Consumer Federation of America

H.R. 21
"HOMEOWNERS' INSURANCE AVAILABILITY ACT OF 1999"

TESTIMONY OF

J. ROBERT HUNTER
DIRECTOR OF INSURANCE

BEFORE THE COMMITTEE ON

BANKING AND FINANCIAL SERVICES

OF THE

U.S. HOUSE OF REPRESENTATIVES

JULY 30, 1999

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STATEMENT OF J. ROBERT HUNTER[1]
DIRECTOR OF INSURANCE,
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ON H.R. 21,
"HOMEOWNERS' INSURANCE AVAILABILITY ACT OF 1999"

1. Introduction

Good morning, Mr. Chairman and members of the Committee. I appreciate your invitation to testify today on the important topic of how the nation will deal with America's natural disasters in the next millennium.

2. Current Reinsurance Situation Implies that no Bill is Necessary

In the July 12, 1999 *National Underwriter*, Mr. Peter R. Porrino, former Chief Operating Officer of Zurich Reinsurance Company and currently national director of Ernst & Young's insurance industry practice, opined that capital markets and securitization have placed a permanent cap on the pricing of catastrophe reinsurance. He said that the reinsurance industry wouldn't again see the hard turns that followed 1992's Hurricane Andrew and 1994's Northridge earthquake.

In the same article Weston Hicks, J. P. Morgan insurance analyst, was quoted as saying that the reinsurance industry is about $75 billion overcapitalized.

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[1] After serving in the private insurance industry as an actuary, Mr. Hunter joined the Federal Insurance Administration as Chief Actuary. He later became Administrator of the FIA, serving under Presidents Ford and Carter. He was founder and President of the National Insurance Consumer Organization, which he headed for 13 years. He served as Insurance Commissioner of the State of Texas during 1993 and 1994. Hunter has served as an advisor to the Florida Academic Task Force studying this problem. He has written extensively on this matter appearing in such diverse venues as the Journal of Insurance Regulation to the opted page of USA Today.

[2] CFA is a federation of some 240 pro-consumer and cooperative organizations with a combined membership of more than 50 million Americans.

Over to last year, the insurance trade press has article after article about the overcapitalized insurance and reinsurance market and the woes of the insurance companies trying to keep prices up in the "soft" market. Even the catastrophe reinsurance market has been very "soft." Indeed, over the last three years, catastrophe reinsurance rates have fallen by more than one-third. This year rates are falling but "the catastrophic reinsurance market rate of decline has slowed", Porrino said in the above-quoted article.

USAA and other insurers have been protected by new, securities-market-based, reinsurance arrangements. It has been clear for some years now that this bill really only would effect State Farm and, maybe, Allstate Insurance Companies. These companies, through diversification, balance in their portfolios of risks insured and, in State Farm's case, massive overcapitalization, are no longer really in need of this bill either.

Thus, Mr. Chairman and members of the committee, the predicate for this bill may have been eliminated by the normal market forces at work. You are to be congratulated for your patience over the years, not overreacting to insurer pressure to enacting an unnecessary intrusion into this area being handled well by the private sector.

3. There is still need for consideration of the current system by Congress

The nation has the time to really do what is needed in the disaster insurance area: rationalize the system that is so inconsistent today. America has allowed its system for preparing and responding to natural disasters to grow in a haphazard way that inconsistently deals with natural disasters and which inadequately acts to save lives and property damage from natural hazards.

Consider the following inconsistent approaches to the three major hazards in America:

HAZARD	MITIGATION REQUIREMENTS	INSURANCE FROM:
FLOOD	Federal	Federal
WIND	State or local	Private (in Homeowners) Or through State Mandated Wind Pools.
EARTHQUAKE	State or local	Private (separate policy) or through State Facility

The lack of a consistent approach to these hazards leaves taxpayers exposed to disaster relief payments and, through clearly insufficient mitigation requirements and enforcement, results in unnecessary loss of life and property.

In the long run, given the nature of the competitive market in insurance, prices reflect risk. Insurance subsidies may exist in the very short run, but they are minimized by state regulatory practices which only allow small impact, if any, of disasters from other states. Exhibit 1 shows the disaster payouts by insurance companies by year over the past three decades. Exhibit 2 shows the premium loads by state for catastrophes.

But disaster relief payments involve cross subsidy from those not exposed to high risk to those who are exposed. There is no risk testing in the collection of federal taxes. For example, there is no surcharge on taxes for living in a high-risk area.

Exhibit 3 shows the FEMA/SBA disaster relief payments made by state from 1988 to 1996. California received $13.1 billion in assistance, 46% of the national total. Florida, albeit Hurricane Andrew is in this time frame, received only $2.5 billion, 9% of the national total over the period. This disparity occurs because Hurricanes are covered in the Homeowners and other fire-related insurance policies, but earthquake is not.

Consider the breakout of payments for insurance vs. disaster relief:

Type of Disaster	Relief payouts	Private Insurance payouts
Earthquake	35.4%	9.1%
Floods	15.6	0
Hurricanes	23.0	40.0
Severe Storms	12.6	4.1
Tornadoes	5.1	29.8
Ice/Snow	3.7	9.5

Insurance takes care of smaller wind events such as tornadoes almost completely. Insurance does a good job on large wind events, too. Thus, the relatively low need for disaster relief for damage from hurricanes compared with the large need for relief for the less insured hazard of earthquake.

State cross subsidies in disaster relief are apparent (See Exhibit 4). Exhibit 4A shows an estimate of the subsidy by state in dollars per household per year. The largest subsidies go to ND ($104) and CA ($100). The states paying most in are CT ($63) and NJ ($52). Florida had a relatively low subsidy $22, considering that Hurricane Andrew occurred during the period of study. This is due to the people of Florida paying their own way with insurance premiums for wind.

Approaching a Solution to the Nation's Crazy-Quilt Disaster "System"

The way to approach a solution to the above listed inconsistencies is by careful study. The nation needs the answers to such questions as:

- Given the current overcapitalized insurance and reinsurance markets and the ready availability of catastrophe reinsurance, do we really need to have a federal backup for any hazard? If so, should the program be limited to earthquake?
- What form should the program take? USAA has proposed an idea deserving of study: a program of tax-deferred reserves to maintain catastrophe risk in the private sector while ensuring access to affordable insurance to consumers.[3]

- What states really need any federal back up? HR-21 implies that California and Florida are targets. Is there need for a program beyond these states?

- Insurance company reports indicate that the damage caused by Hurricane Andrew would have been 33% to 50% less if building codes then on the books were enforced. Perhaps national verification of building code enforcement would be remarkably useful. Should there be such code verification?

- What are the long-term ramifications of any bill? Where is the cost/benefit analysis? How does the mitigation component really work over time? When can the taxpayer reasonably expect to get off of the disaster relief cycle through this program?

- Does Iowa subsidize California more or less than Iowa does today under the current disaster relief approach? Who gets any subsidy and how much/how long? Who pays

[3] The feasibility of a program like this for consumers depends upon how the program is set up. We believe that a condition for such tax relief should be a requirement to provide insurance for disasters to consumers and have mitigation programs in effect to prevent creating any incentives for unwise construction. "Firewalls" would need to be constructed to ensure that tax-deferred reserves would be used only to fund claims from certain disasters and not for profits of other purposes. Consideration must also be given to mitigation, including use of some of the investment income on these reserves for mitigation purposes.

subsidy and how much/how long? Will the people who chose to inhabit high-risk zones ever fully pay their own way?

- As to mitigation, what are the state of the art standards that will be required? Who enforces it? Is just one standard required or should it vary by place? Should there be federal minima that must be met for a state or locality to qualify for federally backed insurance?

- What will any program adopted mean vis-à-vis new construction? Will new construction be controlled in high-risk areas? Or, will the program encourage new construction to be unwisely built by making insurance more available/affordable even if poorly built in high-risk zones?

- Should there be one plan for all catastrophic hazards or is the issue different coverage by coverage? How should the National Flood Insurance Program be integrated into the overall plan? What are the lessons from the NFIP that should be instructive in developing the overall plan? Have the actuarial rates really been self-sustaining during the life of the program?

Before the flood insurance program was enacted, Congress did the right thing. It undertook a feasibility study under the leadership of the National Academy of Sciences that carefully answered the questions that attended to the flood risk. This sort of impartial study of what sort of federal back-up, if any, is needed for this country's insurance industry for natural disaster, what appropriate mitigation measures should be employed, what other quid-pro-quos should be exacted to protect taxpayers and answers to many other fundamental questions.

The Wharton School is well into such an effort. This study should answer many of these and other important questions. The Committee should find out the status of the study and have Wharton testify prior to any action on the bill. This important study is nearing completion as to many aspects and some of the key questions can doubtless be addressed soon, if not now.

Moving toward a political solution

Naturally, the ultimate program for rationalizing the handling of catastrophes in America will require political compromise. If we can find the right balance of mitigation, tax-deferral, response, insurance, risk securitization and enforcement, we can devise a plan to pay for current natural disasters and plan for future ones in a way that demonstrates to the taxpayer in states such as Connecticut, New Jersey, New York, Massachusetts, Ohio, Pennsylvania, Texas and Illinois (among other states currently footing the cost of disaster relief) that they will be freed from today's cycle of higher and higher tax support of unwise construction in high risk areas of the country.

The nation needs a true system to handle natural disaster. It is time to develop it.

APPENDIX

Problems with H.R. 21 as Drafted

a) The Congressional Findings (Section 2) are not valid

There are several findings that the passage of time and facts on the ground has invalidated. Just two examples are:

- Reinsurance costs are falling, not rising anymore. Insurance is now readily available.
- The insurance industry is, by all observers' comments, severely overcapitalized, so the comment that there is a "lack of sufficient capacity" is demonstrably wrong.

b) Where's the promise of availability of insurance?:

There is no requirement that the industry sell any new coverage as a condition of access to the federal treasury for the reinsurance back up. It makes no sense to enact a federal program to back up only the policies already on the books of the insurance companies since, as is obvious, they are in place today with no taxpayer exposure.

c) Mitigation.

The mitigation sections of the bill are remarkably weak. I am led to understand that this is because the Committee does not want to allow any other Congressional Committee to have to act on the Bill, which would be the case if mitigation requirements were put into the Bill. If it is true that a "turf battle" is at the heart of the weak mitigation in this Bill, you should reconsider. Weak mitigation, coupled with lower cost, more readily available insurance, will not only cost taxpayers more in the future, it will cost lives.

Examples of the weakness of the mitigation requirements are:

- The need for a strong mitigation component for new construction is particularly important in any bill which will tend to make insurance more available or affordable. The reason is obvious: if insurance is available, a home built in a very high-risk area can get protection by insurance and, thus, is more likely to be built. Even with the flood insurance rate maps and supposed full actuarial rates for new construction, there has been building on barrier islands that is questionable and which likely would not have been built were it not for the federal insurance availability. Simply put: any program that encourages unwise new construction is dangerous both to taxpayers and to the lives of persons inhabiting such structures. The bill only waives at the new construction issue, by requiring the state in the state program part of the bill, to certify that "new construction insured by the program complies with applicable building, fire and safety codes." No standards are imposed. No improvement in the inadequate status quo is gained.

- The lack of clear standards for construction and no standards for enforcement. Some money (10% of investment income on the State program for coverage; a very weak adjustment allowed in reserve prices for the private part of the program that "takes into account any efforts that are being made to reduce losses") will be made available for mitigation but there is no direction on how these moneys will be used, except for the weak phrase that the "State, or appropriate local governments ... have in effect building, fire, and safety codes generally consistent with" FEMA guidelines. This will go nowhere to reduce losses. There must be clarity. If there is not, pressure from builders at the local level will continue to degrade any tough standards in place.

EXHIBIT 1

DISASTER PAYOUTS BY INSURANCE COMPANIES IN THE U.S.A.

YEAR	CAT LOSSES[1]	YEAR	CAT LOSSES
1965	$ 694 Million	1981	714 Million
1966	111	1982	1,529
1967	327	1983	2,255
1968	135	1984	1,548
1969	256	1985	2,816
1970	450	1986	872
1971	174	1987	905
1972	215	1988	1,409
1973	376	1989	7,642
1974	696	1990	2,825
1975	514	1991	4,723
1976	271	1992	22,970
1977	423	1993	5,705
1978	646	1994	17,010
1979	1,703	1995	8,310
1980	1,177	1996	7,375

[1] Source: Property Claims Services Division of American Insurance Services Group, Inc. Actual payouts. These payouts include commercial insurance as well as insurance on homes.

INS. CAT LOADS BY STATE

Exhibit 2

STATE	PREMIUM FACTORS (%)	STATE	PREMIUM FACTORS (%)
Hawaii	8.56	Virginia	0.95
Florida	7.73	Tennessee	0.93
South Car.	5.22	Minnesota	0.89
Kansas	4.51	Pennsylvania	0.84
Oklahoma	4.16	Oregon	0.76
California	3.49	Ohio	0.76
Texas	3.22	New York	0.76
Colorado	3.17	Maryland	0.7
Louisiana	3.07	Washington	0.62
Mississippi	2.94	New Jersey	0.62
Alabama	2.78	Maine	0.62
Nebraska	2.47	Vermont	0.61
Rhode Is.	2.32	Wisconsin	0.58
Arkansas	2.29	Alaska	0.55
North Car.	1.85	New Hampshire	0.43
Wyoming	1.75	Arizona	0.39
Delaware	1.75	Utah	0.35
Iowa	1.65	Michigan	0.29
Missouri	1.61	Idaho	0.21
South Dakota	1.45	Dist. of Col.	0.2
Georgia	1.42		
Kentucky	1.41		
Connecticut	1.31		
North Dakota	1.28		
West Virginia	1.27		
New Mexico	1.24		
Indiana	1.24		
Nevada	1.23		
Massachusetts	1.11		
Illinois	1.09		
Montana	0.97		

Source: New York Insurance Department Catastrophe Premium Reserve Factors, 5/14/97 (used unadjusted factor as proxy for cat costs)

FEMA/SBA
TOTALS
DISASTER
RELIEF
1988-96

EXHIBIT 3

$ MILLIONS	STATE
13061.7	California
2491.5	Florida
859.2	Illinois
736.8	Texas
706.9	Georgia
618.7	South Carolina
602.5	Missouri
590	Louisiana
511.1	North Carolina
471.8	New York
467.9	Iowa
444.2	Washington
425.8	Pennsylvania
410.5	Hawaii
304	Minnesota
293.1	Alabama
231.1	North Dakota
204.8	Oregon
195.9	Massachusetts
186.3	Kentucky
172.7	Nebraska
164.6	Ohio
163.3	South Dakota
160	New Jersey
154.4	Mississippi
153.5	Kansas
137.6	Arizona
136.9	Virginia
134	Wisconsin
133	West Virginia
130.1	Tennessee
129.6	Alaska
128.4	Indiana
103.2	Oklahoma
86.8	Arkansas
55.2	Maryland
54.2	Connecticut
53.3	Idaho
52.6	Maine
35.8	Michigan
30.9	Nevada
21.3	Vermont
20.5	Rhode Island
17.2	Delaware
14.9	New Hampshire
14.5	Montana
8.5	New Mexico
8.2	Dist. of Col.
4.8	Colorado
2.6	Utah
0.4	Wyoming
28289.9	Countrywide

EXHIBIT 4

DISASTER RELIEF PAYMENTS AS A PERCENTAGE OF FEDERAL TAXES PAID -- 1/1/88 TO 6/30/96

STATE	DISASTER PAY AS A % OF TAX	STATE	DISASTER PAY AS A % OF TAX
North Dakota	2.9	Oklahoma	0.3
California	2.4	Maine	0.3
Hawaii	2.0	Arkansas	0.3
South Dakota	1.8	Arizona	0.3
South Carolina	1.5	Wisconsin	0.2
Louisiana	1.2	Tennessee	0.2
Iowa	1.2	Pennsylvania	0.2
Florida	1.1	Montana	0.2
Alaska	1.0	Massachusetts	0.2
Nebraska	0.8	Virginia	0.1
Missouri	0.8	Rhode Island	0.1
West Virginia	0.7	Ohio	0.1
Georgia	0.7	New York	0.1
Mississippi	0.6	New Jersey	0.1
Alabama	0.6	New Hampshire	0.1
Washington	0.5	Nevada	0.1
Oregon	0.5	Maryland	0.1
North Carolina	0.5	Indiana	0.1
Minnesota	0.4	Dist. of Col.	0.1
Kentucky	0.4	Delaware	0.1
Kansas	0.4	Connecticut	0.1
Illinois	0.4	Wyoming	0.0
Idaho	0.4	Utah	0.0
Vermont	0.3	New Mexico	0.0
Texas	0.3	Michigan	0.0
		Colorado	0.0
		Countrywide	0.7

Note: Taxes for 1/1/95 to 6/30/96 estimated to be at 1994 levels.

EXHIBIT 4A

ESTIMATED PER HOUSEHOLD[1] CROSS SUBSIDY BETWEEN STATES FOR DISASTER RELIEF 1/1/88 TO 6/30/96

STATE	SUBSIDY PER HOUSEHOLD
12 STATES RECEIVE:	
North Dakota	$104.32
California	99.56
Hawaii	74.38
South Dakota	52.00
South Carolina	31.73
Iowa	25.69
Alaska	24.95
Florida	21.62
Louisiana	20.19
Missouri	4.57
Nebraska	3.31
West Virginia	0.10
OTHER STATES PAY:	
Georgia	-0.09
Mississippi	-2.36
Alabama	-5.75
North Carolina	-8.07
Kentucky	-11.83
Oregon	-12.22
Idaho	-13.11
Arkansas	-13.86
Washington	-15.36
Kansas	-15.40
Maine	-16.75
Oklahoma	-17.39
Minnesota	-17.73
Vermont	-20.60
Montana	-21.76
Arizona	-21.81
Illinois	-22.74
Texas	-23.41
New Mexico	-25.92
Tennessee	-27.40
Pennsylvania	-27.42
Wisconsin	-28.91
Indiana	-30.32
Utah	-30.48
Rhode Island	-31.22
Ohio	-32.62
Colorado	-34.66
Virginia	-35.57
Delaware	-36.06
Wyoming	-37.88
Massachusetts	-38.11
New York	-39.20
Michigan	-41.60
Nevada	-43.41
New Hampshire	-43.65
Maryland	-43.99
Dist. of Col.	-49.73
New Jersey	-51.71
Connecticut	-62.61
Countrywide	$ 0.00

[1] Households estimated by dividing population of state by 2.7 persons per household