY. The gentlelady from New York.

Mrs. MCCARTHY. Thank you, Mr. Chairman, and thank you again for allowing us to sit in and even ask questions.

My opening statement will be brief.

Since Katrina, many of us have been meeting, and the more that we talk about what solutions are out there, the more problems we are actually finding.

I'm from Long Island. We haven't had a major storm in a lot of years, and I want to make sure that we are prepared for the future.

A lot of the questions that we had heard and questions brought up was that a lot of people don't carry any kind of insurance. A lot of people and communities aren't building the homes that they should be building in areas that are close to, say, the beaches and things like that.

So we're talking about zoning, we're talking about making sure that if the government is backing flood insurance, that it is mandatory that they also carry some sort of insurance.

These are things I'm hoping that we're going to hear from all of you and that we can learn from all of you.

We do not expect, with all the problems that we saw on the Gulf Coast, for the insurance industries to have the answer to every problem, but we as a Nation need to face these problems.

We, as a Nation, need to look at every part of this country and how can we—because I've been here for 10 years now, and I'll be very honest with you, we're always having emergency fundings to help one of our States, whether it's a flood, a tornado, earthquake, hurricanes.

We're all in the same boat, so we have to come up with some solutions that are going to work for everybody and be fair for everybody, so that obviously, if our homes are destroyed, we can rebuild.

Thank you, Mr. Chairman.

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

Chairman NEY. I thank the gentlelady.

The gentleman from New York, Mr. Israel.

Mr. ISRAEL. Thank you, Mr. Chairman.

Let me thank you and the ranking member for your courtesy in allowing me to sit in on this subcommittee hearing, and I will return the favor by being extremely brief, less than 2 minutes.

I just held a hurricane preparedness summit in my district on Long Island last week, and one of the panelists was an insurance company executive who suggested that every one of my constituents review their insurance policies to make sure that they will be fully protected or as protected by their policies as they believe that they will be protected in their own minds.

The problem is that, for many Long Islanders, if they take a look at their policies and they realize that the deductibles are too high or the coverage is not as expansive as they thought, there may not be many options.

The fact of the matter is that several insurance companies on Long Island have made a business decision, which I understand, but I'm not happy with, to curtail the availability of homeowners coverage.

They made those decisions based on the fact that the National Weather Service has said that Long Island has a very good chance of getting a Category 3 hurricane this season and a good chance of having a Category 5 hurricane over the next 15 years.

So I appreciate the fact that we're having this hearing. I appreciate the fact that my colleagues are focusing on it.

My predecessor in Congress, Congressman Rick Lazio, introduced a catastrophic, comprehensive bill that would have helped with this problem. Unfortunately, it didn't pass. It's now 7 years since then, and we're having the same discussion.

I'm pleased to join with Congresswoman Brown-Waite on her legislation and I hope that we will fashion from this hearing bipartisan accord to make sure that when my constituents look at their policies, they have the full measure of protection rather than the guesswork that they're doing now.

So I thank the chairman, and I yield back.

Chairman NEY. The gentleman, Mr. Taylor, who hosted us down in Gulfport when we had the hearing, went to Louisiana, Gulfport, and we saw firsthand the pieces left not only of Mr. Taylor's home but of his constituents', and we appreciated the time you took with us and the concern you have for the people you represent.

Mr. TAYLOR. Thank you, Mr. Chairman.

I appreciate, first, you letting me sit in, and above all, being recognized.

Mr. Chairman, for tens of thousands of Mississippians in the weeks after the storm, they discovered that their insurer was neither a good friend or on their side, that people who for years and decades had paid premiums thinking they were going to get some fairness out of the insurance company have been told, no, "It's not what you think it was, it's not the way you read your policy," and the insurance companies have found every excuse not to pay what people thought were legitimate claims.

Just yesterday, this House, unanimously by a voice vote, decided to look into whether or not we as taxpayers have been abused, whether or not claims that should have been paid by private insurance companies were shifted to the Federal flood insurance, be-

cause in the writing of the Federal flood insurance policy, we allowed the same company that writes that policy to adjudicate the claim.

I think the overwhelming majority of us believe that when given the opportunity, and you tell someone, "Well, you can pay that bill or you can stick the government with the bill," well, they stuck the government with the bill, and it's not a coincidence that the insurance industry had about \$44 billion in profits last year and that the national flood insurance program lost about \$25 billion. One got stuck with the other one's bills.

The other thing that I would hope that this panel would talk about is, you know, we pay, as a Nation, a heck of a lot of money to put the hurricane hunters out there. It's a huge expense. We pay a lot of money to have the weather satellites out there. We pay to have civil defense folks.

We do that so that people will get adequate warning to get the heck out of there in time before a hurricane.

In my case, a sheriff's deputy actually came into Sunday morning mass in Long Beach, Mississippi, and kind of whispered something in the priest's ear, and he announced that was the last mass he was going to say that day, and that people needed to get the heck out of there. That was a great public service.

But what has happened in the wake of this storm with the whole wind versus water is completely contrary to that. I cannot tell you how many people have told me that during the next storm, they're staying in their house with a video camera, if that's what it takes to get some justice out of their wind insurance policy.

In my case, I found pieces of my tin roof 30 feet up in the air. It didn't float there, it flew there. I found other pieces of my tin roof 150 yards from where my house used to be.

I took the time to walk the adjuster there, showed him the big holes where it had been ripped off, only to have that adjuster say, "We see no wind damage." Come on. Who's kidding whom?

The Navy Oceanographic Lab says Bay St. Louis and the surrounding area had 6- to 8 hours of hurricane force winds before the water ever showed up, and yet the only people who got any justice were the people who had flood insurance.

Chairman NEY. Time has expired.

Mr. TAYLOR. Mr. Chairman, again, I appreciate you doing this.

I'm very anxious to hear from this panel, because it does have to be addressed, and people don't need to be staying in their houses with a video camera for the next hurricane to get some sort of justice from their insurance company.

Chairman NEY. Thank you.

Our panel today is:

First, Dr. William Gray, professor emeritus of Atmospheric Science at Colorado State University in Fort Collins, Colorado. Professor Gray is a specialist in tropical meteorological weather conditions. He's made Atlantic Basin seasonal hurricane forecasts for more than 20 years.

Next, we have Kevin McCarty, the Florida insurance commissioner. He's testifying today on behalf of the National Association of Insurance Commissioners, an organization representing insurance regulators nationwide.

Admiral James Loy is the national co-chairman of ProtectingAmerica.org, a coalition of interested parties working to establish financial catastrophic backstops at the State and national level.

After serving as commandant of the Coast Guard from 1998 to 2002, Admiral Loy was appointed to the position of Deputy Secretary of the Department of Homeland Security.

Travis Plunkett is legislative director of the Consumer Federation of America, an organization that seeks to advance pro-consumer policy at the Federal and State government level.

And last on the first panel is Guy Williams, the president and CEO of Gulf Coast Bank and Trust Company of New Orleans, Louisiana, testifying on behalf of the American Bankers Association.

Mr. Williams currently serves as director of the New Orleans Financial Authority and is president of the New Orleans Small Bank Group. He has just completed his term as president of the Louisiana Bankers Association.

Welcome to the panel, and we begin with Dr. Gray.

**STATEMENT OF WILLIAM M. GRAY, PROFESSOR EMERITUS OF  
ATMOSPHERIC SCIENCE, DEPARTMENT OF ATMOSPHERIC  
SCIENCE, COLORADO STATE UNIVERSITY**

Mr. GRAY. I appreciate being invited to this session.

I've been looking at hurricanes for a long time, and if you go anywhere along the coast, you find that even in southeast Florida and along the Texas Gulf Coast, the frequency with which these storms hit is quite low. You could live 5, 10, 20, or 30 years and never be affected strongly by one of these storms.

As a result, it's a very tough problem. It's a low probability thing, and there's no way you're going to stop people from living along these nice coastal areas.

We are now in this cycle of higher major hurricanes in the Atlantic Basin.

When I and some of my colleagues have looked back at the damage these storms do, if you normalize by coastal population, inflation, and wealth per capita, you see that it's these major storms, these Saffir/Simpson Category 3, 4, or 5 storms, that do 80- to 85 percent of the damage, even though they only account for roughly 20- to 25 percent of the number of named storms.

Now, we're in a new era for these major storms.

The Atlantic Basin has this multi-decadal cycle where you go 20- to 30 years and you don't have so many of the major ones, and then the same period, roughly, where you have a whole lot of them.

Like in the 1940's and 1950's, we had this era where we had a lot of major storms, and we had a lot of landfalls during that period, but in the 1940's and 1950's, the coastal population was not very great.

So we're quite surprised at this, but we're not surprised, I'm not surprised. I knew something was coming.

When you build up the southeast U.S. coast like we have for the last 3 or 4 decades, and then you move into a new cycle, it was inevitable, we'll see, that we were to see hurricane damage like we've never previously seen it—not that we have more storms than we

had in the last active period, but that there's so much more in harm's way now.

Now, I don't believe the people on the southeast coast realize how lucky they've been over this long period.

From the late 1960's to the middle 1990's, we had a great downturn in the frequency that these major hurricanes formed and of them coming ashore. Also, we moved into this new era in 1995.

In the last 11 years, we've had 45 major storms, and at a rate of about 3 times more than we had during the 1970 to 1994 period, that quarter century.

So now the first 9 years of this active era from 1995 through 2003, we had 32 Atlantic Basin major storms and only 3 hit the United States, less than 1 in 10, when the long-term average is about 1 in 3 or one in three-and-a-half, so we were not prepared for the last 2 years.

In the last 2 years, we've had 13 Atlantic Basin major storms, of which 7 have hit the United States.

So it's natural that we're not psychologically prepared for this, but it's not so surprising.

If the New Orleans levees has not been breached, the damage would have been much less, perhaps only 40- or 50 percent of what we have had.

So now, global warming.

There have been a lot of people jumping in with the global warming question, and in my view, this is not due to global warming.

Although the globe has warmed over the last 30 years, the amount of storms around the globe in frequency and intensity, as best we can tell over the last 20 years, has not changed.

The Atlantic Basin has changed, but this is natural, due to the ocean's circulation in the Atlantic.

Chairman NEY. Doctor, your time has expired. Thank you.

[The prepared statement of Mr. Gray can be found on page 81 of the appendix.]

Chairman NEY. I'd actually like to let you go on about the global warming; I kind of like it.

But we'll have to move on to Mr. McCarty.

Mr. GRAY. Well, I have it in my written testimony, my views there.

Chairman NEY. Yes, sir, it will be entered.

Mr. GRAY. They are all there.

Chairman NEY. It's going to be entered as part of the record.

Mr. GRAY. I wanted to say something about the insurance industry.

Chairman NEY. We can get on to that. It will be entered as part of the record.

And our ranking member is going to be trying to get on the phone with Mr. Gore, also.

[Laughter]

Chairman NEY. Mr. McCarty.

**STATEMENT OF KEVIN M. MCCARTY, FLORIDA INSURANCE COMMISSIONER, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC)**

Mr. MCCARTY. Thank you, Mr. Chairman.

My name is Kevin McCarty, and I'm the insurance commissioner for the State of Florida.

I'm also here as the chair of the Property and Casualty Committee of the National Association of Insurance Commissioners as well as the chair of its Subgroup on Catastrophe Insurance, and have been for many years.

I would like to thank the chairman and the ranking member and members of the subcommittee for inviting me here to testify today on behalf of the association, and I'd also like to thank this body for passing the good flood legislation reform bill yesterday.

In particular, our association is very appreciative of the inclusion of the provision for nonbinding mediation, which we think is going to be critical to serving the consumers of Florida and the rest of the Nation.

The NAIC is currently, and has for a number of years, been active in developing a comprehensive national plan for managing the risk of catastrophic natural disasters.

In addition, the NAIC recently adopted a resolution supporting a natural disaster plan and calling for a Federal commission to study the issues and alternative solutions to our current national plan.

Natural catastrophes are an economic problem, not just an insurance issue. I firmly believe that insurance is a critical component, but not a complete answer to our Nation's recovery in the aftermath of a natural disaster.

Insurance claim payments are the economic engine that revitalizes an area after a disaster, but as experience repeatedly has demonstrated to the people of Florida as well as the people along the Gulf of Mexico, pre-event disaster planning, effective mitigation, rational building codes, and effective enforcement of building codes is a crucial part of the solution.

To the question presented to us today, "Is America's housing market prepared for the next natural catastrophe," I'm afraid the answer is yes, to a limited point, but only to a limited point.

Today, the ability of the housing markets, as well as local and regional economies, to withstand and possibly recover from the next disaster depends critically on what that peril is, where it's located, and the severity of the disaster itself.

Wind events, including tornadoes and hurricanes, are considered a basic part of the insurance policy and the vast majority of homeowners have that coverage.

Flood, on the other hand, is only rarely written in the private marketplace, and since 1968, the national flood program has been the public solution to managing the risk of flood.

Finally, seismic activities, which we've talked about briefly today, especially earthquakes, are not considered a standard part of the policy, it's not required in your mortgage, it's not required in a federally backed guarantee mortgage, it's not considered a standard peril in a policy, and except for the California Earthquake Authority, there's limited private sector availability, so coverage is restricted very often in these places.

If the next catastrophe is a significant flood, the ability of affected housing markets and economies to endure and recover is

going to depend on the degree the properties were insured with the NFIP.

Unfortunately, the evidence from 2004 and 2005 suggests that far too many properties in our country are underinsured or not insured at all. Either they're outside the mandatory flood area or the maps were so antiquated no one knew that they were subject to a flood.

A recent study by the Rand Corporation provides evidence that suggests that the takeup rates outside the mandated zones is about 5 percent and the takeup rate, even where it's mandated, is only 75 percent.

If the next disaster is an earthquake, the ability of an affected housing market in those areas and the recovery of the economy will be dependent on the degree of disaster relief coming from the Federal Government.

The reason, quite simply, is that the majority of residents in catastrophically prone earthquake areas do not buy for this risk.

In California, the takeup rate of an optional earthquake coverage is 14 percent. The same takeup rate is frequently suggested in the New Madrid area and along the eastern seaboard that is a seismically active area.

The economic results of a major earthquake, as Congresswoman Brown-Waite has already referred to, would be cataclysmic to the economy of the United States.

So how will we deal with this? How would these homes be rebuilt? Without houses for people to live in and businesses to return to, how will the economy in the local area ever recover?

Given these scenarios, one might think that a market for earthquake insurance is growing. Instead, we have seen quite the opposite. After North Ridge, 35 percent of the people of California had earthquake coverage. Today that number is less than 15 percent. Yet across the country, insurance companies are substantially reducing their appetite for writing this coverage.

If the next disaster is a catastrophic hurricane, the impact is likely to be quite different than either of the scenarios I've already suggested.

The ultimate impact is going to depend on the severity of the storm and the level of preparation in the local or State area.

For a moderate storm, the wind damage will be covered by a standard homeowner policy and the insurance company will pay the claim, so long as the insurance companies have the financial wherewithal to pay those claims.

Chairman NEY. The witness's time has expired.

Mr. MCCARTY. I would just like to suggest that there are several things that we need to do, including a Federal backstop program, encouraging insurance companies to accumulate catastrophe reserves, which has been suggested by Representative Foley, and also the potential of having personal savings accounts to help consumers mitigate against future claims.

We know we're going to have a natural disaster. It's not a matter of if, but when, and we need to have our Nation, our States, and our local governments coordinated in planning for those disasters.

Thank you, Mr. Chairman.

[The prepared statement of Mr. McCarty can be found on page 134 of the appendix.]

Chairman NEY. And all witnesses, without objection, also, your statements will be entered, of course, as part of the record.

Admiral.

**STATEMENT OF JAMES M. LOY, ADMIRAL, U.S. COAST GUARD (RET.), NATIONAL CO-CHAIRMAN, PROTECTINGAMERICA.ORG.**

Admiral LOY. Thank you, Mr. Chairman, and members of the subcommittee.

I appreciate the opportunity to appear before you today in my capacity as co-chairman of ProtectingAmerica.org, an organization committed to finding better ways to prepare and protect American families from the devastation caused by natural catastrophes.

My fellow co-chairman is James Lee Witt, former Director of the Federal Emergency Management Agency.

Our coalition members include first responders, emergency management officials, insurers, municipalities, small businesses, Fortune 100 companies, and private citizens.

ProtectingAmerica.org was formed to raise the national awareness about the important responsibility we all have as citizens to prepare and protect consumers, families, businesses, and communities.

We hope to build a campaign to create a comprehensive natural catastrophe management solution that saves lives, protects homes and property at a lower cost, improves preparedness, and reduces the financial burden on consumers and taxpayers, all in an effort to protect our property, to save money and lives, and speed recovery efforts after one of these catastrophes.

The simple fact is that natural catastrophes can and do occur virtually anywhere in our country. The unfortunate reality is that tens of thousands of our fellow citizens are unable to pick up their lives where they left off after these catastrophes occur.

Some quick facts.

Fifty-seven percent of the American public live in areas prone to catastrophes like hurricanes, earthquakes, or other natural disasters, and more are moving to those areas every day.

Seven of the 10 most costly hurricanes in U.S history have occurred in the last 5 years.

Some of the most valuable real estate in this country is squarely in the catastrophes' path, on the Atlantic, Gulf, and Pacific coasts, and on top of the New Madrid fault in the Greater Mississippi Valley.

In the past 100 years, 11 hurricanes have made direct hits on New England; 6 have made direct hits on Long Island. The most famous of those, in 1938 became known as the Long Island Express, 700 people killed, 63,000 left homeless, and if that storm hit 20 miles west of this 1938 landfall today, the losses would be staggering.

Although the San Francisco quake of 1906 is the best known earthquake in America, perhaps a \$400 billion event if it hit today, in fact the New Madrid series of quakes in the early 1800's covered a far greater area with a force every bit as strong as the Frisco earthquake.

The New Madrid earthquakes emanated from New Madrid, Missouri, and struck over a 3-month period in 1811 and 1812. They changed the course of the Mississippi River, shook the ground from Mississippi to Michigan, and rang church bells in Boston. Structures were damaged throughout the Mississippi Valley.

These quakes are largely unknown today because they struck at a time when earthquake zones were largely a wilderness. What was then the newly acquired Louisiana purchase now encompasses major population centers across the Midwest.

Katrina notwithstanding, when catastrophe strikes, our after-the-fact response programs and protocols have historically done a remarkable job getting victims into shelters and mobilizing emergency supplies.

All Americans, regardless of whether or not they've been victimized by a catastrophe, owe our first responders an enormous debt of gratitude and thanks.

While little can be done to completely eliminate the actual crisis, ProtectingAmerica.org believes that its impact can and must be mitigated.

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

ProtectingAmerica.org believes that in addition to minimizing the extent of catastrophic losses through prevention and mitigation programs, we should also reduce the taxpayer subsidy of recovery efforts.

ProtectingAmerica.org advocates the establishment of a stronger public-private partnership as part of a comprehensive integrated solution.

The solution would include privately funded premium-based catastrophe funds in catastrophe-prone States that provide more protection at lower cost to consumers.

These State-level CAT funds would serve as a backstop to the private insurance market and would generate investment earnings that in addition to helping to pay claims could also be used for mitigation, prevention, preparation, and first responder programs.

We have been advocating the creation of a national catastrophe fund that would serve as a backstop to participating State funds in the event of a mega-catastrophe.

Those State funds would be financed through mandatory contributions by insurance companies in each of those States in an amount that reflects the risk of the policies that they have written in each State, actuarially sound premiums, no tax dollars, growth potential with the same structure of tax advantages we each enjoy in our IRA's.

Qualified State funds would be able to repurchase reinsurance from the national backstop program. Rates for this coverage would again be actuarially based and self sufficient and would only be available to those State programs that have established prevention and mitigation funding as described above.

Chairman NEY. Time has expired.

Admiral LOY. Mr. Chairman, the last two hurricane seasons have been devastating wakeup calls. We at ProtectingAmerica.org be-

lieve that this committee is the right venue to offer America a better, more comprehensive national catastrophe solution.

Thank you for the time, and we would be happy to answer your questions.

[The prepared statement of Admiral Loy can be found on page 102 of the appendix.]

Chairman NEY. Thank you. Mr. Plunkett.

**STATEMENT OF TRAVIS B. PLUNKETT, LEGISLATIVE  
DIRECTOR, CONSUMER FEDERATION OF AMERICA (CFA)**

Mr. PLUNKETT. Chairman Ney, Ranking Member Waters, members of the subcommittee, and other concerned members, my name is Travis Plunkett. I am legislative director of the Consumer Federation of America.

I would particularly like to thank Representative Taylor for being here, because of the extraordinary work he has done in fighting unfair claims practices in the Gulf Region since Hurricane Katrina.

I appreciate the opportunity to offer the Consumer Federation's comments on the very important issue of the impact of natural disasters on the ability of homeowners to purchase insurance.

In order to understand why many insurers are dramatically increasing home insurance rates and dropping coverage in coastal areas, and what the Federal Government should or should not do about it, I would like to emphasize three points.

First, these rate hikes, coverage cutbacks, and non-renewals are a betrayal of the promises property casualty insurers made to consumers and regulators in the wake of Hurricane Andrew in 1992.

In particular, insurers have reneged on a promise that new weather modeling procedures that they implemented, which caused considerable pain to consumers at the time, would stabilize rates and not lead to sharp swings in pricing and coverage, and coverage cutbacks, in the future.

The industry's shameless violation of these promises indicates either mismanagement or duplicity, and they have harmed the credibility of those who are now claiming that they need Federal assistance for catastrophe losses.

Second point. The insurers who are now proposing such programs have not come close to making the case that the private market can't handle these losses, even during a period of increased hurricane activity.

In fact, there is much opposition to these proposals from insurers and reinsurers who think the market can handle the situation, and much evidence that primary insurers are in one of the strongest financial positions in their history to cover these losses.

Thirdly, if this body does consider a Federal catastrophe insurance program, we urge you to consider only plans that mandate and enforce wise construction in coastal areas, that are actuarially sound, and that do not impinge on the ability of the private market to cover these losses.

In particular, it makes no sense to create an expanded catastrophe insurance program until the one that exists, the national flood insurance program, is in the black and doing a much better job at mitigating and limiting reckless construction.

Now let me address in somewhat greater depth each of these issues.

After Hurricane Andrew, insurers adopted new ratemaking techniques based on scientific models that forecasted damage up to 10,000 years into the future, rather than using a simple history of hurricanes for the last few decades.

That is, they built into their rate base losses due to periods of intense activity as we're going through now and periods of little or no activity. A consumer might pay a little more in downtime, but a huge hurricane the next year wouldn't cause rates to shoot through the roof or the insurer to refuse to renew coverage.

Insurers also cut back a great deal of coverage and sharply increased out-of-pocket costs for consumers by introducing much higher percentage deductibles, new deductibles, caps on replacement cost payouts, and other coverage costs.

This upheaval did hurt consumers. Consumer groups, however, largely supported many of these changes because we understood that the industry was not well prepared for Andrew and because it brought the promise of price stability.

We were shocked to learn this spring that, at the urging of the insurance industry, Risk Management Solutions and other modelers are moving from a 10,000-year projection to a 5-year projection, which will cause a 40 percent increase in loss projections in Florida and a 25 percent jump in the Northeast. We've called on regulators to reject these rate hikes.

The insurance industry has a serious credibility problem with these rate hikes. What is their excuse for engaging in another round of massive and precipitous actions? They surely knew that forecasters had predicted for decades that an increased period of hurricane activity and intensity would occur from the mid-1990's to about 2010.

In particular, the non-renewals announced by insurers like Allstate raise the question of whether they are using the threat of hurricane damage as an excuse to drop customers who from their point of view are not terribly profitable.

Whether it was mismanagement that started a decade ago or the clever use of an opportunity today, consumers are being unjustifiably harmed.

I also point out in our testimony, and I will not go into great depth here, that the industry is enjoying its highest profits in history. Its retained earnings are extremely high. Its financial position is very strong.

In our testimony, as well, we have a number of principles that we would recommend being met before any Federal program is considered.

Chairman NEY. Time has expired.

Mr. PLUNKETT. Thank you very much.

[The prepared statement of Mr. Plunkett can be found on page 145 of the appendix.]

Chairman NEY. Thank you.

Mr. Williams.

**STATEMENT OF GUY WILLIAMS, PRESIDENT, GULF COAST BANK AND TRUST COMPANY OF NEW ORLEANS, LOUISIANA, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION (ABA)**

Mr. WILLIAMS. Chairman Ney, Ranking Member Waters, and members of the subcommittee, my name is Guy Williams. I'm president of Gulf Coast Bank and Trust in New Orleans, and I'm testifying on behalf of the American Bankers Association.

Hurricanes Katrina, Rita, and Wilma caused unprecedented devastation to the Gulf Coast Region. Lives, homes, businesses, and neighborhoods were lost. Tens of thousands of people were displaced. The rebuilding has just begun.

I'm proud that the banking industry was one of the first to respond. We learned many valuable and painful lessons which will help us and others to face future catastrophes.

I recently served on an ABA task force on emergency preparedness which prepared a toolkit for ABA members that will help them prepare for and deal with emergency situations. In fact, I have one of these toolkits with me today.

When a disaster strikes, we want every consumer to know that their bank is prepared. Banks are required by law to have extensive disaster recovery plans and State and Federal regulators routinely examine banks on their preparedness.

Post-9/11 procedures strengthened our ability to deal with a broad range of disruption. Our experiences after last year's hurricanes enhanced those abilities. In even some of the hardest hit areas, banks were up and running the day after Katrina hit.

My bank could not return to any of its offices or our operations center. Nonetheless, we reopened the Monday after the storm in rented facilities; our Internet banking product continued to operate 24/7; and we made \$18 million in reconstruction loans in the first 30 days after the storm.

Banks are key players in the recovery from any disaster, from ensuring that cash is available immediately; making bridge loans for short-term recovery; and providing long-term financing for construction. Banks are integral to disaster recovery.

In the aftermath of last year's storms, bankers put competition aside. Bankers from across the country immediately began providing assistance to banks in the most affected areas and bankers in the affected areas shared resources and facilities in order to serve our communities.

We began working with our customers to help them deal with the disaster and plan for the recovery. We extended forbearance on loans. We pushed the SBA to make disaster loans more available, mostly unsuccessfully. And we began making new loans to help customers rebuild.

The lack of available and affordable property and casualty insurance after a disaster is a serious ongoing concern.

Insurers have stopped writing new homeowners coverage in coastal areas around the Gulf. Many insurers, including the market leaders, are declining to renew policies. Insurers cannot find reinsurance at rates low enough to offer homeowners policies at a rate that the State governments consider appropriate.

As a result, Gulf residents are forced to replace their coverage with a policy written by the State's insurer of last resort.

The State of Louisiana has a backstop insurance program called the Louisiana FAIR plan. It provides insurance to those residents who are unable to obtain it in the private market.

Unfortunately, the Louisiana plan is actuarially bankrupt, and only the full faith and credit of the State of Louisiana is keeping it afloat.

In order to cover last year's losses, all insurance policies issued in Louisiana will be subject to an 18 percent surcharge this year to replenish the FAIR plan.

Because of its low limits and precarious financial condition, the FAIR plan is not the answer, nor will other States' similar plans suffice in the face of future disasters.

Just this week, my bank approved two commercial loans that may not close because the borrowers cannot secure windstorm insurance at any price.

Without affordable insurance, our continued recovery is in doubt. Due to limitations faced by both the private insurance market and the State-sponsored backstop plans, the ABA believes that the creation of a Federal disaster insurance program is necessary.

Legislation to do so has been introduced in the last several Congresses. The latest proposal has been introduced by Representative Ginny Brown-Waite.

Absent such a program, taxpayers cover the cost of uninsured and underinsured properties. Providing a backstop ensures that insurance will remain available and affordable.

Mr. Chairman, thank you for inviting me to testify today, and thank you for your help with flood insurance yesterday.

[The prepared statement of Mr. Williams can be found on page 187 of the appendix.]

Chairman NEY. Thank you very much.

The first question I want to ask, and I appreciate the panelists today, about—a question that's raised all the time.

For example, let's not pick on earthquakes, but use it as an example.

Is it fair for taxpayers in non-earthquake areas to subsidize the damage of people that are in earthquake areas?

Yes, Mr. McCarty.

Mr. McCARTY. I may be a little prejudiced on this, Mr. Chairman, since mortgages require people to have hurricane coverage, so 92 percent of the policyholders in homes in Florida are covered. We buy most of the flood insurance, 42 percent of the flood insurance.

And clearly, I think that the message, however, is that if it costs too much for the coverage and if we're looking at governments coming in after the fact, very generously responding to a natural disaster and providing block grants and monies for them to rebuild homes, then I think we're putting the wrong incentives in our system.

We should be trying to put in incentives for us to purchase insurance and require that.

I think that if you are taking out a loan and it's a federally backed loan, then you ought to be required to have catastrophic

coverage, including hurricane, flood, tsunamis, as well as earthquakes.

Chairman NEY. But should that risk be spread across the United States?

Mr. MCCARTY. It should be spread across, because any insurance risk is spread across, but it should be risk driven.

So a Florida homeowner in a coastal area will pay 10 or 15 times the premium you'll pay in a safer location.

Obviously, if you live on the New Madrid area in the Midwest, or in the San Andreas area on the West Coast, it should be price driven.

But if more people are purchasing, and everyone who has a loan is required to have the coverage and pay a premium commensurate with that risk, actuarially sound as the admiral had alluded to, then you're paying into the system your fair share commensurate, where the risk of the loss potentially is there to pay out.

Chairman NEY. For example, with the piece of legislation we have, if you have a second home, it phases in where you're paying a different actuarial rate, because it's a second home, on the Federal flood.

But I'm saying on the private market, I think, for example, my premiums after New York went up, I believe I was told they went up because you're in Ohio but you're paying for what happened, to basically spread the risk around because how could people, you know, be able to cover a catastrophic event.

And I realize if you're in California or another earthquake prone area you would have a certain actuarial rate, but I'm just saying for disasters, should that then also be spread across policyholders across the United States.?

Mr. MCCARTY. Well, you know, if 49 of 50 States have a risk of catastrophic events, so everyone should pay a certain amount of premium for their catastrophic risk, so in that sense, it should be spread around the country.

But I think it's very important to point out, and I think that others have testified to that you can't have a subsidized rate. We don't want to model this after some of the struggles we've had with the Federal flood program. It should not matter whether your risk is a first home or a second home.

The risk of potential catastrophic loss should be conditioned on the condition of the property, the risk of loss from a catastrophic event, how well it's mitigated, shutters, et cetera, retrofitting.

But the concept of the risk spreading around the country makes sense, but it should be specific to the risk of loss for that particular risk and it should be actuarially sound, it should not be subsidized.

Chairman NEY. Mr. Plunkett, I wanted to ask you, you stated in your written testimony that expanding taxpayer involvement in catastrophic insurance by creating a taxpayer backed disaster insurance pool isn't a sound idea, and the national flood insurance program should likewise be fixed.

Now that we've approved yesterday some reforms to the flood insurance program, would you consider looking at a different way of expanding the Federal authority regarding catastrophic insurance if we cover the catastrophic insurance in the same way as we're trying to reform the flood insurance program?

Mr. PLUNKETT. Mr. Chairman, both the House bill and the Senate bill on the flood insurance program are a step in the right direction, but let me say that we think that we need a couple of years to make sure that what you're proposing to do works and to see that the program gets back into the black before we launch another Federal program.

In particular, we think that you're going to need to look at more measures to ensure that localities do better at requiring building codes that ensure wise construction and that the States do better at mitigation.

We don't know that the House bill does enough there. There's very little in the House bill that would not just encourage mitigation, but to do everything that the Federal Government has within its power to ensure that better mitigation and better construction occurs.

Some States are doing better than others, but overall, a huge problem with the national flood insurance program is that much unwise construction has occurred.

So there are a few steps in the right direction, but we don't know at all that the unwise construction will be stymied.

Chairman NEY. Thank you.

The gentlelady from California.

Ms. WATERS. Thank you very much, Mr. Chairman.

I want to concentrate a little bit, and perhaps Mr. McCarty can help me.

You're insurance commissioner in Florida; is that right?

Mr. MCCARTY. Yes, ma'am.

Ms. WATERS. And you have the responsibility for helping to oversee the insurance companies that do business in your State; is that right?

Mr. MCCARTY. Yes, ma'am.

Ms. WATERS. You have heard perhaps more than once that consumers are pretty unhappy with insurance companies.

For those who do pay premiums, it seems as if when they make claims, the insurance company is doing everything possible to keep from paying the claims, to deny the claims.

I suspect there is little wonder that the amount of coverage in some areas is diminishing rather than increasing, such as mentioned here in several places in this testimony.

What do you recommend for consumers who are dealing with insurance companies who have a lot of money, who have a lot of confused wording in policies, who deny claims and leave consumers holding the bag?

What have you done? You represent the whole group of commissioners all over the country. Have you dealt with this issue? If so, how?

Mr. MCCARTY. Well, I do come here with two hats. I am representing the National Association, but I am the insurance commissioner of Florida, and Florida has had a bit more to deal with than other States in terms of dealing with companies in a natural disaster.

I'm generally not an apologist for the insurance industry, but I would say that with respect to 2005 in particular, the insurance in-

dustry performed remarkably well in terms of its claim paying ability.

2004, I think, was a little more problematic. I think a lot of that has to do with the vast number of storms and the shortage of adjusters.

We implemented in Florida a fairly aggressive mandatory mediation program. Most, about 90 percent, of the claims were paid within 90 days. We had a 92 percent success rate with our mediation program.

We also had calibrated with the data collection from our consumer services offices, so we were able to identify early those companies that were not promptly dealing with consumers, not returning phone calls, or not adequately paying claims.

We then used our market investigation unit to thoroughly go through those claims processes.

Some of them we found had some startup problems because their own offices were destroyed or damaged because of a storm.

Others had a pattern of practice where they were not treating the consumers appropriately. We dealt with those very harshly.

And I think that would be the model.

Other States, one of the things you have to understand also is just how huge this problem is.

I recently concluded a tour of the area. We had 2.5 million claims, and that huge volume of claims in itself did overwhelm the industry for a period of time.

But on balance in Florida—I can't speak for the other commissioners in other States—they performed well, with the exception of the area in Hurricane Ivan, where we had the difficulty whether the damage was water damage or the damage was wind damage, and one of the problems we had was the inability to get the flood insurance program to sit down with the insurance company, and thankfully, through the good work of this committee, that will hopefully be addressed—

Ms. WATERS. Let me just interrupt you for a moment, because this is a national issue. It sounds as if you're doing well in Florida.

Is this discussed at your national association, and if so, why do consumers believe that they're not being treated fairly by the insurance companies when they make their claims generally?

Mr. McCARTY. I think there's a misunderstanding, as has been alluded to before, as to what exactly is covered in the policy.

You pick up a policy and look, most folks who have been paying in Mississippi thought they were covered for flood. They had no reason to believe that they weren't covered.

It was very disconcerting for these folks who had been paying premiums for a number of years that their most important investment that they had, and they looked through the pages and some endorsement clause somewhere says this is not covered.

Ms. WATERS. Is there anything that the insurance companies can do about helping people to understand what their coverage is and what it is not?

Mr. McCARTY. And I think some agents do a very good job working with their policyholders and educating them, and I think others perhaps could do a better job, and certainly the industry, I think

has recognized through this hurricane season that they, too, have to do a better job.

Many of them have been advocating changes in the policy forms, advocating checklists and consumer education checklists.

Commissioners from other States certainly encourage people to contact their insurance departments and consumer outreach programs to help explain what's in a policy, and what's not in a policy.

I know in your State, California, that the commissioner has been very active in trying to promote an understandable policy and working to make sure that Californians have a better understanding of what's covered and what's not.

It is—we are a collection of various States. We do work together on a national basis with a national planning to help other States use checklists and other best practices and procedures, and I say that in those instances where it doesn't work, those companies are the responsibility of the insurance commissioner of that State, to take them to task.

Ms. WATERS. Thank you very much. I now yield back the balance of my time.

Chairman NEY. Thank you.

The gentlelady from Florida.

Ms. BROWN-WAITE. Thank you very much, Mr. Chairman.

I was a little concerned with Mr. Plunkett's testimony because I don't think that he has read the bill.

Taxpayer dollars are specifically prohibited from being used. This is funded by insurance companies. And I wanted to set the record straight on that.

Additionally, if I may ask Mr. McCarty, could you tell me if there was a decision made by your colleagues, the insurance commissioners from around the Nation, about a national catastrophic fund?

Mr. McCARTY. Well, there's certainly a great deal of disagreement.

We did pass a resolution recently endorsing the concept of the establishment of a commission and a national catastrophic fund, and a recognition that at some point, we don't know whether it's \$25 billion or \$55 billion that the insurance industry cannot sustain a catastrophic event like the 1906 earthquake or the 1938 Long Island Express, which would essentially bankrupt part or a good part of the industry.

We do endorse the concept of a national plan, endorse a commission to go through the various issues that we've talked about, some of which has been laid out today, particularly catastrophe reserves and potentially looking at personal savings accounts, but also a comprehensive plan to make sure we have, as Mr. Plunkett has referred to, better building codes, actuarially sound rates, elimination of unnecessary price controls by States, so that we encourage maximizing the private sector, maximizing personal responsibility, and using the Federal backstop as a rational backstop instead of an emotional backstop, bailing-out money after the event for insured properties.

Ms. BROWN-WAITE. Thank you very much, Mr. McCarty.

Mr. Plunkett, did you ever read the bill?

Mr. PLUNKETT. Of course. I'm well aware that you've proposed a pool.

The issue there is that without strong mitigation protections and strong building protections, it's not taxpayers who are going to be hurt, it's the ratepayers who will pay the additional assessments that the insurers will pass on because they are required to fund such a pool.

The other issue in general, and we would be glad—more than happy in fact—to provide specific comments to you, but we've looked at a number of the proposals in Congress right now and the other broad concern is that these proposals cover unnecessary catastrophe losses.

I mean, one proposal—another one, not yours—would cover hail damage. There's no evidence that there is a problem with potential catastrophe losses for hail damage nationally.

Now, I understand the goal is to cover as much as possible so you can spread the risk as much as possible, but once again, ratepayers pick up the tab here, and one really has to—

Ms. BROWN-WAITE. Are you aware that actually—

Mr. PLUNKETT.—carefully justify—

Ms. BROWN-WAITE. Are you aware, sir, that actually in the bill we do call for building codes and that we also have mitigation language in there?

I'm appalled that there are some areas where there are absolutely no building codes. Frankly, they're not in the areas that are most prone to disasters.

But we do call for stronger building codes. We also call for mitigation.

As a matter of fact, you have to have stronger—you have to have building codes in places to even qualify for the CAT fund.

So, you know, I guess it's a question of whether you look at this as the glass being half empty or half full, but you have to consider that either pay now or you're going to pay later, because if there is a catastrophic fund that is funded by the insurance companies, then that will provide—that will make sure that homeowners' claims are paid. That's my goal, sir.

And I would think that as a consumer group, that should be your goal.

Mr. PLUNKETT. Congresswoman, projection is always the best approach, you're absolutely correct. We would agree with you there.

But we think stronger measures are needed on mitigation. New Orleans has building codes, and in New Orleans we've seen people lining up at City Hall to get their adjustments changed so that their homes wouldn't be determined to be more than 50 percent damaged.

We've proposed some—

Ms. BROWN-WAITE. Many of them—

Mr. PLUNKETT.—very far reaching measures here.

Ms. BROWN-WAITE.—building codes were there, many of those older homes were there before the building codes were even there.

But, you know, it is either pay now or the Federal Government is going to pay later. I'd rather have the insurance companies pay into a catastrophic fund, and that's really the difference here.

Chairman NEY. Time is expired.

Ms. BROWN-WAITE. I thank the gentleman.

Mr. WILLIAMS. Mr. Chairman?

Chairman NEY. Yes.

Mr. WILLIAMS. Since he's addressed New Orleans, may I respond?

Chairman NEY. Yes.

Mr. WILLIAMS. The State of Louisiana passed a comprehensive building code in this last legislative session.

The City of New Orleans provides a mediation program so that homeowners whose homes were evaluated to be 40 percent, 50 percent, or 55 percent, can appeal that evaluation and determine whether or not that home needs to be razed, but that's simply an administrative procedure to give the consumer his day in court and due process, which is certainly something that the consumer league which you represent should be in favor of.

Thank you, Mr. Chairman.

Chairman NEY. Thank you.

Mr. PLUNKETT. Mr. Chairman, would it be possible to tell you what we've said on that item?

Chairman NEY. Hold that thought, and we'll move on to the gentleman from Missouri, and then we'll come back to that.

Mr. Cleaver.

Mr. CLEAVER. Thank you, Mr. Chairman,

Who would be responsible for the gaps in the private coverage? Who should be responsible for the gaps in private coverage?

Mr. MCCARTY. Congressman, I'm not sure what you mean by gaps in coverage. Do you mean their deductible or where there's a gap between the wind and water damage?

Mr. CLEAVER. Yes, what happened to our colleague.

Mr. MCCARTY. Well, quite candidly, that should not occur.

If the property is appropriately rated and they're collecting a premium for both the exposure of wind and the exposure of flood, the combination of the policies, given that it's partially by one and partially by the other peril, should be enough.

Mr. CLEAVER. I know, but it did happen.

Mr. MCCARTY. Well, we had the same problem, sir, in Florida, and we think that part of that problem was—and we had a different experience than the Mississippi experience. Our problem was that we weren't getting the flood payments paid.

But what happens is, the flood folks will tell you that it's 30 percent damaged by water. The wind folks from the other part of the policy will say it's 30 percent. And the poor homeowner is left with it not being made whole.

That's why I think the legislation in the flood legislation that previously passed requiring that both parties participate in a mandatory State-run mediation would get at that issue, at least get the parties talking so that, "Listen, my home is destroyed. It cost \$150,000 or \$200,000 to fix. I need to get the benefit of the bargain from both of my contracts."

Anytime you have a bifurcated product where one company is selling one piece of the coverage and someone else, you run the risk of that problem, so either the insurance company has to be on the hook for the whole amount and then backstop through the Federal

Government or you have to have some kind of legal mechanism to ensure that the person is made whole.

Mr. CLEAVER. I mean, if a Member of Congress is experiencing this problem, think about what's happening to all of the other people down in the region, and these are real people. These are human beings.

Let me ask one final question.

Insurance companies, is there some kind of unwritten, unspoken policy that everybody just can't get their claims paid?

I'll ask anybody. I don't care.

Something is going wrong; it looks as if people are trying to figure out a way not to pay.

Admiral LOY. Let me just make a positive observation—that should not be the case. That policy is outlandish, if it is there, so—and I don't believe that it is.

Mr. PLUNKETT. Congressman, we certainly think that some of the issues that Congressman Taylor has brought to light regarding unfair claim settlement practices and particularly insurers who have customers with wind coverage trying to shift losses to flood insurance, we certainly have seen some of what look to be very serious cases of that kind of unfair practice occurring in the Gulf Coast Region, very recently.

Mr. CLEAVER. Maybe we need some Federal legislation to make it a felony when companies do that to human beings and citizens of our country.

I yield back the balance of my time.

Mr. MCCARTY. I'd just like to add, I do think there are a number of States, not all States, that have a number of tools in the toolbox to deal with that.

Clearly, if it's an unfair trade practice. States, I think, can aggressively pursue companies who do that, but there are also bad State provisions and laws in general in all jurisdictions.

So if a company is in fact treating a consumer in their desperate times in this fashion, they could be subject to sanctions by the courts.

Unfortunately, we don't want to get to that point. We want companies to settle their claims promptly. And I do believe—

Mr. CLEAVER. We're already there.

Mr. MCCARTY. Yes, sir, I understand. But I do believe the legislation, the flood legislation and the amendment that you put in there will go a long way to address this issue, and I really appreciate that coming in. It will help I think many of the people who were affected this past hurricane season.

Chairman NEY. The gentleman from Texas.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

I'm going to kind of take back up a point that the gentleman from Missouri is making, and it's something that I've been thinking about quite a bit, even before Katrina.

And that is the confusion to people that are buying insurance that, you know, yes, you're insuring your home, but it covers everything but.

And I think one of the problems that begins to happen there is the "but" part, and when the "but" part happens, then that's when the confusion occurs.

I know that there's been some thought about the government getting more involved in that process, but maybe the government's involvement has been part of the problem, both from sending the signal that if that "but" happens, the Federal Government is going to—if that exception happens, it's going to, you know, come in and save the day, or the understanding that this is not a flood policy but if your roof leaks, it covers you, and ruins the carpet, but if the water rises from the rain around it, you're not covered.

And I'm not so sure that down the road what we really need is for the Federal Government to get out of the flood insurance business and let the marketplace determine what that risk is and have an endorsement.

You know, I've got endorsements for all—I mean, I get my insurance policies and there's an endorsement for this and an endorsement for that, and that particularly for people in a flood plain, that they understand that there's a disclaimer there that this does not include flood insurance but you can get an endorsement for that.

I'd like to kind of explore that concept with the panel and see what your thoughts are.

Dr. Gray?

[No response]

Mr. NEUGEBAUER. Mr. McCarty?

Mr. MCCARTY. I think that you're absolutely correct.

We are constantly struggling with sophisticated consumers, who have a difficult time understanding what's in their policy and what's not, and clearly what happened, particularly in Mississippi, with the number of people who were lulled into a false sense of security.

They were not in the flood zone. The flood maps had not been updated. So they did not believe they had to purchase that coverage.

And I think most people think if their home is destroyed, regardless of the peril, that they're going to get paid.

And so that's why the National Association has put forth a recommendation for adoption by the States of a consumer education checklist, so it goes through there and you check off whether you have flood, earthquake, hurricane, mold, mold exclusion, etc., so that would be a better choice.

An alternative, as you have alluded to, is perhaps having a requirement that people buy comprehensive coverage if they have a mortgage, and if the rest of us are going to have to be backing that mortgage, a federally guaranteed mortgage, that is an all-peril policy.

I entertained the concept of eliminating the flood program, privatizing the flood program, and having a Federal backstop similar to what we're talking about today. The industry did not evidence any appetite for writing the flood program directly, and I think that would be an impediment to advancing this project.

Certainly it would be easier if you had an all-perils policy so irrespective of the loss, or what caused the loss, the consumer would be paid on their policy.

Admiral LOY. Sir, I think the commissioner is right on track here, and your thoughts are very constructive.

At the other end of the day, it's a matter of trying to understand what the Federal role and the legislator's role can be in incentivizing good behavior at the other end of the day, whether it's good behavior, that there be sanctions on the part of the insurance companies if they're not doing what they're supposed to be doing, but also good behavior, meaning informed behavior, on the part of the consumer who is attempting to cover these extraordinary parts of his life's experiences—houses, car, whatever.

So the notion of cognizance and oversight and sort of incentive standardization across the country are the kinds of things that can be legislated into the construct that we at ProtectingAmerica.org are attempting to advocate, and part of that can clearly be if you, in the State of "X" are looking for, in a mega-catastrophe circumstance, assistance at some threshold from the national backstop program, that will only be available to you if you have in fact done A, B, C, and D along the lines you're just describing in your State, and the same circumstance can very much apply between the State and the balance of what we would hope would be everything sort of Category 3 and below that would be normally handled by the commercial marketplace and the insurance industry.

So the notion of what we're attempting to build in this comprehensive construct that ProtectingAmerica.org advocates is incentivizing good behavior on the part of the legislation that would be forthcoming—

Ms. BROWN-WAITE. [presiding] The gentleman's time has expired. Thank you very much.

Next, we have the gentlelady from New York, Mrs. McCarthy.

Mrs. MCCARTHY. Thank you, and I appreciate this opportunity.

Mr. Williams, I'm curious. With the disaster that happened on the Gulf Coast and certainly in Louisiana, you probably had an awful lot of mortgages down there with your customers.

Mr. WILLIAMS. Yes, ma'am.

Mrs. MCCARTHY. And here we are having fights with the insurance companies, in which they couldn't get their monies for the claims on the homes that they lived in.

And so how much of a disaster was it for the bankers in the Gulf Region on all the insurance companies that—I should say all the banks that probably had customer who couldn't actually pay their mortgage anymore?

Mr. WILLIAMS. I think it's fair to say that we're all mad at the insurance companies.

But start with the biggest risk, which is flood. We had a diligent program at our bank to make sure that everyone who was in the flood zone had flood insurance, and to date, every single customer at our bank who was in the flood zone had flood insurance, because we insisted that they get it. If they didn't get it, we bought it for them.

So we had no exposure to people in the flood zone not having flood insurance.

We did have some problems with people who were told by the government, "You're not in a flood zone, you don't need flood insurance." Fortunately, there weren't so many that we couldn't work those out, and we've been working them out on an individual basis.

But that was a bit of a problem, and it particularly was a problem when months later the Corps of Engineers says, "Guess what, guys? We blew it. Our design was bad. Our engineering was wrong. And it was really our fault."

So people were told by their government, "You do not need flood insurance, it is not required, you're not in a flood zone."

The Corps of Engineers, which designed and built the levees, says, "Whoops, we made a mistake."

And at that point, the consumer is left to hold the bag. Fortunately, Congress did appropriate some money and that is forthcoming.

Mrs. MCCARTHY. With that being said, we're going to be hearing the next panel coming up soon, and I don't know when we're going to go down for votes, but I did have the opportunity to review the testimony, and one of the panelists, Mr. Burke, on behalf of the Reinsurance Association of America, states that there is no evidence that State catastrophe funds result in the availability of more homeowners' insurance.

Mr. McCarty, you had brought this up a number of times. What was the availability of insurance in Florida before the creation of Florida's State program and what is it now?

Mr. MCCARTY. Well, the RAA has been saying that for a long time, and it's no more true today than it was when they first said it.

The fact of the matter is that the Florida Hurricane Catastrophe Fund was the anchor for the recovery of the Florida marketplace.

We had nearly a million policies that were being nonrenewed by the private marketplace. We had substantial coverage change where consumers had much more deductible, much higher deductibles. We had significant rate increases. And even with all of those in place, there was a contraction in the reinsurance marketplace.

The Florida Catastrophe Fund provided a limited amount of relatively inexpensive reinsurance for the primary marketplace. There's still plenty of opportunity to purchase reinsurance in the private sector. It is a public-private partnership for the large part that worked, that paid through 8 storms and \$38 billion or \$35 billion worth of damage.

So yes, the CAT fund has been exhausted of the capital, but it still has bonding authority, it has recapitalized \$2.5 billion. It is what I believe a very true success story, plus \$10 million—there are allocations every year that have to go for mandatory mediation. They give credits and discounts for retrofitting homes, et cetera.

So they're trying to—we're trying to use this as a model of providing incentives as well as disincentives in a system so that people act in their economic best interest to protect their home, and I think it has been a very successful program, and I think it would be a model for the rest of the country in terms of a State program and a facility above that would serve to provide greater stability and long-term viability of the insurance marketplace and the economy of the country, because the insurance industry only insures up to a certain amount. They can't insure up to a one in a 1,000 year event. No one could afford the premiums. They are in the risk assuming business.

Some of the scenarios that we've talked about that happened in the past, you know, these could very well happen in the future, would definitely bankrupt the insurance industry and there would not only—people would not be able to rebuild their homes, they would not be able to revitalize the economy.

I think it's a key component part of any national plan along with all the other things—

Ms. BROWN-WAITE. The gentleman's time has expired.

Mrs. MCCARTHY.—retrofitting and responsible building codes and building code enforcement.

Ms. BROWN-WAITE. The gentleman from Mississippi, Mr. Taylor, you are recognized.

Mr. TAYLOR. Thank you, Madam Chairwoman.

The gentleman, Mr. Cleaver, touched on this, but I would be curious if anyone in the panel could offer a suggestion on what should be the mechanism, hard and fast mechanism for resolving the dispute that arises between wind and water, because I don't have any faith, based on what's happened in Mississippi, in the remediation that's going on.

The second thing is, and I think most Americans who hear this are going to be shocked to hear it, is it really a good idea that the insurance industry is not regulated?

They were given exemption from Federal regulation during the Great Depression. It might have made sense then. I don't see how something that is so important to every American could escape the regulation.

The gentleman on the panel is from a relatively sophisticated, high tax State, that provides high services, but that's not the norm around the country.

Mississippi, on the other hand, is a fairly low tax State, that provides low services, and boy do we know it when something like this happens. There really isn't much of a State agency to go to bat for the consumers.

I don't say that happily, because I've got tens of thousands of people who are on the verge of losing everything in the wake of what the insurance company has done to them.

So the first question is, would you have a recommendation for a hard and fast judge, so to speak, who is going to decide whether it's wind or water?

The second one, is I'd like to open up to the panel, do you think it's time for Federal regulation of the insurance industry?

Mr. WILLIAMS. Congressman, as a bank with an awful lot of customers who are having disputes with their insurance company, and a bank that has yet to collect on our own business interruption insurance, I would suggest binding arbitration with a short time-frame.

Mr. TAYLOR. And who would you get to be the arbitrator?

Mr. WILLIAMS. I think there are a number of alternatives.

You have the American Arbitration Association. There are a number of groups that do that. Something unrelated to insurance, but something that would be short-term where you could get a quick answer.

We all know that litigation is an option, but our customers can't wait and can't litigate for years.

Mr. TAYLOR. I'm sure the gentleman is aware that just in the past 2 weeks, State Farm settled on some insurance claims relating to a tornado from 1999. Those people waited almost 7 years for justice.

Mr. PLUNKETT. Congressman, the consumer community would strongly oppose mandatory arbitration of the kind that you see in credit card contracts and other, many other contracts, because most often the playing field is tilted towards the entity, usually the business involved, or an association of the businesses involved that are paying the tab for that arbitration.

Voluntary arbitration is a possibility. Much tougher oversight by State regulators, administrative law oversight as mandated by State regulators is a possibility.

Clearly, many States aren't doing enough here.

Regarding your question on the McCarran-Ferguson anti-trust exemption, consumer groups have long called for repeal. We don't think it's justified. We think a great deal of collusive activity by the insurance industry is allowed.

It's a virtually unprecedented exception, not totally, but virtually unprecedented, and we'd like to see it repealed.

The question of Federal versus State regulation, you've also touched on that.

We don't have a particular dog in that hunt, but we do understand that, in smaller States with fewer resources, good strong oversight to the benefit of consumers is harder, and we just think there needs to be strong consumer protections. The trend has been in the other direction.

And, in fact, the insurance industry is whipsawing the States because they're threatening greater Federal oversight as a way to get the States to sort of back off in some ways in terms of strong consumer protections.

So one has to be careful when one looks at Federal regulation as to what type of regulation one is looking at.

Mr. TAYLOR. Admiral?

Admiral LOY. Mr. Taylor, I'm not sure I'm smart enough to talk about the hard and fast dispute resolution, other than from a fairness doctrine that I would hope would, as Mr. Plunkett suggests, if anything, tilt toward the consumer as opposed to those who would be perceived as taking advantage of the consumer.

On the regulation side, the construct that we have thought our way through that appears largely in H.R. 4366, the House bill. I would get back to this notion of inducing fair and reasonable behavior on the part of the players in the system and making it quite clear in the legislation that that's what's expected.

Ms. BROWN-WAITE. The gentleman's time has expired.

I appreciate your lengthy answer and I am sure that Mr. Taylor would like to hear the rest of it, but we do have to recognize another member of the committee whom I should have recognized before, the gentlelady, also from Florida, who also has a hyphenated name, Ms. Wasserman-Schultz.

Representative Wasserman-Schultz, you're recognized.

Ms. WASSERMAN-SCHULTZ. Thank you so much, Madam Chairwoman, and actually, as a non-member of the committee, I want to thank the chairman through you for allowing me to participate,

and I wouldn't mind if Mr. Taylor wants the gentleman to finish his answer, just yielding some of my time in order for him to be able to do that.

Mr. TAYLOR. Thank you.

Admiral LOY. Thank you, ma'am. I'll just be very quick.

You know, the notion of incentive standardization and consumer protection, those kind of thought patterns have to be part and parcel of the construct that this committee and this venue would consider in terms of going forward.

Your first question, sir, about arbitration is at least at the moment fixated on how do we fix those tens of thousands of Mississippians and others in the wake of this immediate nightmare, but going forward, to have, as the commissioner has mentioned, tools of the trade in the hopper that are fair to lead towards arbitration judgments, that's got to be built into the system.

Mr. TAYLOR. Thank you, sir.

Ms. WASSERMAN-SCHULTZ. Thank you.

Mr. Plunkett, where do you live?

Mr. PLUNKETT. I live near here, in Maryland, born in New Orleans, lived all over the Gulf Coast, and grew up in southern Missouri.

Ms. WASSERMAN-SCHULTZ. Okay. Well, then, you should have a passing familiarity with the danger of living in a region like the Gulf Coast or the one that I represent, which includes Fort Lauderdale, Hollywood, and Miami Beach.

And I concur with my colleague, the gentlelady from Florida, that—and with Commissioner McCarty, whose testimony I appreciate and whom I very much appreciate the opportunity to work with.

I was elected to the Florida legislature in 1992, the year that Hurricane Andrew hit. In fact, the primary in that election year was delayed by a week in one of the counties that I represent because no one knew where the precincts were.

And quite honestly, if we didn't adopt a catastrophe fund, which we struggled mightily to do, and we were only able to be successful after convening a commission that included all of the presidents of the universities, who were able to make an objective overview and study of the matter and make recommendations that we could buy into in a bipartisan way, only then were we ensured of not losing the entire property and casualty industry in the State of Florida.

There would be, and I firmly believe we wouldn't have any P&C companies doing business in our State if we did not adopt a catastrophe fund.

Now, I feel like I have a little bit more—not more, but I have—I think I'm well within my pedigree to disagree with you, since I've been the recipient of about every award that your organization and its Florida affiliates gives out, and I have a very longstanding reputation of agreeing with the Consumer Federation and your affiliates.

I completely disagree with you on this. It is irresponsible to take the position that we should not adopt a national catastrophe fund and that the reason for that is that consumers would be on the hook.

You don't think consumers are on the hook now? You don't think consumers are struggling to obtain property and casualty insurance, afford property and casualty insurance, rebuild their homes and be able to actually live in the communities that get hit by hurricanes?

Mr. PLUNKETT. Well, certainly as we point out in our testimony, they are struggling in coastal areas—

Ms. WASSERMAN-SCHULTZ. So what's your answer?

Mr. PLUNKETT.—serious issues, and let me mention that we're not opposed to State CAT funds.

In fact, our insurance director, Bob Hunter, was involved in discussions and debates after Hurricane Andrew that led to the creation of that fund in Florida.

We have made the point that we don't think the case has been proven yet for such a national fund, but at the same time have offered principles in the testimony for review of that approach if considered.

So we think we're engaging in a very responsible, constructive way.

One piece to the puzzle that isn't discussed very frequently is proper regulation. One of the things that was done right after Hurricane Andrew was that Allstate and others were forbidden for one year, as I understand it, from pulling out, because a precipitous move involving tens of—in fact hundreds of thousands of ratepayers was proposed.

In other States, the ability to look at rates, to examine rates, has been crucial to preventing some insurers, certainly not all, from taking advantage of these situations.

So our solution is strong regulation, including rate regulation, and then getting the national flood insurance program in order, and making sure that whether ratepayers pay or taxpayers pay—

Ms. WASSERMAN-SCHULTZ. Mr. Plunkett, why isn't—

Mr. PLUNKETT.—set up fairly.

Ms. WASSERMAN-SCHULTZ. Why isn't it far better—and I'm certainly for a regulatory scheme that would ensure consumer protection, but why isn't it far better, rather than artificially propping up the market, doing something that would actually open up the market and make sure that the free market system could be effective with a healthy dose of regulation?

I mean, if we had continued in perpetuity the moratorium that you referred to, which was far longer than a year, and there were a number of other things that we actually did—

Mr. PLUNKETT. Congresswoman, we have called for perpetuity. We—

Ms. WASSERMAN-SCHULTZ. Well—

Mr. PLUNKETT.—concerned about the immediate impact.

Ms. WASSERMAN-SCHULTZ. If a moratorium in perpetuity is your solution, then we really are on a different page.

Thank you, Madam Chairwoman.

Ms. BROWN-WAITE. The gentlelady's time has expired.

If Mr. Plunkett will submit a written answer on that, and the Chair notes that some members may have additional questions for this panel which they may wish to submit in writing.

Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

I want to thank the panel for being here and for participating. I think every member learned a great deal. And I hope that you all have a safe trip home.

Thank you very much.

As you leave, we're going to be calling the second panel up.

I will briefly read their names.

It is Mr. Dennis Burke, vice president of State Relations for Reinsurance Association of America.

Mr. Ernst Csiszar, president and CEO, Property Casualty Association of America.

Governor Marc Racicot, president of the American Insurance Association.

Mr. Tim Russell, president of Baldwin Mutual Insurance Company of Foley, Alabama, testifying on behalf of the National Association of Mutual Insurance Companies.

Mr. Alex Soto, president of InSource, Inc., in Miami Florida, testifying on behalf of the Independent Insurance Agents and Brokers of America.

As well as Mr. David A. Treutel, Jr., of Treutel Insurance Agency of St. Louis, Missouri—I'm sorry, Bay St. Louis, Mississippi. I apologize.

Welcome. We'll give you a moment to get seated and we have some water there for you.

We'll proceed in the same order, so the first presenter will be Mr. Burke. Welcome.

**STATEMENT OF DENNIS C. BURKE, VICE PRESIDENT OF STATE RELATIONS, REINSURANCE ASSOCIATION OF AMERICA**

Mr. BURKE. Good afternoon, Acting Chairwoman Brown-Waite, Ranking Member Waters, and members of the subcommittee.

My name is Dennis Burke, and I am vice president of the Reinsurance Association of America, the RAA. It's a pleasure to be here to appear before you this afternoon.

As this committee has called a hearing to address the question, "Is America's housing market prepared for the next natural catastrophe," I am here to present the reinsurers' perspective.

Reinsurance enables insurers to offer more homeowners insurance in catastrophe-prone areas. The United States attracts reinsurance capacity from all over the world, as was demonstrated after the 2005 hurricanes in which the global reinsurance community paid approximately half of the \$80 billion in losses.

Despite the resilience of the reinsurance market, some insurers are claiming that there is a need for a Federal natural disaster reinsurance program. The RAA does not believe that market conditions warrant such a program.

First, the primary industry made a \$45 billion profit after paying for the hurricanes.

Second, the capital markets responded strongly after the hurricanes by investing \$24 billion in reinsurers, and an additional \$4 billion to \$6 billion in new and existing catastrophe bonds and other capital market alternatives to reinsurance.

What does that mean for actual reinsurance capacity?

Reinsurance capacity is adequate in most markets throughout the United States. There is anecdotal evidence that in some markets, notably Florida, the demand for reinsurance has exceeded supply. The RAA believes that this imbalance will be temporary.

If the free market is permitted to work, these temporary price spikes will be followed by increased competitors entering the market, increased competition, and a moderation of price. The markets do take time to adjust, however.

At the core of H.R. 4366 is the creation of State and Federal catastrophe funds to provide reinsurance for natural disasters.

As the gentlelady from New York noted, we do not believe there is any evidence that State catastrophe funds result in the availability of additional homeowners' insurance. The RAA believes that natural disaster risk is insurable in the private market and that State catastrophe funds displace the private market.

Only Florida has a catastrophe reinsurance fund that meets the standards of the bill, and we would state that Florida is not a success story. It is broke and it is in debt.

The model of the Florida hurricane fund is one that offers inexpensive reinsurance premiums up front because it's backloaded on the backs of taxpayers.

When the fund runs out of money, it issues bonds. Insurers do not pay off the bond debt, policyholders pay off the bond debt. They are taxed to do so in the form of insurance assessments.

State catastrophe funds also violate one of the fundamental tenets of insurance, spreading of the risk. Private reinsurance spreads risk globally. A State catastrophe fund concentrates the risk in one jurisdiction and shifts the risk from insurers to policyholders.

The RAA believes that the public policymakers should make it their top priority to remove regulatory constraints and price constraints and enable the private insurance market to willingly assume more risk.

If policymakers follow competitive free market practices, a Federal natural disaster catastrophe fund is unnecessary.

Our specific concerns with H.R. 4366 are noted in our written testimony. We'd like to note three things, however.

The trigger levels for the Federal reinsurance program are far too low and interfere with a functioning private reinsurance and insurance market.

Second, there is no assurance that the Federal program will result in an increased offering of homeowners' insurance. Unlike TRIA, which has a mandate to offer additional coverage, there is no requirement that those insurers who benefit from the Federal program offer more homeowners' insurance.

Third, if H.R. 4366 was the law, all catastrophe or most catastrophe risk would be in State and Federal Government catastrophe funds.

In the event of a catastrophe, policyholders and taxpayers, who are already suffering under the catastrophic burden, would now have a tax or a policy assessment burden imposed upon them as well, whereas if it was insured in the private market and the global

reinsurance market, funds would everybody coming from global reinsurers to the much-needed areas.

In conclusion, the reinsurance industry has responded to virtually every catastrophe that has occurred in the United States in the last century. It continues to serve a vital role of providing capacity to insurers so that those insurers may offer additional homeowners' insurance. We urge you not to interfere with this functioning private market.

Thank you.

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

Ms. BROWN-WAITE. Next, Mr. Csiszar. Welcome.

**STATEMENT OF ERNST CSISZAR, PRESIDENT AND CEO,  
PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA**

Mr. CSISZAR. Thank you, Madam Chairwoman, and members of the committee.

I appreciate the invitation to appear before you today. I represent some 1,000 property and casualty companies throughout our association, and they operate in every State of the union, including those States that have significant catastrophe exposures.

Quite frankly, I think the industry faces a dilemma.

What you heard from Professor Gray is very, very true. More people—about 39 percent more if you start counting from 1970 onward, larger homes, more expensive homes, more net worth by individuals tied up in their home, a geographic distribution that is simply awful.

Twenty-five percent of total insured value of total exposure is in one State, in Florida. New York comes a close second. Texas is in there. All the coastal States along the Atlantic as well as the Gulf Coast.

Add to that, an increasing frequency of storms with higher severity, destruction of coastal wetlands and sand barriers that open up the entire coastline, the significantly increased storm surges, and the significantly increased damages, and what you face here, I describe it as an inverted pyramid.

The Insurance Services Office, in a recent publication, estimated that just the hurricane exposure along the Atlantic and the Gulf Coast, the insured value of that amounts to \$7.2 trillion—\$7.2 trillion.

What my friend from the RAA, and I know he didn't do this on purpose, but I'll mention it, what he neglected to mention is that there is really only about \$100 billion worth of capacity that's dedicated to catastrophe exposures.

Some of it comes from reinsurance, some of it comes from the capital markets in terms of catastrophe bonds, some of it comes from what the insurers, companies like ours, retain, a total of \$100 billion.

For perspective, the insured value, not for tsunamis, not for earthquakes, not for hailstorms, not for floods, not for anything but hurricanes, I repeat, is \$7.2 trillion. You have \$100 billion worth of capital sustaining an enormous amount of exposure. Hence, we are all looking for solutions.

The PCI has recently adopted a policy statement that sets out in effect a mix of policy solutions. There is no single best solution to this entire problem.

We start with the fact that there are ways in which we can reduce exposure. Building codes, we've heard about those before; loss prevention; mitigation; preparedness effort; better preparedness; as well as better land use planning overall.

Secondly, we welcome much-desired reforms to the NFIP, and we hope that those reforms ultimately will also address what I would describe as the single two most significant problems with the program.

One, pricing. I have seen estimates, for instance, that suggest that a flood policy even in today's terms with the enhancements that we've seen is only at about 35 percent of the true risk of those properties, on average. So the pricing is inadequate.

Repeat claims. I understand that in the recent storms, Katrina and Wilma and Rita, about one-third of the claims that are being paid out are in fact repeat claims.

So the reforms are welcome. They're well needed. And we hope that they will continue and go much further than where they are.

Thirdly, free markets. We don't have a free market in this industry. We have never had a free market in this industry. Our prices are set by the regulators. They're set by the Kevin McCartys of the world.

I was a regulator. I was insurance commissioner in South Carolina for 6 years. I know how those rates are set. They are not set adequately. They're suppressed, and they're suppressed in many cases for political reasons, pure and simple political reasons. The end result is, there is no free market.

So how do you attract capital? How do you make yourself attractive when the rates of return, regardless of how much profit you've made last year, the rates of return, particularly on capital invested for catastrophe exposure, is inadequate?

I'll give you one example.

Last year, in Louisiana, as a result of Katrina, we paid out \$20 billion in claims. The entire State of Louisiana produces about \$1 billion worth of premiums. That is 20 times more than the premiums for homeowners in Louisiana.

Ms. BROWN-WAITE. The gentleman's time has expired.

Mr. CSISZAR. I will conclude by simply stating that we support State CAT funds and we also support a Federal role, but we would prefer to see credit arrangements on that Federal role, and I'll be more than happy to explain that further.

Thank you.

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

Ms. BROWN-WAITE. Thank you. I'm sure there will be some questions.

Governor Racicot.

**STATEMENT OF MARC RACICOT, PRESIDENT, AMERICAN  
INSURANCE ASSOCIATION**

Mr. RACICOT. Good afternoon, and thank you, Madam Chairwoman.

My name is Mark Racicot, and I represent the American Insurance Association here this afternoon. We work with major property and casualty insurance companies around the country.

And of course, I appreciate the opportunity to be here this afternoon and to address this matter of extraordinary importance to our industry and to our Nation.

Like have many members of the committee, I, too, have had the opportunity to see firsthand the extraordinary and terrible destruction that Hurricane Katrina inflicted upon the Gulf Coast, on the residents there, the businesses there, and communities there.

The damage was and is both breathtaking and heartbreaking, and the private sector property insurers have been very diligent and are proud to be one of the financial engines trying to drive Gulf Coast recovery.

Just for the record, for insurers, 2005 was the most costly year on record. Total catastrophe losses totalled more than \$70 billion.

Insurance companies adjusted more than 3 million hurricane claims, as you heard the commissioner from Florida say, close to 95 percent of them already concluded, 1.6 million of those claims were from Hurricane Katrina alone.

Yet, despite last year's recordbreaking losses, approximately \$28 billion of new capital has entered the U.S. property insurance market since Hurricane Katrina struck.

Although the property insurance market currently is under stress in several Atlantic and Gulf Coast States, we strongly believe the solution to this stress lies in improving and not displacing private sector ability to serve homeowners and businesses in the path of potential storms.

The challenge is how to enable markets to manage catastrophe risk. We believe this can be done without establishing new government mandates or programs and without subsidies from taxpayers living in less risky areas.

To this end, AIA has constructed a reform agenda, including both Federal and State initiatives.

While we recognize that not all elements of our agenda are politically popular, we believe that now is the time to tackle these complex issues head on before the degree of difficulty gets even higher. The risks of not doing so in good faith are extraordinary, and could have grave consequences for our citizens and for our economy.

The AIA natural catastrophe agenda comprises four major parts, which are expanded on in my written comments.

First, AIA advocates protective measures to keep people out of harm's way and strengthen their ability to withstand future hurricanes.

These measures include enactment and enforcement of strong building codes, policies to encourage retrofitting of existing buildings, and sensible land use planning.

Secondly, AIA advocates regulatory and legal reforms to improve the stability of insurers' operating environment.

Central to insurability to manage CAT risk is the ability to predict such disasters and charge an appropriate premium. Unfortunately, the political climate in many States leads to arbitrary rate suppression and expensive, unpredictable insurance regulatory mandates.

Insurers also must have confidence that the insurance policies they write will be upheld following a major disaster.

If trial lawyers or others successfully and retroactively rewrite insurance contracts, the predictability upon which a healthy insurance system is based is undermined.

Third, AIA supports tax incentives to encourage residents to take more responsibility for hurricane preparation and response.

There are other ways that Federal and State tax policy also can enhance affordability and encourage the use of proactive measures.

Finally, AIA advocates national flood insurance program reforms to ensure that the NFIP continues its vital role in protecting homes and businesses.

Among needed NFIP reforms are phasing out current subsidies and replacing them with risk-based premiums, expanded program mandates to cover more homeowners in more places, increases in coverage limits and deductibles, and policy terms that are more consistent with private insurance.

Additionally, NFIP must complete its map modernization initiatives as soon as possible.

We also analyzed the Brown-Waite–Shaw Homeowners’ Insurance Protection Act, and respectfully, very respectfully, disagree with the premise that government must step in and displace large segments, or potentially displace large segments, of the private property insurance sector.

It’s also important to note that creation of State and/or Federal CAT funds would do very little to solve the many complex issues surrounding the natural catastrophe risk.

To the contrary, such funds could supplant and discourage the private market, cause unfair subsidies, increase unwise building in catastrophe-prone regions, and compromise the property insurance infrastructure that has served this Nation so long and so well.

So while we do not support creation of catastrophe funds, we do support the bill’s provisions that target opportunistic pricing of the building and construction issues that are facing the country and the prevention of fraud.

One final note, Madam Chairwoman, and that is that we also support the creation of a national commission to look beyond insurance to such critical risk management issues as public education and mitigation.

Thank you very much.

[The prepared statement of Mr. Racicot can be found on page 160 of the appendix.]

Ms. BROWN-WAITE. Thank you for being here, Governor.

Next we have Mr. Tim Russell. Welcome.

**STATEMENT OF TIM RUSSELL, MAYOR, FOLEY, ALABAMA AND PRESIDENT, BALDWIN MUTUAL INSURANCE COMPANY, FOLEY, ALABAMA, ON BEHALF OF THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES**

Mr. RUSSELL. Good afternoon, Members of Congress and members of this committee and Ranking Member Waters.

My name is Tim Russell, and I am pleased to testify today on behalf of the National Association of Mutual Insurance Companies.

We represent approximately 40 percent of the premium volume of the property casualty industry in this great country.

I'm also the president of Baldwin Mutual Insurance Company. We are a single State writer in Alabama. We write about 35,000 families' policies.

I also have the distinct opportunity to serve as Mayor of the great city of Foley, Alabama.

Foley is a coastal city that was directly impacted by Hurricane Ivan in 2004 and by Hurricane Katrina in 2005.

In my dual roles as president of Baldwin Mutual Insurance and Mayor of Foley, I have seen a unique perspective on the devastation caused by natural disasters and the challenges that face insurers, government policymakers, citizens, and many others in preparing for and managing large-scale natural disasters.

As we have heard from the previous testimony, we know that 2005 was one of the worst years of natural disasters in this great country.

For residents in our city, we were still recovering from Hurricane Ivan when Hurricane Katrina hit. Hurricane Ivan was the worst single catastrophe loss in the history of the State of Alabama.

I wish I could sit here today and say that the worst is behind us, but again, many previous witnesses have testified today that our catastrophic exposure in America is greater than ever.

NAMIC, our trade association, is pleased that the members of this committee are making a serious effort to understand the nature of catastrophic risk and the role that insurance can play to better prepare for and manage future large-scale natural disasters.

To assist in this effort, NAMIC convened a special task force in December of 2005 to identify and analyze the critical issues that we believe policymakers should consider as they move forward.

Today I'd like to share with you, the members of this committee and those representatives, several observations and recommendations that emerged.

We have four key points.

The first principle is the belief that market freedom and competitive pricing will lead to innovation in developing solutions to problems relating to natural disasters and insurance mitigation.

NAMIC believes that insurance markets function most efficiently in the absence of government rate suppression and underwriting restrictions.

A flexible regulatory environment in which insurers are free to price coverage based on risk will create incentives for property owners in high-risk areas to invest in loss mitigation measures.

Likewise, risk-based pricing will create incentives for individuals, homebuilders and mortgage lenders, to engage in risk avoidance strategies.

The second important principle is the belief that competitive pricing and risk-based underwriting are essential to development and maintaining a viable disaster insurance market.

Lawmakers and regulators alike sometimes impose rating and underwriting restrictions on property insurers that allow high-risk property owners to pay artificially low premiums, forcing lower-risk property owners to subsidize the insurance cost of high-risk buyers for paying inflated premiums.

NAMIC believes that using the insurance pricing mechanism creates hidden cost subsidies among risk classes, and this is not good public policy.

A third principle is the mitigation, and that mitigation is indispensable in disaster risk management and insurance.

Effective mitigation efforts include the development of strong building codes, which our city supports. We have shown that strong building codes reduce property and human damage during natural disasters.

In my capacity as Mayor of Foley, I spent a great deal of time surveying damage firsthand during Hurricane Ivan and then later Hurricane Katrina, and can tell you that those homes that were built in less strong capacities and less building codes suffered much greater damage than those with modern building codes.

Earlier this year, the LSU hurricane center released a study that concluded that if Mississippi were to have adopted a tougher building code, it could have saved an estimated \$3 billion the next time that a hurricane Category 3 storm hits the State.

NAMIC supports the concept of Federal legislation that would create financial incentives to encourage States to adopt and enforce strong statewide building codes.

With respect—

Ms. BROWN-WAITE. The gentleman's time has expired.

Mr. RUSSELL. Thank you very much, members.

And the last principle is that we believe in the Federal flood insurance program—thank you for your recent act in that regard—and strongly support the reform of the Federal program.

[The prepared statement of Mr. Russell can be found on page 168 of the appendix.]

Ms. BROWN-WAITE. Thank you very much for being here, Mr. Russell.

Next, we have Mr. Alex Soto, also from Florida. Welcome.

**STATEMENT OF ALEX SOTO, PRESIDENT, InSOURCE, INC., MIAMI, FLORIDA, ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA, INC.**

Mr. SOTO. Thank you very much, Madam Chairwoman.

My name is Alex Soto, and I am the president-elect of the Independent Insurance Agents & Brokers of America; you know us as, "The big I."

We have 24,000 member agencies which are small businessmen and women, 300,000 agents and their employees, that are located virtually everywhere in the United States.

We are the people who deal as intermediaries between the insurance company and our clients and the consumers.

But I'll tell you, I make my living as an agent in Miami, Florida. I am the president of an agency called InSource, Inc. We're located, our main office, in Miami. We have a branch in Broward County. We have 65 employees, and we sell an array of all insurance products: financial services, homeowners, automobiles, and business insurance to business owners.

We represent a number of the brand name insurance companies that each of you are familiar with and that are represented by these associations to my right.

We have a very good, warm relationship with those companies and we also have a good working relationship with the associations that are represented here today.

I want to take a moment to tell you what is happening in my marketplace, which is the entire State of Florida, and most particularly, south Florida.

There is a systematic contraction of the insurance marketplace in Florida, and particularly in south Florida, and it is spreading to what we call the smile of the United States, which is the entire coast from Mexico all the way to New England.

We represent—not only do business with those companies, but we also access as what is known as the surplus lines business, which are companies that from a ratemaking mechanism, and this is important, are not regulated by the Department of Insurance, so they have the freedom to set price according to what they believe a particular risk bears.

And it's important to note that we have seen this contraction in the marketplace in personal lines and in commercial lines over a number of years. This is not something that has occurred or has only occurred since Katrina, Rita, or Wilma.

We represent about 50 insurance companies in the surplus lines market and in the direct marketplace, and yet we practically don't have any product to sell today, and it has occurred during a period of time that we have just heard capital has increased.

So this anomaly of Florida is not a short-running anomaly, and let me tell you how it occurs.

It starts with a phone call or a letter from one of our insurance company partners indicating to me that they are shutting down in a particular area, and worse yet, they may be non-renewing a number of our insureds.

I immediately in that conversation stress to the company that if they need more rate, if they need more premium, we are well acquainted with the Department of Insurance and have a good working relationship with them, and we can get them more rate.

Their response uniformly has been, "It's not about rate. Rate is an important component. But it's about reinsurance, it's about our capital, it's about our exposure."

We are in effect—and in fact, this commentary comes from some surplus lines companies that are not rate regulated, and they tell us, "our reinsurers are forcing us to take these steps."

Therefore, we happen to believe that this is a national problem, this is a taxpayer problem, this is an economic problem, and in order to protect insureds and in order to protect taxpayers, we ought to, we ought to have the Federal Government have a role in providing a backdrop and a gapstop, reinsurance, and whether that reinsurance is only to catastrophe funds in States such as mine, in the State of Florida, or even beyond that, the private marketplace, and maybe that attachment point will be substantially high, we believe there's a role, measured, limited, and it's got to be sold at actuarial rates.

We are encouraged by proposals that allow insurance companies to accumulate tax-free reserves. We salute the reforms in Florida. We do believe that less regulation is better.

I look forward to the day that insurance companies compete for the business of my clients so that prices will be moderated and coverage broadened.

We all have indicated that we believe in strong building codes and mitigation. I think we need to, and my colleagues and I need to invest in those research programs. There are very exciting programs going on in Florida that lead to mitigation.

Thank you, Madam Chairwoman.

[The prepared statement of Mr. Soto can be found on page 173 of the appendix.]

Ms. BROWN-WAITE. The gentleman's time has expired. Thank you.

Mr. Taylor, I understand that our next presenter is from your area. If you'd like to introduce him, I would appreciate that.

Mr. TAYLOR. Thank you, Madam Chairwoman.

Dave Treutel is a true community leader in the Bay St. Louis area. He's up here, to the best of my knowledge, on his own nickel to talk about some of the mistakes that he as an independent insurance agent has seen that need to be corrected.

I think it's fair to say that he's picked up a heck of a lot of business since the storm because the people that the Governor and others may represent have let us down.

And so I'm very pleased that he's here today, and look forward to what he has to say.

**STATEMENT OF DAVID A. TREUTEL, JR., PRESIDENT, TREUTEL INSURANCE AGENCY, INC., BAY ST. LOUIS, MISSISSIPPI**

Mr. TREUTEL. Thank you, Congressman. Thank you, Madam Chairwoman.

My name is David Treutel and I am president of Treutel Insurance Agency, a third-generation independent agency located in Bay St. Louis, Mississippi.

I serve on the board of directors of the Mississippi Wind Pool, the Governor's Recovery Commission on Katrina, and on the agents advisory boards of several insurance companies.

I'm an active member of the Independent Insurance Agents & Brokers of America and served as president of the Mississippi Association in 1998.

However, I'm speaking here today on my own, in my capacity as a private citizen, and as an independent insurance agent who saw some of the worst from Hurricane Katrina.

On August 29, 2005, Hurricane Katrina made its way into my hometown, making an indelible imprint on the lives of my family, my insureds, my business, my small town, our Mississippi coast, our State, and ultimately our country.

Winds from Katrina damaged much in its path, with water over 30 feet high and sent inland over 10 miles in my county.

My home, 3 miles inland, and not in the flood plain, was devastated. My extended family counted losses that included 15 autos, 8 homes, and 3 businesses.

However, we consider ourselves fortunate that we survived, unlike the five neighbors who drowned within a block of my home.

Katrina's winds and 7-foot floodwaters severely damaged my 2-story office building. We quickly set up a makeshift tent in the

parking lot of my town's Chamber of Commerce to serve insureds in the 110-degree heat index.

At the same time, we commuted back and forth over 110 miles each way to an office apartment set up outside of Mobile, Alabama.

These daily round trips to Mobile continued for almost 6 months, and we logged 38,000 miles on my vehicle.

Our agency has over 10,000 policy holders, and we ultimately handled close to 8,000 claims in the ensuing months.

As we try to prepare for the next natural catastrophe, I'd like to raise several issues that my insurance agency and insureds face.

One, the lack of available, sufficiently trained adjusters was an early problem.

Two, communication was a serious problem. The simple process of having an adjuster and an insured make contact often did not happen for quite a while.

Three, multiple policies meant dealing with multiple adjusters in most cases.

Four, multiple policies also meant dealing with extremely different insurance contracts that did not complement each other. This situation often left an insured without proper coverage even when they had purchased all that was available in the marketplace.

Wind versus flood. Multiple policies create a difficult situation when two or more perils cause or contribute to the same loss. Millions of dollars are spent by companies through engineering firms to support the eternal question: which came first, the water or the wind?

As a result, millions of dollars that could have gone to consumers will be spent on litigation and additional engineering studies.

Multiple policy confusion led many insureds to believe incorrectly that they would be paid fully for each separate policy they purchased.

Number seven, major inconsistencies in the adjustment process.

Insureds who were neighbors and had insurance policies written with different insurance agents and companies quite often had vastly different outcomes when or if their claims were paid. Homes on the same block had varying outcomes with their insurance claims.

Number eight, confusion on proper values on the homes.

Nine, State catastrophe pools cannot do it alone.

Based on these issues, I would make the following recommendations.

One, that companies offer one all-risk policy that would include insurance for natural disasters, wind, flood, and earthquake, provided that they have access to adequate insurance and reinsurance.

This would mean one adjuster for all risks, avoiding the wind versus water debate, costly litigation, and excess costs for engineering studies.

Two, continue to use existing State and Federal earthquake, wind, and flood catastrophe programs.

Three, implement a Federal reinsurance backstop devised similar to TRIA. A limited Federal backstop could complement State and Federal catastrophe pools which could include a Federal role to

help make reinsurance more available and affordable to States and their catastrophe pools.

Four, tax incentives for companies and consumers to be prepared for the next catastrophe.

Five, more properly equipped and trained adjusters. Both private carriers and Federal or State catastrophe programs should review their approach to handling disaster claims.

Six, better communication with compatible state-of-the-art equipment. Communication issues should be reviewed in light of current available technology to find solutions in advance of the next round of catastrophes.

In conclusion, the current process for dealing with catastrophe losses is not an efficient or effective process. It is not effective for all interested parties, particularly the American people—my clients and your constituents.

Natural disasters can and will occur anywhere in our country at any time. Failure to act effectively now will continue to cost consumers and taxpayers much more than it should.

Thank you for the time to speak this afternoon and thank you for the generous response that Mississippi has received from all of you after Katrina.

Most importantly, our heartfelt thanks go to the many millions of generous Americans across our great country.

Thank you, Madam Chairwoman.

[The prepared statement of Mr. Treutel can be found on page 179 of the appendix.]

Ms. BROWN-WAITE. Thank you very much.

There are some of you on the panel that I have met with and you've expressed concern about my bill, and most of you represent the reinsurers.

Let's take a worst-case scenario, and I'd like to use Mr. Csiszar's figures of \$100 billion worth of coverage for a possible \$7.2 trillion exposure along the coast, and perhaps simultaneously in the same year, an earthquake on the other coast.

Can those who do not support this bill assure this Congress and citizens that there actually is going to be adequate capacity and coverage should such a major catastrophe happen?

I'm talking about several hurricanes dwarfing, God forbid, Katrina, along with perhaps something on the other coast.

Mr. Burke, you're recognized.

Mr. BURKE. Representative Brown-Waite, we cannot state that if \$7.3 trillion worth of disasters occurred during a given year, \$100 billion, or even \$800 billion, which is the combined property casualty insurance and reinsurance capacity, could support such catastrophic events, but the reality is that the property and casualty insurance industry is based upon facts.

As Dr. Gray pointed out, massive hurricanes do not happen every day. They are few and far between. Earthquakes do happen, but they don't happen every day.

I would point out that in California, earthquakes are excluded under most insurance policies because there is a—or at least homeowners' policies—because there is a government pool out there, the California Earthquake Authority.

So the likelihood of all things happening at the same time in all places is, in fact, remote.

If all things happened at all times during the same year, that would be a problem, and I would suggest that to have adequate reinsurance or insurance and reinsurance available at that time would be cost prohibitive to policyholders and no one could afford to support that sort of catastrophic risk.

So actually, in those extreme—and I'm talking very extreme—circumstances, in excess of probably \$200 billion to \$300 billion, I think an after-the-fact Federal solution would be appropriate in those circumstances.

Ms. BROWN-WAITE. So we have to wait, just so I'm sure I understand you, you're suggesting we wait until there's a catastrophe, is that what you're saying?

Mr. BURKE. I am suggesting that in the realm of possibilities, the types of catastrophes that would exceed free market capability are so remote that I do not—particularly if we free the private market by ending rate suppression, which would attract additional capacity to the industry—

Ms. BROWN-WAITE. Sir, I can just tell you that I have a daughter who lives in another State, my family lives in Florida, and if you think that the people who are paying the rates out there think that rates are suppressed, you can go into my district and you deal with people who are paying more for homeowners insurance than they are for their taxes.

To say rates are suppressed I believe is no longer an adequate excuse.

I would ask Governor Racicot if he would comment also.

Mr. RACICOT. Well, I think, Madam Chairwoman, that the answer given by Mr. Burke addresses the issue, and that is that you can imagine all kinds of extraordinary situations, but the insurance model of this country for 150 or 175 years has been based upon modeling, upon risk assessment based upon history and projection into the future and trending, and it is based upon an actuarial science that allows for you to draw possibilities and to price those possibilities or risks.

And pursuant to that system, obviously, that's what we believe the private market can respond to. That's why we see new capital entering into the reinsurance market so rapidly.

But you can certainly, if you desire, conjure up an extraordinary situation that no one could imagine—

Ms. BROWN-WAITE. Well, I think, too, in response to I believe it was Mr. Soto, who said it's not about the rate, it's about the exposure, at some point, you know, the insurance companies are going to be saying, "We can't afford the reinsurance we had before," and at that point, it may be too late.

I think we need to plan for natural disasters and we need to plan so that our constituents aren't left in a lurch with a piece of paper policy that they think has some coverage to it.

Mr. RACICOT. Madam Chairwoman, if I could address that.

First of all let's place these questions in their context. This is the most highly regulated industry in the United States of America, at the State level. It's always been regulated at the State level.

They pass upon the rate structure. They pass upon the language of these contracts. They approve wind and water definitions within these policies. They require solvency.

So it's within that context that we're talking about these particular issues.

Now, we know that—

Ms. BROWN-WAITE. Governor, my time is up, also. My time is up. I have to—I can't take more time than anyone else.

The gentleman from Mississippi, Mr. Taylor, do you have any questions?

Mr. TAYLOR. Yes, ma'am, I do. Thank you.

Ms. BROWN-WAITE. You're recognized.

Mr. TAYLOR. Governor, could we directly quote from your Page 6:

“Pending ‘wind versus water’ litigation brought by the Mississippi attorney general private plaintiffs epitomizes the problem that insurers face in an uncertain legal environment, particularly where cases are fraud [sic] and [sic] ‘hometown’ juries. Insurers should not be made to pay claims for losses that are beyond the scope of an individual’s policy, and for which the policyholder did not pay premiums.”

Governor, when an extremely powerful U.S. Senator, the former majority leader, when a sitting Federal judge, when a sitting Congressman feel like they have to go to court to get fairness from the insurance company, the problem is not with the individual, it's with your industry.

Secondly, you talk about the importance of sticking to contracts. In each of those contracts was a hurricane deductible.

Now, if you're going to have a hurricane deductible, a prudent person would think you'd be covered for a hurricane.

And so if someone who has voted for almost every tort reform measure that's come before this body, I've got to tell you, the problem isn't the legal system, the problem is with your industry.

Mr. RACICOT. Well, Mr. Congressman, I would steadfastly disagree with you, with all due respect.

Let me point out, first of all, that if you take a look at what has happened in Mississippi during this last year, you'll find that the record total of homeowner insurance claims payments resulting from the 2005 hurricanes in Mississippi is enough to wipe out all of the homeowner premiums paid in that State during the past 17 years.

Mr. TAYLOR. You wrote the policies. No one dragged you to the State of Mississippi.

Mr. RACICOT. But let me—

Mr. TAYLOR. You were certainly happy to take their payments all these years.

Mr. RACICOT. No, you're asking about where is the problem here, and I'm just trying to describe the context for you.

First of all, this extraordinary amount of claims has been paid out.

Secondly, these contracts are regulated by your State. Commissioner Dale regulates these contracts, and approves the language. In that State, you have solvency requirements that they have to meet as well. In that State, the rates are approved, as well.

So everything that is done in that State is done with the approval of your State authorities, and whether you're a Congressman or a painter doesn't matter. The sanctity of contracts is absolutely critical to establishing a stability within which people can do business.

Tell me, I don't know what your business is, or what are the contracts you have, but I'm certain that you would agree that the foundation stone upon which this democracy depends is the sanctity of contracts. If they can be changed at any point in time, and what I'm telling you is that when you have a regulatory environment, as you quoted there, that changes at the whim and caprice of elected officials because there are huge political pressures upon them, and they set about to abrogate contracts after they have been entered into, agreed upon, and reviewed by State authorities, you cannot have a stable regulatory environment that attracts capital—

Mr. TAYLOR. Governor, do you think it is in the best interests of the taxpayers that employees of your industry go out and look at the damages and decide whether the taxpayers through the Federal flood insurance program should pay the claim or your industry should pay the claim? Do you think that is a good thing for the taxpayers, that no one from the government even bothers to check that? If your industry files a claim, the Federal flood insurance program pays it?

And I will give you a for instance.

If that lady Member of Congress wants to be reimbursed for her trip to the airport, she has to send me a voucher. She has to actually have the receipt from the taxicab for that 15 or 20 bucks.

But if someone who works for State Farm or Allstate or Nationwide walks onto a piece of property and just makes an arbitrary decision that all of that was water damage and no wind damage, despite all evidence to the contrary, despite evidence that they had wind damage 10 miles further inland, 20 miles further inland, 50 miles further inland, 100 miles further inland, but down there where they can blame it on the water, they're going to blame it all on the water, do you think that's a good thing for the taxpayers?

Mr. RACICOT. Well, I don't agree that that's what happens. If it does happen, there are a number of different possibilities for—

Mr. TAYLOR. I want to make your industry aware, it's called the Fraudulent Claims Act, and it calls for treble damages in addition to a \$5,000 to \$10,000 fine per incident.

Please make the presidents of the associations that you represent aware of that, because it's coming.

Mr. RACICOT. There are already State-based statutes, Congressman, that are very, very strong in their application, criminal statutes, for deceitful practices, fraud, any kind of oppression or breach of a fiduciary duty that has to do with insurance contracts.

In this particular instance, there are going to be disputes about what the facts in an individual case might reveal to be either wind or water.

Even though the language is approved by the commissioner before those contracts were ever utilized, there are a number of different venues you can address that in.

One, of course, right off the bat, is with the commissioner's office. They have—

Ms. BROWN-WAITE. The gentleman's time has expired.

Mr. RACICOT.—regulatory control. The second thing you can do is with an arbitration or mediation process.

The third thing to do if you have to is to resort to litigation.

But remember—

Ms. BROWN-WAITE. The gentleman's time has expired.

Mr. RACICOT. Oh, I'm sorry. Excuse me.

Ms. BROWN-WAITE. The gentleman from Ohio, Mr. Ney.

Chairman NEY. Thank you.

Ms. BROWN-WAITE. You're recognized.

Chairman NEY. Thank you, Madam Chairwoman.

Mr. Csiszar—I'm sorry if I mispronounce—you were also going to say something else when your time ran out.

Would you like to comment?

Mr. CSISZAR. Thank you, Mr. Chairman.

I was referring to the fact that, as PCI, we recognize the value of State-based CAT funds, and where necessary, we support State-based CAT funds.

The second thing I was going to add was that we also support a Federal role.

We think that the most innocuous type of Federal role under these circumstances revolves around credit.

We think that a national program, an overall national program will always—and I saw this at the NAIC—you always run into the argument, "Well, why should Iowa support the millionaire in Florida?"

One way around that is to turn the program into a credit program so that in essence, a Federal credit becomes available when a State has a State-based CAT fund, and that credit then of course is repayable from that State.

So we support a liquidity approach, if you will, to the problem by providing liquidity from the Federal level to the State level to that State CAT fund.

Chairman NEY. Who would determine that Federal credit?

Mr. CSISZAR. That's something that would have to be worked out under a program with the Federal Government and the particular State, the particular State CAT fund.

Chairman NEY. We've heard about mitigation. I don't know if it was you or not that said that in certain cases mitigation could have saved \$3 billion, or was it \$3 million?

Mr. RUSSELL. That was me, sir. Research at LSU Institute—LSU is Louisiana State University, independent research of the insurance industry.

I don't know if you were in the room when I was testifying, but I am the Mayor of a city, the fastest-growing city in the State of Alabama, by the way, with some 17,000 homes under construction at this time.

Proper building codes are absolutely essential to all of us in mitigating loss in America, absolutely essential, and we all have to support that, in my opinion.

Yes, some people would be affected adversely if they could not afford that, and that's where we as elected officials, me being the

Mayor, need to step up to the plate and provide governmental remedies to help pay and subsidize individuals. That's testimony on my own, away from the insurance industry.

But proper mitigation would save us all billions of dollars in catastrophic loss.

Chairman NEY. Thank you.

I yield back the balance of my time.

Ms. BROWN-WAITE. Just for the record, we have a written statement that has been submitted by the National Multi-Housing Council, and I ask unanimous consent to have it entered into the record.

Without objection, it will be entered into the record.

There may be some additional members who have more questions for this panel that they may wish to submit in writing, and without objection, I would like the hearing record to remain open for 30 days for members to submit written questions for those witnesses and also for the witnesses to have time to submit their responses.

Without objection, this hearing is adjourned. Thank you for being here.

[Whereupon, at 4:38 p.m., the subcommittee was adjourned.]

# **A P P E N D I X**

June 28, 2006

**Statement of the Honorable Michael Oxley  
Chairman, Financial Services Committee  
Subcommittee on Housing and Community  
Opportunity Hearing  
“Is America’s Housing Market Prepared for the  
Next Natural Catastrophe?”**

**Wednesday, June 28, 2006**

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Thank you, Mr. Chairman, for holding this hearing and for your continued leadership on issues that are important to American homeowners. As the rain and flooding of the past few days have proven, this is a topic relevant to the entire country, and not just those coastal regions that are annually threatened by hurricanes.

Catastrophes can happen anywhere at any time. Many Americans would be surprised to learn that the epicenter of the strongest

earthquake that has ever struck the continental United States was right in the middle of the country - in Missouri – rather than in California.

Yesterday, by the overwhelming margin of 416-4, the House passed a comprehensive flood insurance reform bill sponsored by my friend and colleague Rep. Richard Baker of Louisiana. The Flood Insurance Reform and Modernization Act, or “FIRM” Act, goes a long way to shoring up the National Flood Insurance Program so that America’s homeowners will be protected from catastrophic flooding.

Today the committee meets to further discuss the challenges facing our nation’s insurance

markets in the wake of a series of natural catastrophes that have ravaged the Gulf Coast the past two years. I applaud my colleagues, especially Rep. Brown-Waite from Florida, for focusing the Committee on this important issue.

The Congress needs to get out in front of this issue. In the wake of last year's hurricane season, I sent a letter to GAO requesting a full report on the risk of natural catastrophic loss and potential government responses. I look forward to continuing to work with Members as this study progresses. In the meantime, today's hearing will provide a good forum to discuss the wide range of proposals currently being discussed.

Of course, the debate really boils down to this: what role can or should the federal government play? Insurance has traditionally been regulated at the state level, and the states have developed a variety of rate and form controls for their property and casualty markets. These state practices, particularly price controls, have contributed to inefficiencies in the marketplace by subsidizing certain areas and consumers. Any Congressional effort in this area must avoid exacerbating or contributing to these inefficient price subsidies.

Unlike terrorism, natural catastrophic losses are events that can be modeled for frequency and severity. This allows insurance companies, in a free market, to price according

to the risk. Congressional efforts should focus on maximizing the contributions and efficiency of the private market, including vital reinsurance capacity, to make sure that any federal relief is as remote as possible and that taxpayers are made whole over time. Some ideas that would encourage private capacity building, such as tax-free reserving, should be examined more closely. Providing insurers with more flexibility will inevitably be more efficient and effective than any federal program.

I'd like to thank our witnesses for joining us today to help shed some light on the state of the disaster insurance marketplace and the threat to American homeowners. I look forward to working with Chairman Ney to

help ensure that the next large-scale disaster to hit the United States does not catch us off guard.

**Opening Statement of the Honorable Bob Ney  
Chairman, Subcommittee on Housing and Community Opportunity**

**Hearing on**

**“Is America’s Housing Market Prepared for the Next Natural Catastrophe?”**

**Wednesday, June 28, 2006**

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This afternoon the Subcommittee on Housing and Community Opportunity meets to discuss the capacity of America’s housing market to withstand future catastrophes and the strain that natural disasters are having on homeowner insurance markets.

For the past decade, the rising toll from natural disasters placed a significant strain on homeowner insurance markets in parts of the country that frequently experience catastrophic events. In the aftermath of Hurricane Andrew in 1992 and the California Northridge earthquake in 1994, many insurers stopped underwriting policies in these areas entirely, leaving many families with very little protection against catastrophic losses. Insurers continue to be reluctant to enter coastal states that are at risk for severe earthquakes and hurricanes due to the increasing cost of paying for the damage that would be caused in a once-in-a-lifetime-event.

Many factors that underlie why the U.S. coastal areas may have increased risk are related to an above average cycle for large hurricanes as well as increased coastal development. Up until the 20<sup>th</sup> century, most of the U.S. coastline was sparsely populated and protected from storms by marshy wetlands and sandy barrier islands. But for almost 60 years, there has been a surge in coastal development that has put more than half of the U.S. population within 50 miles of the sea.

In the 105th and 106th Congresses, the Committee on Banking and Financial Services (now the Committee on Financial Services) held 4 hearings to address the issue of preparing the housing market for a natural disaster. In those hearings, Members discussed proposed legislation that would have created a Federal reinsurance program to protect insurance companies that would be unable to cover the costs of a large scale natural disaster.

Due to the frequency and severity of natural disasters, the federal government has taken a greater interest in seeking to relieve the strain placed on public and private insurance pools engaged in catastrophe risk management and financing. With a focused public debating whether to implement a comprehensive solution to the problem presented by the housing markets natural catastrophe exposure, the 109th Congress has several legislative proposals that address these issues. I’m certain today’s discussion will focus on several of these initiatives.

While there may be competing philosophical views regarding the nature and role of the Federal Government, all parties would agree that the problem of insurance availability in disaster-prone areas is real and is worthy of congressional attention. I hope today’s hearing will raise important questions regarding the ability of America’s housing market to withstand future natural catastrophes, especially in light of recent availability and affordability issues surrounding homeowner insurance.

U.S. Congresswoman

**Ginny Brown-Waite**

*Representing Citrus, Hernando, Lake, Levy,  
Marion, Pasco, Polk, and Sumter Counties*



**Subcommittee on Housing and Economic Opportunity  
“Is America’s Housing Market Prepared for the Next Natural  
Catastrophe?”  
June 28, 2006**

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Thank you Mr. Chairman for holding this hearing today.  
And thank you to the witnesses who are here.

We are holding this hearing to determine whether the housing market is prepared for a major natural catastrophe. And when we think of natural catastrophes, lately we think of hurricanes hitting Florida and other gulf coast states. But hurricanes aren't the only threat facing the United States.

In the last 2 centuries, 24 tsunamis have caused the U.S. harm.

In fact, there is a 10-14% chance that a tsunami comparable to that of South Asia will hit the American West Coast in the next 50 yrs.

Over 75 million Americans live in metro areas subject to moderate to high earthquake risk.

And researches are warning that a repeat of the 1906 San Francisco earthquake is very likely.

What I find more startling is that the insurance industry might not be prepared.

In California, only 14% of homeowners have earthquake coverage. And if a repeat of the 1906 earthquake did occur, it could cost up to \$500 billion in insured losses.

If the 1938 Long Island Express Hurricane hit today it would 10s of billions in dollars of insured losses.

Since policyholder surplus for all lines – not just homeowners – only stood at \$370 billion in 2004, I am gravely concerned that the industry does not have the capacity to withstand a great natural catastrophe.

Floridians learned all too well what happens when the industry isn't for a catastrophic natural disaster.

When Hurricane Andrew hit in 1992, 11 insurers became insolvent. This is the largest number of insolvencies at one time in U.S. history. Sixty-three insurance providers pulled out of the state for fear of excess losses, leaving homeowners with no coverage at all.

Many estimate that if Hurricane Andrew had hit a metropolitan area like downtown Miami, the amount of insured losses would have bankrupted the industry nationwide. Why does this Congress have to wait for a catastrophe to happen again before we act?

Florida learned some valuable lessons after Hurricane Andrew. We made some changes to hurricane preparedness that were radical at the time but that states are now emulating.

Florida enacted some of the strongest building codes in the nation and set up forward thinking mitigation plans. We established Citizens Insurance, to ensure that homeowners would never again be without coverage.

Most importantly, Florida established the State Catastrophe Fund, the first of its kind in the nation.

Florida's Cat Fund is a tax-exempt, low cost source of reinsurance to property insurers. The Cat Fund ensures that while reinsurance rates rise, a minimal, affordable amount will always be available to insurers in the state.

This safety net brought insurers back to Florida and helped them remain solvent – after the 2004 and 2005 season when 5 hurricanes ravished Florida, only one company became insolvent.

If this safety net worked for Florida, it is time we consider the same solution nationwide. I have introduced H.R. 4366, the *Homeowners' Insurance Protection Act*, which would create a national catastrophe fund similar to that of Florida.

To participate, states would have to establish state catastrophe funds to handle their own disasters – hurricanes, earthquakes, tornados, or anything else. States are also encouraged to establish building codes and mitigation plans to prepare for natural disasters.

Additionally, my bill specifically prohibits price gouging for products or services after a natural catastrophe. And H.R. 4366 directs GAO to report to Congress on the correlation between flooding and hurricanes, and how the NFIP could work with the HELP Fund.

Mr. Chairman, while my bill has been around for several years – long before this Committee ever discussed or considered TRIA – the fund it creates is a unique program.

My bill is categorically different from the federal flood insurance program and to compare the two is inane. The intent of my bill is to take the federal government out of providing insurance.

This bill guarantees that no longer will the federal government be the insurer of last resort. Under my bill, insured losses will be covered by the insurer only – not the taxpayer.

I want to be perfectly clear: I support the private insurance market. The intent of my bill is to enhance the private market, not take the place of it.

This Congress must start looking at natural disasters as a nationwide problem. Because when a state is unprepared, taxpayers all over the U.S. pick up the tab.

I do not imply that a federal catastrophe fund is the only solution to the crisis facing homeowners. But, a federal catastrophe fund should be part of the solution and one this Congress should consider immediately.

I look forward to hearing from the witnesses today to shed some light on this issue.

I thank you again Mr. Chairman for holding this hearing today.

**RAA**  
REINSURANCE  
ASSOCIATION  
OF AMERICA

STATEMENT

TESTIMONY

OF

DENNIS C. BURKE  
VICE PRESIDENT OF STATE RELATIONS  
REINSURANCE ASSOCIATION OF  
AMERICA

IS AMERICA'S HOUSING MARKET  
PREPARED FOR THE NEXT NATURAL  
CATASTROPHE

BEFORE

THE SUBCOMMITTEE ON HOUSING AND  
COMMUNITY OPPORTUNITY

JUNE 28, 2006

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

My name is Dennis Burke and I am Vice President of the Reinsurance Association of America (RAA). It is an honor to appear before you on behalf of the RAA. The RAA is a national trade association representing property and casualty organizations that specialize in reinsurance. The RAA membership is diverse, including large and small, broker and direct, U.S. companies and U.S. subsidiaries of foreign companies. Together, RAA members write nearly 2/3 of the gross reinsurance coverage provided by U.S. property and casualty reinsurers and affiliates.

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

As the Committee has called this hearing to address the question of "Is America's Housing Market Prepared for the Next Natural Catastrophe?" I am here to share with you the reinsurance perspective on this most important question. The Committee has also expressed an interest in receiving the RAA's comments on H.R. 4366, legislation that

will create a federal reinsurance program for natural disasters. To address both of these issues my testimony will focus on: 1) the 2006 reinsurance marketplace; 2) the RAA's general position on state and federal catastrophe funds; and 3) RAA's specific concerns with H.R. 4366.

#### The Property and Casualty Reinsurance Marketplace Today

An important component of ensuring the availability of homeowners' insurance is the reinsurance market and its capacity, the amount of reinsurance it is able to provide to primary companies with reinsurance protection. The U.S. attracts reinsurance capacity from all over the world and global reinsurers view U.S. catastrophe risk an essential component of their diverse assumed risk portfolios. The important role reinsurance plays in our nation's economy was demonstrated during the 2004 and 2005 hurricane seasons. As you are aware, in 2004 there were four major hurricanes that hit Florida resulting in \$30 billion of damage. The global reinsurance industry paid approximately one-third of those losses, enabling insurance companies who purchased reinsurance to honor their obligations to their homeowner policyholders. Despite this huge financial hit to reinsurers, there were no reinsurer insolvencies and the reinsurance market was able to meet the primary insurance community demand for the 2005 hurricane season.

The hurricane season of 2005 turned out to be a year of unprecedented losses in terms of frequency and severity. The insurance/reinsurance industry weathered the single largest loss in the industry's history (Katrina). Insured Katrina losses were an estimated \$45 billion, even greater than the projected \$35 billion in 9/11 losses. The 27 named hurricanes and tropical storms in 2005 set a new record, an aggregate total of \$80 billion in insured losses. The Big Three: Katrina, Rita and Wilma produced losses estimated to be as high as \$60 billion. The reinsurance industry once again played a critical role,

providing stability to the insurance market, by paying approximately one-half of all of these losses. Even with these unprecedented losses there were no resulting reinsurer insolvencies.

It has been said that the 2005 hurricane season was an “earnings event” for insurers, rather than a “capital event.” The effect of the hurricane losses on the primary industry was mitigated by two major factors: the global reinsurance market paid for 50% of these losses; and the insurance industry was experiencing an excellent year financially. Even after the storms, the primary industry profit was \$45 billion for 2005. Thus the effect of these two factors is that the storms impacted earnings but did not reduce industry surplus.

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

First, remember the primary insurance industry made a profit in 2005.

Second, let us look at the capital markets, response in late 2005 and 2006. As they did in 1993 after Hurricane Andrew and 2001 after the terrorism losses of 9/11, the capital markets promptly provided new reinsurance capital and capacity in response to the 2005 hurricanes. Since late fall 2005, approximately \$21 billion in new capital has been raised. Of that capital, \$7.5 billion was invested in new start up reinsurance companies; the remainder replenished the capital positions of existing reinsurers. In addition to that new capacity, an additional \$3 billion was invested in special purpose vehicles, whose investors, such as hedge funds, collaborate to provide extra underwriting capacity to existing reinsurers for property and catastrophe retrocessions and other short

tail lines of business. Thus \$24 billion in new capital has been raised in the reinsurance industry since Hurricane Katrina on August 29, 2005. An additional \$4 to \$6 billion (estimated) was invested in new and existing catastrophe bonds.

So what does that mean for actual reinsurance capacity to provide natural disaster protection for primary insurance companies for 2006? Despite the unprecedented losses in 2004 and 2005, private market reinsurance capacity increased in 2006. The private reinsurance market is financially strong and diverse. Reinsurance capacity continues to be adequate in most markets.

However, in 2006 demand increased in some peak zones at a greater rate than the supply increase due to: rating agencies requiring more capital; reinsurance modelers increasing loss predictions; and insurance company managements' desire to purchase more protection. Rating agencies determined that companies with catastrophe exposures needed additional capital to support their ratings. Insurance catastrophe modelers revised their models due to new data and a belief that we are entering into an era of increased hurricane frequency and severity. Insurance company managements also have reacted due to a changed perception of risk. Such managers have seen the impact of increased hurricane frequency and severity on their losses and want to purchase more reinsurance protection. At the same time as demand is increasing, reinsurers are reevaluating (known as re-underwriting in the industry) the losses that their ceding insurers could suffer. The confluence of these events has resulted in reinsurance prices increasing.

The RAA believes this imbalance will be temporary, however. As the events after Hurricane Andrew suggest, typical insurance and reinsurance cycles involve temporary spikes in pricing, followed by new market participants, leading to increased competition and price moderation. Ultimately, free markets will create a more diversified

insurance and reinsurance market that will spread risk widely, increasing capacity and price competition.

#### RAA's Position on State and Federal Catastrophe Funds

At the core of H.R. 4366 is the creation of state and federal catastrophe funds to provide reinsurance. In H.R. 4366, the U.S. Treasury would sell reinsurance to state catastrophe funds. The state catastrophe funds would then sell reinsurance to insurance companies. The stated intent is that this would result in insurance companies providing more homeowners with insurance in high-risk areas. The RAA believes that there are many flaws with state catastrophe funds. There is no evidence that they result in the availability of more homeowners' insurance. The creation of both a state and federal reinsurance fund would displace the private reinsurance market. Since H.R. 4366 aims to create more state catastrophe funds we wanted to focus the Committee's attention on many of the flaws associated with state catastrophe funds.

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

Only Florida has a catastrophe reinsurance fund that meets the standard of the bill, and the Florida Hurricane Catastrophe Fund does not rely solely on its premiums to pay its hurricane losses. The Florida Catastrophe Fund is also broke and in debt. The model of the Florida Catastrophe Fund is one that offers insurers inexpensive reinsurance premiums up front, because it is back loaded - on the backs of the taxpayers, as the current situation demonstrates. When a hurricane occurs which requires the Florida

Catastrophe Fund to pay losses in excess of its cash balance, the Catastrophe Fund issues bonds. The bond debt is not paid by the insurance companies who received the cheap reinsurance. Instead, it is paid by assessing/taxing (the terms are interchangeable) Florida policyholders of other lines of insurance, such as automobile insurance and commercial insurance. So, the effect is that insurers have offloaded a substantial part of their property risk to a government catastrophe fund, and that government is then forced to tax its citizens to make up for the revenue shortfall caused by the low catastrophe fund reinsurance premiums. Real world experience tells us that when government markets like the Florida Catastrophe Fund under-price the market, business will flow to them. That is what happens over time with a government catastrophe fund - it will continue to displace the private reinsurance market and taxpayers will continue to make up the difference.

State catastrophe funds also violate one of the fundamental tenets of insurance- spreading the risk. Private reinsurance spreads the risk globally and the cost of the reinsurance is paid up front. Of the losses caused by Hurricanes Katrina, Rita and Wilma, reinsurers paid approximately 60%, with global reinsurers paying over three-quarters of that amount. A state catastrophe fund concentrates risk in one jurisdiction and shifts the financial risk of catastrophe losses from the private sector insurers to insurance buyers and taxpayers.

It is important that Congress recognize that state funds like the Florida Hurricane Catastrophe Fund are a "pay me later" approach- there is no free lunch- someone will pay for the losses. Private reinsurance is a "pay me now" approach with insurance companies paying reinsurance companies an appropriate risk premium up front. The "pay me later" approach of state catastrophe funds costs homeowners, not insurers, since policyholders are obligated to pay any shortfalls in the state catastrophe fund claims paying ability.

State catastrophe funds also create unfair cross subsidies. First, coastal and earthquake prone properties are subsidized by property policyholders that cannot afford or choose not to live in such hazard zones. In addition to property policyholder subsidies, the catastrophe funds rely on cross-subsidies to pay for hurricane risk rather than relying on current affected property policyholders paying those costs. For instance in Florida, Floridians with cars, small businesses, school districts, day care centers, renters, professionals, and business owners – anyone with a property and casualty insurance policy (other than medical malpractice and workers' compensation) - will pay off the billions of dollars in bonds authorized for the Florida Hurricane Catastrophe Fund shortfalls. These policyholders, even those far from the coast, will pay annual assessments needed to pay off the hurricane bonds that will benefit the coastal property owners.

These are just some of our observations regarding state catastrophe funds. We urge Members of the Committee to take a serious look at the inherent problems with state catastrophe funds and whether they would actually create an improved homeowners' insurance market. We strongly suggest that such funds do not.

**RAA's Concerns with H.R. 4366**

Over the last 15 years, the RAA has worked with Members of Congress and their staffs on many different legislative proposals to create federal reinsurance programs. We believe that natural catastrophe risk is insurable in a free market. We do not believe the creation of a federal reinsurance program solves the homeowners' insurance availability problem. It ignores the many constraints that are occurring now in the private market. We believe public policymakers should make it their top priority to remove regulatory constraints from the private insurance market's ability to willingly insure risk. By

removing regulatory constraints policymakers will maximize private sector risk bearing. These regulatory constraints include: price controls, coverage mandates, and involuntary residual market facilities and associated assessments. If policymakers follow competitive, free market principles, a federal natural disaster reinsurance fund is unnecessary.

The RAA offers the following concerns with H.R. 4366:

1. The trigger levels for the federal reinsurance program are too low and will interfere with the private marketplace. The legislation provides for the sale of federal reinsurance to a state reinsurance fund at a level as low as \$25 billion, a relatively low attachment point. These are levels of losses where the private reinsurance marketplace is currently providing capacity. If such a program had been in place last year with such low trigger levels, rather than the private insurance and reinsurance markets paying for the insured losses associated with Katrina, Rita and Wilma, the federal government through its reinsurance fund would have paid for these losses. In past Congresses proposed trigger levels for federal involvement have been set at a 1 in 250 year event.
2. There is no assurance that a federal reinsurance program will result in more availability of homeowners' insurance. Unlike the Terrorism Risk Insurance Act where the quid pro quo for the federal reinsurance is that insurers must offer terrorism insurance on the same terms and conditions as they offer other lines, there is no requirement that insurers who benefit from the federal reinsurance offer more homeowners' insurance. The intent of the legislation is significantly undermined without such a requirement.

3. The federal reinsurance will be under priced because the legislation does not include language that requires the federal government to add a risk load reflecting the true cost of capital when pricing the reinsurance. In the private reinsurance market a catastrophic risk load is required on all pricing, thus there is no way the private reinsurance market can compete with the federal government. This puts taxpayers at a significant risk and further displaces the private reinsurance market.
4. H.R. 4366 strips many of the private sector protections contained in previous bills. In past Congresses, Members of Congress were very concerned that the federal program would compete with the private sector. Thus, various amendments were included that prevented the federal government from competing with the private market. For example, previous bills provided for a “private sector right to compete.” This provision provided the private sector an opportunity to step in the shoes of the federal government and sell the reinsurance. The absence of these protections only exacerbates the problems with H.R. 4366.
5. Many supporters of H.R. 4366 suggest that the federal program is necessary because reinsurance prices are too high. The RAA believes that a free market should be allowed to work and that it is totally inappropriate to create a federal program simply because of the concepts of supply and demand playing out in the free market. As we learned following Hurricane Andrew in 1992, markets need time to adjust but they are resilient and the supply/demand equation will come back into balance.
6. A federal fund that sells reinsurance to state catastrophe funds concentrates all of the risk associated with natural disasters in the government. A private market diversifies this risk, spreading it globally. A classic example of the importance of

a diversified insurance/reinsurance market occurred in 2005. In 2005, of the total reported losses, U.S. insurers paid (all approximate) 41%. The other payers and their percentage of losses paid were: U.S. reinsurers 11%, Bermuda reinsurers 24%, European reinsurers 13%, Lloyds 9%, and all others 1%. If H.R. 4366 were to become law, most of this risk would no longer be spread across the global insurance/reinsurance market; instead it would be concentrated in the State and Federal governments.

### **Conclusion**

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

**TESTIMONY OF ERNST CSISZAR  
ON BEHALF OF  
THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA  
BEFORE THE  
HOUSE FINANCIAL SERVICES COMMITTEE  
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY  
CONCERNING  
“IS AMERICA’S HOUSING MARKET PREPARED FOR THE NEXT  
NATURAL CATASTROPHE”**

**JUNE 28, 2006**

My name is Ernie Csiszar and I am President and CEO of the Property Casualty Insurers Association of America (PCI). PCI is a trade association representing over 1,000 property/casualty insurers that write 40 percent of the homeowners insurance sold in the United States. Thank you for the opportunity to appear before you today and to present information regarding natural catastrophes, the impact of these disasters on homeowners insurance and housing markets, and what can be done to address future major natural disasters.

**Introduction**

The Committee has requested comments on a number of important questions, including the role PCI and its members play in supporting housing markets in the United States; whether there’s enough insurance capacity to cover homeowners in the event of a major natural disaster; if the private market has been tested sufficiently to give lawmakers an adequate indication that the market is prepared; what lawmakers can do to ensure that the private market is ready to handle a major disaster; models that have worked well for states or foreign governments that should be considered; whether we anticipate that either rising insurance rates or a lack of availability will adversely impact the housing market; whether natural catastrophes in one area of our nation affect the rates of homeowners in other areas; the long-term budgetary implications of disaster recovery expenses incurred by the federal government; steps that need to be taken to expand private-sector capacity for insuring disaster losses; and the impact of decisions by individual insurers to reduce or eliminate coastal exposures on consumers’ ability to purchase adequate protection and on insurance markets in general?

PCI believes that developing effective public policy solutions regarding natural catastrophes is one of the most significant issues facing the nation and the insurance industry today. Experts agree that America faces the prospect of more frequent and severe natural disasters in the coming decade. Moreover, significant development, population growth, and rapidly rising real estate prices in areas prone to natural disasters exacerbate the potential for larger human and economic losses, requiring stronger loss prevention and mitigation and greater financial resources for recovery.

**Comments on the Catastrophe Problem**

PCI members play a pivotal role in supporting housing markets by providing the products and services needed to protect homeowners, lenders, businesses, and communities against exposure to natural catastrophes. Without a healthy private homeowners insurance market, it is impossible to imagine the robust housing market America enjoys today.

Over the past two years, homeowners insurance markets have been tested as never before. Catastrophe losses in 2005 totaled some \$57 billion, nearly doubling the previous record losses in 2001. Hurricane Katrina itself caused \$40 billion, in insured losses, surpassing the \$32 billion from 9/11.

The vast majority of claims from last year's storms have been paid and there is no doubt that the market has the financial capacity to meet its obligations. But the question of whether last year's claims will be paid in full (they will) is not the most important issue in our view. The better question is whether the market has, or is building, the capacity to pay exposures the nation will face in the future.

Given the very serious catastrophe losses we've seen over the past several years and the significance of this issue for our membership, our organization has devoted considerable time and effort to study the problems associated with natural disasters. Over the past nine months, we have had a special task force of our Board of Governors considering the catastrophe problem and have developed a policy framework to guide our thinking.

We can't answer definitively the specific question of whether there is enough capacity to address a "major natural disaster". There are too many possible events that can happen – indeed, that have happened in our history. We can tell you that experts believe that there are catastrophe exposures facing us that may be beyond the capacity of the capital currently available.

There are several fundamental issues that have to be addressed:

1. First, America clearly faces the prospect of increased frequency and severity of major hurricanes and the continuing threat of other major natural catastrophes including earthquakes, floods, tsunamis, and volcanic eruptions. Hurricane forecasters have predicted another very busy storm season this year and catastrophe modelers are telling insurers they are in a prolonged period of increased severe storm activity. Seven of the ten most costly natural disasters in U.S. history have occurred since 2004. We can't afford to ignore this reality.
2. Second, America is experiencing significant development, population growth, and rapidly rising real estate prices in areas that are highly prone to natural disasters. Even if storms were no more frequent or severe in the past, this pattern would mean that future storms would be more damaging and more costly to insure. As a result, the nation faces growing exposure to significant catastrophe losses and increasing costs of recovery.

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

4. As insurers, we would like to rely on private markets alone to solve this problem with prices set according to the risks assumed. We think that such a system would go a long way toward establishing the incentives needed. At the same time, we have to recognize that our segment of the industry does not operate in an unregulated market. Our members work in a world where prices and coverages are highly regulated and generally are not allowed to respond freely to changing risks or conditions. This is the opposite of the structure in which world catastrophe reinsurance markets operate. Our members have faced restraints on their ability to pass along the real cost of the reinsurance they use, which ignores the economic reality imposed on them by the reinsurance market. In other cases, catastrophe reinsurance has simply been unavailable for the risks our members face.

In addition, since Hurricane Katrina we have seen politically-motivated litigation by a state attorney general seeking to require coverage where none exists. This is an assault on the sanctity of contract, a principle so fundamental that it is enshrined in our Constitution. These restrictions and legal challenges impair the ability of markets to respond, prevent markets from providing accurate risk signals, and discourage new capital from entering these markets.

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

In summary, while insurance capacity to cover catastrophe exposures is growing and the market has generally done well in protecting against these losses, we believe there are exposures that may, in the right circumstances, overwhelm the existing system. I am not here to tell you that we face a crisis in homeowners markets today. But I do want you to know that we face, and should prepare for, catastrophe losses far larger than before for which a range of policy solutions should be considered.

#### **Policy Options to Consider**

I would suggest four major areas for consideration.

##### *Reduce Exposure to Catastrophe Losses*

First, we need to do more to control and reduce catastrophe exposure. I would suggest the following:

- State and local governments should urgently and immediately review their building codes in catastrophe-prone areas. Wherever needed, they should upgrade their codes. Stronger building codes protect lives and significantly reduce property damage and repair costs. In a highly competitive insurance market, those savings will be passed directly back to consumers. Some have argued that it costs too much to rebuild to meet modern building code standards. Louisiana State University's Hurricane Center has estimated that the marginal cost of building a structure to meet the wind-borne debris requirements in the International Residential Code is between 1.5 and 4.5 percent of additional cost. On a single-family home with a \$100,000 mortgage, that works out to about \$27 extra dollars per month. We think such investments are vital.
- A second idea is the establishment by the federal government of incentives for greater investment in loss prevention and mitigation. Let me offer several ideas: (1) the insurance industry's Building Code Coalition has recommended that enhanced disaster mitigation grants under the Stafford Act be provided for states that adopt stronger state-wide building codes; (2) Rep. Tom Feeney (R-FL) has proposed legislation (H.R. 4836) to create a special catastrophe savings account for purposes of allowing homeowners to build up, tax-free, funds for payment of qualified catastrophe expenses. We have not yet studied Rep. Feeney's proposal in detail and have not established a position on the bill, but we need this type of creative thinking; (3) the federal government could consider whether to grant special tax credits for qualifying expenditures by homeowners to retrofit their homes to better protect against disasters. An investment in this protection now could save many dollars later in disaster assistance and other government programs.
- We believe state and local governments must take seriously the need to restrict development in catastrophe-prone areas. Professor Roger Pielke, Jr. of the University of Colorado at Boulder is on point when he says, "More storms like Katrina are inevitable. And the effects of future Katrinas and Ritas will be determined... by the decisions we make now about where and how to build and rebuild in vulnerable locations."<sup>1</sup> This is not only an issue for single family homes. Ongoing condominium and commercial development on our nation's barrier islands or the wetland marsh areas threaten the same risks.
- We believe greater steps can be taken for preparedness. As a first step, PCI has recently completed development of a new PCI Regulators' Kit-Recommendations for Disaster Preparation and Response. We will begin sharing this kit in coming weeks with insurance regulators in the most catastrophe-prone states. This kit contains model regulations covering five critical areas, including: establishing an Insurance Emergency Operations Center; disaster claim reporting requirements; cancellation and non-renewal of insurance under disaster

<sup>1</sup> "Managing the Next Disaster," Roger A. Pielke and Daniel Sarewitz, The Los Angeles Times, September 23, 2005.

conditions; suspension of premium payments under disaster conditions; and mediation of disputed claims. These regulations are modeled on those developed in Louisiana last year and, if adopted, could improve the necessary coordination and communication after a catastrophe.

*Fix the Flood Program*

Second, we believe Congress should complete its efforts to reform the National Flood Insurance Program (NFIP). The NFIP is a necessary policy response to an uninsurable peril and must be continued. However, the program needs numerous reforms, the majority of which are contained in the reform bills pending in both the House and the Senate. As currently structured, the NFIP does little to discourage development in high risk areas, does not provide the level of protection needed by consumers and has not achieved the breadth of participation needed. PCI encourages your swift consideration and passage of the pending NFIP reform legislation.

*Expand Private Sector Capacity*

Third, as several of your questions anticipate, a key part of the solution to natural catastrophe exposure is to expand private sector capacity to handle the risk. As I noted earlier, we strongly support this direction and any efforts to tie prices more closely to the underlying risks insured. But homeowners insurance markets are heavily regulated in all aspects of their operations. We face significant regulatory constraints, particularly in rating, but also in other areas, that inhibit effective market responses and discourage capital from entering these markets. There are several things lawmakers can do to address this problem:

- First, policymakers should give insurance markets greater freedom to respond to the exposures we face. In free markets, prices and terms of coverage tell consumers the true cost of insuring against catastrophes and the most efficient means of funding exposures. Regulators often fear that giving up regulatory control will make the problem worse and invite consumer backlash. Based on my experience as the insurance commissioner for South Carolina, where I helped slash regulation in the market for car insurance, I can tell you the results were just the opposite. Free markets encourage new capital to enter where insurance protection is needed and develop more capacity, not less. PCI will support state legislative initiatives intended to remove regulatory barriers to free markets for catastrophe insurance and will oppose enactment of new barriers. We will be working with our partners in the states to develop specific proposals that can be enacted in key state legislatures next year. At the federal level, we would encourage you also to consider measures you can take to encourage greater market freedom, such as enactment of the SMART Act.
- We will also continue to point out, wherever we can, the extremely damaging effects on free markets and capital allocation of politically-motivated litigation, such as that initiated after Hurricane Katrina by Mississippi's attorney general.

This type of litigation does great harm to the principle of sanctity of contract and can only discourage new sources of capital from entering the state.

We would also encourage your review of two additional possible market responses:

- First we are continuing to examine the potential benefits of establishing voluntary, tax-deferred catastrophe reserves. Legislation previously introduced by Rep. Mark Foley (HR 2668) would create the opportunity for this tool to be used and it deserves your consideration.
- Second, we will be examining specific steps that might be taken to remove regulatory, legal, accounting, or tax barriers to further growth in the catastrophe bond market. This market provides another outlet for catastrophe risk financing and introduces new sources of capital and competition. While we don't believe the cat bond market will ever displace traditional reinsurance, market participants tell us that bringing more of these deals "onshore" in the U.S. and reducing a variety of regulatory barriers would permit the market to grow.

#### *State and Federal Government Involvement*

Finally, you've asked about regulatory models that might be examined. I'd like to offer several comments:

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

When we consider a cat fund for a state, we'll be looking particularly to see: (1) whether private markets have freedom to respond to market conditions; (2) whether care has been taken to prevent a catastrophe fund from damaging private markets or preventing new capital from entering the market; and (3) that their funding doesn't rely on cross-subsidies across lines of business. By their nature, cross-subsidies damage the ability of markets to provide strong price signals and incentives for behavior. Having said that, we believe there may be cases and states where a catastrophe fund can be part of a well-rounded solution and must be considered. We believe they can be structured to avoid crowding out private market capacity while still offering benefits to consumers in some cases.

- Second, we would also suggest that there may be some mega-catastrophe exposures that are beyond the capability of the private market and even of an

individual state catastrophe fund to address. In these instances, it may be necessary for the federal government to offer liquidity protection to state catastrophe funds at a very high level, consistent with the maintenance of stable markets and avoidance of widespread insurer insolvency. Federal involvement may be essential if the nation suffers repeated mega-events within a short time period. Lest anyone think such a scenario is far-fetched, I would remind you of how close Hurricane Rita came to hitting Houston last year, only a few short weeks after Katrina devastated New Orleans and the Mississippi coast. It is not inconceivable that several of our major cities could be struck by Category 4 or 5 storms within a single season, or that a major earthquake could strike in the same year.

There are many ideas for how a federal role could be structured, but we would suggest that one idea worth considering is whether a federal catastrophe financing facility could offer credit financing to state catastrophe funds, intended to provide access to liquidity to meet immediate claim requirements in the event of a mega-catastrophe or a series of very large events. A key advantage of this approach (but not the only advantage) would be to offer the benefits of better timing risk management, while limiting the offer to state catastrophe funds and thus helping to minimize any potential disruption in private markets.

We are very mindful of the need to be extremely careful in structuring any federal role and of the overriding need to attract new private capital to the market. Accordingly, we also believe that any federal financing role must also include measures intended to promote freedom for markets to respond to these exposures, including meaningful limitations on the ability of participating states to control or suppress rates or to maintain other unnecessary restrictions on markets. The point of tying standards for market freedoms to the creation of a federal financing facility is to provide incentives for the states themselves to do everything they can to attract private capital before asking for federal assistance. In addition, we believe any federal credit should be specified in advance, as private sector lines of credit are, in order to prevent political pressure from influencing what should be a market-based credit agreement. We would have the same concern about the need for a federal program to avoid cross-subsidies and other negative design elements as we have for state programs.

My main point, however, is to tell you that we think there may be a role, properly structured, for the federal government to play in assisting the financing of mega-catastrophe risk and we believe it should be given further review by Congress. We do not agree with those who would uniformly reject any such role out of hand.

### **Conclusion**

Again, let me thank you on behalf of PCI and our members for the opportunity to appear before you today, respond to your questions, and provide you with our input on possible solutions to the catastrophe problem. We believe this is one of the most serious public

policy issues facing our nation and is deserving of your time and thoughtful attention. I look forward to working with you in the future on this very important issue.

Summary Report to the U.S. House of Representatives  
Sub-Committee on Housing and Community Opportunity  
(to be given on 28 June 2006 at 2:00 PM)

***CLIMATE INFLUENCES ON U.S. LANDFALLING HURRICANES AND  
RECOMMENDATIONS FOR THE INSURANCE INDUSTRY***

by

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Mr. Chairman and Members of the Committee, I am William M. Gray, a Professor Emeritus of Atmospheric Science at Colorado State University in Fort Collins, Colorado. I have been studying, teaching, and forecasting weather and climate for over 50 years (see my attached Vitae). My specialty has been tropical meteorology and tropical cyclones. I have made Atlantic basin seasonal hurricane forecasts for the last 23 years. I am pleased to present information to your sub-committee on the outlook for future US hurricane landfall frequency, economic loss, and insurance questions.

***1. SUMMARY DISCUSSION***

Trends in global oceanic and atmospheric observations during recent years indicate that we are in a multi-decadal period (since 1995) of increased Atlantic basin major hurricane activity. The latter include hurricanes of Saffir/Simpson intensity classes 3, 4, and 5 (or hurricanes with maximum sustained winds greater than 110 mph). Major hurricanes, when normalized by coastal population, wealth per capita, and inflation over the last century typically cause about 80-85 percent of the total US tropical cyclone destruction even though they only account for about one-fourth of the total number of named tropical cyclones (Pielke and Landsea, 1999). We are presently in a period of enhanced Atlantic basin major hurricane activity that is typical of what was experienced in the 1940s and 1950s when US coastal population and coastal property values were much lower than today. We were very fortunate during the very active 9 year period from 1995-2003. Of the 32 Atlantic basin major hurricanes, only 3 made US landfall (or less than 1 in 10). The long term average of US major hurricane landfall to total Atlantic basin major hurricanes is about one in three.

Most southeast coastal residents probably do not know how fortunate they have been in the prior 38-year period (1966-2003) leading up to 2004-2005. Only 17 major hurricanes (0.45/year) crossed the US coastline. In the prior 40-year period of 1926-1965, 36 major hurricanes (0.90/year or twice as many) made US

landfall. It is understandable that current coastal residents were not prepared for the great upsurge in US landfalling major hurricanes in 2004-2005.

The recent US landfall of major hurricanes Dennis, Katrina, Rita and Wilma in 2005 and the four Florida landfalling hurricanes of 2004 (Charley, Frances, Ivan and Jeanne) has raised questions about the possible role that global warming and increased human induced greenhouse gas outputs may be playing in these two unusually destructive seasons.

The global warming arguments have recently received much attention in the media and by innumerable blog citations. The recent published papers claiming to show such a linkage (Emanuel 2005; Webster et al. 2005) have been cited frequently over the last 9 months. These papers should not be accepted. The observations that a number of my hurricane forecaster-research colleagues and I, have been gathering over many years, however, do not observationally or theoretically support the contention that hurricane activity globally or in the Atlantic has undergone anything but natural variability. The above papers have been discredited by many of us in the tropical cyclone research community. Despite the global warming of the sea surface of about 0.3°C that has taken place over the last 3 decades, the global number of hurricanes and their intensity has not shown increases in recent years (Klotzbach 2006). The recent increase in Atlantic major hurricane activity reflect the natural multi-decadal alteration of the Atlantic Ocean thermohaline circulation (THC) which is not directly related to global temperature increase. Changes in ocean salinity are believed to be the driving mechanism for these Atlantic basin multi-decadal changes which have been termed the Atlantic Multi-Decadal Oscillation (AMO). The Atlantic has seen a very large increase in major hurricanes during the last 11 years (1995-2005), an average of 4.1 major hurricanes have occurred per year in comparison to the prior 25-year period (1970-1994) where an average of 1.5 major hurricanes per year occurred.

There have been similar periods in the past (1940s-1950s) when the Atlantic was just as active as in recent years. For instance, when we compare Atlantic basin major hurricanes of the last 11 years (45) with an earlier 11-year period of 1948-1958 (44) we see virtually no difference. If we compare the number of Atlantic basin major hurricanes during the last 20 years (1986-2005) with the 20 year period of 1950-1969, we find the earlier period had 11 more major hurricanes (67 vs. 56) in the Atlantic basin (Table 1). This active earlier period occurred despite the global mean sea-surface temperature (SSTAs) being cooler than the later period. Also, the technology available in the earlier period was less able to document cyclone intensity as well as recent-year observations. It is also likely that hurricane intensity in the earlier period (when the global SSTs were cooler) was, due to limited technology, somewhat under-estimated in comparison to the recent periods.

Table 1. Comparison of numbers of Atlantic basin major (Cat 3-4-5) hurricanes during two recent 11-and 20-year periods to major hurricane numbers in two earlier periods of similar length. Technology changes may have led to reports of higher numbers in the more recent periods.

1948-1958 <i>(11 years)</i> <b>44</b>	1995-2005 <i>(11 years)</i> <b>45</b>
1950-1969 <i>(20 years)</i> <b>67</b>	1986-2005 <i>(20 years)</i> <b>56</b>

## **2. MULTI-DECADAL VARIABILITY OF ATLANTIC BASIN MAJOR HURRICANE ACTIVITY**

A surprising feature of Atlantic basin hurricane activity is the 20-30 year up-and-down variability in the frequency of major (Cat 3-4-5) hurricanes. Figure 1 illustrates these large swings. During the quarter-century periods of 1900-1925 and 1970-1994 there were only about one-third as many 6-hour periods per year of major hurricane activity as there were in the two periods of 1926-1969 and 1995-2005. We attribute these decadal period differences to the amount of North Atlantic Ocean water which sinks to deep levels off eastern Greenland and western Norway as illustrated in Figure 2. There are multi-decadal periods when there are enhanced amounts of North Atlantic Ocean subsidence (or deep-water formation) in which major hurricane activity is usually 2-3 times greater than when this North Atlantic subsidence (or strength of Thermohaline Circulation) is weaker than average. Figure 3 shows how this North Atlantic circulation can swing back and forth on time scales of 20-30 years. Figure 4 illustrates the large variability in major hurricane activity which occurred when the Thermohaline Circulation (THC) was stronger than average during 1950-1969 vs. when it was weaker than average during 1970-1994.

The combination of the weaker strength of THC and fortunate tracking of major hurricanes has led to a surprising multi-decadal variability to Peninsula Florida's landfalling hurricane activity. Note that Peninsula Florida went 38 years between 1966-2003 with only one major hurricane landfall event (Andrew 1992). Yet in the prior 33 year period (1933-1965) and the following two year period (2004-2005) –a total of 35 years, there were 14 major landfall events (Figure 5). It is no wonder that Florida residents were not mentally prepared for such a sudden onslaught of major hurricanes in 2004-2005.

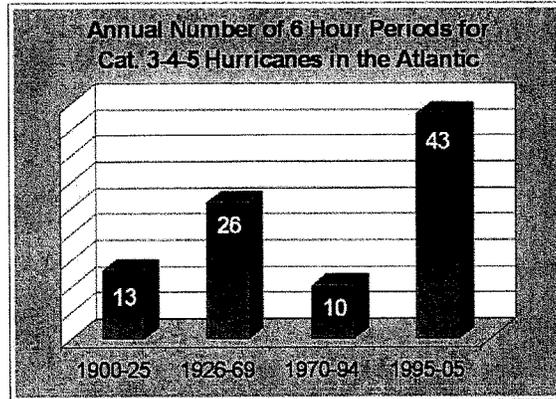


Figure 1. Multi-decadal comparison of number of Atlantic basin annual 6-hour reports of major (Cat 3-4-5) hurricane activity. The two earlier periods may be somewhat of an underestimate.

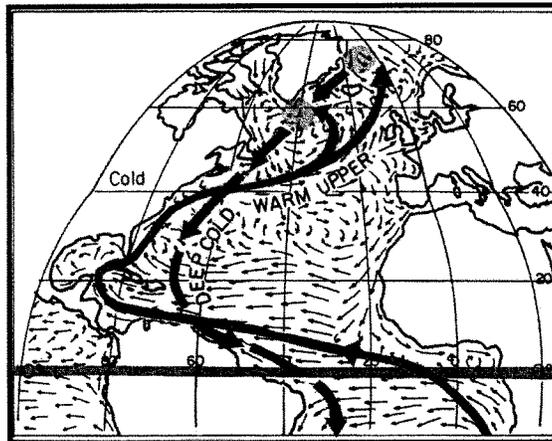


Figure 2. Idealized Atlantic Ocean circulation showing the upper ocean gulf stream (red) and the deep Atlantic return flow. Green circles portray typical area of upper to lower level ocean sinking.

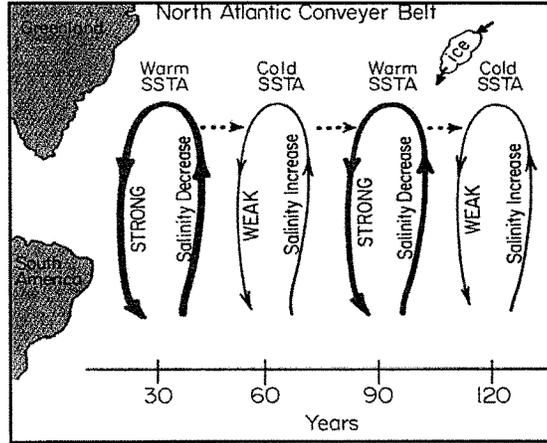


Figure 3. Idealized portrayal of how the Atlantic Thermohaline Circulation (THC) varies from strong to weak and back to strong again on multi-decadal periods due to salinity variations.

### TRACKS OF CATEGORY 3-4-5 HURRICANES

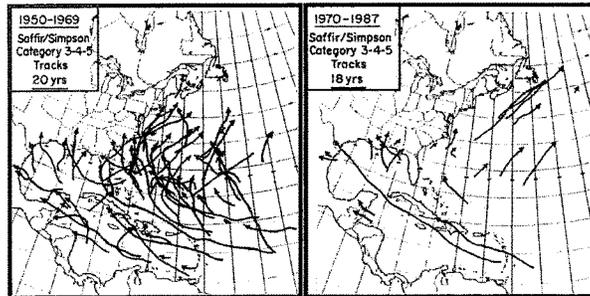


Figure 4. Illustrations of how different were the number of tracks of major hurricanes during the 20-year period of 1950-1969 when the Atlantic Ocean Thermohaline Circulation was strong (left) as compared to an 18-year period of 1970-1987 when the THC was weak (right).

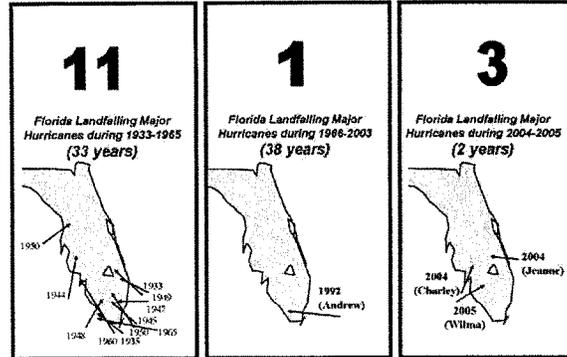
**FLORIDA LANDFALLING MAJOR HURRICANES**

Figure 5. Portrayal of number of landfalling major hurricanes in Peninsula Florida by various periods. Note how fortunate Florida was during the 38-year period of 1966-2003.

There are no direct measurements of the strength of THC. It must be inferred from proxy measurements which are related to its strength. We infer the strength of the THC from a combination of North Atlantic sea surface temperature anomaly (SSTA) in the area between 50°N-60°N; 10°W-60°W minus the mean Atlantic sea surface pressure anomaly (SLPA) in the broad North Atlantic area of 0-50°N; 10°W-70°W. Figure 6 portrays these areas. Figure 7 is a graph of the yearly combination of these two parameters (SSTA minus SLPA) for the 55 year period of 1950-2005. Note the higher than average values of this parameter between 1950-1967 and 1995-2005. Table 2 gives the average number of Atlantic basin major hurricanes during the two periods of high THC and the period of 1968-1994 when the THC was calculated to be weak. Note that the proxy derived strong vs. weak strength of the THC (given by SSTA minus SLPA) is related to an overall annual variation of Atlantic basin major hurricane activity of 2.32 and of major US East Coast landfall variation of 2.48.

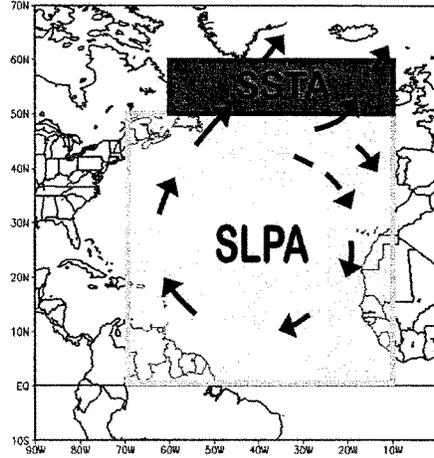


Figure 6. Area of parameters used as a proxy for the strength of the THC. Sea surface temperature anomaly (SSTA in red) and sea level pressure anomaly (SLPA in green).

#### PROXY TO ATLANTIC THERMOHALINE CIRCULATION OR AMO

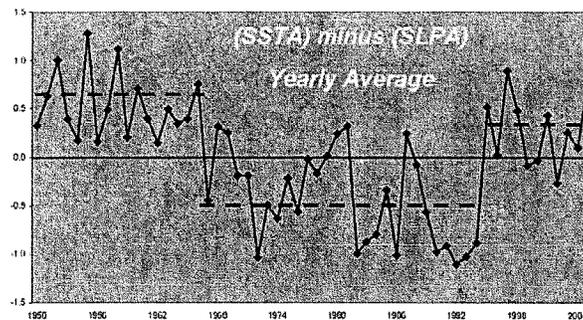


Figure 7. Graph of annual values of SSTA minus SLPA during the last 55 years. Above average values occur when the THC is stronger than average as in 1950-1967 and 1995-2005. During 1968-1994 below average values occur when the THC was judged to be weaker than average.

Table 2. Comparison of Atlantic basin major hurricane activity during the two periods when the THC was judged to be strong and in the period between when it was judged to be weak.

Period	THC Strength	Atlantic basin annual average of major hurricanes	US annual average of major hurricane landfall	US East Coast landfall
1950-1967 <i>18 years</i>	<b>Strong</b>	3.44	0.89	.67
1968-1994 <i>27 years</i>	<b>Weak</b>	1.59	0.56	.22
1995-2005 <i>11 years</i>	<b>Strong</b>	4.09	1.00	.36
Ratio of Strong/Weak THC years		2.32	1.66	2.48

Figure 8 illustrates the amount of Atlantic basin major hurricane activity during the 25-year period during 1945-1969 when the globe was undergoing a general cooling and the THC circulation was judged to be strong versus the 25-year period of 1970-1994 when the THC circulation was weak but global warming was occurring. Note how Atlantic basin major hurricane activity was much greater (about 2 ½ times more) during a period of global cooling and that significantly less Atlantic basin major hurricane activity was occurring during a 25-year period when the globe was undergoing warming. This data indicates that the THC trumps any global temperature changes that may be occurring.

Figure 9 illustrates the annual average differences in Atlantic major hurricane activity within the overall global warming period between 1970-2005. Note that when the THC was generally weak as during the global warming period 1970-1994 the annual average of major hurricane activity was much less than it has been during the last 11-year period 1995-2005 when the THC has been strong. This illustrates again that the THC is a dominant player in Atlantic major hurricanes. Figure 10 shows a longer time-series of the THC circulation going back over 140 years. Note the multi-decadal periods of back and forth swing of the North Atlantic temperature anomaly. There have been nearly twice as many Atlantic basin major hurricanes during the warm versus compared to the cooler periods.

## ATLANTIC BASIN

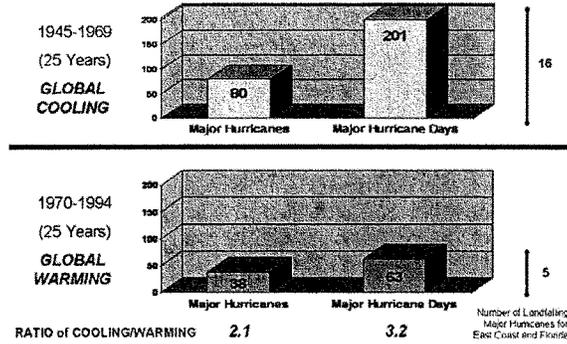


Figure 8. Comparison of Atlantic basin hurricane activity during two 25-year periods during which the globe was cooling (top – more hurricane activity) and in a similar 25-year period when global warming was occurring (bottom – less hurricane activity). Numbers to the right (16 and 5) give the number of US landfall major hurricanes during the eastern US during each time period.

## ATLANTIC BASIN ANNUAL AVERAGE

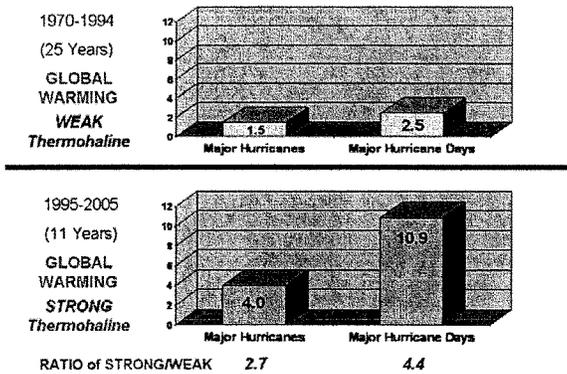


Figure 9. Comparison of Atlantic basin major hurricane activity during two periods when global warming was occurring. The top gives the annual major hurricane activity when the THC was weak and the bottom during the last 11 years when THC was strong.

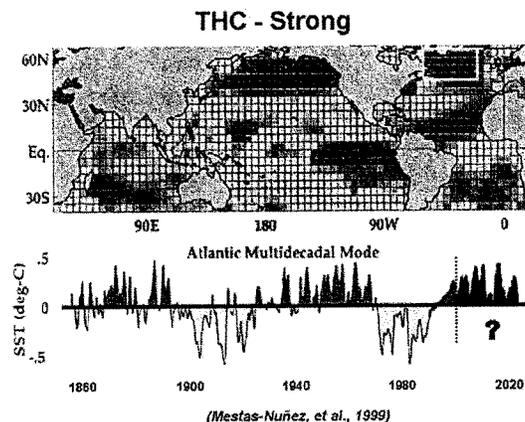


Figure 10. Illustration of the relative changes in Atlantic thermohaline circulation (THC) over the last 145 years and extrapolation to 2020 (bottom). Red color indicates when THC was stronger than average, yellow color when it was weaker than average. The top diagram shows the typical global sea surface temperature (SST) condition which is associated with a strong THC. Red gives positive SST anomalies, blue are negative SST conditions. The opposite SST conditions occur when the THC is weaker than normal. Note the 3 distinctive multi-decadal periods when the THC is above average and the two periods when it was below average.

### 3. DETERMINATION OF HURRICANE INTENSITY

There always has been, and there probably always will be, problems in assigning an accurate and representative maximum surface wind to a hurricane. As technology advances and the methods of determining a hurricane's maximum winds become more accurate, different values of maximum winds (generally higher) will be assigned to hurricanes than would have been possible in previous years. Advancement in technology is, in general, telling us that hurricanes are somewhat stronger than we have previously thought.

With the availability of new aircraft-deployed inertial dropwindsondes and the new step-frequency surface wind measurement instruments on the reconnaissance aircraft, it is being established that a portion of Atlantic hurricane surface winds are stronger than they were previously thought to be when surface winds were estimated from downward extrapolation of upper-level aircraft measurements. Although most of the comparative differences in the 45 Atlantic basin major hurricanes of the last 11 years (1995-2005) vs. the 15 major

hurricanes of the prior 11 years (1984-1994) is thought to represent real variability, a small part of this difference may be due to the assignment of a Category 3 status to a few hurricanes which in earlier years might have received a weaker designation.

#### **4. PERSPECTIVE ON THE LAST TWO HURRICANE SEASONS**

We should interpret the last two years of unusually large numbers of US landfalling hurricanes as natural (but very low probability). During 1966-2003, US hurricane landfall numbers were substantially below the long-term average. In the last two seasons, they have been above the long-term average. This is how nature often works. We should not try to read more into these years than this. Although the 2004 and 2005 hurricane seasons have had an unusually high number of major landfall events, the overall Atlantic basin hurricane activity has not been much more active than it was in seven of the recent hurricane seasons since 1995 (1995, 1996, 1998, 1999, 2000, 2001, 2003). What has made the 2004-2005 seasons so unusually destructive is the high percentage of major hurricanes that moved over the US coastline. These landfall events were not primarily a function of the overall Atlantic basin net major hurricane numbers, but rather of the favorable broad-scale Atlantic upper-air steering currents which were present the last two seasons. It was the favorable Atlantic basin steering currents (produced by middle troposphere high pressure or ridge conditions over the Northeast US) which caused so many of the major hurricanes which formed the last two years to move further westward than normal and come ashore.

It is rare to have two consecutive years with such high numbers of landfalling major hurricanes. The historical records and the laws of statistics indicate that the probability of seeing another two consecutive hurricane season like 2004-2005 is very low. Even though we expect to see the current active period of Atlantic major hurricane activity continue for another 15-20 years, it is statistically unlikely that any future two consecutive year periods will have as many major US hurricane landfall events as were seen in 2004-2005 period. It is possible; however, that US hurricane destruction could be as high as ~ \$100 billion if a major hurricane were to make landfall in a few highly populated metropolitan areas such as Galveston-Houston, New Orleans, Tampa, the gold coast of SE Florida and/or Long Island-NY City.

The large increase in hurricane-spawned destruction of the last two seasons has not surprised us as it likely has surprised many others. We have been anticipating a great upsurge in hurricane destruction for many years. The following are a few quotes from our previous Colorado State University forecast papers:

**April 1989:** "Because of the rapid growth in U.S. coastal population and property investment in recent years... it would appear that major increases in hurricane-spawned coastal destruction are inevitably to come."

**August 1996:** "There has been a significant lull in the incident of intense category 3-4-5 hurricanes striking the U.S. East Coast, Florida and Caribbean basin (except for 1995) during the last 25 years. We see this trend as a natural consequence of the slowdown in the Atlantic Ocean Thermohaline Conveyor Belt circulation which appears to be associated with a long list of concurrent global circulation changes during the last quarter century... Both historical and geological (proxy) records indicate that this lull in major hurricane activity will not continue indefinitely; the return of increased major landfalling hurricane activity should be expected within the next decade or so... Increased intense hurricane activity striking U.S. coastal area is an assured threat to the U.S., much more so than earthquakes, greenhouse gas warming and other environmental problems which are receiving comparatively much greater attention."

**June 1997:** "Recent data and historical and geological (proxy) records indicate that this extended lull in major hurricane activity is unlikely to continue. A new era of major hurricane activity appears to have begun with the unusually active 1995 and 1996 seasons... As a consequence of the exploding U.S. and Caribbean coastal populations during the last 25-30 years, we will begin to see a large upturn in hurricane-spawned destruction – likely higher than anything previously experienced."

**April 2001:** "It is highly likely that climatology will eventually right itself, and we must therefore expect a great increase in landfalling major hurricanes in the coming decades. With exploding southeast coastal populations, we must also prepare for levels of hurricane damage never before experienced."

**August 2001:** "We owe our good fortune to a persistent upper-air trough which has been located along the U.S. East Coast during a high percentage of the time during the last six hurricane seasons. This fortunate trend has caused a large portion of otherwise northwest moving major hurricanes to be recurved to the north before they reached the U.S. coastline. However, our good luck cannot be expected to continue forever."

**May 2002:** "If the future is like the past, it is highly likely that very active hurricane seasons will again emerge during the next few years, and the prospects for very large U.S. and Caribbean increases in hurricane damage over the next few decades remains high. We should indeed see future hurricane damage much greater than anything in the past as future storms begin to impact the very greatly increased coastal population and property values."

**May 2003:** "Regardless of whether a major hurricane makes landfall this year, it is inevitable that we will see hurricane-spawned destruction in coming years on a scale many, many times greater than what we have seen in the past."

### **5. HURRICANE INTENSITY AS RELATED TO INCREASES IN GLOBAL MEAN SEA SURFACE TEMPERATURE (SST)**

There is no physical basis for assuming that global Atlantic hurricane intensity or frequency is necessarily related to global mean surface temperature changes of less than  $\pm 0.5^{\circ}\text{C}$ . As the ocean surface warms, so too do global upper air temperatures to maintain conditionally unstable lapse-rates and global rainfall rates at their required values. Seasonal and monthly variations of sea surface temperature (SST) within individual storm basins show only very low correlations with monthly, seasonal, and yearly variations of hurricane activity. Other factors such as tropospheric vertical wind shear, surface pressure, low level vorticity, mid-level moisture, etc. play more dominant roles in explaining hurricane variability than do sea surface temperature. Although there has been a general global warming over the last 30 years, SST increases in the individual tropical cyclone basins have been smaller than the overall global temperature increase (about half) and, according to the observations; have not brought about any significant increases in global major tropical cyclones. No credible observational evidence is available or likely will be available in the next few decades which will be able to directly associate global surface temperature change to changes in global hurricane frequency and intensity.

Although there has been a general warming of the globe in recent decades, observations do not show increases in global tropical cyclone activity. The new analysis of Klotzbach (2006) shows no increase in global TC frequency and intensity over the last 20 years when global mean temperatures have been rising (Figures 11 and 12), and global satellite technology has advanced to the stage where reliable non-Atlantic intensity estimates can be made. Klotzbach also shows that except for the Atlantic and the Northeast Pacific, there is no significant correlation between SST and hurricane intensity in the four TC basins of the Northwestern Pacific, the North Indian, the South Indian and the South Pacific.

One of the most misunderstood topics in tropical meteorology is the association of sea surface temperatures (SSTs) and tropical cyclone frequency and intensity. Although local areas of warmer SST, such as along the Atlantic Gulf Stream and over the Gulf of Mexico loop current may act to enhance individual hurricane intensification, one should not conclude that these observations that a direct SST-hurricane intensity relationship exists that would also be applicable to a global warming scenario.

Such local patches of warm SST can increase local convective buoyancy (where upper-tropospheric temperature-moisture contents remain the same) and allow for the potential for greater deep cumulus convection and hurricane intensity increases. Such changes in convective buoyancy should not be expected to occur in a slow multi-decadal global warming scenario, however. Here the whole troposphere warms in unison with the surface temperatures, global rainfall rates

are not significantly altered, and tropical cyclone basin convective buoyancy patterns do not change. There is thus no reason to expect that convective buoyancy (a required component for increased hurricane intensity) will become significantly greater in a global environment where mean SSTs are a little warmer than current global temperatures.

In distinguishing between active and inactive Atlantic basin hurricane seasons, the author and his colleagues have found that seasonal changes in SST explain just a small portion (about 10%) of the variance of seasonal and monthly hurricane activity. Other factors such as tropospheric vertical wind-shear, low-level horizontal wind-shear, middle level moisture, strength of the Atlantic equatorial trough, etc. play much more important roles in explaining Atlantic seasonal and monthly hurricane variability. This has also been found and discussed by Shapiro and Goldenberg (1998). Hurricane intensity is also a function of eye-wall size, depth of ocean mixed layer, cyclone motion, and other factors not necessarily related to global sea surface temperature.

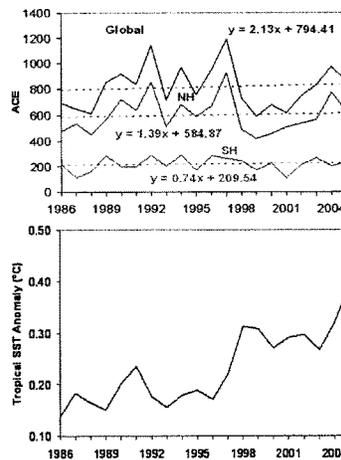


Figure 11. Accumulated Cyclone Energy (ACE) index values for 1986-2005 for the Northern Hemisphere (NH) green line, the Southern Hemisphere (SH) pink line, and the globe (brown line) (from Klotzbach, 2006). Linear trends have been fitted to the three curves. Five-year running mean tropical NCEP Reanalysis SST anomalies (23.5°N-23.5°S, all longitudes) blue lines are also plotted. The base period for tropical SSTs is 1951-1980. ACE is the sum of the square of each cyclone's maximum wind at each 6-hour measuring period.

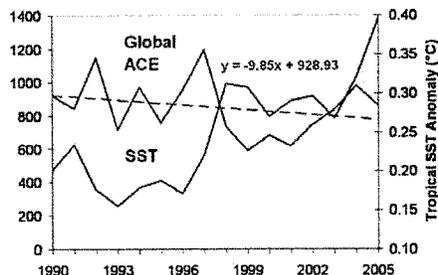


Figure 12. Global Accumulated Cyclone Energy (ACE) index values for 1990-2005 (brown line). A linear trend has been fitted to global ACE. Five-year running mean tropical NCEP Reanalysis SST anomalies (23.5°N-23.5°S, all longitudes) blue lines are also plotted. The base period for tropical SSTs is 1951-1980 (from Klotzbach, 2006).

Although the climatology of Atlantic major (Cat 3-4-5) hurricane activity sharply peaks around 10 September (Landsea, 1993), Atlantic SST variations do not peak around this period. They are no higher around 10 September than they are a month earlier or a month later when major hurricane frequency is typically much less frequent. Such strong Atlantic peaking of major hurricane activity without a similar peaking in SST shows that SST by itself is not a dominant factor.

It should also be noted that there can be quite strong high latitude tropical cyclones existing over ocean surface water temperature 3-5°C cooler than SST conditions in the tropics. In these cases, low-level temperatures are 3-5°C colder, but the potential buoyancy can be maintained by similar upper-level cooling brought about by upper-level cold air advection. Thus, it should not be expected that if the earth were to continue to warm as it has for the last 30 years that global tropical cyclone activity would necessarily be more frequent and/or more intense.

## 6. THE GROSS EXAGGERATION OF HUMAN INDUCED GLOBAL WARMING

Over the last 20 years, I have been dismayed over the bogus science and media hype associated with the nuclear winter and the human-induced global warming hypotheses. My innate sense of how the atmosphere-ocean functions does not allow me to accept either of these scenarios or the new scenario that a portion of the US hurricane destruction over the last two years is a result of human influences on global temperature. Observations and theory do not support these ideas.

Few people know enough about how the atmosphere and oceans function to be able to judge the validity of these claims. Warming advocates and the media have adroitly exploited this general lack of knowledge on how the global climate system functions to justify themselves and their organization's agendas. I do not believe most of the statements concerning human-induced global warming that have previously been made by former Vice-President Al Gore in his new book and his new film on this topic. The scientific questions are far from being settled. Most of my meteorology and climate colleagues are quite skeptical of the human-induced scenarios which have been so confidently advanced by the warming advocates. The global average temperature changes we have seen over the last century and the last 30-years are, in my view, and the view of most of my colleagues (whose opinions I value), of natural origin.

There are many other physical processes which can cause global warming besides an increase in human-induced greenhouse gases. It is nature that we have to worry about, not human-induced influences. My great skepticism of both human and natural global warming influences on the alteration of Atlantic basin hurricane activity is shared by most of us who have spent our careers studying hurricanes. This includes most of the hurricane forecasters and researcher of NOAA and most of the retired former National Hurricane directors, such as Neil Frank, Robert Sheets and Jerry Jarrell, and nearly all of my long-period hurricane research colleagues. I find that, in general, it is those meteorologists or climatologists who have had limited operational or research backgrounds who are most prone to claim a human-induced component to the 2004-2005 increase in US hurricane damage. Most of those who claim such a global warming – hurricane intensity association have a vested interest in having this idea accepted so they can request research funds to study the relationship in greater detail.

#### **7. WHAT OTHERS SAY**

I fully subscribe to the view expressed by Max Mayfield, Director of the NOAA National Hurricane Center when he stated (20 September 2005) before the Senate Committee of Commerce, Science and Transportation Sub-Committee:

"We believe this heightened period of hurricane activity will continue due to multi-decadal variance, as tropical cyclone activity in the Atlantic is cyclical. The 1940s through the 1960s experienced an above average number of hurricanes, while the 1970s into the mid-1990s averaged fewer hurricanes. The current period of heightened activity could last another 10-20 years. The increased activity since 1995 is due to natural fluctuations/cycles of hurricane activity, driven by the Atlantic Ocean itself along with the atmosphere above it and not enhanced substantially by global warming. The natural cycles are quite large with an average of 3-4 major hurricanes a year in active periods and only about 1-2 major

hurricanes annually during quiet periods, with each period lasting 25-40 years".

I also fully subscribe to the views expressed in the new paper titled "Hurricanes and Global Warming" which will soon be published in the **Bulletin of the American Meteorological Society (June 2006)**. This paper is authored by:

- *Roger Pielke, Jr.*, Director, Center for Science and Technology, U. of Colorado;
- *Christopher Landsea*, Dir. of Research, NOAA Nat. Hurricane Center, Miami, FL;
- *Max Mayfield*, Director, National Hurricane Center, Miami, FL;
- *James Laver*, Director, NOAA National Climate Center, Washington, DC;
- and
- *Richard Pasch*, Hurricane Specialist, NOAA Nat. Hurricane Center, Miami, FL

and makes the following statements:

"Since 1995 there has been an increase in frequency and in particular the intensity of hurricanes in the Atlantic. But the changes of the past decade are not so large as to clearly indicate that anything is going on other than the multi-decadal variability that has been well documented since at least 1900 (Gray et al. 1997; Landsea et al. 1999; Goldenberg et al. 2001)".....

and

"Globally there has been no increase in tropical cyclone frequency over at least the past several decades (Lander and Guard 1998, Elsner and Kocher 2000). In addition to a lack of theory for future changes in storm frequencies, the few global modeling results are contradictory (Henderson-Sellers et al. 1998; IPCC 2001)"

## **8. INSURANCE DISCUSSION**

The great natural attraction and the desire of people to live along US coastal locations vulnerable to hurricanes will continue to increase. This is understandable. The statistical probability of a hurricane making landfall at any one location along the southeast US coastline in any year or decade is very low. Most coastal locations will experience decades of enjoyable coastal living without any hurricane problems. But they must realize that living in vulnerable coastal areas has its occasional drawbacks. They must pay for the added insurance protection for their location and/or be willing and sufficiently wealthy to absorb large property losses should a hurricane make landfall.

## 9. ASSUMPTIONS

Our country needs a vibrant insurance industry that is willing to sell hurricane coverage to any person or group who desires it. But insurance companies have to show profits to attract needed investment. Investment in the insurance industry will surely follow insurance profits. This can only be accomplished if insurance rates are allowed to float to levels which make them actuarially sound with regard to our country's long-term hurricane risk. Due to the new era for increased US major hurricane landfall which our country is in, hurricane risk over the next 15-20 years will be much higher than it has been over the last 40 years where we have witnessed a natural downturn in US landfalling US major (Cat 3-4-5) hurricane activity. The large downturn in US hurricane damage of the 34-year period between 1966-2003 was not at all representative of the last 2 years and will likely not be representative of what we are likely to see over the next 15-20 years. Hurricane landfall conditions and risk has undergone large changes in recent years. The best available evidence indicates that annual US hurricane damage is going to undergo a large increase over the next 15-20 years in comparison with the prior 38-year period of 1966-2003. This expected increase should be considered a natural phenomenon of the Atlantic basin ocean circulation. It should not be associated with global warming or increases in human-induced greenhouse gases.

It is important that the insurance industry not embrace the human-induced global warming rationale for increased hurricane destruction that has been advanced by those attempting to profit from this scare. There is no way such hypothesized human intervention of hurricane activity could be incorporated into insurance actuarially rate structures, even if it were true. Nature is difficult enough to deal with without having to factor in the false speculations of credentialed scientists who have little knowledge of hurricane-climate relationships, but strong desires to profit from the general ignorance on this topic.

The problems arising from insurance companies pulling out of coastal markets – such as South Florida, can only be solved by the development of a new national insurance regulation standard. It is assumed that the goal of both the general public and the insurance industry is to arrange that future insurance hurricane financial losses be made as actuarially realistic as possible and that the rate structure be able to cover most of the catastrophic hurricane events. The attempt should be to reduce, as much as possible, the need for federal government economic assistance in rebuilding. Coastal residents should assume as much as possible the economic consequence of their choosing to live along hurricane-vulnerable coastlines.

It is recognized, however, that a few rare catastrophic hurricane events (such as Katrina) will be beyond the ability of the insurance industry to handle – and that some federal government intervention for rebuilding will be necessary.

To accomplish such a desired actuarially sound US insurance industry for hurricane loss it is inevitable that insurance rates will have to substantially rise to meet the increased natural vulnerability of our southeastern coastlines. It is recognized that these rate increases may be beyond the ability of many less affluent coastal residents to pay. It should be expected that economic pressures will, over time, gradually force many less affluent US coastal residents to move to less vulnerable locations.

Catastrophic hurricane damage (>\$50 billion in current dollars) occurs when a major hurricane goes into a heavily populated area. Over the last century, these normalized event losses occurred about once per decade. As coastal populations and property increase, we should expect catastrophic hurricane damage to become more frequent, perhaps one event about every 5-8 years. It is also possible (but statistically, a very low probability) to have two or more US landfall catastrophic events in one year. Although the US experienced seven major hurricane landfall events (Charley, Frances, Ivan, Jeanne, Katrina, Rita and Wilma) during 2004-2005, it is only Katrina that can be defined as a catastrophic event.

It is inevitable that hurricane-spawned destruction will sharply rise in the coming years due to increased coastal population and property values. It is possible, however, that per-capita insurance rates will not have to rise as much as might be envisioned if the majority of the new and older coastal residents take out coverage. An ever increasing home owner and business owner insurance coverage base should help alleviate a portion of the required increased insurance needs and aid in keeping per-capita coverage at a manageable level.

#### **10. RECOMMENDATIONS FOR THE INSURANCE INDUSTRY ADJUSTING TO THE INEVITABLE INCREASE IN US HURRICANE DESTRUCTION**

1. Insurance companies need to be allowed to set aside a portion of their yearly profits as tax-free investment to cover inevitable future catastrophic losses.
2. Insurance coverage rates should not be regulated by individual state government commissions. Rates should be allowed to float in conformity to the last century US hurricane landfall frequency/intensity statistics and current coastal population and property values. Fifty year probability values by US coastal region – down to the county level (205) are available on our website (<http://www.e-transit.org/hurricane/welcome.html>) see Figure 13. These probabilities are based on 100 years (20<sup>th</sup> century) of US tropical storm and hurricane landfall statistics. We believe these 50-year landfall probabilities can be used to estimate relative US landfall frequency/intensity. Hurricanes do not know state boundaries. Insurance

rates should be nationally based on the last 100 years of US landfall hurricane frequency and intensity.

3. Wind engineers have verified that homes and business structures can be built to withstand all but the strongest hurricane wind speeds with a small percentage added to building costs. Also, retrofitting of most homes and businesses to withstand hurricane-force winds is quite feasible. There needs to be a national building and retrofitting code established for hurricane vulnerable coastal structures, and these codes need to be enforced. There are, however, diminishing return limits for some home and business construction for hurricane wind mitigation. It may not be cost-efficient to attempt to build structures to withstand Category 4-5 hurricane winds in areas of low major hurricane landfall probability.

County (High) Information		Subregion:1	
Name	Miami-Dade FL	Subregion - Coastline Distance (km)	89
Region	6	Subregion - 2000 Population	2,253,362
Region - Coastline Distance	483	Subregion - Prob. TS Force	8.2% (5.8%)
Region - 2000 Population	5,213,884	Subregion - Prob. TS Vicinity	52.0% (39.7%)
Region - Named Storms (1900-1999)	47	Subregion - 50 Year TS Prob.	94.5%
Region - Prob. 1 or More HS	54.4% (37.5%)	Subregion - Prob. H Force	2.5% (1.7%)
Region - Prob. 2 or More HS	11.8% (8.1%)	Subregion - Prob. H Vicinity	20.1% (14.3%)
Region - Hurricanes (1900-1999)	34	Subregion - 50 Year H Prob.	58.0%
Region - Prob. 1 or More H	41.8% (28.8%)	Subregion - Prob. IH Force	0.8% (0.6%)
Region - Prob. 2 or More H	6.7% (4.6%)	Subregion - Prob. IH Vicinity	6.9% (4.8%)
Region - Intense Hurricanes (1900-1999)	16	Subregion - 50 Year IH Prob.	24.1%
Region - Prob. 1 or More IH	21.4% (14.8%)	County - Coastline Distance (km)	89
Region - Prob. 2 or More IH	1.7% (1.2%)	County - Inland Border Width (km)	--
Region - Prob. TS Force	44.3% (30.5%)	County - 2000 Population	2,253,362
Region - 50 Year TS Prob.	100.0%	County - Prob. TS Force	8.2% (5.8%)
Region - HS Vicinity Prob.	98.1% (93.6%)	County - Prob. TS Vicinity	52.0% (39.7%)
Region - Prob. H Force	13.5% (9.3%)	County - 50 Year TS Prob.	94.5%
Region - 50 Year H Prob.	99.3%	County - Prob. H Force	2.5% (1.7%)
Region - H Vicinity Prob.	70.4% (56.9%)	County - Prob. H Vicinity	20.1% (14.3%)
Region - Prob. IH Force	4.3% (3.0%)	County - 50 Year H Prob.	58.0%
Region - 50 Year IH Prob.	78.1%	County - Prob. IH Force	0.8% (0.6%)
Region - IH Vicinity Prob.	32.3% (23.8%)	County - Prob. IH Vicinity	6.9% (4.8%)
		County - 50 Year IH Prob.	24.1%

Figure 13. Example of the type of tropical cyclone landfall probability information which is available on our Colorado State University website (<http://www.e-transit.org/hurricane/welcome.html>).

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**STATEMENT OF**  
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**NATIONAL CO-CHAIRMAN**  
**PROTECTINGAMERICA.ORG**

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

**June 28, 2006**

Thank you Mr. Chairman and members of the subcommittee. My name is James M. Loy. I appreciate the opportunity to appear before you today in my capacity as co-chairman of ProtectingAmerica.Org, an organization committed to finding better ways to prepare and protect American families from the devastation caused by natural catastrophes.

My fellow co-chairman is James Lee Witt, the former director of the Federal Emergency Management Agency. Our coalition members include first responders, emergency management officials, insurers, municipalities, small businesses, Fortune 100 companies and private citizens. The membership is broad and diverse and includes members from virtually every state in the nation.

ProtectingAmerica.org was formed to raise the national awareness about the important responsibility we all have to prepare and protect consumers, families, businesses and communities. We hope to build a campaign to create a comprehensive, national catastrophe management solution that protects homes and property at a lower cost, improves preparedness, and reduces the financial burden on consumers and taxpayers – all in an effort to speed recovery, protect property, save money and save lives.

Though we come from all walks of life, we share a common belief that the current system of destroy – rebuild and hope in the aftermath of extraordinary natural disasters is fatally flawed in two significant and dangerous ways.

First, we simply do not prepare well enough in advance for natural catastrophes.

Fundamental to the current system is the vain belief that “it won’t happen here.” This denial, which is pervasive from homeowners to officeholders, has provided us all with the false comfort that, while we would like to prepare for the possibility of catastrophe,

the likelihood of an event actually happening “here” is so remote that we should spend our time and resources on other more immediate and pressing problems.

This denial undermines efforts to prepare in advance of catastrophe which, naturally, leads to the other sweeping shortcoming which is that the current system is a patchwork of after-the-fact responses with all of the inefficiencies that are inherent in a system dominated by crisis and confusion.

The simple fact is that catastrophe can and does occur virtually anywhere in this country.

Let me give you some quick facts that should crystallize the urgent threat posed by natural catastrophe in America:

- The bulk – in fact 57% -- of the American public lives in an area prone to catastrophes like major hurricanes, earthquakes or other natural disasters, and more move toward those areas every day.
- Seven of the 10 most costly hurricanes in US history occurred in the last 5 years.
- Some of the most valuable real estate in this country is squarely in catastrophe’s path – on the Atlantic, Gulf and Pacific coasts and on top of the New Madrid fault in the greater Mississippi Valley.

Catastrophe preparedness, prevention and recovery are not a challenge limited only to Florida and the Gulf Coast, nor to the earthquake zone of northern California.

- In the past 100 years, 11 hurricanes have made direct hits on New England; 6 have made direct hits on Long Island.

The most famous of those hurricanes hit in 1938 and is known as the Long Island Express. It hit Long Island and ripped up into New England. 700 people were killed; 63,000 were left homeless.

- Although the Great San Francisco Earthquake of 1906 is the best known earthquake in America, in fact, the New Madrid series of earthquakes in the early 1800s covered a far greater area with a force every bit as strong as San Francisco's earthquake.

The New Madrid Earthquakes emanated from New Madrid, Missouri and struck over a three-month period in 1811 and 1812. They changed the course of the Mississippi River, shook the ground from Mississippi to Michigan and from Pennsylvania to Nebraska. Structures were damaged throughout the Mississippi Valley, landslides occurred from Memphis to St. Louis. These earthquakes are largely unknown today because they struck at a time when the earthquake zone was largely wilderness. What was essentially the bulk of the Louisiana Purchase now encompasses major population centers across the Mid-West.

Climatologists are united in their observation that surface water temperatures are up and that we are in a weather cycle that is likely to last for many years, possibly several decades, and will include hurricanes with greater force and frequency than even those we have experienced in recent years.

Seismologists are similarly united in their observation that we are overdue for a major earthquake along many of the fault lines that run along our Pacific Coast or, as in the case of the New Madrid Fault, transect the very heartland of this nation.

There should be no comfort in the notion that the great earthquakes and hurricanes that previously ravaged our country seem to have occurred in such a vastly different age and time that they are not likely to repeat.

Is our modern society so sophisticated and our cutting-edge technology so advanced that Mother Nature will choose to strike in some remote and distant land?

To wager our families' futures on that sort of conceit is a fool's bet.

Simply put, catastrophe can happen here, it has happened here and there is no doubt that it will happen again. It is a question not of "if" but "when" and "how bad."

The costs of any of those catastrophes repeating themselves would be enormous.

- Disaster experts project that a replay of the San Francisco earthquake – same force at the same location – could result in more than \$400 billion in replacement and rebuilding costs.
- Were we to experience a replay of the 1938 "Long Island Express" hurricane, the damages could exceed \$100 billion. If that hurricane made landfall a mere 20 miles to the west, smack in the middle of Manhattan, the damages would be even more staggering.

The effect of such tremendous losses would be felt through our entire national economy.

When catastrophe strikes, our after-the-fact response programs and protocols do a remarkable job in getting victims into shelters and in mobilizing emergency supplies and personnel so that the situation does not worsen.

All Americans, regardless of whether or not they have been victimized by catastrophe, owe our first responders an enormous debt of gratitude and thanks. We are equally indebted to the people behind the scenes – the government employees who work around-the-clock to see that logistics are worked out, that supplies are ordered and that funding is delivered. These men and women are too often overlooked. Their service is invaluable.

The first responders in harm's way and the government workers in makeshift outposts perform exceptionally well in this crisis mode. But, as we all know, the crisis mode is hyper-stressful both on a human level and on a system-wide level. It requires split-second triage and prioritization that can lead to inefficiencies and unfairness.

While little can be done to completely eliminate the crisis mode, ProtectingAmerica.Org believes that it can, and must, be mitigated. 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.

Public education programs would help homeowners to make necessary plans and be prepared in advance of an emergency. Mitigation programs such as strong building codes and effective retrofitting programs would improve the integrity of catastrophe-prone structures so that damage would be minimized if catastrophe strikes. An increase in first responder funding would help finance these critical programs that too often get shortchanged in the give-and-take of local budgeting.

To provide an example of the positive impact of these kinds of programs, consider the extensive study by FEMA following the 1993 flood of the Mississippi River, which affected nine states. Using money from the Stafford Act and Community Development Block Grant dollars, FEMA worked with the governors in each state and undertook a relocation program for residents of frequently flooded properties. FEMA bought out 4,000 pieces of property in Missouri alone, turned that space back into open green space and deed-restricted it.

In 1995 another flood struck the same area and not one taxpayer dollar was spent on responding to the disaster. Experts found that for every dollar spent on mitigation, we saved \$5 to \$7 in future losses.

Studies in the aftermath of Hurricane Katrina suggest that the current after-the-fact recovery funding for catastrophes results in an enormous taxpayer subsidy for uninsured and underinsured properties. In fact, a Brookings Institution study published in March of this year found that of the first \$85 billion in taxpayer dollars spent on Katrina recovery efforts, more than \$10 billion went to cover losses for uninsured or underinsured properties.

ProtectingAmerica.Org believes that in addition to minimizing the extent of catastrophic losses through prevention and mitigation programs, we should also reduce the taxpayer subsidy of recovery efforts, ensure the adequacy of recovery dollars, and improve the delivery of those critical funds to homeowners.

ProtectingAmerica.Org has been advocating the establishment of a stronger public-private partnership as part of a comprehensive, integrated solution at the local, state and national levels. The solution would include privately funded catastrophe funds in catastrophe-prone states that provide more protection at lower cost to consumers. These CAT funds would serve as a backstop to the private insurance market and would generate investment earnings that, in addition to helping to pay claims in the aftermath of a mega-catastrophe, would be used for mitigation, prevention, preparation and first responder programs.

We have also been advocating the creation of a national catastrophe fund that would serve as a backstop to participating state catastrophe funds in the event of a mega-catastrophe.

Those state catastrophe funds would be financed through mandatory contributions by insurance companies in each of those states in an amount that reflects the catastrophe risk of the policies that they write in each state.

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

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

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.

Because this program relies on the traditional private market for paying claims, the inherent inefficiencies and bureaucracy in a government-run program are eliminated.

Because this program requires states to fund meaningful prevention and mitigation programs, catastrophe planning, protection and preparation will take place before the onslaught of catastrophe and will be in a state of continuous and rigorous improvement.

All of these elements are contained in HR 4366 and in companion legislation in the US Senate. We commend Rep. Brown-Waite and Senator Nelson and the growing number of co-sponsors for their foresight on this very important issue.

This needs to be a top national priority. It reflects strong leadership to act before the next crisis. There is urgency and opportunity to act.

Mr. Chairman, I want to thank you, again, for taking the time to consider and discuss this important subject. I would be happy to answer any questions that you may have.

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## **An Agenda to Prepare for and Protect America from Catastrophe**

America can do a better job preparing and protecting her citizens from natural catastrophes. ProtectingAmerica.org supports a comprehensive, integrated approach that will provide more protection at lower cost to consumers, improve preparedness, mitigate the impact of a catastrophe on our economy and reduce the financial burden on consumers and taxpayers. The solution should include five key elements:

### **Financial Protection for Consumers**

- ◆ Strengthen financial protection for consumers by establishing catastrophe funds (CAT Funds) at the state and national level. CAT Funds would provide a backstop to the insurance protection provided by private insurers and help pay claims arising from major disasters once a threshold is exceeded.
- ◆ At the state level, create CAT Funds based on the model bill adopted by the National Conference of Insurance Legislators (NCOIL). The NCOIL bill is based on the Florida CAT Fund. State CAT Funds would sell reinsurance to all property and casualty insurers doing business in the state. The money paid by insurers into the Fund stays in the state and grows tax-free. Once an insurance company has paid a specified amount in claims, the Fund pays a percentage of the claims above that amount.
- ◆ At the federal level, Congress should pass H.R. 4366, which provides a backstop for state catastrophe funds through a national catastrophe fund. The national backstop would be administered by the Treasury Department to provide an added layer of protection for state catastrophe funds in the event a major catastrophe exhausts the state fund's financial capacity. State CAT Funds could not tap into the national catastrophe fund until both private insurers and the state CAT Fund meet their financial obligations.

### **Recovery and Rebuilding**

- ◆ Improve the process of relief, recovery and rebuilding by developing new processes to stage and deploy essential relief materials and to make sure there are adequate building materials, supplies and licensed contractors available in the aftermath of a catastrophe.
- ◆ The federal and state catastrophe funds would establish new programs and processes that aid in the relief, recovery and rebuilding process.
- ◆ These efforts could include:
  - Better and more coordination among FEMA, state and local governments.
  - Better and more coordination among private relief agencies, insurance companies and policyholders.
  - Creation of staging areas so that adjusters, contractors, suppliers, FEMA, law enforcement, charities can all be centrally located so consumers can "one stop shop" for all their recovery needs.

- FEMA waiver of rules or guidelines that hinder the expedited processing of claims.
- State waiver of or temporary suspension of licensing requirements to allow out-of-state contractors into the state.
- FEMA creation of a national contractor license to facilitate contractor access to damaged areas.
- Better coordination among insurers, local officials and FEMA to facilitate quicker access to damaged areas.
- Consider development of Alternative Dispute Resolutions programs to promptly settle disputes that may arise.

#### **Prevention and Mitigation**

- ◆ Strengthen prevention and mitigation programs through stronger building codes and better enforcement to require new construction to better meet the challenges of catastrophic events. Prevention and mitigation programs save lives and protect property.
- ◆ Under the state CAT Fund laws the Legislature would:
  - Appropriate from the investment income of the fund an amount to be determined by the state (e.g., 10 percent of the investment income earned by the fund) for the purpose of providing funding for first responders, local governments, state agencies, public and private educational institutions, and nonprofit organizations and charities to develop and/or support programs intended to:
    - Improve catastrophe preparedness.
    - Prevent and reduce potential losses from a covered loss.
    - Provide research into means to prevent and reduce such losses.
    - Educate or inform the public as to means to reduce losses from covered events.
    - Assist the public in determining the appropriateness of particular upgrades to structures or in the financing of such upgrades.
    - Provide funding for the enforcement of catastrophe appropriate building codes.
    - Protect local infrastructure from potential damage from a covered loss.
- ◆ State and federal legislation should include the following provisions for prevention and mitigation:
  - Creation of an advisory council specifically charged with the creation, implementation and enforcement of prevention and mitigation programs and guidelines. These include:
    - The development and implementation of modern state building codes appropriate for the risk with no allowance for weaker codes to be adopted by local communities.
    - Adequate enforcement of risk appropriate building codes.
    - Building materials that prevent or significantly reduce potential damage.
    - Focus on prevention and mitigation for any substantially damaged structure.
    - Innovation to retrofit existing homes.

**Consumer Protecting and Education**

- ◆ Improve consumer education and consumer protections to make sure people are better prepared for catastrophes before they strike and to empower them to guard against scam artists who take advantage of families at their deepest time of need.
- ◆ The federal bill conditions participation by the states on the state enacting and enforcing tough anti-gouging laws so that consumers are protected against predators.
- ◆ Both the federal and state bills stress the need for consumer education. The Advisory Council shall develop and implement consumer education standards.

**Continuous Improvement**

- ◆ Create a rigorous process of continuous improvement by establishing a commission of local, state and federal officials along with the private sector to review and assess recovery efforts after every disaster to identify ways to continually improve our ability to recover from catastrophes.
- ◆ Both the federal and state bills contain continuous improvement provisions. The federal bill creates a high level Commission to deal with this issue and gives the Secretary of the Treasury the authority to promulgate regulations. Furthermore, the bill states:
  - The Commission shall meet for the purposes of advising the Secretary regarding the estimated loss costs associated with the contracts for reinsurance coverage and developing and implementing prevention, mitigation, recovery and rebuilding standards. The Commission will be charged with continuous analysis of the effectiveness of the Act and recommending improvements to Congress.
  - The Secretary of the Treasury shall conduct an annual study on the cost and availability of homeowners' insurance for losses resulting from catastrophic natural disasters covered by the reinsurance program as well as reporting on the efforts of the participating states in enacting prevention, mitigation, recovery and rebuilding standards.
  - State Advisory Councils should report their findings to their legislatures on an annual basis.

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## **H.R. 4366 Will Prepare for and Protect America from Catastrophes**

America can do a better job preparing for and protecting her citizens from natural catastrophes. H.R. 4366 is a comprehensive approach that protects homes and property at a lower cost, improves preparedness, strengthens first responders, mitigates the impact of a catastrophe on our economy and reduces the financial burden on consumers and taxpayers.

### **Financial Protection for Consumers**

- ◆ Uses insurance premium dollars to establish the Consumer HELP Fund as a financial backstop to private insurance and state or regional catastrophe funds. The Consumer HELP Fund will pay claims only when a natural catastrophe is of such magnitude that it exhausts the financial capacity of the state fund.
- ◆ State catastrophe funds will pay actuarially sound and self-sufficient rates to the Consumer HELP Fund for this added level of protection. This provision guarantees that catastrophe-prone states are not subsidized by other states.
- ◆ The Consumer HELP Fund will be administered by the Treasury Department and will grow tax-free. The fund may issue obligations in the event losses exceed revenues.

### **Prevention and Mitigation**

- ◆ To be eligible for protection by the Consumer HELP Fund, states must adopt mitigation and prevention standards, including effective building codes and code enforcement.
- ◆ State catastrophe funds must dedicate a significant portion of their investment income to first responders, local governments, state agencies, public and private educational institutions, nonprofit organizations and charities to support prevention, mitigation and public education programs.

### **Consumer Protection and Education**

- ◆ Resources are provided for programs to educate consumers about protecting themselves from natural catastrophes and guarding against predators after a catastrophe.
- ◆ Participating states must enact and enforce tough anti-gouging laws.

### **Continuous Improvement**

- ◆ A national commission will manage the Consumer HELP Fund and assist the states in developing mitigation, prevention, recovery and rebuilding standards and programs.
- ◆ The GAO shall study the relationship between floods and hurricanes to coordinate between the National Flood Insurance Program and the Consumer HELP Fund.
- ◆ The Secretary of the Treasury shall conduct an annual study on the cost and availability of homeowners' insurance for losses resulting from catastrophic natural disasters and report on the efforts of the participating states in enacting prevention, mitigation, recovery and rebuilding standards.

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### **Myths and Facts About H.R. 4366 and the Consumer HELP Fund**

**Myth:** The Consumer HELP Fund would force taxpayers in states that are not vulnerable to natural catastrophes to subsidize homeowners in states that are routinely struck by hurricanes or susceptible to earthquakes.

**Fact:** The Consumer HELP Fund would provide a financial backstop to state catastrophe funds, and only state catastrophe funds, using money it collects from insurance companies, would pay into the national Consumer HELP Fund. States that don't have catastrophe funds wouldn't pay into the national fund and would not be eligible for assistance in the event of a major catastrophe in their state. The rates paid by state catastrophe funds would be actuarially sound—based on risk that each individual state faces—so that the residents of states with a higher risk of natural catastrophes would pay more than states with less risk. The Consumer HELP Fund would be pre-funded – money would be deposited into the Fund before a crisis to be better prepared and protected.

Residents of states that are not prone to catastrophes would, however, realize benefits from the Consumer HELP Fund. With more resources available to help people recover and rebuild, there will be less dependence on tax-supported programs by those victimized by natural catastrophes. Additional resources will also be available to communities in participating states to make the financial and human toll of catastrophes less severe. Moreover, the insurance shortages, price hikes and insurance company insolvencies that often follow catastrophes are less likely to occur with a national backstop in place. Consumers in every state depend on a healthy, competitive insurance market, which the Consumer HELP Fund will help ensure following a major catastrophe.

**Myth:** The private market is capable of providing the insurance protection America needs without creating another government program.

**Fact:** The property and casualty insurance industry has about \$350 billion in capital, but only 16 percent of this is attributable to homeowners insurance. The remainder supports automobile, workers' compensation, product liability, marine, crop, commercial property & liability and other lines of insurance. A repeat of the 1906 San Francisco earthquake could cause \$400 billion in economic losses, creating a national economic crisis of unprecedented proportions. A major hurricane will some day strike New York again, and the losses could cripple the state and the nation.

Homeowners insurance companies today purchase reinsurance to spread the risk of catastrophes, but this is an expensive and inefficient way to protect consumers. Most reinsurance is purchased from companies in Europe, Bermuda and Asia, and at the end of the year, reinsurance profits are taxed and the remainder stays with the reinsurance companies or returned to their investors as profits. The Consumer HELP Fund would allow money to be set aside on a non-profit, non-taxed basis, and the money would grow from year to year to be available to help consumers when it is needed. The cost to manage the consumer HELP Fund would come from the Fund itself. No tax money would be required to administer the Fund except for \$10 million in start-up costs. No massive bureaucracy would be needed to manage the Fund.

Florida is an example of how consumers can save money with a catastrophe fund. The state catastrophe fund provides up to \$15 billion of protection at a cost of \$800 million. That same protection in the private reinsurance market would cost approximately \$3.5 billion. That's a savings of at least \$2.7 billion or \$450 per policy in Florida.

A plan that says "all is well, just raise rates and hope for the best" is not viable. It is more responsible to make sure consumers are prepared and protected. It is time to face reality and acknowledge that the government is and must be involved in catastrophe management. This plan would provide for a refocused, smarter role for government that would shift from "reacting and responding" to "preparing and protecting."

**Myth:** This is just a bailout for insurance companies.

**Fact:** Nothing could be further from the truth. Insurance companies must control their exposure to catastrophes to remain financially solvent and to fulfill their obligations to their customers across the nation. At the present time, insurance and reinsurance companies limit their exposure to catastrophes by raising prices and limiting sales of insurance in catastrophe-prone areas. Following the 2005 storms, reinsurers have raised prices in Florida by 25 percent so far, and that cost is ultimately paid by consumers. Under H.R. 4366, insurance will be available and affordable because insurance companies will know in advance what their catastrophe exposure is, will know what resources will be available to help consumers and will know that one big storm will not jeopardize their financial solvency. The Consumer HELP Fund, created by private premiums paid by insurance companies, will grow over time and tax-free, creating a large reserve to help cushion the blow when a major catastrophe eventually hits. Moreover, the Consumer HELP Fund and state catastrophe funds won't leave the state where a catastrophe has struck. Consumers win both ways: by having money set aside in advance of catastrophes and by preventing market problems that often follow major catastrophes.

**Myth:** Bond financing will saddle future generations of Americans with the cost of recovering from today's catastrophes.

- Fact:** Unlike typical events that trigger insurance claims, like fender-benders and kitchen fires, major catastrophes are unpredictable. The Consumer HELP Fund will be designed to grow over time and the money saved in years when there are no major catastrophes will stay in the fund to grow to help consumers recover from future events, reducing the probability that bond financing at the state level will be needed. Bond financing is only a safeguard in the event that the state fund has not grown enough to pay for a major catastrophe. If bond financing is needed, it is less expensive than relying on reinsurance as we do now. The bonds will be repaid by assessments on insurance policies sold in the participating states and not taxpayers in general. Debt capital is cheaper than equity capital.
- Myth:** State catastrophe funds, which H.R. 4366 would encourage, internalize the risk to the citizens of a particular state in contrast to private reinsurance companies, which spread the risk of catastrophe to stockholders around the world.
- Fact:** State catastrophe funds are not intended to replace private reinsurance, but rather to work in concert with reinsurance in a complementary and coordinated fashion. Florida has a state catastrophe fund and California has the California Earthquake Authority; private reinsurance plays an important role in both. Private reinsurance is an important source of capital, and the more capital that is committed to insuring against catastrophes, the more affordable and available insurance will be. There is room for both private and non-profit capital to protect America from catastrophes.
- Myth:** The solution is to strengthen building codes and reduce the financial toll of natural catastrophes.
- Fact:** Stronger risk-appropriate building codes are needed in catastrophe prone areas, and H.R. 4366 includes incentives for states to adopt stronger codes. But while important, this is only part of the solution. A comprehensive, integrated solution, which includes financial protection for consumers, additional resources for first responders, consumer awareness and education and disaster recovery, together with stronger building codes, is necessary to prepare and protect America from natural catastrophes. H.R. 4366 addresses all these needs and the Consumer HELP Fund will help pay for them.

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## **Frequently Asked Questions About H.R. 4366 and the Consumer Hurricane and Earthquake Loss Protection (HELP) Fund**

### **Why do we need the Consumer Hurricane Earthquake Loss Protection (HELP) Fund?**

H.R. 4366, which would create the Consumer HELP Fund, is a comprehensive, integrated approach to help better prepare and protect America from natural catastrophes. The current system leaves many people and businesses at risk of being unable to replace what they lost, wastes tax dollars, raises insurance premiums and leads to shortages of insurance needed to sustain our economy. The Consumer HELP Fund will provide more protection at lower cost to consumers. It will provide the backstop necessary for insurance companies to insure against catastrophes such as hurricanes and earthquakes in a financially responsible manner that doesn't threaten their solvency or their ability to protect their customers from other potential losses. It will help stabilize insurance markets following a catastrophe and help steady insurance costs for consumers while making it possible for private insurers to offer more insurance protection in catastrophe prone areas. H.R. 4366 will protect taxpayers by establishing a process of financing catastrophe response and recovery through insurance companies and will facilitate a better system of preparedness, prevention, mitigation, consumer education and continuous improvement.

### **How else can the Consumer HELP Fund help reduce the toll of major catastrophes?**

H.R. 4366 would require states and the federal government to promote programs that will mitigate and prevent injuries and property damage from future catastrophes. A portion of state catastrophe fund revenues must go to programs that educate consumers about how to protect their families and homes from catastrophes and from those who prey on victims after catastrophe strikes. H.R. 4366 also supports a rigorous process of continuous improvement so that America becomes better prepared and protected over time.

### **How would the Consumer HELP Fund work?**

A portion of the premiums collected by insurance companies would be deposited into the Consumer HELP Fund, which would be administered by the U.S. Treasury and grow tax-free. The Fund would only be accessed when private insurers and state catastrophe funds have paid losses in excess of a defined threshold. No tax dollars would be used to subsidize the Consumer HELP Fund, and insurance companies would not have access to the Fund for any purpose other than to pay claims from catastrophes that meet certain conditions specified in the law. Utilizing the capacity of the federal government would help smooth out fluctuations consumers currently experience in insurance prices and availability because of exposure to large catastrophic losses and will provide better protection at a lower price.

**Will consumers save money if Congress creates the Consumer HELP Fund?**

Yes, the Consumer HELP Fund will help contain the cost of homeowners insurance. The money paid into the Consumer HELP Fund stays in the U.S. Treasury where it will be available to help consumers recover from catastrophes. The same cannot be said of money paid to reinsurers, much of which flows to Bermuda, London, Tokyo or Paris, where, after a year with no catastrophes, it becomes profit. The Consumer HELP Fund saves money to help catastrophe victims, where it grows tax-free to pay future catastrophe losses. Money not paid out in one year remains in the Fund to pay for losses in subsequent years. This is a far more efficient way to prepare for the economic devastation of major catastrophes.

**What other benefits can we expect if the Consumer HELP Fund is established?**

The Consumer HELP Fund would make it more likely that homeowners insurance will continue to be available before and after a major catastrophe. This is critical in catastrophe prone areas, where insurance is necessary for rebuilding, as well as every other state where growth and development depend on a healthy insurance market. Insurance is the oxygen of free enterprise – without it our economy cannot prosper and grow. Florida is a perfect example: There has been unprecedented growth in Florida since Andrew devastated that state, which would not have been possible without a strong insurance market. The Florida Hurricane Catastrophe Fund kept insurers in the state, which made rebuilding, growth and continued prosperity possible.

**How does the Florida Hurricane Catastrophe Fund work?**

Although improvements are needed, the Florida Hurricane Catastrophe Fund (FHCF) serves as a model for other states and the nation. The FHCF provides hurricane reinsurance to insurance companies at rates that are less than half those charged in the private reinsurance market and in amounts that are difficult to obtain from private reinsurers. Lower rates are made possible by the FHCF's non-profit, tax-exempt status, and consumers realize the benefits of lower reinsurance costs when they pay their homeowners' insurance premiums. The FHCF helped make it possible for insurers to continue providing homeowners insurance after Hurricane Andrew and the four major hurricanes that struck Florida last year.

**Why should states that are less vulnerable to catastrophes support the Consumer HELP Fund?**

When there is a gap between the insurance protection consumers buy and the damage caused by a major catastrophe, taxpayers across the country pay much of the difference. Congress has appropriated billions of dollars for disaster relief in the aftermath of Hurricane Katrina. H.R. 4366 requires the rates paid by state catastrophe funds to the Consumer HELP Fund must be based on the risk. States that don't have catastrophe funds don't financially support the Consumer HELP Fund, but they will benefit because the impact from catastrophes on taxpayers and insurance consumers across the country will be less with the Consumer HELP Fund in place.

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### Is America Prepared for the Next Catastrophe?

"Hurricane Katrina and the subsequent sustained flooding of New Orleans exposed significant flaws in our national preparedness for catastrophic events and our capacity to respond to them. Emergency plans at all levels of government—including the 600-page National Response Plan that set forth the Federal government's plan to coordinate all its departments and agencies and integrate them with State, local, and private sector partners—were put to the test and came up short."

The White House, *The Federal Response to Hurricane Katrina: Lessons Learned*, February 23, 2006. <http://www.whitehouse.gov/reports/katrina-lessons-learned/>

"It remains difficult to understand how government could respond so ineffectively to a disaster that was anticipated for years, and for which specific dire warnings had been issued for days. The crisis was not only predictable, it was predicted. If this is what happens after we have advance warning, we shudder to imagine the consequences when we do not. Four and a half years after 9/11, America is still not ready for prime time."

U.S. House of Representatives Select Bi-Partisan Committee to Investigate the Preparation for and Response to Hurricane Katrina, *A Failure of Initiative*, February 16, 2006. <http://halrogers.house.gov/media/PDFs/KatrinaReport-web.pdf>

"What I recognized then was that all emergencies of a certain scale require an integrated response at a local, state and federal level. And that means the key to our success, in creating this kind of security and response capability for America, is expanded partnership with state and local leaders, and the private sector, as we move forward together in the area of catastrophic planning."

Remarks by Homeland Security Secretary Michael Chertoff at the National Emergency Management Association Mid-Year Conference, February 13, 2006.  
<http://www.dhs.gov/dhspublic/display?content=5414>

"Without policy solutions, federal taxpayers in particular face unnecessarily large burdens for future disaster relief. The time has come for the federal government to convert what is *de facto* insurance—relief provided 'after the fact'—into a formal reinsurance system that assesses the cost of such catastrophic risks before such events occur."

Robert E. Litan, The Brookings Institution, "Preparing for Future Katrinas," March, 2006.  
<http://www.brookings.edu/comm/policybriefs/pb150.pdf>

"The scale and scope of the damage from Katrina and Rita are unique, but costly natural disasters are not. The Congress may wish to consider options to incorporate planning for such events in the regular budget process. That planning may help evaluate policies for reducing the costs of future disasters and budgeting in advance for a greater share of those costs."

Douglas Holtz-Eakin before the Committee on the Budget U.S. House of Representatives. *Macroeconomic and Budgetary Effects of Hurricanes Katrina and Rita*, October 6, 2005. <http://www.cbo.gov/ftpdocs/66xx/doc6684/10-06-Hurricanes.pdf>

"With regard to the status of emergency preparedness across the nation, we know relatively little about how states and localities (1) finance their efforts in this area, (2) have used their federal funds, and (3) are assessing the effectiveness with which they spend those funds."

Government Accountability Office, *Emergency Preparedness and Response: Some Issues and Challenges Associated with Major Emergency Incidents*, February 23, 2006. <http://www.gao.gov/new.items/d06467t.pdf>

"Although many of these efforts were successful, it appeared that Hurricane Katrina seriously challenged the capacity of organizations such as the American Red Cross and FEMA to provide expected services to certain populations and in certain areas and at certain times."

Comptroller General David M. Walker on GAO's Preliminary Observations Regarding Preparedness and Response to Hurricanes Katrina and Rita, February 1, 2006. <http://www.gao.gov/new.items/d06365r.pdf>

"...money spent on reducing the risk of natural hazards is a sound investment. On average, a dollar spent by FEMA on hazard mitigation provides the nation about \$4 in future benefits. In addition, FEMA grants to mitigate the effects of floods, hurricanes, tornados, and earthquakes between 1993 and 2003 are expected to save more than 220 lives and prevent almost 4,700 injuries over approximately 50 years."

National Institute of Building Sciences, Multihazard Mitigation Council, *Natural Hazard Mitigation Saves: An Independent Study to Assess the Future Savings from Mitigation Activities*, December 19, 2005. [http://www.nibs.org/MMC/MitigationSavingsReport/natural\\_hazard\\_mitigation\\_saves.htm](http://www.nibs.org/MMC/MitigationSavingsReport/natural_hazard_mitigation_saves.htm)

"Mississippi would have fared much better in Katrina if we had a modern building code in place. Instead, the current patchwork system of no code in some jurisdictions and minimal code in others left our building stock especially vulnerable to the devastation brought by Katrina's winds."

Marc Levitan, *New LSU Hurricane Center study shows stricter building codes and better construction practices will dramatically reduce damage from future Mississippi Gulf Coast hurricanes*, January 19, 2006. <http://app1003.lsu.edu/unv002.nsf/0/bec2b96b843b135a862570fb0064f3d4?OpenDocument>

**PROTECTING...**  
**AMERICA**  
PREPARING FOR AND PROTECTING AMERICA FROM CATASTROPHE

**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  
 Chief Executive Officer, International Code Council

January 25, 2006

**Help America do a better job preparing for catastrophe...  
 Join ProtectingAmerica.org**

Hurricanes Katrina, Rita and Wilma are tragic reminders of how catastrophes threaten the lives, property and economic security of our nation. Catastrophe will strike again. Policymakers must act now to make sure America is better prepared.

The system in place to prepare for and recover from the economic impact of catastrophic events falls short of what we expect from our government and the private sector. At the same time we teach our children the importance of saving for a rainy day, our nation does the opposite: We pay for disaster recovery after the fact. Too many people and businesses are inadequately protected. Too many tax dollars are wasted. Insurance premiums go up, and some people have difficulty obtaining insurance at any price.

ProtectingAmerica.org was formed to educate the public about the need for a comprehensive, integrated solution that will prepare America to respond to major catastrophes in a sensible, cost-effective fashion. Some elements of our agenda include:

- Strengthening financial protection for consumers by establishing catastrophe funds at the state and national level. Catastrophe funds would help pay claims from disasters exceeding a certain level, providing a backstop to the insurance protection consumers buy from private companies.
- Strengthening prevention and mitigation programs through stronger building codes and better enforcement to require new construction to better meet the challenges of catastrophic events. Prevention and mitigation programs save lives and protect property.
- Improving preparedness, response, relief, recovery and rebuilding by providing additional resources from the national and state catastrophe funds to first responders, local governments, state agencies, public and private educational institutions, nonprofit organizations and charities.
- Improving consumer education and consumer protections to make sure people are better prepared for catastrophes before they strike and to empower them to guard against scam artists who take advantage of families when they are at their most vulnerable.
- Creating a rigorous process of continuous improvement by establishing a commission of local, state and federal officials along with the private sector to review and assess recovery efforts after every disaster to identify ways to continually improve our ability to recover from catastrophes.

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January 25, 2006  
Page two

This comprehensive approach is essential. A stronger, coordinated partnership will help victims recover and reduce the human, as well as financial, toll of a major catastrophe. And most importantly, it will ensure that America is better prepared for the consequences of catastrophes and resources are available to help recover from catastrophes without causing irreparable damage to our nation's economy.

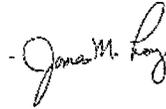
Please join us and learn more about helping America prepare for and protect our citizens from catastrophic loss by visiting our Web site, [www.ProtectingAmerica.org](http://www.ProtectingAmerica.org). By completing and returning the attached form, we will send you updated information that will help you and your organization play an important role in this debate.

Thank you.

Sincerely,



James Lee Witt  
National Co-chair



James. M. Loy,  
Admiral, USCG (Ret)  
National Co-chair



Monday, February 13, 2006

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## **National Catastrophe Fund Will Pay Dividends For All**

BY JAMES LEE WITT AND JAMES M. LOY

California Insurance Commissioner John Garamendi took a bold step last year to alert America that as a nation we are not as prepared as we should be for the consequences of catastrophe.

The step the commissioner took to convene a summit of the nation's insurance regulators, for the purpose of preparing for and protecting America from disaster losses, came at a critical moment as the threat of catastrophic events continues to rise.

The fact that Mr. Garamendi was joined by top regulators from New York, Florida and Illinois underscores the nationwide concern and acknowledges that catastrophes are not contained and isolated events. These policymakers question whether we will have the mechanisms in place to enable families to be prepared for and protected from catastrophes when they strike.

A new coalition of first responders, emergency personnel, building code experts, insurers and others began calling for the creation of a privately funded national catastrophe fund even before the onset of the devastating hurricane season of 2005.

The members of this coalition-ProtectingAmerica.org-applaud the vision and leadership of these insurance regulators from across the country.

The national economic impact of catastrophes is shouldered not by the residents of individual states, but by all Americans. Earthquake faults run all along the West Coast and throughout the Midwest, while hurricanes run throughout the Gulf and eastern shores. Had state, local and federal officials paid closer attention to preparing for natural disasters, the consequences from the 2005 hurricane season might have been less tragic.

As California marks the 100th anniversary of the Great Earthquake of 1906, it is worth noting that if an earthquake struck today at the same location with the same magnitude as that of only a century ago, the likely economic losses are estimated to exceed \$400 billion. Financial recovery in the wake of such a catastrophic event would be an unrivaled national economic challenge for our families, our communities and our nation.

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San Francisco's experience in 1906 is thought by many Americans as the largest of all earthquakes to hit the United States, but the fact is that San Francisco's earthquake doesn't even rank in the top-10 strongest in U.S. history.

Eight of the top-10 U.S. earthquakes occurred in remote parts of Alaska, but two enormous earthquakes occurred along the New Madrid Fault, right in the middle of our nation, in 1810 and 1811. Had the Richter Scale been in use at the time, these quakes would have registered an eight. Their tremors were felt from Mississippi to Michigan, from Pennsylvania to Nebraska.

When the New Madrid series of earthquakes struck, our heartland was vast and uninhabited. Were either of the New Madrid quakes to occur today, the damage would be enormous.

The point is, catastrophes can strike anywhere in America. They are not an issue for our coastlines alone, but for every American in every state.

The 2005 hurricane season brought with it the most extensive and expensive damages our nation has ever incurred. In fact, eight of the most costly catastrophes in U.S. history occurred in the past four years.

As the National Geographic noted at the outset of the 2005 hurricane season, "The mighty Atlantic conveyor belt is in high gear, and sea-surface temperatures are up. That means we could be in for decades of coast-crushing hurricanes."

With every possibility that America will be facing years of record-shattering catastrophes, the commissioners are absolutely right to call for a national financial backstop standing behind the private insurance market to help us repair, rebuild and recover from catastrophe.

The creation of a national catastrophe fund would assure the viability of the private market and its ability to provide coverage to families, businesses and communities.

Such a catastrophe fund would function much in the same way as personal IRAs. Insurers would be required to deposit a portion of homeowners insurance premiums into the fund, where they would grow free of taxes, just like in an IRA. And, just like IRAs, those funds could only be tapped for very restrictive purposes. The fund would only be used to help pay claims in the aftermath of a true catastrophe.

Shortly after the national catastrophe summit, H.R. 4366-the Homeowners Insurance Protection Act of 2005-was introduced in the House of Representatives by two Florida Republican representatives, Ginny Brown-Waite and Clay Shaw. These members of Congress recognize that America can do a better job preparing for and protecting its citizens from natural catastrophes.

H.R. 4366 is a comprehensive approach that protects homes and property at a lower cost. It

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improves preparedness, strengthens first responders, mitigates the impact of a catastrophe on our economy, and reduces the financial burden on consumers and taxpayers.

The bill would use private premium dollars to fund a backstop to the private market and state catastrophe funds. This Consumer HELP Fund will stand behind state catastrophe funds and pay claims when the state fund has exceeded its capacity.

Contributions to the fund would be based on actuarially sound and self-sufficient rates according to local exposures to ensure there will be no subsidization of catastrophe-prone states by other states.

H.R. 4366 is a market-based approach to a true national challenge that should be embraced by all members of the House of Representative and the Senate before the next catastrophe strikes.

## **Earthquake! Could it happen here?**

### **On centenary of San Francisco quake, experts worry**

By James Lee Witt and James M. Loy

As San Francisco prepares to mark the 100th anniversary of the Great 1906 Earthquake, we can't help but think that while the San Francisco quake was certainly the most costly earthquake up to that point in U.S. history, it wasn't the biggest.

Nor can we help but fear that America is not adequately prepared to meet the economic challenges of a replay of either the San Francisco earthquake or the far larger New Madrid earthquakes of 1811.

San Francisco's 1906 earthquake leveled much of the city. It is estimated that as many as 3,000 people lost their lives and 225,000 of the city's 400,000 residents were left homeless following the catastrophe.

The earthquake struck at about 5 a.m. on April 18, 1906. For about a minute, strong shocks and constant shaking emanated from the epicenter on the San Andreas fault. Shock waves were felt from Oregon to Los Angeles and east as far as Nevada. The US Geologic Survey's (USGS) analysis of the event found that the plates that support the earth's surface near the city shifted by as much as 18 feet.

Fire raged through San Francisco for three days. When it subsided, 28,000 buildings were destroyed. Damages, according to a National Oceanic and Atmospheric Administration report, were \$400 million, in 1906 dollars.

Catastrophe experts suggest that if the same earthquake hit in the same spot today, the damages would approach \$400 billion. Ninety-five years earlier, beginning on Dec. 16, 1811, and finally ending in February 1812, a series of three earthquakes struck in New Madrid, Mo., mid-way between St. Louis and Memphis. According to the USGS, they were equal to the San Francisco earthquake in force, but caused strong shaking in an area 10 times larger. Those earthquakes changed the course of the Mississippi River, formed new lakes and damaged structures as far away as Cincinnati.

Their shock waves covered more than 1 million square miles, from Mississippi to Michigan, from Pennsylvania to Nebraska. Landslides and extensive subsidence occurred in an area that today would stretch from Cairo, Ill., to Memphis, Tenn.

*The Courier Journal, Sunday, April 16, 2006 – Page 2*

Damage was limited because those earthquakes struck when the region was a vast wilderness, a part of the newly acquired Louisiana Purchase. Today, millions of American families make their homes right on top of the New Madrid fault. Mid-America cities like Nashville, St. Louis, Louisville, Memphis and Little Rock would all suffer were we to experience a replay of the New Madrid earthquakes. Because the area is host to countless natural gas lines and other critical national infrastructure, the entire country would suffer from the collateral damage.

The New Madrid series provides a compelling historical lesson and warning -- earthquakes can happen anywhere, and when they strike in the heartland, they can affect a huge geographic region.

The New Madrid earthquakes raise a critical question: How prepared are we for a second round? The answer is a disappointing, "not enough."

Unlike California, where earthquake awareness is a way of life, the same has not been historically true in much of the heartland.

Fortunately, earthquake education has recently been mandated in some Mississippi Valley states, the National Earthquake Hazards Reduction Program has expanded its efforts in the area, and most states in the earthquake zone have adopted better building codes.

Those codes only apply to new buildings, and cover only a fraction of structures in the area of the New Madrid fault line. Most of the existing homes, schools and commercial buildings have not been designed to withstand the stress of earthquakes, so enormous destruction could be expected when the next tremors roll.

State insurance commissioners from across the country have recently been sounding an alarm that we are not prepared to meet the economic consequences of catastrophes. They are calling for the creation of a privately funded national "catastrophe fund" as a backstop to stand behind state funds and the private insurance market to help us repair, rebuild and recover from catastrophes.

Such a fund would assure the viability of the private market and its ability to provide coverage to families, businesses and communities. Insurers would be required to deposit a portion of their premiums into the fund, where they would grow free of taxes. The fund could only be tapped for restrictive purposes -- to help pay claims in the aftermath of a true catastrophe and to prepare our communities before one strikes.

A national catastrophe fund would be a true private-public partnership. All monies in the fund would come from the private sector.

*The Courier Journal, Sunday, April 16, 2006 – Page 3*

This comprehensive and integrated program would increase public awareness through improved education, and allow for better coordination with state, federal and local mitigation and recovery efforts. The fund would also strengthen emergency response and provide contingency monies to expedite the rebuilding after a major event.

Legislation to create a privately funded catastrophe fund has been introduced in the U.S. House of Representatives. Hopefully, it will be enacted before the next earthquake strikes.

*The writers are co-chairmen of ProtectingAmerica.org. Mr. Witt is the CEO and chairman of James Lee Witt Associates, a public safety and crisis management consulting firm, and the former director of the Federal Emergency Management Agency. Admiral Loy is senior counselor at The Cohen Group, a global strategic consulting firm, and is the former commandant of the U.S. Coast Guard and former deputy secretary of the Department of Homeland Security.*

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# The Washington Times

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Friday, March 3, 2006

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## When the next catastrophe strikes

By James M. Loy

There are few places in America that are immune from the physical threat of catastrophe, and none would be exempt from the economic consequences if catastrophe struck today.

The onslaught of Hurricanes Katrina, Wilma and Rita provided sobering insights into the shortcomings of our preparedness for catastrophic storms. To this day, the nightly news and the daily newspapers remind us of the devastation of the 2005 hurricane season.

So terrifying were the storms of 2005 that many people fail to remember that just one year earlier, Florida was hit with four major hurricanes in six weeks. Seven of the 10 most damaging hurricanes in U.S. history have occurred within the past five years.

It would be easy to think that the force and fury of major hurricanes are reserved for the coasts on the Gulf and Southeast. That would be wrong. Since 1900, 11 hurricanes have made direct hits on New England, six have made landfall squarely in New York. In 1938, the most powerful of those hurricanes landed with such force that it became known as "The Long Island Express." It killed 700 people and left 63,000 homeless. If a hurricane of the same force struck New York today, the economic damages could exceed \$100 billion. The potential loss of life would be extraordinary.

Earthquakes, often associated only with California, pose a tremendous threat not just to the West Coast, but to America's heartland as well. April will mark the 100th anniversary of the Great San Francisco Earthquake, the costliest earthquake to ever rock America. Replacement costs for a similar quake today are estimated at \$400 billion.

But there have been worse earthquakes in America. In 1811, the first of a series of earthquakes hit near New Madrid, Mo. Newspaper and eyewitness accounts indicate that these earthquakes probably exceeded the strength of San Francisco's 1906 earthquake.

The epicenter of the New Madrid quakes was midway between St. Louis and Memphis. Those earthquakes changed the course of the Mississippi River and damaged structures for hundreds of miles. Their shock waves covered more than a million square miles, from Mississippi to Michigan, from Pennsylvania to Nebraska.

Damage was limited because those earthquakes struck in an area that at the time was a vast wilderness, a part of the newly acquired Louisiana Purchase. Today, millions of American families make their homes right on top of the New Madrid fault. Families in

The Washington Times, Friday, March 3, 2006 – Page 2

middle-America cities -- like Nashville, St. Louis, Memphis and Little Rock -- would all suffer were we to experience a replay of the New Madrid earthquakes.

Fortunately, policy-makers have finally begun to recognize that catastrophe can strike anywhere in America, and that better preparation and protection must be national priorities. Unfortunately, the debate has been limited primarily to investigating the failures in the government response to Katrina, on the rebuilding of New Orleans and on structural changes to the federal bureaucracy.

In addition to debating the government response and structure, we need to find private-sector solutions as well. We need comprehensive, integrated solutions at the local, state and federal levels that leverage the knowledge and expertise of the private sector in an effort to mitigate the potential damage during a catastrophic event and to ensure that adequate financial resources are available to lessen the economic consequences in catastrophe's aftermath.

America's private insurance industry is efficient and effective in providing financial resources to families that have been victims of foreseeable losses and small-scale catastrophes. But, in total, the property and casualty insurance industry has only about \$400 billion of capital to cover all claims for all lines of insurance. While this amount is adequate to cover predictable losses, it may well be inadequate to cover unpredictable mega-catastrophes. Why take that chance?

Supplementing those reserves to make sure consumers will be protected could be easily accomplished by creating privately funded state and national catastrophe funds. These funds would include deposits of private insurance-company revenues that could grow free and would be used to pay the extraordinary claims following a catastrophe. A limited amount of the investment income could be used to support consumer education, expand first-responder programs, strengthen building codes and improve code enforcement.

A bipartisan group of representatives has introduced legislation that would allow for a IRA-like national financial backstop. It is important legislation that should be considered before the next catastrophe strikes.

*Adm. James M. Loy (Coast Guard Ret.) is co-chairman of ProtectingAmerica.org. He also served as deputy secretary of the Department of Homeland Security.*

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Testimony of  
The National Association of Insurance Commissioners

Before the  
Subcommittee on Housing and Community Opportunity

Of the  
House Committee on Financial Services

Regarding:  
Is the Housing Market Prepared for a Natural Disaster?

June 28, 2006

Room 2128  
Rayburn House Office Building

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

**Testimony of Kevin McCarty  
Florida Insurance Commissioner  
On Behalf of the National Association of Insurance Commissioners**

Mr. Chairman and esteemed members of the Subcommittee on Housing and Community Opportunity, I thank you for the opportunity to testify on the question before you today.

My name is Kevin McCarty, and I am the Insurance Commissioner for the State of Florida. I am also the Chairman of the Property & Casualty Insurance Committee of the National Association of Insurance Commissioners (the "NAIC") as well as chair of the Committee's Catastrophe Insurance Working Group.

The NAIC, through these groups, has been involved in research and analysis of the effect of natural disasters on our society for a number of years, and is currently heavily engaged in developing a comprehensive national plan for managing the economy wide risk of catastrophic natural disasters. In addition, the NAIC has adopted resolutions, both in December of 2005 and most recently in June of 2006, supporting a national disaster plan and calling for a federal commission to further study the issues and any alternative solutions.

The Committee has phrased today's question succinctly: the problem is an economic problem, not simply an insurance problem. I have spent much of my professional career working on issues resulting from the economic effects of natural disasters, both before they occur as well as after they occur. As a result of these experiences, I firmly believe that insurance is a critical, but not complete, answer to our nation's resilience in the face of catastrophic natural disasters. Insurance claim payments are the economic catalyst that restarts an affected region in the aftermath of a natural catastrophe. But, as experience repeatedly shows, pre-event disaster planning, effective mitigation and rational building codes are crucial parts of the solution.

My testimony today focuses on the role of insurance within the context of the question: "Is America's Housing Market Prepared for the Next Natural Catastrophe?" If I were to try and offer a simple answer to this terribly important question, I am afraid that answer would have to be "maybe, up to a point."

**Is America's Housing Market Prepared for the Next Natural Catastrophe?**

Today, the ability of housing markets, as well as local and regional economies, to withstand and recover from the next natural catastrophe depends critically upon what type of peril creates the disaster, where the disaster occurs, and the severity of the disaster event. The different types of natural disasters are managed very differently. This, in turn, can lead to highly different outcomes.

Wind events, including tornados and hurricanes, are considered a basic covered peril in the vast majority of homeowner's insurance policies. Flood, on the other hand, is only rarely written by the private insurance industry for residential property; since 1968 the National Flood Insurance Program (NFIP) has been the public solution to managing this risk. Finally seismic events, especially earthquakes, are not considered a standard covered peril, and aside from the California Earthquake Authority, there is no public mechanism to underwrite the risk, so coverage is restricted to being an optional coverage, where available, in the private insurance market.

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

I know that there is pending legislation, both in this body and in the Senate, to improve and modernize the NFIP. I encourage you in your efforts, especially to create current risk assessment maps and tools, and to bring rationality into the pricing of flood insurance. An under-priced policy that does not accurately reflect the risk of the event only makes the economic problems associated with flood worse.

If the next natural catastrophe is an earthquake, the ability of the affected housing markets regional economies to endure and recover is going to be dependent upon the

degree of disaster relief coming from the federal government. The reason is really quite simple; the majority of residential property in earthquake prone areas is not insured for this very real risk.

In California, for example, it is estimated that the take-up rate for optional earthquake insurance is about 14%. The same take-up rate is frequently cited for the earthquake prone areas in the Midwest's New Madrid area, and along the eastern seaboard's seismically active areas.

The economic results of a major earthquake could be disastrous. Consider a recent widely referenced study by Risk Management Solutions, a catastrophe modeling firm, which estimated the losses associated with a repeat of the 1906 San Francisco earthquake. While much has been made of the reported estimate of \$50 to \$80 billion in insured losses, the much more disturbing number is an estimate of total property damage of around \$260 billion. How will the majority of the damage be rebuilt without insurance? Without houses for people to live in and business for people to work in, how will the economy recover?

At the same time, in a recent article in *Nature*, Yuri Fialko, of the Scripps Institution of Oceanography at La Jolla, California, analyzes movements along the southern end of the San Andreas Fault, which has been dormant for 250 years. The recent analysis suggests the fault could be ready to end its dormant cycle with a seismic movement in excess of that experienced during the 1906 San Francisco earthquake or the 1994 Northridge earthquake.

Given these scenarios, one might expect the market for earthquake insurance to be growing. Instead we have seen the opposite. After Northridge 35% of residential property owners had coverage, and now it is 15%. Yet, across the country, insurance companies are making the decision to either substantially reduce, or in some cases eliminate, their earthquake coverage offerings.

If the next natural catastrophe is another hurricane, or series of hurricanes, the impact is likely to be quite different than either of the two scenarios I have described. The ultimate impact is going to depend upon the ferocity of the storm and the level of preparation that has occurred in the affected areas.

For “moderate” storms, the wind damage will be covered by standard homeowner’s policies, so insurance claim payments will quickly find their way to the affected areas so long as the insurance companies have the financial wherewithal to pay the claims. But make no mistake; there is a finite limit to those financial resources. Whether it is in the Gulf of Mexico, along the Carolinas, or in the Northeast, a mega storm, or series of storms, could render parts of the private insurance market insolvent. Being cognizant of this reality, it is not too surprising to see the reports of insurance companies restricting or eliminating their underwriting activities in these areas.

Especially for hurricanes, the private insurance market relies heavily on reinsurance (insurance for insurance companies). Catastrophic reinsurance is obtained in a highly competitive global marketplace. While it is true that the supply of capital in the reinsurance market moving into 2006 has increased, it is also true that the demand has increased even more; the result being a constriction in the market that is expected to continue for some time.

More specifically, following the 2004-2005 hurricane seasons, we have witnessed a significant constriction of global reinsurance funds available to the US markets and primary insurers. Reports of rate increases over 300% or more are not uncommon; so are reports of significant restrictions in the amount available to any one company as well as reports of the inability of some insurers to obtain reinsurance coverage at any price.

A survey conducted by the Reinsurance Association of America and the Association of Bermuda Insurers and Reinsurers was recently provided to the NAIC Catastrophe Working Group and reinforces this point with an estimate of global reinsurance capital capacity for natural disasters at around \$55 billion. This amount of global capacity is leaving a shortage for the risks, primarily hurricane, that are currently being written by the private industry in the U.S. It would be woefully inadequate if the take-up rate for seismic events were increased to prudent levels.

#### **What Can Be Done?**

I do not think we can truly prepare the housing market for a mega-catastrophe without a comprehensive national strategy. As I said earlier, insurance is critical, and I believe the offer of catastrophic coverage at actuarially fair prices needs to be greatly expanded.

However, insurance is only one of the critical components needed to truly provide a level of economic security in the face of catastrophic natural disasters for all Americans.

Currently, the United States is one of the only industrialized nations in the world not to have a comprehensive catastrophe plan. Part of the reason is historical. In 1945 Congress wisely passed the McCarran-Ferguson Act, which delegated most insurance regulation to the states, as insurance issues were deemed to be more effectively regulated at the state level. This act has been the bedrock upon which the United States has built a robust and profitable insurance industry. However, that does not mean the federal government is not involved in disaster prevention and recovery. In the last two years alone, the federal government issued 115 major disaster declarations in more than 30 states. In the aftermath of Hurricane Katrina, the federal government authorized over \$100 billion in monies to be used by HUD and FEMA to help catastrophe victims.

It is like the old television commercial featuring the auto mechanic – “You can pay me now, or you can pay me later.” Whether it be the tax treatment of insurance company reserves as in HR 2668, the encouragement of mitigation efforts, or a federal financial backstop like those presented in HR 4366 and HR 846, it will be more cost effective in the long-run if the federal government works with the States in a comprehensive catastrophe planning and preparation system, as opposed to the current “system” of paying for the consequences of a mega-catastrophe after-the-fact.

Based on my experience as Florida’s Insurance Commissioner, I will now outline some things that the federal government can do to become involved in helping the housing market survive another catastrophic event.

#### **Step 1: Improve Disaster Preparedness and Disaster Response**

Disaster planning and disaster response are the very first steps to saving lives and protecting communities. The sad evidence from Hurricane Katrina bears solemn testament to this fact. The recently released study of community disaster preparedness by the Department of Homeland Security suggests there is still much to be done around the country. The report states the “current catastrophic planning is unsystematic and not linked within a national planning system.” It states that “this is incompatible with 21st century homeland security challenges...” It goes on to suggest, “the need for a

fundamental modernization of our Nation's planning processes." The NAIC has endorsed disaster planning as a top priority and maintains disaster preparedness manual for use by all states.

### **Step 2: Build Better Homes**

Catastrophic events like tsunamis hitting the west coast, volcanic eruptions in the Pacific Northwest, a hurricane through downtown Manhattan, and earthquakes along the San Andreas and New Madrid faults have all occurred in our nation's past. It is inevitable that destruction from these perils will occur sometime in our future. We cannot possibly stop natural disasters, but there are measures we can take to mitigate damage. The first component of any comprehensive national strategy must be mitigation.

By mitigation, I mean preemptive measures taken to reduce or eliminate risk to property from hazards and their effects. In practical terms, this involves strengthening building codes for new structures by making them more resistant to hazards such as wind, flood, and earthquakes. It also means stricter state and local guidelines to limit construction in highly hazardous areas. Also, it means a substantial effort to retrofit existing structures in hazardous areas.

After an event, an economic recovery depends upon the ability of people to return to livable houses, get their children back in safe schools, and go back to work for their families. Mitigation has proved cost effective in numerous studies and there is growing evidence that safe building is becoming important to the consumer. In Tulsa, houses with "safe rooms" are significantly more marketable and desirable than houses without safe rooms. An article in the New York Times on June 22 highlighted the growing interest and demand for "hurricane proof" homes in Texas, Florida and Mississippi.

### **Step 3: Mitigate by Improving Infrastructure**

Although it may be outside the purview of this committee, another element of improving the homeowners market is to improve our nation's infrastructure. This includes dikes, levees, tunnels, bridges, solid waste facilities, transportation facilities, and roads. Let us recall during the Hurricane Katrina tragedy in New Orleans, many of the structures withstood the initial damage of the storm, only to be destroyed due to the failed levee system. The American Society of Civil Engineers' March 2005 Report Card showed

deteriorating conditions in 13 of the 15 infrastructure areas surveyed. Insurers are becoming reluctant to insure structures in areas with outdated or outmoded infrastructure risks. A commitment to improving our infrastructure, especially as it relates to structures that place homes in greater risk during a catastrophic event, will help prevent or mitigate damages to homes.

#### **Step 4: Expand the Capacity of the Insurance Marketplace**

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

In order to expand the capacity base, both the quantity available and the terms at which coverage is offered, several things can be done. The first would be maximizing the private sector capacity by imitating the other major industrialized nations and allowing for tax deferred reserves against potential catastrophic losses. While various plans have been introduced over the last several years, no action has been taken. An analysis by my office suggests that had this been done when first introduced, there would be somewhere between \$20 and \$30 billion (depending on assumptions) in reserves available to pay for catastrophic insured losses.

More recently, HR 4836 was introduced that would allow property owners to create tax advantaged catastrophic savings accounts for either paying their deductibles in the event of a natural catastrophe or for making effective mitigation investments to their property. This is an interesting concept that could also serve to expand capacity.

Lastly, the idea of a federally sponsored reinsurance backstop for large scale natural catastrophes is an idea I encourage you to develop further. If based on actuarial principles, and with the right incentives in place, such a program could encourage better building, better disaster planning and response, and provide the capital support necessary

to ensure the stable operation of the insurance market, which in turn provides stability to the housing market. And it can be done without creating another heavily subsidized program.

### **The Florida Experience**

Before the federal reinsurance backstop, I would also encourage you to consider the development of state or regional catastrophe funds. As I close my testimony, I would like to share with you the recent catastrophe experience in Florida as evidence of how important all of these ideas can be. As you know, Florida has been hit by eight major hurricanes in a 15 month period, creating over \$35 billion in insured losses. As a matter of fact, seven of the ten most expensive, in insured losses, natural disasters in U.S. history have occurred in the last two years and have touched Florida, either in part or exclusively. Yet, by any measure of economic performance you prefer to examine, you cannot find any lingering impact. A large part of the reason for this is that we have developed and implemented a rigorous building code, we have one of the most comprehensive disaster response and preparation programs in the nation, and we have developed public and private partnerships to enhance the insurance marketplace.

Florida, like many states, is growing rapidly. Projections from the Florida Demographic Estimating Conference show an estimated growth of five million people in Florida from 2005 to 2020. These five million people will require estimated 900,000 homeowner's insurance policies. In order to maintain this growth rate, the Insurance Information Institute estimates a minimum of \$7 billion must be added to Florida's insurance market, or roughly \$500 million in new capital every year. Without a dramatic overhaul in how we insure against catastrophic damage, the future of the homeowners insurance marketplace in Florida and other states in the Gulf Region is grim. We cannot simply hope to maintain the *status quo*. We must decrease the risk, stabilize the business environment, and infuse more capital into the marketplace.

Fortunately, the Florida Legislature made several proactive changes to our insurance laws that have stabilized the marketplace:

- In 1995, the creation of the Florida Hurricane Catastrophe Fund (CAT Fund), which has been the lynchpin of Florida's property insurance market. Florida's

policyholders have ultimately benefited through reduced insurance premiums – The CAT Fund premium for reinsurance purposes is generally three to four times less expensive than the private reinsurance market due to its tax-exempt status, low administrative costs, and has no profit or risk-load. In addition, the CAT fund has fostered a true private-public partnership, wherein private insurers are strong proponents and when faced with buying coverage at different layers, more than 85% are buying at the highest level of CAT fund coverage (the 90% layer).

- In 2002, the creation of Citizens Property Insurance Corporation – Following Hurricane Andrew in 1992, the State of Florida endured several insurer insolvencies and a virtual collapse of the private insurance market in some segments of the homeowners market in Florida. The Florida Legislature created two quasi-governmental agencies, which eventually merged into Citizens Corporation Insurance Company --- the state insurer of last resort for Floridians. Although we struggle with growth in Citizens, the fact remains that our citizens have been able to obtain insurance for their properties following two remarkable hurricane seasons that have caused a number of insurers to, at least temporarily, reduce their Florida exposure.

More recent legislative bills and packages have also been aimed at enhancing and stabilizing the marketplace:

- Funding the Deficit of the Citizens Corporation – the State Insurer of Last Resort.
- Restricting the risk portfolio for Citizens Corporation.
- Augmenting the reserves of the Florida Hurricane Catastrophe Fund.
- Incentivizing Insurer Capital Build-Up by creating a program to issue surplus notes to authorized residential insurers.
- Authorizing the Florida Comprehensive Hurricane Damage Mitigation Program which authorizes free home inspections, and matching grants (of up to \$5,000 per policyholder) to encourage policyholders to retrofit older homes to make them more resistant to wind damage; and

- Overhauling the insurance rating guidelines to allow more flexibility for the industry in determining rates.

In addition, our executive branches of government need to play an integral role in improving the marketplace. Florida became the first state in the nation to take a proactive role in promoting the state, its jobs, climate and opportunities to national and international insurance companies. During 2005, the Florida Office of Insurance Regulation created a new unit, called "Business Development and Market Research". The new unit is responsible for the expansion and retention of companies in the Florida marketplace and serves as the information clearinghouse for the collection and dissemination of public insurance data. The Business Development Section is responsible for promoting the benefits of expanding or moving lines of business to Florida and facilitating the process for established and new insurance companies. Their primary role is to identify solvent companies, communicate the positive aspects of the Florida marketplace, and encourage companies to apply for a Certificate of Authority or license.

We hope that all of these changes will achieve a reduction of risk, larger catastrophe reserves, and the infusion of new investment capital. At the same time we realize that a mega-catastrophe in any state, absent a federal backstop, devastate our economy and its citizens, and severely cripple the U.S. property insurance industry. The \$100 billion event will come sooner or later. The economic result or impact will depend largely on what we do now.

Thank you for your time today. Ladies and Gentlemen of this Committee, I commend you for your vision in holding this hearing. The economic security of our country is dependent to a large extent on the result of your deliberations.



**Consumer Federation of America**

**Testimony of**

**Travis Plunkett, Legislative Director  
Consumer Federation of America**

**Before**

**The U.S. House of Representatives  
Committee on Financial Services  
Subcommittee on Housing and Community Opportunity**

**Is America's Housing Market Prepared for the Next Natural  
Catastrophe?**

**June 28, 2006**

Good morning Chairman Ney, Ranking Member Waters and members of the Subcommittee. My name is Travis Plunkett and I am Legislative Director for the Consumer Federation of America. CFA is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education. I appreciate the opportunity to provide CFA's comments on the impact of natural disasters on the ability of homeowners to purchase insurance. This issue has been one of special concern to CFA and our Director of Insurance, Bob Hunter, for over a decade. Bob, as you may know, is a former Federal Insurance Administrator under Presidents Ford and Carter who helped launch the National Flood Insurance Program.<sup>1</sup>

### **Introduction**

In order to understand why many homeowners in coastal areas are now experiencing sharp insurance rate hikes, cutbacks in coverage and non-renewals, it is important to examine developments in the insurance industry since the devastating losses caused by Hurricane Andrew in Southern Florida in 1992. Hurricane Andrew was a shot across the bow of the insurance industry. Insurers had not properly prepared for a storm of this magnitude. In the wake of the storm, insurers made massive changes in how they did business:

- They adopted new ratemaking techniques, based on scientific models that forecasted wind damage many years into the future, rather than using a simple history of hurricanes for the last few decades.
- They "purified" their portfolios of business along the nation's coasts by non-renewing hundreds of thousands of people and balancing their risk near the coasts.
- They sharply increased out-of-pocket costs for consumers by introducing much higher percentage deductibles, caps on replacement cost payouts and other coverage cuts.
- They introduced state-only insurance company "running mates" to lower the possible impact on national corporate capital.

Although this upheaval hurt consumers with higher prices and less coverage, consumer groups supported most of these changes because we saw that insurers had not properly prepared for large hurricane risk in heavily developed areas. It is very important to note that consumers were also promised that the changes of the mid 1990s would bring stability into the coastal insurance markets, a promise that the insurers have now broken.

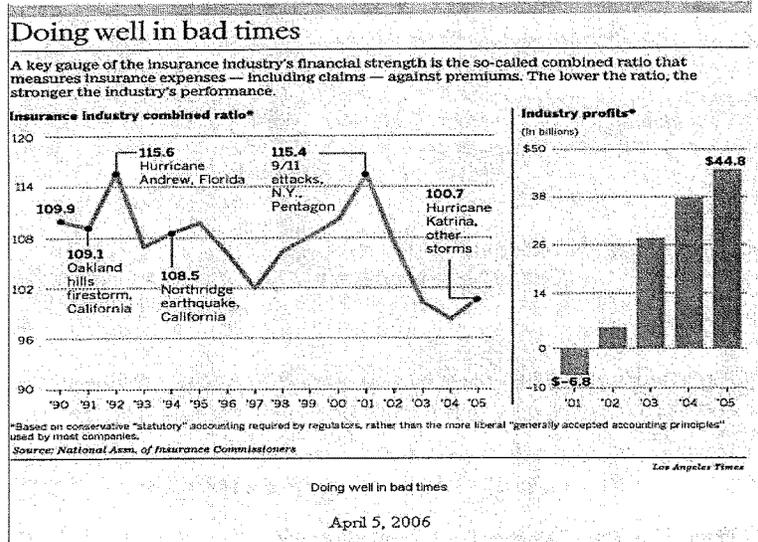
In the wake of the hurricane activity of the last two years, property-casualty insurers are once again causing major market upheaval that is harming consumers. This time the upheaval is precipitous and unnecessary. It demonstrates either gross insurer mismanagement since Hurricane Andrew or duplicity and opportunistic price gouging today.

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<sup>1</sup> Bob Hunter is also a former Texas State Insurance Commissioner, a Fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries.

Where Have All the Risk Takers Gone?

In 2004, four major hurricanes hit Florida, but the property-casualty insurance industry enjoyed record profits of \$38 billion. In 2005, Hurricane Katrina resulted in the highest hurricane losses ever, but the insurance industry also had another record year of profits, which reached \$45 billion.<sup>2</sup> Here is a chart from the *Los Angeles Times* article on this subject:



The property-casualty industry is overcapitalized because of all of the retained earnings it is piling up. At year-end 2005, the industry had \$427 billion in capital, up from \$297 billion in 2001. The net premium written to surplus ratio as of 2005 was one to one, which means that for every dollar of premium that was sold, the industry had a dollar of surplus. Historically, this is an extremely safe leverage ratio. As a result, with the exception of property insurance on the nation's coasts, insurance prices are falling and coverage is easily available.<sup>3</sup>

Data on existing industry profits and surplus is extremely relevant to any discussion about whether the industry can handle catastrophe losses in the future. This data shows that

<sup>2</sup> Gosselin, Peter, "Insurers Saw Record Gains in Year of Catastrophic Losses," *Los Angeles Times*, April 5, 2006.

<sup>3</sup> Council of Insurance Agents and Brokers, news release, "Commercial PC Rates Hold Flat or Drop Slightly for First Quarter 2006 Renewals, Council Survey Shows," April 19, 2006. According to the Council, commercial property-casualty rates held steady or fell slightly during the first quarter of 2006, with renewal premiums for half of all account sizes remaining stable or dropping between 1 and 10 percent in the first three months of the year.

because of the market developments since Hurricane Andrew that have reduced the industry's exposure to risk, the industry has not only survived the two worst hurricane years on record, but has done so with record profits. Secondly, surplus and windfall profits can be allocated for unexpected losses in the future.

Some might argue that insurers are risk takers. That may be true for the reinsurance industry, but it is certainly not true for the primary market. The primary market has succeeded in eliminating much risk. This is not an opinion, but a simple fact.

If one purchases a property-casualty insurance company's stock, with few exceptions, one has bought into a business that is lower in risk than the market in general, hurricanes notwithstanding. This is shown in any Value Line publication, which tests the riskiness of a stock. One key measure is the stock's Beta, which is the sensitivity of a stock's returns to the returns on some market index, such as the Standard & Poor's 500. A Beta between 0 and 1, such as utility stocks, is a low-volatility investment. A Beta equal to 1 matches the index. A Beta greater than 1 is anything more volatile than the index, such as a "small cap" fund.

Another measure of a shareholder's risk is the Financial Safety Index, with 1 being the safest investment and 5 being least safe. A third measure of risk is the Stock Price Stability reported in five percentile intervals with 5 marking the least stability and 100 marking the highest.

Consider these numbers from the Value Line of March 24, 2006 for Allstate, which has taken a leading role in claiming that catastrophe insurance is too risky for the private market alone to bear:

Beta = 0.90                  Financial Safety = 2                  Stock Price Stability = 90

The top 12 insurers in Value Line post these average results:

Beta = 0.95                  Financial Safety = 2.2                  Stock Price Stability = 84

By all three measures, property-casualty insurance is a below-average risk business: safer than buying an S&P 500 index fund. Another measure of insulation from risk is the record industry profits for 2004 and 2005 that have already been mentioned.

How did insurers do it? Some of the answers are clear:

First, insurers made intelligent use of reinsurance, securitization and other risk spreading techniques. That is the good news.

Second, after Hurricane Andrew insurers modernized ratemaking by using computer models. This development was a mixed blessing for consumers. While this caused huge price increases for consumers, CFA and other consumer leaders supported the change because we saw insurers as genuinely shocked by the scope of losses caused by Hurricane Andrew. Insurers promised that the model, by projecting either 1,000 or 10,000 years of experience,

would bring stability to prices. The model contained projections of huge hurricanes (and earthquakes) as well as periods of intense activity and periods of little or no activity.

In the last few months, however, CFA has been shocked to learn that Risk Management Solutions (RMS) and other modelers are moving from a 10,000-year projection to a five-year projection, which will cause a 40 percent increase in loss projections in Florida and the Gulf Coast and a 25 percent jump in the Northeast. It is truly outrageous that insurers would renege on the promises made in the mid 1990s. CFA has called on regulators in coastal states to reject these rate hikes.

It is clear that insurance companies sought this move to higher rates. RMS's press release of March 23, 2006 states:

'Coming off back-to-back, extraordinarily active hurricane seasons, the market is looking for leadership. At RMS, we are taking a clear, unambiguous position that our clients should manage their risks in a manner consistent with elevated levels of hurricane activity and severity,' stated Hemant Shah, president and CEO of RMS. 'We live in a dynamic world, and there is now a critical mass of data and science that point to this being the prudent course of action.'

The "market" (the insurers) sought leadership (higher rates), so RMS was in a competitive bind. If it did not raise rates, the market would likely go to modelers who did. So RMS acted and other modelers are following suit.<sup>4</sup> It is simply unethical that scientists at these modeling firms, under pressure from insurers, appear to have completely changed their minds *at the same time* after over a decade of using models they assured the public were scientifically sound.

In a third major development, insurers have not only passed along gigantic price increases to homeowners in coastal areas, but they have also sharply gutted coverage. Hurricane deductibles of two to five percent were introduced. Caps on home replacement costs were also added. State Farm has a 20 percent cap. Other insurers refuse to pay for any increased replacement costs at all, even though demand for home rebuilding usually surges in the wake of a hurricane, driving replacement costs up sharply. Insurers also excluded coverage for laws and ordinances, so that if a home has to be elevated to meet flood insurance standards or rewired to meet local building codes, insurers no longer have to pay.

Finally, insurers have simply dumped a great deal of risk, non-renewing tens of thousands of homeowner and business properties. Allstate, the leading culprit after Hurricane Andrew, is emerging as the heavy once more in the wake of Katrina. After Andrew, Allstate threatened to non-renew 300,000 South Floridians, provoking a state moratorium on such action. Today, Allstate is non-renewing even in Long Island.

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<sup>4</sup> According to the *National Underwriter's* Online Service on March 23, 2006, "Two other modeling vendors—Boston-based AIR Worldwide and Oakland, Calif.-based Eqecat—are also in the process of reworking their hurricane models."

These actions present a serious credibility problem for insurers. They told us, and we believed, that Hurricane Andrew was their “wake up” call, with the size and intensity surprising them and causing them to make these massive adjustments in price, coverage and portfolio of risk. What is their excuse now for engaging in another round of massive and precipitous actions?

Insurers surely knew that forecasters had predicted for decades that an increased period of hurricane activity and intensity would occur from the 1990s to about 2010. They also surely knew a storm of Hurricane Katrina’s size, location and intensity was possible. The *New Orleans Times-Picayune* predicted exactly the sort of damage that occurred in a series of articles four years ago.<sup>5</sup>

Take Allstate’s pullout from part of New York. It is very hard to look at this move as a legitimate step today when no pullout occurred after Hurricane Andrew. Why isn’t the probability of a dangerous storm hitting Long Island already accounted for in the modeling – and rate structure – that were instituted after Hurricane Andrew? This type of precipitous action raises the question of whether Allstate is using the threat of hurricane damage as an excuse to drop customers they have had but do not want to retain for other reasons, such as clients in highly congested areas with poorer credit scores. Whether it was mismanagement that started a decade ago or the clever use of an opportunity today, consumers are being unjustifiably harmed. Insurance is supposed to bring stability, not turmoil, into peoples’ lives.

#### **Should Congress Expand Federal Backup to Wind Coverage While the Flood Insurance Program is Near Collapse?**

Calling for greater federal involvement in catastrophe insurance is remarkable, given the significant problems that the National Flood Insurance Program (NFIP) is currently experiencing. The NFIP was brilliantly conceived. Taxpayers would subsidize existing construction but new construction would not be allowed to occur in the highest-risk areas, such as high velocity “V” zones. In lower risk areas that would still experience serious wind damage and flooding, all new construction would have to be elevated according to local building codes.

However, poor management by the Federal Emergency Management Agency and lax enforcement of building requirements by local governments has made the program insolvent. Flood maps that FEMA was originally supposed to update every three years are antiquated. Some are over 20 years old. As a result, flood levels that were predicted before Hurricane Katrina were more than ten feet too low in areas like Hancock County, Mississippi. Moreover, the areas of predicted high-risk were much too small. Many who appeared to be “outside” the flood plain were actually in it and should have been required to buy flood insurance coverage. Since rates and mitigation requirements are based on these maps, taxpayers are subsidizing unwise construction as a result.

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<sup>5</sup> McQuaid, John; Schleifstein, Mark, "Washing Away," *New Orleans Times Picayune*. June 23-27, 2002.

Problems with the National Flood Insurance Program are so dire that in testimony before the Senate Banking Committee,<sup>6</sup> CFA raised the frightening possibility that it might have to be ended. If the program encourages unwise construction in flood plains, it is a danger to the nation rather than a blessing. If the program lures people into flood plains, if it subsidizes construction in unsafe places, if it can't stop communities that defy the program's mitigation requirements, if it falsely assures people that they are in a low-risk area that does not need flood insurance, then either it must be reformed to keep the promises of safer construction made to the taxpayers when the program was begun or it must be abolished.

The idea of Congress expanding taxpayer involvement in catastrophe insurance by creating a taxpayer-backed disaster insurance pool is almost laughable given the federal failure in handling flood insurance. Congress should stick to trying to repair this program and to proving to taxpayers it can actually end subsidies of unwise construction. It should bring the program into fiscal soundness before thinking about expansion into the wind insurance field. CFA opposes any expansion of federal authority regarding catastrophe insurance until the NFIP is fixed.

#### **If Insurers Want Out of the Risk-Taking Business, Are They Really Necessary?**

The unmistakable long term trend is that insurers are increasingly avoiding risk and shifting it to consumers and taxpayers. Higher rates, declining coverage and periodic non-renewals on a large scale have gotten to the point where the states and Congress must ask the question: "Do we really need private insurers writing any of this business?" Perhaps insurers should get out of the high-risk business but under terms and conditions that benefit the consumers and taxpayers.

For example, CFA has proposed a Florida fund for all wind insurance coverage in the state. Because of the ability of the state to build reserves tax-free, to avoid purchasing reinsurance and to set up a non-profit insurer, this approach could increase reserves by at least \$3 billion a year if rates stayed the same. The program could be launched through the competitive bidding of contracts with private insurers. The risk of large losses during the transition to a self-funded state plan would be borne by insurers who, after all, aggressively wrote high-risk business and have created the current situation. Assessing all property-casualty insurers for all lines of insurance in Florida, if such a step is necessary, would build up adequate reserves and protect against this "timing risk." If wind coverage by itself is too narrow a base upon which to make such a program work, the state should consider expanding it to cover all lines of homeowners and possibly even the highly profitable auto insurance line. Perhaps an interstate compact could help states along the Gulf Coast to launch this kind of program.

Private insurers would be able to sharply lower their prices as wind coverage was removed from all contracts. Insurers would no longer have excuses for high rates and limited

<sup>6</sup> Hunter, Robert J., testimony before the Senate Committee on Banking Housing and Urban Affairs, "Oversight of the National Flood Insurance Program," October 18, 2005 (available at [http://www.consumerfed.org/pdfs/Flood\\_Insurance\\_Senate\\_oversight\\_testimony\\_101805.pdf](http://www.consumerfed.org/pdfs/Flood_Insurance_Senate_oversight_testimony_101805.pdf)).

coverage. Regulators would no longer have to regulate policies for which they are given inadequate information, in “black box” filings. The market would likely be stabilized and would stay stable: as stable as the property-casualty stock risk has been.

#### **Support for a Federal Role in Catastrophe Insurance is Very Limited**

It is important to note that Congress is phasing out the federal role in the Terrorism Risk Insurance Act, the program that some have pointed to as a model for a federal catastrophe insurance program. Last year, Congress increased the amount of money that insurers would have to pay in the event of future terrorist attacks, eliminated some lines of coverage, reduced potential federal expenditures and rejected proposals to expand the scope of the program. The program is scheduled to completely terminate at the end of 2007 and is likely to do so.

Support for a federal catastrophe program is also limited within the insurance industry. Only a few companies have supported such a program. The American Insurance Association, the Reinsurance Association of America and Lloyd’s America oppose such a plan. For instance, Ms. Wendy Baker, President of Lloyd’s America has said, “We don’t need taxpayer natural catastrophe funds...Lloyd’s is in very good shape going into this hurricane season. And capital markets are showing a robust confidence in us and the wider industry, with billions of dollars coming into the business.”

Simply put, there is no need for the federal government to get into another program covering insurance risk. However, if such a role is contemplated, at the very least a number of important conditions should be met first. As we have already mentioned, the National Flood Insurance Program should be put in order first. Measures must also be taken to ensure that loss of property is clearly and demonstrably reduced. All at-risk properties should be insured for all risks covered by the program and rates should be actuarially sound, with no cross subsidies. The role of the private sector must be maximized and closely regulated. Insurers must not be allowed to adversely select against the program by selecting the lowest risks and leaving the highest risks to taxpayers. Government at the local and state level should also assume financial risk, as a way to provide financial assistance to federal taxpayers and as an incentive for these governments to ensure that home builders and developers abide by building restrictions. Finally, federal financial involvement should be clearly defined and strictly limited. (Please see the attached, “Principles for Protecting Consumers and Taxpayers under a Federal Catastrophe Insurance Program.”)

#### **Answers to Questions in the Hearing Notice**

1. **What role does your organization play, if any, in supporting or enhancing the housing market in the United States?** Through our educational and advocacy efforts, CFA has worked vigorously over the last decade to help Americans of modest means buy and keep their homes. CFA has been a strong advocate of state and federal reforms to eliminate reckless and abusive lending practices, including predatory

mortgage lending, to help Americans protect their income and assets. CFA has also launched a major, national social marketing campaign called *America Saves*, which has helped over fifty thousand low and moderate income Americans build wealth. One of the major goals of *America Saves* is to increase home ownership.<sup>7</sup>

2. **Is there enough insurance capacity to cover the nation's homeowners in the event of a major natural disaster? Has the national market been tested sufficiently to give lawmakers an adequate indication that the market is prepared?** Only a few insurance companies are seeking federal catastrophe backup, an indication that many insurers in the business of underwriting major risks think adequate capacity exists. As stated above, the American Insurance Association, Lloyds of America, the Reinsurance Association of America and other major players in the property-casualty market oppose a federal role and say that they can handle the risk. Additionally, despite record hurricane losses in the last two years, property-casualty insurers have posted record profits and have increased their surplus, pushing their capitalization to the highest levels in history. Reinsurers are gaining capital as well. The use of securitization of risk, such as through "CAT Bonds," is gaining momentum. The *National Underwriter* recently reported that industry experts are saying that, "Catastrophe bonds and other risk securities are seeing steady growth and appear to have a bright future .... despite opinions to the contrary that the vehicles were fated to obscurity just a few short years ago."<sup>8</sup> A federal catastrophe reinsurance program would likely stymie these positive private sector developments.
3. **Is there anything lawmakers can do to ensure that the private market is ready to handle a major disaster? Are there any models that either states or foreign governments have established that lawmakers should consider?** The proper federal role would be limited to facilitate the tax-free buildup of reserves in pools and ensure the proper use of these funds for catastrophic claims. The federal government could also consider encouraging the development of regional pools (coastal state pools) by explicitly authorizing interstate compacts for such a purpose.
4. **Do you anticipate that either rising homeowner insurance rates or a lack of insurance availability will adversely affect the U.S. housing market?** Homeowners are definitely at risk if the states continue to allow insurers carte blanche in unjustifiably raising rates and refusing to renew policies. Maintaining the record homeownership gains of the past decade depends upon whether recent circumstances that have favored this growth can continue. Already there are indications that home affordability is eroding and the gap between median home prices and household incomes is widening. This is particularly true for the hottest real estate markets. Responding to these pressures, borrowers are further stretching their household budgets and taking on riskier mortgage products, such as interest-only loans. These products feature rapidly escalating mortgage payments. The sustainability of these loans is often dependent upon continuing house price appreciation. Sharp increases in property and casualty insurance premiums only add to the financial pressures many of

<sup>7</sup> For more information, see <http://www.americasaves.org/strategies/homeownership/default.asp>.

<sup>8</sup> Ruquet, Mark E., "Future Brightening for CAT Bonds," *National Underwriter* Online Service, June 22, 2006.

these homeowners are facing and could even contribute to the current rise in mortgage defaults and foreclosures.<sup>9</sup>

Some “adverse impact” might be a good thing if the result is a decrease in dangerous building practices along the coast. However, it is clear that reasonably priced homes can be built safely.<sup>10</sup> Further, insurance rates along the coast may have been artificially increased by the unjustifiable modeling changes implemented by RMS others that are mentioned above. Politicized rate-making, caused by pressure from the insurance industry, is inappropriate and totally in violation of promises made when these models were introduced.

5. **How do natural catastrophes in one area of our nation affect the rates of homeowners in other areas, if at all?** Hurricanes should not impact rates around the nation. Actuarial methods are prospective, not retrospective and a few hurricanes should not significantly impact long-term projections. States should be checking to assure that prices are prospective and based upon the risk in their own state. The one exception to this rule is the reinsurance industry, which is not regulated. They may price beyond state borders. If an insurer gets a higher reinsurance bill, it may have to raise its price somewhat to cover that cost. However, most states make prices on a direct (before reinsurance) basis. In these states, the cost of reinsurance is not passed through and there will be no impact. Indeed, prices for property insurance away from the coasts are falling today.<sup>11</sup>
6. **What do you see as the long-term budgetary implications of disaster recovery expenses incurred by the federal government?** The NFIP was supposed to reduce the long-term budget impact on taxpayers by requiring safe building and, ultimately, by ending subsidies through the charging of full actuarial rates for flood insurance. As stated above, the program has failed miserably in this effort and, indeed, clearly has encouraged unwise construction in the nation’s floodplains. The budget impact of NFIP has been extremely negative, as recent bills authorizing over \$20 billion in taxpayer payouts for flood claims demonstrate. To add other natural disasters to the taxpayer burden is not justified given this negative track record. CFA urges Congress to fix the NFIP before even thinking about an expanded federal role in insurance. If catastrophe pooling is put in place without meaningful mitigation measures that are vigorously enforced at the local level, it will fail.
7. **What steps, if any, should be taken to expand private-sector capacity for insuring disaster losses?** The insurance industry is currently taking steps to increase capacity. States with catastrophe insurance problems are also taking steps to set up or improve state programs. The federal government need do nothing more that it does today. Indeed, federal intervention could upset the positive developments that will help

<sup>9</sup> Simon, Ruth, “Late Payments on Mortgages Rise: Studies Find Higher Loan Delinquencies Stemming from 2005” Lending Boom, *Wall Street Journal*, May 18, 2006.

<sup>10</sup> Treaster, Joseph B., “Let a Hurricane Huff and Puff,” *New York Times*, June 22, 2006.

<sup>11</sup> Treaster, Joseph B., “Home Insurers Embrace the Heartland,” *New York Times*, May 20, 2006.

increase catastrophe coverage in the future, such as the growth in the reinsurance market and the expansion of CAT Bonds.

8. **Major primary insurers operating in coastal high-hazard Gulf and Atlantic Coast areas have decided that they cannot adequately spread their catastrophe risks. Consequently, many primary insurers have stopped writing new policies in hurricane-exposed states or have shut down operations altogether for fear of over-exposure, financial impairment, or even insolvency. What impact do you see this having on the ability of consumers to secure adequate homeowners insurance? What impact will this have on the insurance market in general?** If insurers have stated that they cannot spread this risk, they are grossly exaggerating. As stated above in great detail, the financial fundamentals of the insurance market are extremely strong: in some cases, the strongest in history. The market has the capital to cover catastrophic weather losses without federal back-up. Problems are concentrated in a few states. There are solutions even for Florida, the epicenter of the problem, through innovative approaches such as those outlined earlier in this testimony. There are also new ways to spread the hurricane loss privately, such as through the growing CAT Bond market.

#### **Conclusion**

This testimony documents the many reasons why no federal role is necessary in the catastrophe insurance industry, especially given the problems with the National Flood Insurance Program. Indeed, a federal intervention now will likely undo positive private sector developments. Such a backstop should only be established if the NFIP is fixed, if local mitigation on building standards is in place and working and if the program that is developed conforms to all of the attached principles.

Thank you for the opportunity to testify.



## Consumer Federation of America

### PRINCIPLES FOR PROTECTING CONSUMERS AND TAXPAYERS UNDER A FEDERAL CATASTROPHE INSURANCE PROGRAM

The Consumer Federation of America (CFA) has previously opposed proposals to provide federal reinsurance with taxpayer funds for natural catastrophes. This is because these plans have either directly subsidized insurance companies or have provided below-cost insurance to high-risk areas, which would likely spur an increase in unwise construction. Congress should not expand the federal role in providing catastrophe insurance assistance until the federal government fixes the significant flaws that already exist.

- a) **The National Flood Insurance Program (NFIP) must be repaired and functioning smoothly before proposals to expand federal back up to cover other disasters can be taken seriously.** Mitigation is clearly not working under the NFIP. Too many new structures in high-risk areas are being built. Significant insurance subsidies are available to these structures because of problems like antiquated maps indicating much lower flood risk than is currently likely. Insurance rates are based on these erroneous maps, creating a subsidy for new construction and misleading homeowners and business owners into thinking their property is safe. The penetration of flood insurance in at-risk areas under the NFIP is also very low. Too many Americans who live in flood plains are not insured for the flood risk. Moreover, the NFIP allows insurers to charge too much for servicing insurance policies without assuming any financial risk. Some insurers even get windfall payments for commissions when no agent is involved.

CFA is very concerned about any federal catastrophe insurance proposal that would duplicate the kinds of serious problems that exist in these programs. In order to be fair to consumers and taxpayers, any proposal that is offered must conform to the following principles:

#### Loss of life and property must be clearly and demonstrably reduced.

- Mitigation measures must strictly prohibit construction in extreme risk zones and control construction in all other risk zones.
- Actuarial rates should be charged for each property.
- GAO should monitor compliance on an ongoing basis.
- The federal government should invest in loss prevention instead of spending money after a catastrophic event occurs. It should provide grants and loans to state and local

governments to carry out mandatory loss prevention activities and should provide loans to consumers and businesses for loss prevention investments and retrofits.

**All at-risk properties in the nation should be insured for all risks.**

- Insurance must be required on all properties to achieve maximum spread of risk and to ensure that uninsured properties do not exist after a catastrophic event.
- Insurance companies writing property coverage in the nation must be required to take all homeowners and small business property risks that meet national mitigation standards for disaster risk.
- All risk coverage on new construction should be initially provided for five years on a policy purchased by the builder and sold along with the structure.
- Reasonable deductibles and limits should be standardized under policy terms set nationally. Persons seeking lower premiums through higher deductibles and other changes to the base policy should be able to do so by signing an agreement that no disaster assistance will be sought for losses in amounts below the higher coverage levels.

**Rates should be actuarially sound. There should be no subsidies or cross subsidies.**

- Rates on insurance for new construction must be fully actuarial so that new construction that is higher risk will pay its own way and unwise construction will be deterred.
- Rates on insurance for existing construction must be fully actuarial and disclosed at the time of sale so that people buying unsafe structures have fair warning.
- Rates should be adjusted over a reasonable period of time to repay any monies contributed by local, state or federal taxpayers after a catastrophic event.

**The role of private sector insurers should be maximized.**

- Insurers must make insurance available and be responsible for losses up to a specified insurer deductible. Insurers should be instructed to set up pooling arrangements where they can reinsure business at the insurers' option by sending the loss portion of the premium to the pool. The pool should be monitored to verify that state approved actuarial rates were properly applied to the property.
- The initial insurer deductible for the first year of this program should be \$100 billion, indexed to inflation in home prices nationwide on a year-to-year basis. To ensure that all regions of the country will have reinsurance protection and that small insurers benefit from the program, it should require the establishment of a national pool to reinsure all homes and small business properties in the nation over retentions of 15

percent of premiums in the impacted line by insurer group. Each insurer would be required to forward the appropriate part of the premium to cover the claims sent to the pool. These premiums would be earmarked for disaster payments only and held as reserves for such an event. These reserves would not be subject to federal income taxes.

**Government at all levels should carefully regulate the program.**

- Local governments have the key role of enforcing land-use requirements.
- State governments should regulate both policy forms and prices. This will assure consumers that models and other methods used to rate the business are fair and do not result in excessive charges. It will also assure taxpayers that there are no subsidies in the rates. Regulation should follow the detailed methods in use in California under Proposition 103 regulations. State regulation should be monitored by the GAO to assure that it is competently and efficiently performing this important oversight role.
- The federal government should determine the best, most efficient mitigation standards. Local governments should enact and enforce these strict mitigation standards, subject to state audit of compliance and GAO review of the effectiveness of the implementation of these mitigation standards in high-risk areas.

**Federal, state and local governments should assume financial risk.**

- Local governments should agree to pay 5 percent of costs over the insurer deductible on damage to new construction, as an incentive to encourage rigorous enforcement of land use standards. Bonds could be used for this purpose.
- State governments should contribute a 10 percent layer over insurer and local deductibles. Bonds could also be used for this purpose.
- The federal government should back up the system over the insurer, local and state layers.
- This plan must be designed so that long-term costs to local, state and federal taxpayers will be equal to or less than zero. This means that, as stated above, rates should be actuarially sound to insure that the program is profitable to taxpayers in the long run, or at the very least, does not cost the taxpayers anything.
- No disaster relief should be given to those homes or businesses that should have been insured for coverage but were not, or were inadequately insured. Disaster relief should no longer cover deductibles of insurance policies.

**All stakeholders must give up something to make this type of plan work.**

- Insurers give up the right to choose to underwrite if mitigation standards are met (i.e., to make sure that insured homes meet construction and loss prevention standards). They must be subject to high quality regulation of price, product, underwriting and claims service.
- Property owners in high-risk areas give up the right to unfettered use of their land unless strong mitigation standards are met.
- Developers give up the right to loosely regulated construction. They must be required to build wisely in risk zones and to arrange for the initial insurance coverage for the first five years.
- Consumers give up their right to take a chance on being uninsured for low frequency/high severity events. Consumers must pay actuarial prices for the coverage, prices that can be very high.
- Government must take on mapping of risk and monitoring to assure compliance with mitigation and actuarial soundness standards. Government must have the ability to obtain funds for the catastrophic back up of the private insurance market.

**A fair process and affordable insurance must be ensured.**

- One way to ensure that lobbying by private interests does not result in taxpayers shouldering an unjustifiably large portion of the risk in such a program would be to set up a Congressional commission modeled after the base closure commission, which would present Congress with a plan that it could either vote for or against.
- Requiring insurers to offer actuarially sound rates will make it difficult for some low and moderate-income households to afford catastrophe insurance. It will likely be necessary to establish a transitional program to help these consumers afford insurance payments.

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

**“IS AMERICA’S HOUSING MARKET PREPARED  
FOR THE NEXT NATURAL CATASTROPHE?”**

**JUNE 28, 2006**

**GOVERNOR MARC RACICOT, PRESIDENT  
AMERICAN INSURANCE ASSOCIATION**

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

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

Hurricane Katrina and the other devastating 2004/2005 storms focused renewed attention on the role of the private sector insurance industry 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 – the insurance industry is 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.

**Recent Experience**

The 2005 hurricane season was, by far, the worst year on record. Records were set for the number of named storms (28), the number of hurricanes (15), and the number of hurricanes reaching category 5 status (4). The season also was remarkable for its early beginning and late end.

Beyond these statistics, the hurricanes of 2005 underscored the human toll of catastrophes. Ten months after Hurricane Katrina, thousands of former Gulf Coast residents remain homeless. The City of New Orleans has yet to rebuild its infrastructure or housing stock, recover its economic base, or reclaim its unique spirit. Some experts believe it will take years, if not decades, for the recovery process to be complete.

For insurers, 2005 was the most costly year on record, with insured losses from Hurricane Katrina estimated to reach \$40 billion, and total catastrophe losses for the year totaling more than \$70 billion, taking into account property insurance losses as well as automobile, marine, energy, commercial liability, workers' compensation and other insurance losses. Insurers adjusted more than three million hurricane claims, 1.6 million claims from Hurricane Katrina alone.

Insurers are fully committed to working with local, state, and federal policymakers to "bring back the Gulf." We recognize that the insurance mechanism plays a vital role in preparing for, and responding to, future natural catastrophes. At the same time, we believe that long-term solutions must look beyond insurance. 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. We welcome the opportunity to be fully integrated into the planning process, in terms of logistics, communications, and coordination with relevant government agencies and private groups.

#### **The Homeowners' Insurance Protection Act**

AIA has closely analyzed the Brown-Waite Shaw Homeowners' Insurance Protection Act. The legislation would create a federal reinsurance mechanism to encourage states to establish catastrophe funds (Cat Funds) for homeowners insurance. The bill also prohibits price gouging for products following a natural disaster, establishes the National Commission on Catastrophe Preparation and Protection, and directs the Government Accountability Office (GAO) to study availability of flood insurance coverage.

The legislation's Cat Fund provisions are 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. Despite last year's record-breaking losses, private sector capacity for dealing with natural disasters has grown – with approximately \$28 billion in new capital entering this market since Hurricane Katrina struck – 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. As Warren Buffett recently told investors at the Berkshire Hathaway annual meeting, "We're willing to lose many billions of dollars in a catastrophe if we think we've been paid adequately for it." Moreover, it is important to recognize that new government programs are no panacea for natural catastrophe risk, and that such programs can encourage and lead to inefficient allocation of capital, unfair subsidization, and increased (and unwise) building in catastrophe-prone regions.

Although we do not support the creation/expansion of federal or state natural disaster Cat Funds, we do support other provisions in the Brown-Waite Shaw bill. After disasters, the prices of virtually all building and construction supplies increase, often exponentially. This greatly – and unfortunately – increases both insured and uninsured costs for policyholders.

Similarly, fraud can flourish. For example, people claiming to be contractors or roofers demand substantial "down payments" from homeowners to do repairs and then disappear. Insurance claim fraud also proliferates after a disaster. The last thing policyholders in the affected areas need is to bear extra costs of artificial pricing and fraud by contractors and other opportunistic individuals/businesses.

We also support the establishment of a national commission and believe that such a Commission provides an opportunity to look beyond insurance to such critical issues as public education and mitigation.

In addition, we support reforms to the National Flood Insurance Program (NFIP) to make sure that the NFIP provides an effective safety net, while encouraging homeowners and businesses to engage in prudent risk management behavior.

#### **Needed Reforms**

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

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

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

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

### **I. Protective Measures**

Natural catastrophe losses can be reduced through mitigation, including effective building codes, policies that encourage retrofitting of existing buildings, and sensible land use planning. From a community perspective, mitigation can make the difference between a community recovering relatively quickly from disaster – with citizens returning to homes and jobs – and a community remaining devastated and economically stagnant for many months or longer. From an insurance perspective, mitigation helps preserve market capacity, reduce solvency risk, and enhance insurer ability to cover more risks (assuming a flexible regulatory environment and stable legal environment).

- **Strong building codes help reduce deaths, injuries, and property damage from natural catastrophes and more routine property losses.** Building codes set minimum safety standards for design, construction, and maintenance of residential and commercial buildings. They are based on established scientific and engineering principles that have been thoroughly tested to ensure safe, predictable building performance in wide-ranging situations. Recent benefit/cost studies indicate that each dollar spent to comply with stronger minimum code provisions for natural hazard vulnerability reduction results in long-term savings of \$3 to \$16. Strong statewide building codes, with no opt-out features, are needed in every state, particularly those with significant catastrophe risk. Statewide building codes also must stay current and consistent with the latest mitigation technologies.
- **Enforcement of, and compliance with, building codes is critical.** Enforcement of building codes is as important as their enactment. Independent studies following Hurricane Andrew revealed that lax code enforcement contributed to total damage. Clearly, training for many new inspectors, as well as contractors, will be needed during the post-hurricane building booms and to implement/enforce new codes.
- **Land use planning can help make communities more disaster resistant.** Hurricane and other catastrophe risk should be factored into land use planning decisions in order to protect lives and property. Research shows that effective land use planning also helps reduce insured hurricane losses. States should enact laws to require local governments to prepare comprehensive plans, specifically taking natural disasters into account in local planning and zoning decisions. Even in jurisdictions without such mandates, the state could offer guidance to local governments on land use planning, even as a voluntary guideline.
- **Disaster awareness and preparedness can mitigate the negative personal and financial impact of a catastrophe.** Natural disasters present a real threat to all individuals and businesses. Having a disaster preparedness plan in place

before a disaster strikes can reduce losses, as well as potentially save lives. It can also make the difference between a business continuing its operations after a disaster and closing down temporarily or permanently, and whether residents return to their communities or move to another location.

## **II. Regulatory Modernization**

Central to insurers' ability to manage hurricane risk is their ability to predict risk and charge appropriate premiums for bearing such risk. Unfortunately, the political climate in many states includes arbitrary rate suppression, expensive and unpredictable regulatory mandates, and other regulatory and legal burdens. These must be addressed in order to create a more stable business environment for insurers making a capital commitment to the region.

- **Risk-based pricing is critical to any viable insurance system.** Property insurance rates must be based on insurer evaluation of underlying catastrophe risk in hurricane-prone areas. Risk-based pricing, utilizing the best possible scientific information, is essential to insurers' ability to provide protection against hurricanes. Equally important, appropriate pricing encourages loss prevention, thus reducing the individual and societal costs of disasters.

Given the opportunities for politically influenced government rate suppression, all states should repeal requirements for rate approval by state insurance regulators. If a free market system cannot be achieved in the short-term, interim incremental measures are essential. One way this might be achieved is by shifting the burden of proof, so that the insurance department must prove that a filed rate is excessive; another is by allowing insurers to raise or lower rates by a specified percentage (within a "flex band") without regulatory approval.

- **Computer-based disaster models help insurers measure catastrophe risk and reduce likelihood of insurer insolvency.** Since Hurricane Andrew in 1992, the insurance industry has significantly improved its ability to monitor natural catastrophe accumulations through computer-based models that measure risk on a probabilistic basis using sophisticated simulation techniques. The models are not perfect; Hurricane Katrina prompted some improvements, which recently were announced by the major modeling firms. Just as insurers use models to manage catastrophe risk, states should accept their use in the ratemaking process, and protect the confidentiality of proprietary models. However, some states remain opposed to models, particularly if they indicate that higher rates are needed for actuarial soundness. Ignoring scientific models is another form of artificial rate suppression that increases subsidization, reduces incentives for mitigation, and ultimately undermines the role of the private sector in managing catastrophe risk.
- **Higher deductibles can make insurance more affordable; tax incentives can help policyholders pre-fund their deductible obligations.** Higher deductibles

reduce the cost of insurance, conserve insurance capacity, and help focus post-event attention on homeowners who have had a major loss. They also encourage residents to take personal responsibility to mitigate loss (prior to and following a storm) and reduce cross-subsidization by shifting a portion of the risk back to policyholders likely to incur the loss.

- **Broad-ranging and shifting post-event regulatory mandates increase insurer uncertainty and divert attention needed to respond to claims.** Insurers must have some certainty that, if a major hurricane strikes, they will not be hit with shifting, wide-ranging regulatory mandates of questionable legality. Following Hurricane Katrina, for example, insurers were confronted with literally hundreds of legislative and regulatory mandates that impacted premium collection, underwriting, claims handling, and claims data reporting; most of these mandates varied from state to state. Recent legislation in Florida recognized the harm these mandates have on the insurance environment. As a result, Florida law now obligates regulators to adopt (through administrative rulemaking) standardized requirements *before* the event that may be applied to insurers *after* a catastrophe. Other states should do the same.
- **States also should facilitate post-event claims adjustment.** While every major hurricane is somewhat unique, a common theme is the need for insurance adjusters to get in quickly and settle claims expeditiously. Yet, there are usually many obstacles in place, such as licensing and establishment of procedures to facilitate payments. In addition to removing specific obstacles, there should be improved integration of insurers into the planning of post-event responses, in terms of logistics, communications, and coordination with relevant federal and state agencies.

### III. *Legal Reform*

- **The legal system must preserve the sanctity of contracts.** Insurers must have confidence that the insurance policies they write will be upheld following a major catastrophe. Pending “wind versus water” litigation brought by the Mississippi attorney general and private plaintiffs epitomizes the problem that insurers face in an uncertain legal environment, particularly where cases are tried by “hometown” juries. Insurers should not be made to pay claims for losses that are beyond the scope of an individual’s policy, and for which the policyholder did not pay premiums. If trial lawyers or others are successful in retroactively re-writing insurance contracts, the predictability upon which a healthy insurance system is based is undermined.
- **Statutes of limitations should not be extended.** Post-hurricane extension of the statute of limitations on hurricane claims raises fundamental fairness and due process concerns. Moreover, it becomes harder to settle claims equitably as the parties become farther removed from the event which caused the loss. All insurance policies provide ample time for the filing of hurricane damage claims.

Extending the statute of limitations is another attack on the sanctity of contract, in this case, by state legislatures.

#### **IV. Tax Incentives**

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 and state tax policy can enhance affordability and encourage the use of protective measures. These include:

- federal legislation to establish tax-exempt Catastrophe Savings Accounts (CSAs) for individuals (similar to health savings accounts) as introduced by Rep. Tom Feeney (R-FL);
- federal or 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; and,
- 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**

The NFIP plays a critical role in hurricane preparedness and response. However, the program as currently structured does not cover enough people or provide the level of protection needed by many policyholders. The NFIP must be reformed so that it provides an effective safety net, while encouraging homeowners and businesses to take personal responsibility. Among needed NFIP reforms are:

- introduction of risk-based premiums;
  - expanded program mandates to cover more homeowners in more locations;
  - increases in maximum coverage limits and deductibles; and,
  - policy terms that are more consistent with private insurance. Insurers have developed a comprehensive list of reforms.
- Additionally, NFIP must complete its map modernization initiative as soon as possible.

#### **Comparisons to Terrorism Risk**

The tools that I have outlined would improve the ability of private insurers to manage natural catastrophe risk, while at the same time making individuals and communities more disaster resistant and resilient. In doing so, they should obviate the need for new federal or state governmental insurance or reinsurance mechanisms for natural catastrophe risk.

However, these tools are insufficient for managing the complex, man-made risk of catastrophic terrorism. While both natural catastrophes and terrorism are capable of causing extreme loss, they are fundamentally different from an insurability perspective. For terrorism, private sector reinsurance or other risk-sharing capital remains woefully inadequate and shows no signs of robust growth in the near future. This is a strong indicator that the capital markets have reached the same conclusions about the private insurability of terrorism risk. Moreover, there is no reliable method for determining the likelihood of a terrorist attack (event frequency) within the United States, a critical component in determining the insurability of a risk. This is complicated by the fact that terrorism is a deliberate act committed by individuals bent on doing the worst possible harm. Additionally, the interdependence of terrorism risk also limits the potential effectiveness of mitigation. Finally, for national security reasons, vital information necessary to assess the terrorism threat is strictly classified and unavailable to insurers as they attempt to manage this risk.

Because of these factors, a federal reinsurance backstop for terrorism risk must remain in place after the December 2007 expiration of the Terrorism Risk Insurance Act Extension Act, and we appreciate the opportunity to work with this committee to develop long-term solutions to the ongoing problem of managing the nation's economic exposure to terrorism risk.

#### Conclusion

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

**NAMIC**<sup>®</sup>  
NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

STATEMENT OF TIM RUSSELL  
PRESIDENT

BALDWIN MUTUAL INSURANCE COMPANY,

ON BEHALF OF  
THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

HEARING ON "IS AMERICAS HOUSING MARKET PREPARED FOR THE  
NEXT NATURAL CATASTROPHE"

BEFORE THE  
HOUSE FINANCIAL SERVICES COMMITTEE

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNIT

JUNE 28, 2006

# NAMIC<sup>®</sup>

NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Good afternoon Chairman Ney, Ranking Member Waters, and members of the Committee. My name is Tim Russell, and I am pleased to testify today on behalf of the National Association of Mutual Insurance Companies regarding the disaster preparedness of the U.S. housing market. Founded in 1895, NAMIC is the nation's largest property and casualty insurance association, underwriting more than 40 percent (\$178 billion) of the property/casualty insurance premium written in the United States.

I am the President of Baldwin Mutual Insurance Company, a single-state writer in Alabama that writes more than 35,000 policies, totaling more than \$14 million dollars in premium across the state. I am a former Chairman of NAMIC and a current member of the Association's Task Force on Natural Disasters. I also serve as the Mayor of Foley, Alabama, a coastal city in southern Alabama with roughly 13,000 residents. Foley was directly affected by Hurricane Ivan in 2004 and by Hurricane Katrina in 2005. In my dual roles as President of Baldwin Mutual and Mayor of Foley, I have a unique perspective on the devastation caused by natural disasters, and the challenges that face insurers and government policymakers in preparing for and managing large-scale natural disasters.

As this Committee is aware, 2005 was one of the worst years for natural disasters in American history. According to the latest estimates from the Insurance Information Institute, Hurricane Katrina alone caused more than \$40 billion in insured losses, including \$1.8 billion in Alabama. In addition, Hurricanes Wilma and Rita caused roughly \$10 billion and \$5 billion in insured losses, respectively. In all, the storms of 2005 produced more than 4 million claims, and over \$60 billion in insured losses. For residents in my community, the effects of the 2005 storms were especially severe because we were still recovering from Hurricane Ivan, which is still the worst natural disaster in Alabama history.

I wish I could sit here before this Committee and say that the worst is behind us. However, according to hurricane forecasters, the increases we have seen in hurricane frequency and severity are expected to continue for at least another decade. Forecasters predict that during the 2006 hurricane season, there will be 17 tropical storms and nine hurricanes, five of which will be major events. Earlier this month, the catastrophe modeling firm AIR Worldwide estimated that a level five hurricane hitting Miami, Florida, would cause over \$130 billion in insured losses. According to AIR, there is a 20 percent chance that a \$100 billion event will occur within the next 10 years.

NAMIC is pleased that the members of this Committee are making a serious effort to understand the nature of catastrophic risk, and the role that insurance can and should play to better prepare for and manage future large-scale natural disasters. To assist in this

effort, NAMIC convened a special task force in December 2005 to identify and analyze the critical issues that we believe policymakers should consider as they move forward. Today I'd like to share with the Committee several observations and recommendations that emerged from our deliberations.

### **General Observations**

First, with the exception of flood insurance generally and earthquake insurance in high-risk seismic zones, we believe that the private insurance market is well equipped to provide coverage for most types of natural disasters under most circumstances. That said, we also recognize that a *true* mega-catastrophe comparable to the 1906 San Francisco earthquake, or a high-category hurricane striking heavily populated areas such as Miami, Houston, or New York City, could potentially exceed private market capacity. It may be appropriate for policymakers to study whether government programs should be created to respond to such mega-events in those states or regions that are particularly vulnerable. Such programs, should they prove necessary, must be carefully designed so as not to distort private insurance markets.

Second, we believe that a flexible regulatory environment, in which insurers are free to price coverage based on risk, will create incentives for property owners in high-risk areas to invest in loss mitigation measures. Lawmakers and/or regulators sometimes impose rating and underwriting restrictions on property insurers that allow high-risk property owners to pay artificially low premiums, forcing low-risk property owners to subsidize the insurance costs of high-risk buyers by paying inflated premiums. In our view, using the insurance pricing mechanism to create hidden cross-subsidies among risk classes is deceptive and unfair.

Moreover, government-imposed rate suppression can have the effect of distorting public perceptions of risk. The result is often unnecessary costs for the federal and state governments when they provide disaster aid to repair properties that should not have been built in the first place. Risk-based insurance pricing, on the other hand, sends accurate signals to consumers about the relative level of risk associated with particular regions and types of structures.

Third, policymakers must recognize that disaster under-preparedness is not simply an insurance availability and affordability problem. Human psychology strongly influences the decisions people make with respect to disaster risk management and insurance. There is ample evidence that property owners as well as government officials tend to underestimate catastrophe risk and fail to prepare adequately for natural disasters. Studies also suggest that many consumers view insurance as a financial investment rather than as a protective measure, so that those who purchase insurance and do not collect on their policies over a period of time feel that their premiums have been wasted, leading them to discontinue coverage.

Fourth, we are disturbed by the fact that in discussions of insurance price regulation, the term "actuarially sound" is often used loosely and without definition. For example, the

term is sometimes used to refer to prices that solely reflect the expected value of future loss costs. It is important to understand that a definition of “actuarially sound” based solely on the value of expected losses is inapplicable to catastrophe exposed coverages. That is because “actuarially sound” pricing for catastrophe exposed coverages must also include compensation for the unusually large “call on capital” that is required to pay catastrophic losses. The call on capital that results from the large-scale losses typically associated with extreme events may well be several times greater than the total annual “expected loss” of the coverage. In other words, the term “actuarially sound” should be understood to include not just the insurer’s expected loss costs and expenses based on yearly averages. It should also include an adequate “risk load” that takes into account the call on capital.

Finally, lawmakers, judges and the general public must recognize the cyclical nature of property insurer profits, how profits relate to surplus, and the role of surplus in ensuring that insurers are able to meet their contractual obligations to policyholders. Using return on equity as the universal benchmark for measuring company profitability, economists have found that property/casualty insurance is less profitable than most other industries. Regulatory decisions and judicial rulings that require insurers to pay disaster-related claims irrespective of the terms of the insurance contract could cause availability problems at best and widespread failures in the market at worst.

These observations aside, we believe there are several measures that Congress should consider immediately to address certain problems associated with natural disaster risk management and insurance.

#### **Policy Proposals that Deserve Immediate Consideration**

First, NAMIC supports federal legislation that would create financial incentives to encourage states to adopt and enforce strong, statewide building codes. Strong building codes as well as responsible land-use planning have been shown to greatly reduce the level of property damage and human suffering caused by natural disasters. With respect to existing properties, we support government initiatives to create mitigation grant programs to enable homeowners in high-risk areas to invest in risk mitigation measures.

Second, we support the concept of amending the federal tax code to allow insurers to set aside a portion of premium income in tax-exempt policyholder disaster protection funds. We also support the concept of allowing homeowners to create tax-free catastrophic savings accounts similar to health savings accounts which could be used to pay hurricane deductibles and costs associated with retrofitting properties.

Third, we recognize 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. Policymakers should therefore consider creating programs to provide direct government assistance, funded from general revenue, to low-income and other groups according to criteria established

by the unit of government providing assistance. However, in designing such programs, care must be taken to avoid reducing incentives to mitigate risk.

Fourth, we believe that the National Flood Insurance Program should be maintained, but that it must undergo significant reforms. First and foremost, NFIP premiums must be actuarially sound for all covered structures. The current method for setting premiums, which is based on average annual losses, has been called “unsustainable” by the Congressional Budget Office. This approach has prevented the NFIP from accumulating the surplus necessary to pay claims during periods when loss costs are above average.

Finally, the borrowing authority of the NFIP should be increased so that program administrators will not be required to seek special appropriations from Congress each time a natural disaster involving major flooding occurs. The flood maps used by the NFIP must be updated and improved. Stiffer penalties should be imposed on financial institutions that either fail to require flood insurance coverage for mortgages on properties in flood-prone areas, or allow the policies to lapse. Greater effort should be made to ensure that more people are aware of the program and the benefits of having flood insurance coverage to protect their properties.

In conclusion, the years ahead will present serious challenges to property owners, insurers, mortgage lenders, realtors, and home builders that live and do business in catastrophe-prone areas. NAMIC believes the most effective mechanism for addressing these challenges is a private insurance market characterized by open competition and pricing freedom. Congress can play a constructive role by reforming the National Flood Insurance Program, offering tax incentives for companies to reserve funds for future disasters, and providing incentives for states to enact and enforce effective statewide building codes.

Thank you again for the opportunity to testify on this issue of vital importance to NAMIC member companies and the U.S economy. NAMIC stands ready to lend its assistance to ensure that the nation’s homeowners are prepared for the next major catastrophe.



*Independent Insurance Agents  
& Brokers of America, Inc.*

**STATEMENT OF ALEX SOTO  
ON BEHALF OF THE  
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA  
BEFORE THE  
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY  
COMMITTEE ON FINANCIAL SERVICES  
UNITED STATES HOUSE OF REPRESENTATIVES**

**June 28, 2006**

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Good afternoon Chairman Ney, Ranking Member Waters, and Members of the Committee. My name is Alex Soto, and I am pleased to be here today on behalf of the Independent Insurance Agents & Brokers of America (IIABA) to provide my association's perspective on efforts to reform how our nation insures against natural disasters. I am currently the President-elect of IIABA and have served on our national association's Executive Committee for several years. I am also President of InSource, Inc., an independent agency based in Miami, FL which offers a broad array of insurance products to consumers and commercial clients in South Florida and beyond.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, and we represent a nationwide network of more than 300,000 agents, brokers, and employees. IIABA represents independent insurance agents and brokers who present consumers with a choice of policy options from a variety of different insurance companies. These small, medium, and large businesses offer all lines of insurance – property, casualty, life, health, employee benefit plans, and retirement products. It is from this unique vantage point that we understand the capabilities and challenges of the insurance market when it comes to insuring against catastrophic risks.

## Background

In 2005, our country faced several devastating and record-setting natural disasters, including 27 named hurricanes, which left the lives of many Americans in ruins. These disasters also roiled the insurance marketplace and our overall economy. Estimates for 2005 hurricane losses are approximately \$50 billion, greatly exceeding the previous record set in 2004 when 22 events caused \$27.5 billion in insured losses. Six of the top 10 most costly catastrophes on record in the United States occurred in the 2004-05 hurricane seasons.

The high costs of recent natural disasters (hurricanes Katrina, Wilma, etc.), combined with the fear of future catastrophes (particularly with another difficult hurricane season being forecast for 2006), have restricted homeowners' insurance availability in many markets. These multibillion-dollar events have created exposure and solvency issues for companies that write homeowners insurance in disaster-prone areas. As a result, many insurance companies have stopped writing new business in or withdrawn from at-risk markets, making it difficult for residents to find homeowners' coverage.

While our members and their consumers have experienced varying types of natural disasters across the country, this problem has been compounded by the fact that an ever-increasing number of people reside in areas where they are exposed to natural disasters. For example, in coastal areas alone we have seen tremendous growth in population. In fact, according to AIR Worldwide, in 2004 the value of insured coastal properties in the 18 East Coast and Gulf states exposed to hurricanes totaled \$6.9 trillion, or 16 percent of insurers' total exposure to loss in the United States. Not unlike other disaster-prone areas, AIR also estimates that property values in coastal areas of the United States have doubled over the last decade.

## IIABA Perspective

The IIABA is grateful for the opportunity to share its views with the Committee on what we feel is a matter of critical importance. We approach the issue of natural disaster insurance from a very simple perspective: we are here to serve consumers' needs, whether it is helping them secure coverage to protect their families and their homes prior to an event, or assisting consumers after an event to ensure that claims are paid quickly and fully. As the intermediaries between consumers and their insurers, our members cannot and will not walk away from consumer needs as long as they demand coverage for these risks. We strongly believe our industry must come together with policymakers to find a common solution that will encourage participation in at-risk markets. For this reason, the IIABA is grateful to you, Mr. Chairman, for calling this important hearing to explore these issues, and we look forward to working with you in the future on this issue.

In short, we are for any and all reasonable ideas and plans that lead us to a healthy and competitive insurance marketplace in which consumers have choices and companies are vying for their business.

When natural disasters strike, independent insurance agents and brokers are on the front lines with devastated policyholders who need to rebuild their lives. In fact, our members live in the communities that they serve, and they and their families are also impacted by many of the same issues facing other consumers. As such, independent insurance agents and brokers understand the challenges that consumers face and their concerns about the availability of affordable coverage for losses from natural disasters.

Over the last several years, our members have witnessed how substantial insured losses from severe hurricane seasons have diminished the insurance industry's capacity, and more importantly their appetite for catastrophic losses in general. Meanwhile, the cost of coverage has increased. Insurers are currently under pressure from rating agencies to limit exposure, and they are reevaluating their exposure to all types of catastrophic losses. As underwriters continue to focus on the aggregation of losses, there is a definite strain on the insurance industry's willingness to cover catastrophic losses—whether they result from natural disasters, such as hurricanes and earthquakes, or man-made threats, such as acts of terrorism.

Any discussion concerning the solution to insuring against future natural disasters starts with admitting there is a problem. The IIABA believes it is no longer enough to say that the private market can handle catastrophic risks, when coverage is not sufficiently available at affordable rates. In fact, it is our experience that private market coverage is scarcely available at any rate in some areas – this is fast becoming an availability problem rather than an availability AND affordability problem. The reality is that many insurers have either stopped writing new homeowners' business in or withdrawn completely from at-risk markets. With the prospect of another difficult hurricane season upon us, something needs to be done to ensure that residents of these areas can find adequate homeowners' coverage.

#### **National Issue**

With these experiences in mind, I would like to stress that this issue is not simply a Gulf Coast problem – it is a national problem. Our members live across the country, serving and living in a wide variety of communities – large and small – and so many of them have been impacted by natural disasters. Certainly, the most devastating natural disasters in recent years have resulted from hurricanes, which have had the greatest impact on the homeowner's insurance market. However, hurricanes are only one of the many catastrophic risks our nation faces. Whether it is tornadoes in the Midwest, earthquakes in California, or ice storms in the Northeast, we all face some risk of natural disaster, and it often takes only one or two events in a particular area for the homeowners' insurance market to be dramatically affected.

In some cases, of course, states have set up entities in an effort to prevent insurance availability crises, such as the California Earthquake Authority and the Florida Hurricane Catastrophe Fund. These programs are certainly useful, but ultimately, even if they are carefully constructed and managed they may not be enough to handle the particularly severe events. In my home state of Florida, for example, our fund is in trouble for several reasons. First, as a state entity it is not immune to political pressure to keep the rates low. The second factor, of course, has been the severity of recent hurricanes that have hit our state during the past two years. The plain truth is that some natural disasters will exceed the financial capacity of state catastrophe funds – only a program that is national in scope will be able to generate enough capacity to cover the most devastating events.

Put simply, insuring against natural disasters is a national problem that requires a national solution. Despite our longstanding position that the insurance market is best served by limited federal involvement, we believe that a federal solution is necessary to help provide capacity and fill a void that the private market cannot and will not service. However, it is important that the day-to-day regulation of insurance remain at the state level, where state insurance departments are best equipped to serve the special needs of local consumers in local markets. As such, given the

absence of affordable coverage and the exposure to consumers and taxpayers, we believe that there is a very limited and appropriate role for the federal government, and we are open to supporting proposals that increase insurance availability and affordability in catastrophe-prone areas.

#### **Federal Solutions**

There are those who continue to question whether federal involvement is necessary. We would encourage these critics to conduct a simple cost-benefit analysis. We would ask the following: is it better to address this issue in advance of a natural disaster in a way that maximizes private sector capacity, or to wait for the federal government to provide post-disaster relief on an ad-hoc basis? That is the choice we are currently facing. I am sure the Members of the Committee are well aware of the recent GAO revelations regarding misuse of FEMA disaster funds disbursed following Katrina, and while I do not suggest that this would be a common occurrence, it does highlight some of the problems with ad-hoc relief efforts. The Big "I" believes the best solution is for a federal role to be in place before the events happen – to have a clear, well-structured mechanism that encourages the private sector to handle as much of the risk as possible, and only trigger federal involvement as a last resort upon private marketplace failure. We believe that such a structure will protect both consumers and taxpayers living in all areas across the country – especially when history has proven that more tax dollars are going to be spent on disaster assistance without a structure to encourage the private sector to take on additional risk.

It is with these sentiments that we approach the legislative proposals pending in Congress. Specifically, we support H.R. 846, the Homeowners' Insurance Availability Act, which was introduced by Congresswoman Ginny Brown-Waite last year. The legislation would allow private insurers to purchase, at auction, reinsurance contracts directly from the U.S. Treasury to cover natural disasters that are equal to or greater than a one-in-100-year event. We believe this is a strong proposal because it will encourage more companies to enter at-risk markets, thus increasing availability and market stability, while limiting federal involvement to only the most devastating catastrophes.

In addition to H.R. 846, the IIABA is examining other proposals that would create a federal catastrophe reinsurance program, such as H.R. 4366, the Homeowners Insurance Protection Act of 2005, introduced by Reps. Ginny Brown-Waite (R-Fla.) and Clay Shaw (R-Fla.), and H.R. 4507, the Natural Catastrophe Insurance Act of 2005, offered by Rep. Carolyn Maloney (D-N.Y.). Under these proposals, states that have their own catastrophe funds could be eligible to purchase reinsurance from the federal government. Both bills seek to encourage states to establish catastrophic funds to protect against natural disasters and reduce costs to homeowners. Our association has not, however, taken a position on these bills at the present time.

IIABA is also looking beyond federal reinsurance proposals to other possible solutions, and in that vein we are encouraged by the introduction of H.R. 2668, the Policyholder Disaster Protection Act, introduced by Congressman Mark Foley. This bill would permit insurers to create tax-free reserve funds for natural disaster claims. We support the goal of this legislation, which is to build up insurance capacity in at-risk markets, although we are somewhat concerned that doing so through the tax code may take a significant amount of time.

We also have noted with interest the introduction of legislation that would create tax-free personal "Catastrophic Savings Accounts" similar the Health Savings Accounts that have been successful in

the health care market. H.R. 4836, introduced by Congressman Tom Feeney, enjoys bipartisan support from members of the Florida Congressional delegation as well as from Florida Insurance Commissioner Kevin McCarty.

In addition to the above proposals, our members support exploring ways to reduce the costs of disasters, such as mitigation efforts. For instance, enhancing building codes and using financial incentives to mitigate risk are among proposals worth exploring in order to protect both consumers and taxpayers across the country.

There are exciting and important research projects underway that merit aggressive support from both the private and public sector. The International Hurricane Research Center at Florida International University ([www.ihr.c.fiu.edu](http://www.ihr.c.fiu.edu)) is conducting groundbreaking research and hope to build a "Wall of Wind" simulator to definitively identify the failure level of each element of a home and commercial building. These efforts will lead to precise improvement of building codes and retrofitting techniques that all consumers can use to safeguard their properties. We should do all that we can to fast track the development of this project in order to reap the benefits of the research as soon as possible.

Other nonprofit organizations, such as FLASH, Inc., the Federal Alliance for Safe Homes ([www.FLASH.org](http://www.FLASH.org)), and the Institute for Business and Home Safety ([www.ibhs.org](http://www.ibhs.org)), deserve our help and attention as well. These two organizations also conduct research to provide home and business owners with existing and proven methods of improving the capacity of buildings to withstand earthquakes and windstorms, among other perils.

#### **Congressional Attention Is Needed**

Unfortunately, Congress has not yet acted on any of the bills that I just mentioned. Part of the reason for this is the lack of consensus within the insurance industry for a solution to this growing problem, which has complicated public and private efforts to address this issue. However, as many insurers and reinsurers express concern with some of the above proposals, consumers still need and demand coverage to protect their homes, their families and their communities. What will it take to bring together all interested parties to focus on a solution? Tremendous dislocation? Another major catastrophe?

It is simply not enough to say that the private sector can handle this risk, when it does not and in reality consumers face severe availability and affordability issues. Turning our back on policyholders who need coverage is never a recipe for a stable economy and unacceptable to our members.

We would strongly urge Congress to step forward and drive the debate over these proposed solutions. We encourage Congress to be realistic, but also ask tough questions and demand responses. Stakeholders need to answer these questions, such as: if not these proposed solutions, then what are the alternatives that could most likely be implemented successfully in a timely manner? Are the public and private sectors doing everything possible to protect consumers, or can more be done? We believe that this type of Congressional attention will spur greater insurance marketplace involvement in debating potential solutions, perhaps leading to even more innovative proposals.

The Big "I" does not pretend to have the answers to these questions, but we are committed to an open dialogue with all interested parties in the public and private sector to begin to address these important issues that consumers face.

**Conclusion**

In conclusion, we commend you, Mr. Chairman, for convening today's hearing, and we hope that it will mark the beginning of a thorough examination of legislative solutions for the catastrophe insurance availability crisis.

The Big "I" supports legislation, such as H.R. 846, that will encourage more insurance companies to enter natural disaster markets and increase availability and affordability of homeowners' insurance coverage. We are open to working with interested parties to discuss potential solutions with limited federal involvement, including federal catastrophe funds, insurer tax-free reserving, consumer-driven catastrophe savings accounts, etc.

We stand ready to assist your efforts in any way we can, and we urge you to see this fight through to the finish.

**Statement of David Treutel**  
**Subcommittee on Housing and Community Opportunity**  
**Committee on Financial Services**  
**U.S. House of Representatives**

**June 28, 2006**

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Good afternoon, and thank you Subcommittee Chairman Ney and Ranking Member Waters for the opportunity to testify before the subcommittee on my personal experience during Hurricane Katrina so we all may better prepare for the next natural catastrophe.

My name is David Treutel, and I am president of Treutel Insurance Agency, Inc., a third generation independent insurance agency located in Bay St. Louis, Hancock County, Mississippi. I also currently serve on the Board of Directors of the Mississippi Windstorm Underwriting Association and on the agents' advisory boards of several insurance companies. I am also an active member of the Independent Insurance Agents of Mississippi (IIAM) and the Independent Insurance Agents & Brokers of America (IIABA), and served as President of the IIAM in 1998. However, I am speaking here today, on my own in my capacity as a private citizen, as an independent insurance agent who has seen first-hand the destruction of hurricanes, most recently Hurricane Katrina.

**Our Experience with Hurricane Katrina**

On August 29<sup>th</sup>, 2005, Hurricane Katrina made its way into my hometown, making an indelible imprint on the lives of my family, my insureds, my business, my small town, our Mississippi coast, our state, our central Gulf region and ultimately our country.

Category III level hurricane winds damaged much in Katrina's path and its tidal surge sent water inland over 10 miles into my county. Katrina's flood waters hit heights in excess of 34 feet with wave action as the storm made its way through Mississippi, Louisiana and Alabama. Before Katrina, my town of Bay St. Louis had a population of about 10,000 – one of a string of 11 coast towns that cover the Gulf Coast in Mississippi with a regional population of about 400,000.

My home, which is approximately 3 miles from the Mississippi Gulf, was not in a designated flood plain and had survived several previous storms and had not

experienced flood waters for twenty-five years. Of course that all changed with Katrina: this time it was devastated by wind and water in excess of 10 feet. Although all that remained of my home was a shell, and my extended family counted losses that included 15 autos, 8 homes and 3 businesses, we consider ourselves fortunate that we survived, unlike the five neighbors who drowned within a block of my home.

My independent insurance agency is located on a high bluff with an elevation of about 30 feet and situated a block back from the bay in old town Bay St. Louis. Katrina severely damaged our two-story office building with car-sized holes on the roof and flood water that reached 7 feet. In the three hundred years since the French explorers D'Iberville and Beinville landed at the Bay of St. Louis in 1699 and founded this part of the Gulf Coast, tidal water had never covered this old town bluff.

Within a week of the hurricane, we set up operations in a makeshift tent in the parking lot of my town's Chamber of Commerce, where we worked in a 110-degree heat index as literally hundreds of my insureds made their way each day to file their claims. Homes were destroyed, land phone service was gone, electricity was out over much of the region, generators had washed away, gasoline was scarce, and cell phones were out because of downed towers. It was days before even water or ice were made available. Yet, by word of mouth our insureds came to file claims at our tent. At the same time, we commuted back and forth over 110 miles each way. We made this round trip back and forth to an office apartment we had set up outside Mobile, Alabama with computers, cell phones and an internet presence with answering service to report and manage claims, returning to our Bay St. Louis tent each morning. This process of round trips to Mobile began immediately after the storm and continued through February, logging over 38,000 miles to our vehicle (this was our only remaining car).

Over the ensuing weeks, our makeshift office tent was blown down by the outer bands of Hurricane Rita. We then moved down the road into an office trailer where we continued to meet with insureds each day. My entire office staff of eight people had returned in the weeks after the storm, but two of these individuals were not able to stay, as they dealt with storm-related personal tragedies. My office staff was tremendous. Six of the eight had suffered severe damage or total loss of homes during the storm, yet they still returned to work each day. Our agency had over 10,000 policyholders, and we ultimately handled close to 8,000 claims in the ensuing months.

#### **Post-Katrina Issues and Concerns**

Let me preface my further remarks by saying that, as with most natural disasters, we saw the best and the worst when it comes to insurance companies, governmental

flood and wind pools personnel, claims adjusters, federal and state assistance providers, and other relief workers. Some insurance companies were well prepared and had planned in advance for the claims process. They employed well trained adjusters, and they appeared to truly want to make the whole process as painless, efficient and fair as they could. Unfortunately, other companies, including some flood providers, fell somewhere short of these goals. To paint all insurance carriers and insurance adjusters into one category would not be accurate or fair to those that were effective or those that were not.

In the aftermath of Katrina, my insurance agency noted a number of issues that occurred in the claims process. I believe that they are important to consider as we try to prepare for the next natural catastrophe.

**1. The lack of available sufficiently trained adjusters was an early problem** especially considering the magnitude of this storm and its large path of destruction. Some companies were prepared and did better than others. Many that relied on hiring independent adjusters found that they were not available in sufficient quantities and training. In fact, once on the ground many of the adjusters were not able to locate the damaged property. GPS was a handy tool but only few had them. Homes were destroyed for miles inland with little remaining but a slab, and quite often roads were washed out and blocked with debris that eventually took months to clear. Accommodations were few and far between and the sheer destruction of infrastructure made it difficult for adjusters to get around. As such, the shortages in available adjusters slowed the payment of claims, especially for those handling flood and wind claims. Very little money was advanced to insureds in the early months, even when it was acknowledged that flood or wind damage existed. Documentation of millions of dollars in claim money was coming across my desk as late as February and March of 2006, some 6 months or more after the claims had been reported. One of my insureds with a flood policy was extremely upset, and rightly so, that his neighbor who carried no insurance received a FEMA payment within 6 weeks of the storm. This individual actually had a flood insurance contract and had paid for coverage, but he did not receive payment until over 6 months after the claim was reported.

**2. Communication was a serious problem.** Land lines were out and would be out for many months to come. Cell towers were down and the load put on the few functioning towers by emergency relief personnel, adjusters, and individuals who lived in the area made them undependable at best and often quite useless. While many insureds remained in the area in the weeks after storm, many more were displaced throughout the region and the country. The simple process of having an adjuster and an insured make contact was not an easy task.

**3. Multiple policies meant dealing with multiple adjusters** in most cases. One of my insureds was a 78-year old widow, named Betty. She made it safely through

the storm, but the confusion and frustration of dealing with four different adjusters on her personal auto policy, her homeowners policy, her flood policy and a separate wind policy had her angry at times and in tears of frustration. She was a strong person and had made it through the storm, but I was concerned for her and many, many other people in the same situation. In addition to the difficulty making contact with any adjuster, the home, flood and wind adjusters were unable to make contact. As a result, claims processing dragged on for months. Many times no contact was made between flood, home or wind adjusters, which meant that insureds did not receive settlements as timely or adequately as they should.

**4. Multiple policies also meant dealing with extremely different insurance contracts that did not complement each other.** This situation often left an insured without proper coverage even when they have purchased all that was available in the marketplace. For example, in Mississippi a policy written through the Mississippi Windstorm Association will provide coverage for only scheduled structures, and no provisions exist to add additional living expenses or loss of income to a wind policy. Flood insurance through the National Flood Insurance Program (NFIP) also does not provide replacement cost coverage on contents and will provide replacement cost coverage only in specific circumstances for owner-occupied homes. A separate flood policy is needed for each structure to be covered and no coverage is provided for any additional living expense or loss of use. Homeowners policies vary and often provide the most comprehensive coverage, including coverage not provided in the wind and flood policies mentioned above.

**5. Wind versus Flood.** Multiple policies create a difficult situation when two or more perils cause or contribute to the same loss. Even though only one loss occurs, insureds must deal with two and sometimes three different companies or policies for settlements. Insurance companies for years have excluded flood as a covered peril, and as a result the NFIP and its Write-Your-Own servicing companies have filled this void. However, in an attempt to not pay flood claims that should not have to be paid, some insurance companies have devised forms that they will not pay claims if losses were caused by not just flood waters but also will not pay when both flood waters and wind perils combined occur. Claims resulting in part from wind loss which should be paid are not being paid because of this concurrent cause form. As a result, many insureds may find themselves in circumstances where they have not been made whole, even when they have purchased a separate flood policy and all the policies that were available to them.

Millions of dollars are spent by companies through engineering firms to support the eternal question – which came first: the water or the wind? During a hurricane if the wind came first and the insurance company has not included a concurrent cause form, then the homeowner's policy including wind is responsible to pay the complete loss. However, if one can prove that the rising flood waters damaged the home before it was damaged by wind, then under the homeowner's insurance contract, no

payments should be paid. In reality, damage by water or wind may be proven to have occurred, but the sequence is often very difficult to prove. If an insured has purchased a policy that was intended to pay wind damage and does not, and the insured is not made whole, then the contract is often litigated and no claim could be paid for years. While most of the companies that I work with did not have or invoke the concurrent cause form, some other companies did. As a result millions of dollars that could have gone to consumers will be spent on litigation and additional engineering studies.

We have seen many of these issues go unresolved. For example, a good friend of mine had his insurance with a direct insurance agent. It has been 10 months and he has not been paid anything on his home by his insurance company. He did have 6 feet of water in his 2-story home which still stands, yet he had roof damage caused by wind, where the flood water did not rise. Although he did not have flood insurance and was not in the flood plain, his homeowner's policy, which includes wind as a covered peril, has not paid the wind damage.

**6. Multiple policy confusion.** Multiple policies led many insureds to believe that they would be paid fully for each policy they had purchased. To them, it was compelling that they had paid for two or sometimes three policies (wind, flood and homeowners) to cover their homes, especially when nothing remained of their home. Unfortunately, the reality that one loss that is contributed to by two perils is only paid as one loss has been hard for consumers to comprehend when they paid for separate policies.

**7. Major inconsistencies in the adjustment process.** Insureds who were neighbors and had insurance policies written with different insurance agents and companies quite often had vastly different outcomes. Homes on the same block had varying outcomes with their insurance claims. Often, the loss of one house was ruled a total loss caused by wind, while next door the loss may be ruled a total loss caused solely by flood, and another home 100 yards down the street see their claim ruled half wind and half water.

**8. Home replacement cost valuations.** Many consumers found themselves in situations where their home may or may not have been insured to current replacement cost levels. Confusion exists among insureds in choosing the property valuation method. Where available the better method to insure is the replacement cost basis. However recent disasters have created a spike in housing costs. Supply and demand with few available contractors and materials in a disaster area along with extremely large number of devastated properties that need repair or replacement will significantly drive up the cost of construction after a disaster. Many insureds that may have been properly insured at the time of loss find that they may not build back their same home even when they received the full settlement on their insurance policies.

**9. State catastrophe pools.** There exists a disparity in the efficiency and cost effectiveness that states are able to provide a catastrophe insurance market for their citizens located in catastrophe prone disaster areas. With more than 50% of our population living within 100 miles of coast waters, catastrophic wind exposure affects a majority of the country's population. Headlines today show that we are all affected by catastrophes, even if we are not in the affected areas. Many argue that they should not have to bear the burden of catastrophe losses in other regions, but they will continue to bear the cost as long as they obtain insurance through regional, national or international insurance companies who purchase reinsurance to protect themselves from catastrophic loss. Most importantly, the assistance that our government provides after the loss to affected areas in the form of emergency response and rebuilding is spread among all of our citizens in the form of tax expenditures. The sheer size of exposed coastal areas and number of citizens affected when providing state wind insurance markets to states with large exposed coastlines, such as Florida or Texas, can be daunting. Some states with relatively small coastlines, such as Mississippi, Alabama, Rhode Island, or Connecticut, face an even more difficult and unique challenge due to the smaller concentrated coastlines and affected population with less ability to spread the risk among state residents. Pools, citizen plans, and fair plans differ greatly in their approach to handling wind exposure among the coastal states. Many plans spread the risk in the form of assessments to those state insurance carriers that will not voluntarily provide wind insurance in designated coast areas. Other state pools temper the exposure with purchased reinsurance, which they must either assess to the companies or pass on to the consumer. Other programs include state-backed revenue bonds to capitalize and stabilize these pools, the cost of which is passed on to consumers in the form of the premiums they pay. Concentrated coast line exposure and the relatively small size of participants in these small state pools can make the cost to operate the pools more expensive for smaller states than larger states. The basic tenants of insurance provide that the risk be spread over an actuarially sound population of risk that may not be available in smaller pools driving the cost of reinsurance per insured much higher than in other states.

### **Recommendations**

In my personal opinion many of the issues of concern noted above could be alleviated with the following recommendations:

1. An 'all-risk' insurance policy that would include insurance for natural disasters including wind, flood, earthquake, etc. that would be provided by private insurance carriers (assuming private carriers have access to adequate insurance/reinsurance – please see #2,3,4 below). Only one adjuster would deal with an insured who would be covered for all risks, which could avoid the wind versus water debate and costly litigation and excess cost for engineering studies. This could potentially address the

disparity that exists between policy forms, including separate wind, flood, earthquake and homeowners policies.

2. Private insurance carriers would be able to provide any insurance they have an appetite to write or reinsure themselves, but they would also have the option to purchase or utilize wind, flood or earthquake insurance through existing state or federal mechanisms including the National Flood Insurance Program, earthquake or state wind pool programs passing reasonable costs to the insured.

3. National disaster legislation in the form of a Federal backstop would be devised similar to that which has already been done for terrorism insurance. This limited Federal backstop would address, complement and backup state and federal catastrophe pools and plans, and it could include the federal government making lower cost reinsurance available to states and their catastrophe pools.

4. Tax incentives could be given to insurance companies to encourage them to write insurance and build the necessary reserves to survive the payout required in catastrophic losses. Likewise, consumers might also be given tax incentives to build their own reserves tax-free to cover their potential uninsured losses and potentially much higher deductibles in disaster prone area.

5. Both private carriers and federal or state catastrophe programs should review their approach to handling disaster claims to ensure adequate quantities of properly trained and equipped adjusters exist to handle potential catastrophe before the catastrophe occurs.

6. Just as communication was an issue with federal, state and local emergency response and relief and aid workers, many of these same communication issues exist between companies, their adjusters, their agents and their insureds. Communication issues should be reviewed in light of current available technology to find solutions in advance of the next round of catastrophes.

### **Conclusion**

In summary, the current insurance process for dealing with catastrophe losses is not an efficient or effective process nor has it been in recent years. It is not effective for insurance companies, agents, states, federal or state catastrophic pools, and most importantly, it is not effective for the American people – my clients and your constituents.

As we face a heightened cycle of natural disasters, the likes of which we have not seen in recent decades, an opportunity exists to dramatically improve what is already in place. It may be too late to help the many people affected by Katrina.

But, natural disasters can occur anywhere in our country and failure to act effectively now will continue to cost consumers and taxpayers more than it should.

Thank you for the time to speak this afternoon. On behalf of the many individuals who were affected by Hurricane Katrina in Mississippi, I also wish to thank you for the generous response we have received from you, our elected officials in Congress, the Administration and most importantly the heartfelt generosity from millions of Americans across our great county.

*Testimony of*  
**Guy Williams**  
*on behalf of the*  
American **Bankers** Association

*before the*  
Subcommittee on Housing and Community Opportunity  
*of the*  
Committee on Financial Services  
United States House of Representatives

Regarding Issues Related to Catastrophe Insurance Availability  
and the Housing Markets

June 28, 2006

Chairman Ney, Ranking Member Waters, and members of the Subcommittee, my name is Guy Williams. I am the President of Gulf Coast Bank and Trust Company in New Orleans, Louisiana. I am here to testify today on behalf of the American Bankers Association regarding issues related to catastrophe insurance availability and the housing market, including legislative proposals that have called for a national catastrophe insurance program.

The American Bankers Association, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of our industry. Its membership - which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks - makes ABA the largest banking trade association in the country.

Last year, hurricanes Katrina, Rita and Wilma caused unprecedented devastation to the gulf coast region of our country. Lives, homes, businesses and neighborhoods were lost. Tens of thousands were displaced, and the rebuilding has only begun. I am proud to say that the banking industry was one of the first on the scene to address the damage caused, to begin the rebuilding and to restore our communities. We, our partners, our customers and our regulators have learned many valuable and often painful lessons which will help us and others face catastrophes in the future. I served on a task force of the American Bankers Association on Emergency Preparedness which prepared a Tool Kit for ABA's members that will help them prepare for, and deal with, emergency situations. Similarly, the banking regulators have published "Hurricane Katrina: Lessons Learned" which will also help us to prepare for and recover from disasters.

I would like to make three points here today:

1. The banking industry is accustomed to responding to customer needs during and after natural disasters.
2. The banking industry is strongly committed to our local communities.
3. We need additional tools and improved programs to help ensure recovery and rebuilding after future disasters.

**The banking industry is accustomed to responding to customer needs during disasters.**

When a disaster strikes, every consumer should know that their bank is prepared, their deposits are safe, and that they will have continued access to their funds. Banks are required

by law to have extensive disaster recovery plans in place to protect customer accounts, and state and federal regulators routinely examine each bank on their preparations. Banks have an admirable record and a proven history of restoring service as soon as possible after any unexpected event and working with our customers to address their needs and concerns. Post 9/11 procedures and extensive preparations for Y2K strengthened the banking industry's ability to deal with a broad range of disruptions, and our experiences after last year's hurricanes have broadened those abilities. In even some of the hardest hit areas of the Gulf Coast, banks were up and running the day after Hurricane Katrina hit. Institutions resumed operations using generators and limited communications, often in temporary facilities. After Hurricane Katrina our bank could not return to any of its offices or our operations center or our main office. Nonetheless we reopened the Monday after the storm in rented facilities, our internet banking product continued to operate 24/7, and we made \$18,000,000 in reconstruction loans in the 30 days after the storm.

**The banking industry is strongly committed to our local communities.**

Banks are a key player in the short and long term recovery after any disaster. From ensuring that cash is available immediately after a disaster to making bridge loans to help in short term recovery of individuals and businesses, to providing long-term financing for reconstruction, banks are on the scene and integral to disaster recovery. In the aftermath of last year's storms our industry has not treated the recovery as a competitive matter. Bankers from across the country immediately began providing assistance to banks in the most affected areas. We began working with our customers to help them deal with the aftermath of the disaster and plan for recovery. We extended forbearance on loans. We pushed the Small Business Administration to work more effectively to make disaster loans available. And we

began making new loans to help customers rebuild. Almost immediately we faced challenges. Which brings me to my third and most extensive point:

**We need additional tools and program improvements to help ensure recovery and rebuilding after a catastrophe.**

A strong residential mortgage market requires a reliable secondary market for liquidity. After a disaster the need for liquidity is only enhanced. One of the first problems we faced in making new loans after the hurricanes was finding post-Katrina comparable appraisals that were acceptable to the secondary market. There simply were no comparables in the sense traditionally required by Fannie Mae and Freddie Mac. Initially we were unable to sell home mortgages to the agencies because of appraisal regulations. As a result of work by the Louisiana Bankers Association and the ABA we were able to work out an interim solution that allows loans to be purchased that are 80% of the hard cost or 70% of the pre-Katrina value. While this is helpful it clearly excludes borrowers that do not have the wherewithal to make 20% to 30% down payments. We are continuing to work with the agencies and hope to improve on these ratios as we go forward.

More problematic than the appraisal issue has been that of the availability and affordability of property and casualty insurance after a disaster. Currently, insurers have suspended writing new homeowners coverage in coastal areas around the Gulf, and many insurers, including the market leaders, are declining to renew some policies already in place. Insurers cannot find re-insurance at rates sufficiently affordable to continue offering homeowners policies at a rate state governments consider appropriate. As you are aware, homeowners insurance is subject to strict rate regulation in most states. As a result, Gulf state residents

are seeing their homeowner's coverage, previously purchased through an insurance company, replaced by a policy written by the state's insurer of last resort.

The state insurers are themselves in a particularly precarious financial position. Not only are the state-run companies gaining market share - many are the second or third largest insurer in their state - but they are also in such a poor financial position that some believe that if these state-run insurers were private companies many would have been placed in receivership.

The loss of willing private insurers and the expansion of state-run insurers of last resort has increased premium costs for consumers, decreased the available supply of private homeowner's coverage as the government displaces private industry, and depressed, sometimes dramatically, the value of homes.

The state of Louisiana, like a number of other states, has a state sponsored "backstop" insurance program to provide insurance of last resort to those residents who are unable to obtain it from the private market. The Louisiana Fair plan will provide homeowners insurance when it is commercially unavailable. Unfortunately, the Louisiana plan is actuarially bankrupt and only the full faith and credit of the state of Louisiana is keeping it afloat. In order to cover last year's losses, all insurance policies issued in Louisiana will be subject to an 18% surcharge this year. Because of its low limits and precarious financial condition, the Fair plan is not the answer, nor will other state's similar plans suffice in the face of future disasters. Just this week our community bank approved two commercial

loans that may not close because the borrowers cannot secure windstorm damage at any price. Without affordable insurance, our continued recovery is in doubt.

Due to these limitations faced by both the private insurance market and state sponsored “backstop” programs, the American Bankers Association believes that the creation of a federal disaster insurance program is necessary. Legislation to create such a program has been introduced in the last several congresses. The latest proposal has been introduced in this congress by Rep. Ginny Brown-Waite (R-FL). The approach taken in these proposals would create a national re-insurance program to be funded through regional auctions of re-insurance contracts to be purchased by eligible state catastrophe funds. These state funds would be financed through mandatory contributions by insurance companies in each of those states in an amount that reflects the catastrophe risk of the policies that they write in each state.

Each state fund would be required to set aside a minimum of \$10 million and a maximum of 35% of investment income for mitigation programs. Rates for this coverage would be actuarially based and self-sufficient and would only be available to state programs that have established prevention and mitigation programs.

Absent this or a similar program, all taxpayers cover the costs of uninsured and underinsured properties when a catastrophe strikes. Providing a “backstop” ensures that risk-based insurance remains available and affordable, increasing the ability to cover those who need it and reducing the cost borne by taxpayers when a catastrophe strikes.

Mr. Chairman, I want to thank you again for inviting me to testify here today. I will be pleased to answer any questions you or other members of the subcommittee may have. Thank you.



NATIONAL ASSOCIATION OF REALTORS®

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**STATEMENT OF  
THE NATIONAL ASSOCIATION OF REALTORS®**

**THE SUBCOMMITTEE ON HOUSING AND  
COMMUNITY OPPORTUNITY  
OF THE  
HOUSE COMMITTEE ON FINANCIAL SERVICES**

**“IS AMERICA’S HOUSING MARKET PREPARED  
FOR THE NEXT NATURAL CATASTROPHE?”**

**Wednesday, June 28, 2006**

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REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.



Thank you for the opportunity to present the views of the NATIONAL ASSOCIATION OF REALTORS® (NAR) on the topic of natural catastrophes and the housing market. NAR applauds Chairman Ney for holding this hearing and thanks him for his leadership on this important issue. The question should not be whether the housing market is prepared for the next natural catastrophe so much as how the nation's homeowners can be prepared when the options for obtaining and maintaining insurance coverage are dwindling.

Homeowners need insurance to cover themselves in cases of emergencies and disasters. Events of the past few years have left many homeowners with inadequate or, in some cases, no insurance for a variety of reasons: cost of insurance, high deductibles, and lack of available insurance products in the competitive marketplace. Recent natural disasters have led a number of insurance companies to cancel policies, not renew policies, and pull out of markets because they fear that a significant event could severely impact them.

Recent research conducted by NAR in Florida concluded that the lack of affordable or available homeowners' insurance in that state contributed to a slowdown in Florida real estate markets, which can presage a slowdown in overall economic activity in the region. A strong housing market is a linchpin of a healthy economy, generating jobs, wages, tax revenues and a demand for goods and services. In order to maintain a strong economic climate, the vitality of residential and commercial real estate must be safeguarded.

This deterioration in the availability and affordability of homeowners insurance in disaster-prone areas is an issue of very real concern to NAR. NAR members specialize in the business of facilitating real estate transactions, but when a young family is precluded from owning a home because homeowners' insurance is too difficult or too costly to obtain, we all suffer the consequences. We cannot emphasize enough that the ultimate victims of this homeowners crisis – and let us assure you that in many states in the Southeast, it is a crisis – are consumers frustrated in their attempt to realize the American Dream of homeownership.

The inability to obtain affordable homeowners insurance is a serious threat to the residential real estate market. Not only does it imperil the market for single family detached homes, but condo, co-op and rental markets are affected as well. New home purchases, resale transactions and housing affordability are impacted in the following ways:

- **Homeowners' insurance is a necessary component in securing a mortgage and buying and selling a home.** If a potential homebuyer is unable to obtain or afford the required insurance, the sale will not be completed. As a result, potential homebuyers are priced out of the market.
- **Homeowners' insurance is tied directly to the cost of owning a home.** If a homeowner is unable to maintain insurance required by a mortgage lender, the mortgage is in default. If disaster insurance coverage is optional, potential buyers may choose not to purchase a home because the insurance they need is too expensive. Others may choose to go unprotected.

- **Insurance costs impact rent levels.** Insurance costs incurred by multi-family property owners are ultimately passed on to tenants through higher rents. This impacts housing affordability, particularly for low-income renters and buyers.

The National Association of Realtors® is pleased that Congress is discussing ways to address the need for a comprehensive natural disaster policy that will ensure that homeowners insurance is available and affordable to all who wish to purchase it. NAR encourages Congress to develop a comprehensive natural disaster policy that will help homeowners protect their most valued asset – their homes.

Congress has, with varying levels of interest, debated and voted on natural disaster policies during the past two decades. In this Congress, a number of bills have been introduced that take different approaches to addressing this problem. No one approach has emerged as a front-runner, but NAR is glad that the debate is beginning again. We applaud the efforts of those members of Congress who have introduced and co-sponsored legislation to address this critical issue.

NAR encourages this subcommittee to examine the several approaches that exist and contemplate those that have not yet been thought of. The issue for NAR is simple: homeowners need insurance to protect themselves, their families and their property in case of catastrophe. Unless insurance is available and affordable, many may choose to go without insurance – precisely the decision many Californians have made due to the high cost of earthquake insurance. If “the big one” hits, and people are not insured, 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 – that is through insurance. However, if

insurance is not available or affordable, people may decide to go without and rely on the federal government to assist them in their time of need.

In conclusion, to answer the question: “Is America’s housing market prepared for the next natural catastrophe?”, NAR believes that some markets are better prepared than others, but not a single one can handle the burden of a major catastrophe on their own. It is in the best interests of all Americans to have a comprehensive federal natural disaster policy that includes aggressive mitigation, assumption of risk, and affordable and available homeowners insurance.

This issue is an extremely important one to NAR, REALTORS® and homeowners across the country, and taxpayers. NAR looks forward to working with this subcommittee, the Committee on Financial Services, and all members of Congress to achieve this goal. Thank you.



June 13, 2006

Hon. Robert Ney  
U.S. House of Representatives  
Washington, DC 20515

**VIA FAX: 2022253394**

Dear Chairman Ney:

The National Multi Housing Council (NMHC) and the National Apartment Association (NAA) are greatly appreciative of the Committee's efforts to address the growing crisis facing apartment owners in the property insurance market.

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

With weather experts predicting another active storm season in 2006, the multifamily industry is currently facing significant challenges as property owners seek to renew their property insurance policies. First quarter renewals for member companies resulted in significant cost increases, and rapidly decreasing capacity. Some members report up to 400 percent price increases for some layers of insurance. Largely the result of the 2005 hurricane season which caused an estimated \$46 billion in insured losses, the multifamily industry is facing an insurance crisis. The industry is seeing similar conditions today for property insurance as those experienced the months immediately following 9-11. In addition to significant cost increases, capacity is rapidly diminishing for portfolios with catastrophic (CAT) exposure. It is anticipated that conditions will worsen and become especially problematic for those companies with renewal dates later in the year.

Risk managers and insurance brokers offered the following additional observations about current market conditions:

- A number of incumbent insurance carriers refused to write coverage. Those that did offer coverage did so at significantly reduced limits. This scenario was true even for companies seeking renewals with an excellent past performance history.
- Insurers are being restricted by the rating agencies on how much catastrophic coverage they can write. They threaten to downgrade carriers who write policies in excess of previously acceptable levels of surplus.
- The upcoming July reinsurance treaties will create additional challenges. Direct insurers

*The American apartment industry . . . working together for quality, accessible, affordable housing.*

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will take on more risk, which will subsequently be built into their pricing and therefore increase costs to policyholders.

- Capacity is shrinking in the global markets as well. Many firms have already written all of their available windstorm business with experts predicting all firms to be capped by early July.

The continued occurrence of catastrophic events, whether the result of a natural disaster or terrorism, will have a significant impact on the national economy. Decreased capacity and pricing increases will result in higher prices for the consumers and ultimately reduce the level of available housing in certain areas. Especially hard hit will be the level of affordable housing, which is already in short supply. In states such as Florida where property owners are forced to pay \$1400-\$1500 per unit for property insurance coverage, rents must be adjusted to absorb these increases, thus placing otherwise affordable apartments out of reach of many people. It is also clear that the private insurance market is losing its capacity to take on this significant risk for much longer. Anecdotal accounts of carriers pulling out of certain high risk states worsen the already deteriorating situation.

It is imperative that Congress take whatever action necessary to ensure that adequate protection is available and at reasonable costs. Legislation to create a federal reinsurance program is a step in the right direction. It is imperative that any federal solution include real property losses to businesses such as multifamily rental properties in the qualified lines of coverage and not limit such programs to residential properties.

We thank you for placing this critical issue on the agenda and look forward to working with you to craft a viable solution.

Sincerely,



Douglas M. Bibby  
President  
National Multi Housing Council



Douglas S. Culkin, CAE  
President  
National Apartment Association