



*Independent Insurance Agents
& Brokers of America, Inc.*

**STATEMENT OF ANDREW VALDIVIA
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

March 27, 2007

Good afternoon Chairwoman Waters, Ranking Member Biggert, and Members of the Committee. My name is Andrew Valdivia, 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 currently serve as the California State National Director for the IIABA. I am also the President of White and Company Insurance Inc. in Santa Monica, CA, a full-service agency that serves clients in Santa Monica and the surrounding area with both commercial and personal insurance. White and Company employees over 45 insurance professionals in 5 separate departments.

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 28 named storms, seven of which made landfall in the U.S. These disasters roiled the insurance marketplace and our overall economy. Estimates for 2005 U.S. catastrophe losses are over \$62 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. In 2005, Hurricane Katrina alone generated \$40.6 billion in insured losses and more than 1.7 million claims.

Although the 2006 hurricane season was relatively light in terms of hurricane activity, the tremendous costs of the 2005 season combined with the fear of future catastrophes 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, a leading risk modeling and technology firm, 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

As a Californian and as your constituent, I first would like to thank you, Chairwoman Waters, for holding this important hearing on an issue that has impacted millions of Americans and many other communities across the country. The IIABA is extremely grateful for your work on this issue and for the opportunity to share its views on what we feel is a matter of critical importance.

Our members 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, Madam Chairwoman, for calling this important hearing to explore these issues, and we look forward to working with the Committee in the future on this issue. We also thank the many other Members of Congress who have proposed legislative solutions to address these difficult issues.

In short, we welcome all proposals and support 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 affordability problem. The reality is that many insurers have either stopped writing new homeowners' business in or withdrawn completely from at-risk markets.

The natural disaster insurance crisis currently threatening the marketplace is not an “insurance company issue.” It is a consumer issue. As the largest trade association representing independent insurance agents, the IIABA feels it is our responsibility to deliver the message that there is a looming crisis facing consumers due to natural disaster risk. As the conduit to consumers, the IIABA recently joined the Natural Catastrophe Policyholders Coalition as an ex-officio member. The Coalition is an alliance of policyholders who have joined together to address issues related to the availability and

affordability of catastrophe insurance. The goals of the coalition are to create a forum to share information and to develop and promote policies to ensure the availability and affordability of catastrophe insurance to both homeowners and businesses. As an ex-officio member of the Policyholders Coalition, the IIABA will continue to be a leading advocate for a federal solution to this crisis. In fact, we are working with another witness here today, the National Association of Realtors, as part of this coalition.

National Problem

I would particularly 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 homeowners’ insurance market. However, hurricanes are only one of the many catastrophic risks our nation faces. According to the Insurance Information Institute, tornadoes, earthquakes, mudslides, blizzards, and other catastrophe events combined have accounted for over half of the U.S. catastrophe losses in the last 20 years. The 3rd most costly natural disaster on record was the Northridge Earthquake in 1994, with \$16.5 billion in losses. 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 (CEA) and the Florida Hurricane Catastrophe Fund (FHCF). The CEA was created in 1996 to offer a basic level of residential earthquake coverage to Californians. The FHCF was created in November 1993 after Hurricane Andrew to protect and advance the state's interest in maintaining insurance capacity in Florida. 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. For example, even with the CEA, an A.M. Best 2006 study shows that only 12 percent of Californians bought residential earthquake insurance in 2005. Meanwhile, AIR Worldwide estimates that if there were a 7.9 Magnitude quake in San Francisco, CA, the losses could top \$100 billion.

In the face of these enormous estimated losses, it is also worth noting that the commercial earthquake market in California has dropped precariously. While the CEA offers some earthquake protection for the residential market, it does not offer policies to the commercial market. Instead, the primary source of commercial earthquake coverage is the non-admitted market. With this market devoting additional catastrophic capacity to the windstorm states and reassessing its aggregate exposure in light of the natural disasters in the Gulf coast region, prices and retentions have skyrocketed. Quite simply, some commercial policy holders in California are unable to secure coverage at reasonable prices.

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 to the issue of natural catastrophe insurance 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 that both consumers and taxpayers face, 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.

IIABA is comprised of thousand of small businesses and as such, we always prefer market –driven solutions to problems and are suspect of new government programs. In short, we do not adopt a position like this lightly. We do so only because we so no other available course of action to resolve this availability crisis. There is currently a clear case of market failure.

National Solutions

In our view, a simple cost-benefit analysis suggests that it is more efficient and less costly for the federal government to address this issue in advance of a natural disaster in a way that maximizes private sector capacity, as opposed to through post-disaster relief on an ad-hoc basis. Members of this Committee are well aware of the GAO revelations regarding misuse of FEMA disaster funds disbursed following Katrina, and while we 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 program 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 such 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. 330, the Homeowners' Insurance Availability Act, sponsored by Rep. Ginny Brown-Waite (R-FL). 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. 330, the IIABA is examining other proposals that would create a federal catastrophe reinsurance program, such as H.R. 91, the Homeowners Insurance Protection Act of 2005, also introduced by Reps. Ginny Brown-Waite, and H.R. 4507, the Natural Catastrophe Insurance Act of 2005, offered by Rep. Carolyn Maloney (D-NY) in the 109th Congress. 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 formal 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. 164, the Policyholder Disaster Protection Act, introduced by Rep. Bobby Jindal (R-LA). 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.

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 must be explored in order to protect both consumers and taxpayers across the country. While it may be a difficult task, we believe that any solution to the natural disaster insurance crisis will likely need to be comprehensive in its approach and include a role for a federal backstop, tax-free reserves, and enhanced mitigation and building codes.

Along these lines, we thank Rep. Kendrick Meek (D-FL) for introducing H.R. 537, the Catastrophic Disaster Risk and Insurance Commission Act. H.R. 537 would help Congress address these issues by establishing a national commission to examine proposals and to make recommendations to help the federal government prepare for and manage natural disasters. We believe that such a Commission would be an important first step towards putting together a comprehensive solution, and we urge the Committee to consider this legislation.

We also recognize that Reps. Mahoney (D-FL), Klein (D-FL), Brown-Waite (R-FL), Jindal (R-LA), Melancon (D-LA), and Maloney (D-NY) are working in a task force to address the natural disaster insurance crisis. We commend these members for taking leadership roles in developing a solution and will be happy to work with them on identifying both the specifics of the problem and any potential solutions. In particular, we urge this task force to consider H.R. 330 as a starting point for legislative solutions. We believe any federal backstop proposal should encourage companies to enter at-risk markets, but should also have an appropriate “trigger” point to limit federal involvement. For the same reasons, we also urge the task force to consider Rep. Maloney’s legislation (H.R. 4507) from last year’s Congress, which has a \$50 billion trigger point (a dollar amount consistent with the losses experienced in Katrina). Any trigger for program coverage should be set at a level appropriate to not impede market-driven efforts to

manage risk, while still encouraging insurers to enter the market. Finally, we urge the task force to consider supporting the Catastrophic Disaster Risk and Insurance Commission Act, which has support in both the House and Senate. A blue-ribbon commission that seeks broad input could lead to a comprehensive solution and could also create momentum necessary to enact legislative proposals.

We also urge you, the full Financial Services Committee, to again pass H.R. 1065, the Nonadmitted and Reinsurance Reform Act, introduced by Rep. Dennis Moore (D-KS) and Ginny Brown-Waite (R-FL). As evidenced by last year's 417-0 vote on the House floor, this legislation enjoys overwhelming support and it will allow us to better serve commercial policyholders, who are also beginning to feel the strain of limited capacity for natural disaster risk. Since many of the current natural disaster proposals primarily focus on homeowners insurance, we believe that H.R. 1065 is a good first step that will help provide efficiency to the surplus lines market that serves commercial policyholders throughout the country, including at-risk markets.

Finally, we are currently analyzing a proposal by Rep. Gene Taylor (D-MS), the Multiple Peril Insurance Act of 2007 (H.R. 920). We support the goals of this legislation, which is to increase the availability and affordability of windstorm coverage for both homeowners and commercial policyholders in areas of the country where coverage is either unavailable or cost prohibitive. However, we do have concerns that, by attaching a windstorm election to the National Flood Insurance Program (NFIP), the proposal may create an undue amount of financial exposure to U.S. taxpayers. Additionally, we are concerned that the proposal may have the unintended effect of crowding out the private marketplace in areas of the country where that marketplace is still vibrant. Finally, I'd like to comment that, as a Californian, this proposal does not help with the very real financial risks associated with earthquakes, mudslides, and other natural disasters that aren't associated with windstorm damage. The IIABA has not taken a formal position on this legislation, but we have and will continue to work with Rep. Taylor on his ideas for increasing the availability and affordability of windstorm insurance.

Congressional Attention Is Needed

Achieving a consensus within the insurance industry for a solution to this growing problem has proven elusive, which has complicated public and private efforts to address this issue. However, as some parties express concern with some of the above proposals, consumers still need and demand coverage to protect their homes, their families and their communities.

We thank this Committee and the Members of Congress mentioned above for their leadership on these issues, and we would strongly urge you to continue to shed light on this important topic. The sheer number of legislative proposals before Congress, as well as the Committee's decision to hold hearings on the issue, indicates to us that progress is being made towards a legislative solution.

We encourage Congress to be realistic, but also ask tough questions and demand responses. Congress can be very helpful in challenging the private sector to engage in this process. In our view, Congressional attention will spur greater insurance marketplace involvement in exploring potential solutions, perhaps leading to even more innovative proposals.

Conclusion

In conclusion, we commend you, Madam Chairwoman, for convening today's hearing, and we hope that the Committee will continue its thorough examination of legislative solutions for the catastrophe insurance availability crisis.

The Big "I" is 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. We are open to a number of potential solutions with limited federal involvement, including federal catastrophe funds, insurer tax-free reserving, enhanced building codes and mitigation.

We stand ready to assist your efforts in any way we can.