

Capitol Hill Briefing on Catastrophe Issues

H.R. 21 - The Homeowners' Insurance Availability Act

*Rade T. Musulin
Vice President – Actuary
Florida Farm Bureau Insurance
Companies*

My Perspective

- Actuary working in public policy.
- Participated in rebuilding the Florida property insurance market and analyzing Federal Legislation.
- Committee work:
 - Sen. Stevens working group on catastrophes.
 - FHCF Advisory Council.
 - Actuarial committees of FWUA and FRPCJUA.
- Today, I speak for myself, not the American Academy of Actuaries.

Post-Andrew Chaos

- Loss of almost \$17 billion in 1992 dollars.
- 12 insolvencies.
- Almost 1 million policies moved out of the private market into public facilities with little capital, dependent on large assessments until bonds with terms up to 30 years are retired.
- Large rate increases.
- Strong public backlash against insurers, which continues today.
- Demands for political intervention.

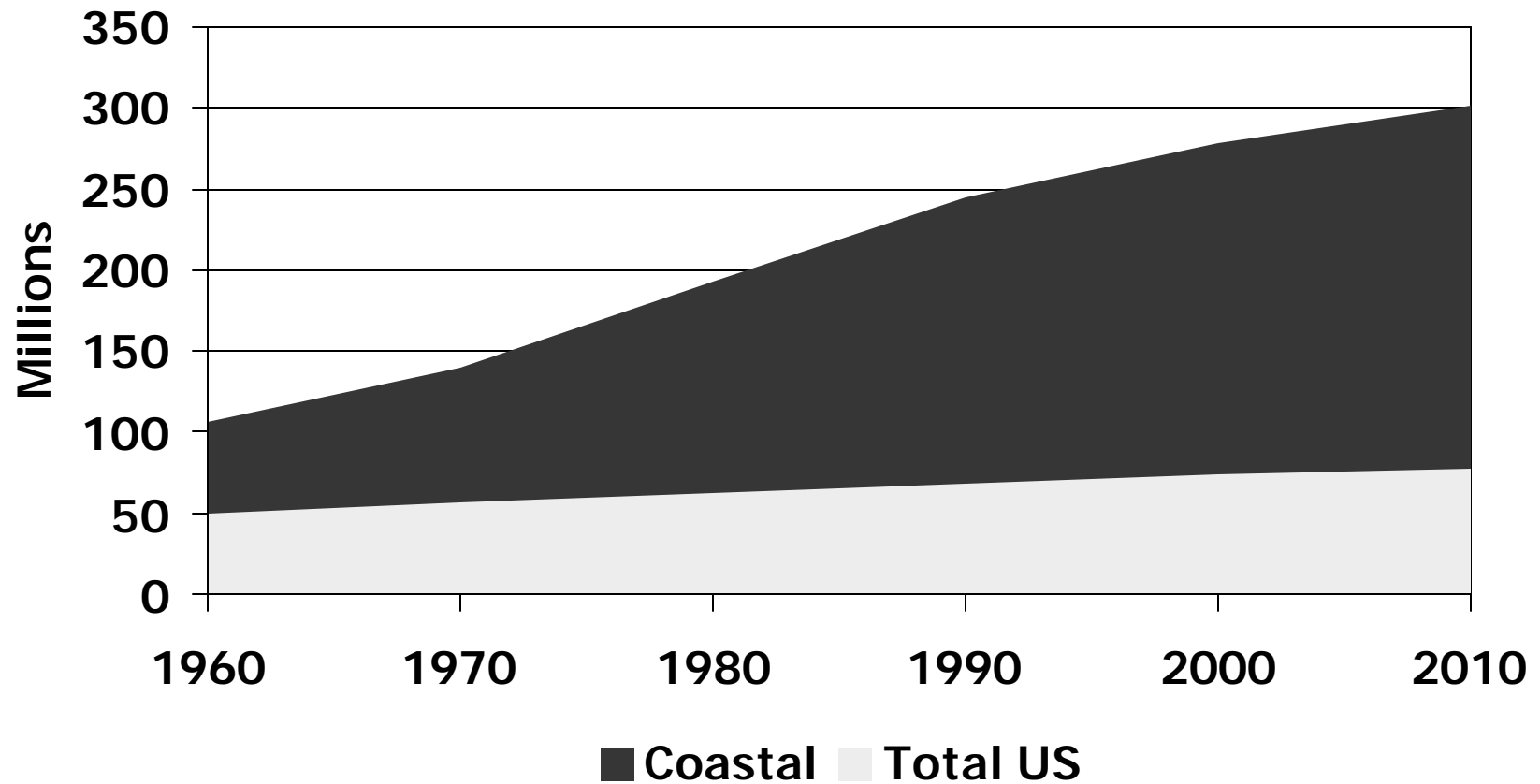
Andrew: A Wake Up Call?

- At the state level, Florida was unprepared for Andrew, but lucky.
 - Significant capital committed to market.
 - Loss could have been much larger.
 - Considering the circumstances, solutions were worked out with great deliberation and care.
- At the national level, will the nation's insurance system be prepared for the "big one"?

The Demographic Problem

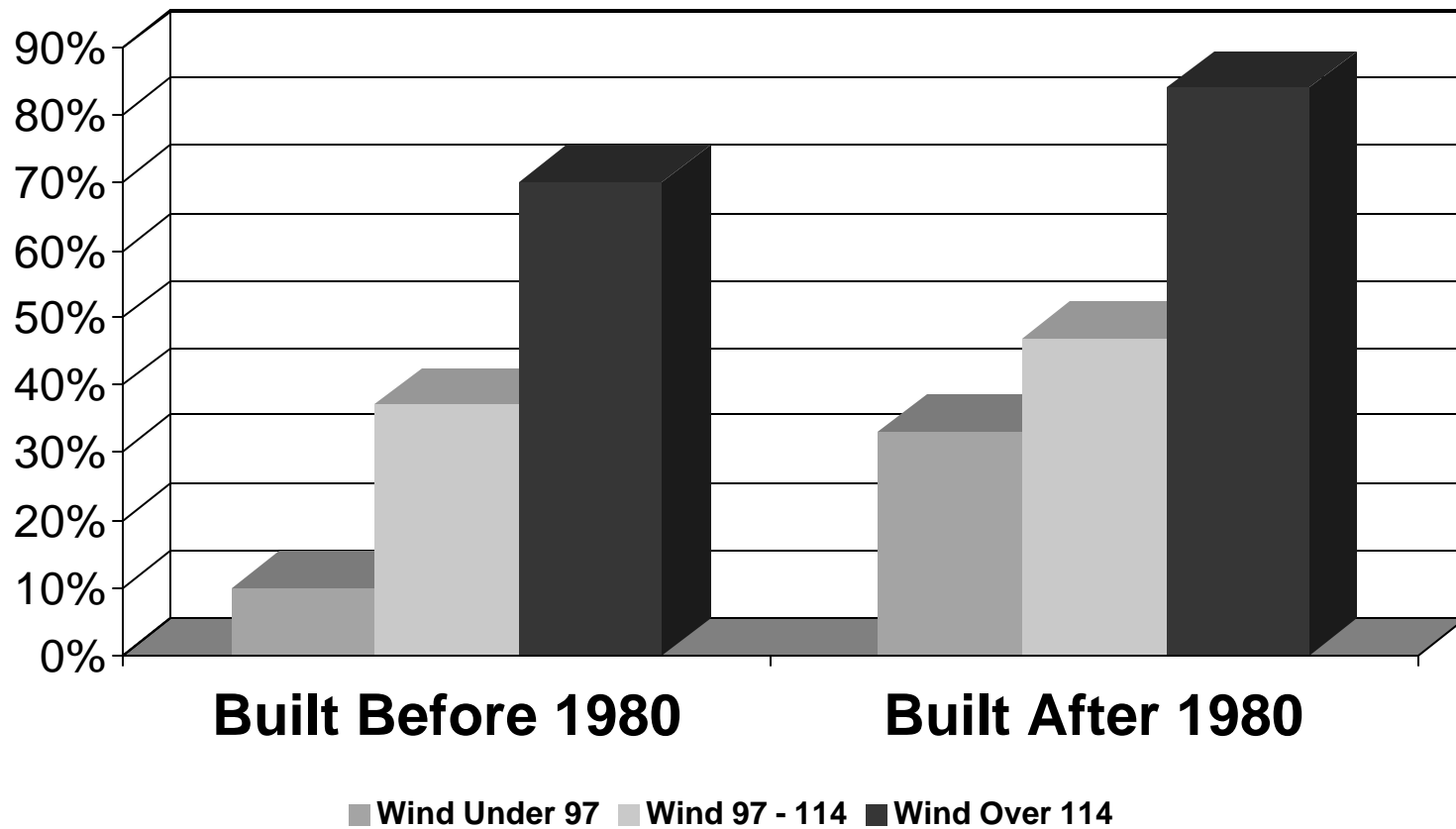
- Population in areas prone to natural disasters is growing rapidly throughout the country.
- Homebuilders and other interests have fought efforts to enact tough codes which will lower losses and keep rates affordable.
- Can consumers afford (or be willing) to pay for premiums to cover losses?
- Unlike gas guzzling cars, insurance guzzling homes have a long life and are not easily moved.

Coastal Population Density



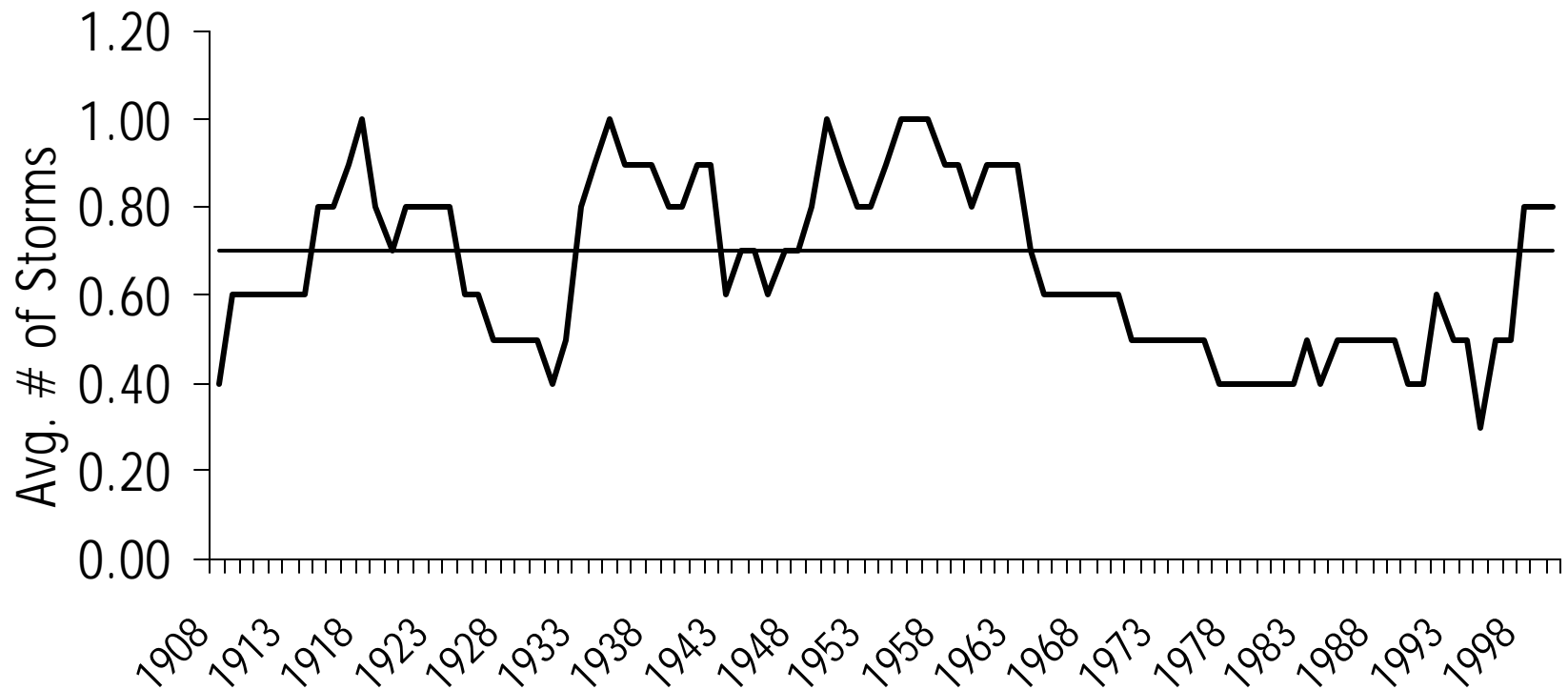
Construction Quality - Andrew

% of Homes Uninhabitable



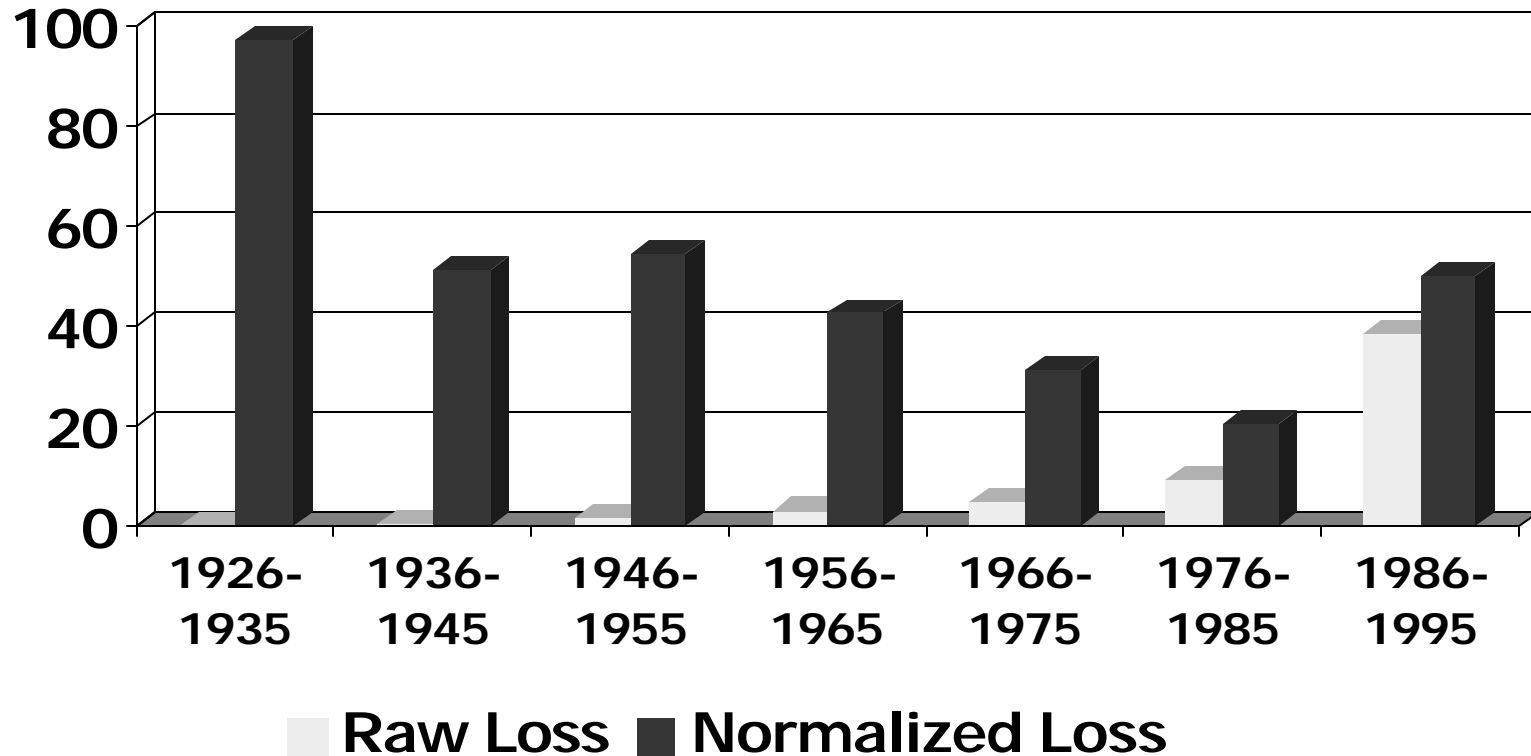
Hurricane Frequency

Average Number of Severe Hurricanes
(ten year moving average)



Normalized vs. Modeled Loss

Gulf/Atlantic Hurricane



Is Federal Action Needed?

- The question is not whether there will be Federal involvement, but whether it will occur before or after an event.
 - Current system cannot handle a huge event without massive consumer disruption.
 - This will lead to demands for action from voters.
- H.R. 2749 is an incomplete solution.

H.R. 2749: Incomplete

- Federal tax law is a problem that needs to be addressed.
- H.R. 2749 will not solve the overall problem of post-market disruption unless it is complimented by some form of Federal reinsurance as in H.R. 21.
 - Reserves are phased in over 20 years.
 - Reserves take a long time to rebuild, but catastrophes are not neatly timed.

Some Major Issues – H.R. 21

- Should the legislation focus on state funds, reinsurers, or primary insurers?
- Should it be national, regional, or by state?
- How can it be structured so that:
 - It provides wide benefit.
 - It results in a “level playing field” among insurers.
 - It avoids tremendous complexity.
 - It does not crowd out private capital.
 - It avoids subsidies over a long time.
 - It can adjust to changing conditions.

H.R. 21 History

- First bill in 1993.
- 1995 Stevens/Inouye bill, incorporated excess of loss auction (XOL) proposed by Treasury Department.
- 105th Congress:
 - H.R. 230, similar to 1995 Senate bill.
 - H.R. 219, proposed reinsurance of state funds.
- Two House bills were merged into H.R. 21.

H.R. 21 Components (1)

- Creates a Federal Reinsurance Program.
 - Direct reinsurance of state funds (*note: this provision was dropped in subcommittee*).
 - XOL auctions for all insurers.
- Secretary of Treasury sets minimum contract prices based on recommendations from a National Commission on Catastrophe Risks and Insurance Loss Costs.
- Contracts are auctioned in at least 6 regions, including Florida and California.

H.R. 21 Components (2)

- Coverage trigger (retention) per region is the greater of:
 - The difference between a 1-in-100-yr and a 1-in-250 year event.
 - The current claims paying capacity of a state program (state programs only).
 - \$2-5 billion, at Treasury discretion.
- 50% of losses in excess of the trigger are covered.

H.R. 21 Components (3)

- Total program coverage is limited so that losses are unlikely to result in Federal liability that exceeds \$25 billion.
- The program sunsets in 10-years, with a 5-year extension if necessary.
- Mitigation programs are funded from a portion of contract sale proceeds.

H.R. 21 Proponents Argue

- Federal reinsurance will provide immediate relief from capacity problems.
- It will limit post-event market dislocation at a reasonable exposure to taxpayers.
- It creates a public-private partnership that preserves the primary role of private insurers in the market.
- It mandates actuarially sound, risk-adjusted, market based prices for contracts.
- It has expected positive budget scoring.

H.R. 21 Opponents Ask

- Will federal reinsurance duplicate private sector reinsurance and capital market mechanisms?
- How will capacity be allocated between state programs/XOL auctions and between regions?
- Will it treat national and regional insurers equally?
- Will it encourage the formation of state programs?
- Will political interference depress market prices and expand coverage?
- Will it lead to more Federal involvement in insurance?

Observations

- Many details have been deliberately left to Treasury to decide in implementation.
- Bill is complicated, but so is the problem.
- There has been considerable controversy over whether the program should provide special treatment of state funds.
- Two primary House sponsors were defeated in attempts at U.S. Senate seats.
- Senator-elect Nelson (D-FL) has been critical of the bill as being too expensive.

Closing Comments

- Demographics are the real problem.
- State rate regulation is a factor.
- Situation is fluid, as new capital market products emerge.
- The problem is most acute in a minority of states, making it more difficult to pass a bill.
- There is not a consensus within the insurance industry on the legislation.
- Despite problems, action is required. Will we be prepared when, not if, the “big one” hits?

Speaker Contact Information

Rade T. Musulin

Vice President – Actuary

Florida Farm Bureau Insurance Companies

P.O. Box 147030

Gainesville, Florida 32614-7030

Phone (352) 374-1514

Fax (352) 374-1514

E-mail: rmusulin@sfbic.com

Web Site: <http://www.ffbic.com/actuary/>