Preparing for Catastrophe: A Better Way?

The fact that an insurance company has a voluntary pre-funded, tax-deferred catastrophe reserve may not necessarily increase the policyholder surplus available to pay claims after a catastrophe.

That is the message of a recent letter to Sen. William Roth (R-Del.) and Rep. Bill Archer (R-Texas) from the Academy's Catastrophe Insurance Work Group. Roth and Archer are chairman of the congressional committees considering H.R. 2749 and S. 1914, jointly known as the Policyholder Disaster Protection Act of 1999.

The two bills allow for the creation of a catastrophe reserve dedicated to pay claims in the event of a natural catastrophe. But the availability of such a reserve may not serve its intended purpose because insurers, rating agencies, and regulators typically evaluate policyholder surplus in relation to the total risk of the enterprise.

By itself, such a reserve might not be the best way to minimize insolvencies after a catastrophe, unless it is employed in a regulatory framework in which insurers demonstrate their financial responsibility to deal with major disasters using one or more acceptable approaches (reinsurance, surplus, securitization, etc.). Under the proposed legislation, financially weaker insurers unable to build a catastrophe reserve would not be prohibited from writing business prone to losses after a catastrophe, says Wayne Fisher, who signed the letter as chairperson of the work group.

The two bills, introduced last year with the support of a coalition of industry and other groups, are designed to give insurers additional capacity to handle large catastrophes, such as Hurricane Andrew or the Northridge Earthquakes. The Clinton administration opposes both bills, calling them an unnecessary taxpayer subsidy of the insurance industry.

The letter also points out that workers' compensation is not included as a qualified line of business for the reserve, yet workers' compensation losses could be significant following certain catastrophes, such as earthquakes. If an earthquake occurred during business hours, it could significantly increase the risk of failure among insurers of commercial lines of business, the letter states, adding that Congress should consider expanding the jurisdiction of the bills to include workers' compensation for states with significant earthquake exposure.

The letter recommends that Congress consider authorization of a commission to review operation of the program, with the commission including actuaries and experts in risk management, risk analysis, and risk assessment.

Other Academy efforts in this area include a Capitol Hill catastrophe issues briefing on Nov. 14. Also, the November Contingencies will feature an article on federal natural disaster legislation by Academy Communications Chair Rade Musulin.

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