STATEMENT of

ROBERT W. PIKE

EXECUTIVE VICE PRESIDENT, SECRETARY AND GENERAL COUNSEL
ALLSTATE INSURANCE COMPANY

before the

HOUSE COMMITTEE ON BANKING AND FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

regarding

H.R. 21
THE HOMEOWNERS INSURANCE AVAILABILITY ACT OF 1999

JULY 30, 1999

Thank you for the invitation to appear before you today to discuss H.R. 21, the Homeowners Insurance Availability Act of 1999.

Allstate insures more than 30 million homes and automobiles, making us the largest investor-owned personal lines insurance company in the United States. We share the Committee's concern about the availability of homeowners insurance and welcome the opportunity to tell you why H.R. 21 is critically important.

Twice in this decade, Allstate has faced massive losses from natural disasters. In 1992, we paid more than $2.3 billion for claims associated with Hurricane Andrew. The loss exceeded *all* of the premiums we collected in Florida over 50 years and consumed 42% of our nationwide surplus.

Two years later the Northridge earthquake caused industry-wide insured losses of more than $12.5 billion. Allstate's share of these losses exceeded $1.6 billion.

Even though we settled virtually all of our claims quickly and to our policyholder's satisfaction, our shareholders demanded that we take certain steps to assure that the company could not be threatened with insolvency from a future disaster. Therefore, we embarked on a plan to limit our exposures to catastrophes in several ways.

First, we increased the amount of private reinsurance we purchased from reinsurance companies and capital markets.

Second, we carefully limited the amount of business we did in certain areas which are susceptible to exceptionally large hurricane and earthquake losses.

Third, we participated in new state-sponsored initiatives in Florida and California designed to create new insurance capacity and improve the availability of coverage.

We are proud of the steps we have taken, but they have by no means solved the problem.

Today, Allstate buys more private reinsurance than any property insurance company in the United Sates. We want to buy more reinsurance, but after five years of trying, we still cannot find coverage in sufficient quantities and at prices which make it a practical means for managing our worst-case risks. It is true that the current market for reinsurance is better now than it has been for some time. We should remember, however, that over the last decade, prices and capacity have been extremely volatile.

We have tried to compensate for the lack of reinsurance capacity by limiting our own growth in certain regions, but these efforts have caused significant hardships for our agents and the communities we serve. Worse, based on our observations of the marketplace, other insurers have been unwilling or unable to absorb the business Allstate, out of economic necessity, can no longer write. From their actions, we can only deduce that other insurers have reached conclusions similar to our own: property exposures are too big; there is not enough reinsurance capacity, and writing *more* coverage without an adequate means to manage the risk is no longer a prudent business strategy.

This is the mindset that has led to the persistent problem of availability and the fraying of the homeowners insurance safety net.

Higher premiums have not eased the situation. In fact, even in markets where rates have risen dramatically, residual market pools for homeowners unable to find coverage from insurance companies have been steadily rising.

The boundaries of the North Carolina windpool have been expanded three times in less than twenty months. The Florida Windstorm Underwriting association accepted more than 250,000 applications in the last year. Louisiana adds 1,000 new families every month to its windpool. These pools would not be growing if reinsurance were available in sufficient quantities to primary insurers and at prices that allowed the risks to be properly managed.

It is our business to insure property, so we have tried everything possible to expand the industry's capacity to deal with catastrophe exposures. We have talked to investment bankers, supported thank-tank initiatives and participated in various industry coalitions. But to be quite honest, it is mostly talk. No one is prepared to put enough money on the table, at a realistic price, to make a serious dent in the reinsurance capacity gap. In fact, the capital markets are less active today than they were even three years ago.

By far, our most successful efforts have involved public-private partnerships between insurance companies, insurance regulators and state government. The Florida Catastrophe Fund (FCF), a state-run, privately financed reinsurance program is the best example. The FCF was established after Hurricane Andrew because, in the words of FCF's chief executive Jack Nicholson, "the private reinsurance market was not able to meet the needs of Florida insurers and policyholders."[1]

The FCF uses an innovative combination of insurance company premiums and bonding authority to create a new source of reinsurance capacity which cannot be duplicated in the private market. From the start, the motive of the program was to prepare for the next great hurricane to strike the state, and according to Deputy Insurance Commissioner Suzanne Murphy, its success is the single most important reason the entire Florida homeowners insurance market has been stabilized for the time being.[2]

The FCF is a significant accomplishment. It provides $11 billion of reinsurance capacity that would otherwise not be available, and unlike private reinsurance, the growing surplus remains in Florida, to be used whenever the next hurricane hits the state. Despite this success, the Cat Fund falls considerably short of what is needed to cover a major hurricane which in Florida could cause $40 or $50 billion in losses.

Another modest success is the California Earthquake Authority. It was covered by the California legislature in the aftermath of the Northridge Earthquake when 96% of the private insurance market stopped writing homeowners coverage entirely. The CEA provides earthquake insurance directly to homeowners. Without it, there would be no reasonable supply of coverage available in the state.

---

[1] Jack Nicholson, Testimony before the House Banking Subcommittee on Housing and Community Opportunity, July 12, 1999, Tampa Florida.

[2] Susanne Murphy, Testimony before the House Banking Subcommittee on Housing and Community Opportunity, July 12, 1999, Tampa, Florida.

Unlike the Florida Cat Fund, which relies on its own resources and bonding capacity for reinsurance, the CEA purchases reinsurance from private sources, including capital markets. It buys the largest layer of reinsurance sold anywhere in the world. To qualify for this honor, you would think the CEA's private reinsurance layer would be huge. In fact, the total is only $2.4 billion, which is less than $1/5^{th}$ of the loss from the Northridge Earthquake and probably less than 2% of the losses which would occur from a worst-case seismic event.

The CEA's capacity is so limited that once claims from a future earthquake exceed $7.5 billion, even with a private reinsurance backstop, homeowners claims will no longer be fully honored. This is not an acceptable long-term solution.

The experience of Florida and California clearly show that even large states with huge insurance markets cannot adequately cover high levels of catastrophic losses. H.R. 21 will help to solve this problem. It would provide reinsurance protection from the worst 1% of natural disasters which are too large and too unpredictable to be reasonably covered by private insurers and states on their own.

The protection would be offered for sale by the Treasury Department in two ways. State programs, like the Florida Cat Fund and the California Earthquake Authority, could purchase coverage directly from the Treasury at actuarial rates. In addition, the Treasury would offer reinsurance contracts to the highest bidders in regional insurance auctions intended for insurance companies and reinsurers.

It is the intent of the program to encourage the development of other, more innovative risk financing mechanisms in the private sector. But it recognizes that those new mechanisms are in their infancy and unlikely to generate significant new capacity for at least a decade.

The federal reinsurance plan envisioned by H.R. 21 is not activated until insured losses from a natural catastrophe exceed a threshold defined as a 1-in-100 year event. This means that the vast bulk of insurance losses will continue to be covered exclusively by the private market. Once losses exceed the 100-year threshold, federal reinsurance pays 50% of eligible losses, up to a predetermined maximum. In the case of the Florida Cat Fund, for example, federal reinsurance would only cover insured losses after $21 billion in losses had been absorbed by insurers and the state program.

Opponents of H.R. 21 have sought to portray the triggers in H.R. 21 as unnecessarily generous. They claim that the program will cover events which cause damage as low as $2 billion. In fact, the bill says that the trigger should be a 1-in-100 year event for a state or region, or $2 billion, whichever is *greater*. Under this standard, the trigger for Florida, as I have already mentioned, is $21 billion not $2 billion. Earthquakes in the New Madrid region of Missouri, Arkansas, Tennessee, Illinois and Indiana would only be covered after losses exceeded $10 billion. In the Pacific Northwest, the trigger would be in the $6 billion range. By using the 1-in-100 year criteria as the standard for each and every region, H.R. 21 assures that *all* states will be treated fairly and equally.

In closing, Mr. Chairman, let me say that Congress has a clear opportunity to address a problem while it is a trend instead of a crisis.

We know that the mechanisms in place are inadequate for the problem. Insurance markets are deteriorating, and they are doing so most quickly in the areas which are likely to suffer natural disasters of extremely large magnitude.

A federal reinsurance program will bring stability and predictability to insurance markets. It will assure the integrity of state programs which are certain to fail if a large event occurs. It is not a replacement for the private markets. Insurance companies, and insurers in cooperation with state government, will continue to cover 99 out of 100 risks with no federal backstop. This means that insurers will still require as much private reinsurance as is available. But there are some events which logic tells us are too big for any insurance company or any state to manage, and it is unrealistic to think that these events should be our responsibility alone.

Whether Congress takes action on H.R. 21 will do nothing to change the odds of a catastrophic event occurring. However, Congress can influence whether the recovery is swift and orderly or delayed and haphazard. Assuring the integrity of the private insurance system is the fairest, most equitable and cost-effective way for government to support the rebuilding process. It is certainly better than the ad hoc relief and government handouts that characterize our current approach to dealing with natural disasters.

We urge the Banking Committee, as it did last year, to report the language contained in H.R. 21 and move it swiftly to the House floor.