June 24, 2013

Matthew A. McKenney
Federal Insurance Office
Attention: Study on Natural Catastrophes and Insurance
Department of the Treasury – Room 1319 MT
1500 Pennsylvania Avenue NW.
Washington, DC 20220

Dear Mr. McKenney:

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to provide comments in response to the Federal Insurance Office (FIO) request published in the Federal Register on April 24, 2013. PCI represents more than 1,000 member property casualty insurance companies comprising the broadest cross-section of insurers of any national trade association. PCI members write over $190 billion in annual premium, equaling 40 percent of the nation’s property casualty insurance.

FIO requested comments from interested parties regarding the agency’s pending study on natural catastrophes and insurance. Comments were specifically requested on several subjects related to natural catastrophe insurance. PCI would like to take this opportunity to comment on each of these subjects.

1. The current condition of, as well as the outlook for, the availability and affordability of insurance for natural catastrophe perils in all regions of the United States, including whether a consensus definition of a “natural catastrophe” should be established and, if so, the terms of that definition.

The availability and affordability of property insurance for natural catastrophe perils depend, in large measure, on the type of insurance regulation a state adopts. Property insurance markets flourish in states that permit actuarially justified rates based on the actual risk being underwritten. In these states, the ability to charge the rate commensurate with the risk creates market conditions that results in: 1) increased competition between insurers; 2) new entrants into the insurance marketplace; and 3) more options and choices for consumers. In contrast, in states where insurance rates are artificially suppressed, the market is characterized by less competition, fewer options for consumers, and a reduction in the amount of insurance available. For example, in Florida and North Carolina, where regulation has historically artificially suppressed rates, private insurers have publicly announced the non-renewal of thousands of policyholders, and some companies have even exited these markets.
Property insurers have been forced to take these actions because rate regulation in these states does not permit them to earn an adequate rate of return on these policies. Property insurers, just like other businesses, need to make a fair rate of return in order to be financially viable and to be able to fulfill their commitments on policies following a natural catastrophe. Property insurers also may need to attract investors and the ability to make a fair rate of return impacts the credit rating of an insurer and how investors view the insurer. Indeed, it is important to remember that when insurers are not able to collect sufficient premium to cover the risks they insure, it is consumers who are at risk after a natural catastrophe if insurers are unable to payout on their policies, which is the focus of state insurance regulators.

In addition to being able to charge the appropriate risk-based premiums, property insurers need to be able to rely on the provisions contained in their contracts. For example, recent events have called into question the wording and the use of hurricane deductibles. Insurers accept windstorm risks at a specific premium that includes the reduced exposure, through a higher deductible paid by the policyholder if a windstorm damages the property.

There should be objective criteria for who will be responsible for measuring wind speeds and where in a particular state to determine what constitutes a “hurricane” for the purposes of applying a hurricane or windstorm deductible. The inability to utilize these deductibles with any certainty causes insurers to pay more for claims than they priced for and impacts their retention levels when obtaining reinsurance and can be expected to impact future insurance premiums. These special peril deductibles also help keep deductibles lower for other perils such as loss by fire.

2. The current ability of States, communities, and individuals to mitigate their natural catastrophe risks, including the affordability and feasibility of such mitigation activities.

   a. The current and potential future effects of land use policies and building codes on the costs of natural catastrophes in the United States.

PCI believes that responsible land use policies and strong, uniform, and statewide building codes promote public safety during a natural catastrophe, and reduce the resulting property damage. It is equally important for legislatures to commit to the allocation of resources to effectively enforce building codes in a consistent manner throughout a state. Less property damage after a natural catastrophe means a more expeditious recovery, and fewer taxpayer dollars are needed for federal disaster assistance. On the other hand, subsidizing development, through either inadequate insurance rates or insufficient building codes, in areas with a high risk of natural catastrophes increases the losses inflicted by such weather events and results in inefficient allocation of resources. During the past several decades, improvements in land use policies and building codes have significantly reduced the loss of life from natural catastrophes and have enhanced the ability of buildings and homes to withstand storms. Nevertheless, as the number of people living, and the amount of property located along the coast continues to increase, land use polices and building codes need to be updated to address the growing risk.
b. The percentage of residential properties that are insured for earthquake or flood damage in high-risk geographic areas of the United States and the reasons why many such properties lack insurance coverage.

Flood and earthquake insurance take-up rates have been historically low. According to an Insurance Information Institute analysis completed after Superstorm Sandy, flood insurance was purchased by less than 50 percent of homeowners in the most vulnerable coastal communities in Connecticut, New Jersey, and New York. Similarly, in earthquake prone California it is estimated that only 12 percent of homeowners purchase earthquake coverage either from the California Earthquake Authority (CEA), or as an optional endorsement from private insurers. PCI supports efforts to promote consumer education on the risks posed by natural catastrophes and the importance of purchasing flood and earthquake insurance coverage.

Regulatory rate distortion is a significant reason why many at-risk properties lack adequate insurance. If homeowners see little or no difference in rates regardless of their mitigation efforts or their geographic risk, they won’t understand the true costs or risks, leading to overdevelopment and under-mitigation in high risk areas. Or if government provides post-disaster relief comparable to what insurance would have paid, homeowners are less likely to purchase insurance or undertake mitigation efforts.

c. The role of insurers in providing incentives for risk mitigation efforts.

Insurers may provide incentives for risk mitigation in every state, including premium reductions, and discounts for mitigation activities. In addition, insurers sponsor programs to educate consumers about the need to purchase insurance and invest in mitigation activities in order to protect themselves from bodily harm and financial loss in the event of a natural catastrophe. The insurance industry funded Insurance Institute for Business and Home Safety (IBHS) is committed to promoting the use of construction techniques and materials that reduce property damage. IBHS has a state-of-the-art research facility located in Richburg, SC. The research center staff tests various residential and commercial construction materials for durability against wind, hail, and fire damage. The results of these tests are invaluable to the development of mitigation techniques and strong building codes. Insurers remain committed to studying, educating, and working for the public good in mitigating losses from natural catastrophes.

3. The current state of catastrophic insurance and reinsurance markets and the current approaches in providing insurance protection to different sectors of the population of the United States.

As discussed in our answer to Question No. 1 above, the current state of catastrophic insurance and reinsurance markets depends, in large measure, on the type of insurance regulation a state has adopted. Not only does rate regulation distort and weaken insurance markets, but it can also hinder the ability of insurers to obtain reinsurance. To the extent that rate regulation and other restrictions and policies (i.e. geographic restrictions, limits on the termination of policies, and state assessments) weaken the solvency of insurers, they limit the ability of insurers to obtain reinsurance and, thereby, diversify their risks.
Global reinsurance rates continue to be impacted by the Japanese Tohoku earthquake and Thailand flooding of 2011. Despite these catastrophic events, reinsurance broker Guy Carpenter (GC) reported a relatively stable reinsurance marketplace for those companies with reinsurance contracts renewing on April 1, 2013. There’s been a notable increase in non-traditional capacity such as the catastrophe bond market. GC estimates that non-traditional capacity makes up approximately 14 percent of the global property catastrophe limit. It is anticipated that the growth in non-traditional capacity will continue in the coming years.

The significant natural catastrophe risk faced by certain areas of the country means that some consumers will face high rates for insurance. PCI recognizes this affordability issue, particularly for lower-income homeowners living in coastal areas. To address this problem, PCI believes that one solution is state- or federally-sponsored programs that provide financial assistance toward property insurance premiums for low-income property owners living in natural catastrophe prone-coastal areas. The eligibility for such programs could be limited to existing construction, so as not to inadvertently encourage new development in disaster prone geographic areas. It is important to have an explicit subsidy for those homeowners least able to afford coverage, rather than artificially suppressing rates in a less transparent fashion. Explicit subsidies not only provide assistance directly to homeowners, ensuring that assistance is targeted toward those who need it, but also avoid distorting the operation of the insurance market.

Overall, the insurance industry has responded extremely well to recent natural catastrophe events impacting policyholders. According to the Insurance Information Institute, over the last 10 years (2003-2012), insurers have paid over $258 billion in insured catastrophe losses to help rebuild communities throughout the United States. Despite these hefty payouts, the industry is resilient and well-prepared to meet the needs of policyholders following the next natural disaster. As of December 31, 2012, the industry held almost $587 billion in policyholder surplus.

Superstorm Sandy resulted in over $18 billion in insurance claims. In New York alone, there were over 500,000 claims for Sandy related damage. More than 4,500 claims adjusters worked actively in the field to settle claims for New York policyholders as expeditiously as possible. The New York State Department of Financial Services reported that formal complaints were made on less than one percent of Sandy related claims.

4. The current financial condition of State residual markets and catastrophe funds in high-risk regions, including the likelihood of insolvency following a natural catastrophe, the concentration of risks within such funds, the reliance on post event assessments and State funding, and the adequacy of rates.

State residual markets are intended to be the last resort option for property owners unable to obtain a policy in the private market. Unfortunately, several states have dramatically expanded the size of their residual markets and transformed them into mechanisms for subsidizing insurance policies in high-risk areas. For example, in March 2013, the Florida Citizens Property Insurance Corporation (Citizens) reported that it had over 1.2 million policies in force, with nearly $400 billion in total exposure, but only $6 billion in surplus. By artificially suppressing its rates, Citizens has become a major competitor in the Florida property insurance market and has pushed private insurers out of the market. As a result, Florida catastrophe risk is heavily concentrated in Citizens, which, since it charges insufficient rates,
does not have sufficient resources to cover substantial claims. In the event a major natural catastrophe strikes Florida, it is very likely that Citizens will have to resort to assessments on policyholders and insurers and, to the extent assessments are not economically or politically feasible, Florida taxpayers. Since these assessments and taxes will hit the state when it is attempting to recover from a major natural catastrophe, they will make the recovery far more difficult than would occur if policies were held by insurers with sufficient surplus to cover claims.

A similar situation exists in North Carolina. Over the past decade, the North Carolina Insurance Underwriting Association (NCIUA) has grown rapidly from having 69,877 policies in 2003 to 227,620 policies as of March 31, 2013. Based on their most recent information, it now has an aggregate liability of $81 billion, but a surplus of only $708 million. Accordingly, the state residual market in North Carolina is ill-prepared financially to meet its obligations to policyholders if a major event such as a Category 4 or 5 hurricane were to make landfall. Moreover, the concentration of risk in the NCIUA leaves the state more vulnerable to natural catastrophes since losses in excess of retained earnings, reinsurance and industry assessments will be borne by instate policyholders and taxpayers.

5. The current role of the Federal Government and State and local governments in providing incentives for feasible risk mitigation efforts and the cost of providing post-natural catastrophe aid in the absence of insurance.

Mitigation is essential to minimizing financial losses from a natural catastrophe. Even simple preparations can significantly reduce the damage caused by natural catastrophes. Accordingly, PCI strongly supports innovative ideas to encourage homeowners and insurers to take the proper mitigation efforts. PCI believes that the Federal government can provide incentives that help reduce financial losses not only to homeowners and insurers, but also to taxpayers by reducing the amount of disaster assistance needed following a natural catastrophe. One way the government can provide incentives is exemplified by the Homeowner Catastrophe Protection Act of 2013, sponsored by U.S. Representative Michael Grimm. This important, forward-thinking legislation would provide tax incentives for individuals and insurers to prepare for future natural catastrophes. The bill would provide tax credits for natural disaster mitigation expenditures; permit individuals to open catastrophe savings accounts; and allow property casualty insurers to create tax-deferred catastrophe reserves for the payment of policyholders’ claims arising from future catastrophic events. PCI believes this approach is preferable to legislative proposals that would establish a federal or state natural catastrophe backstop. Because they price their insurance coverage at below market rates, natural catastrophe backstop mechanisms suppress the true cost of risk, leaving catastrophe funds ill-prepared financially for the next weather event. The private reinsurance market is better suited to accurately assess risk and price it appropriately.


a. Current and potential future Federal, State, and regional partnerships that support private, direct insurance coverage.
Private-public partnerships offer a unique mechanism for insuring and mitigating natural catastrophe risks. To be effective, however, they must be carefully structured to address several inherent problems, including bureaucratic inertia, politicized underwriting standards, and recruitment and retention of highly-skilled professionals. Furthermore, private-public partnerships must guard against adverse selection caused by private insurers transferring their high-risk policies to the state or federal government. In particular, private-public partnerships need to have an effective pricing mechanism. As noted above, regulations that prevent an insurer, whether privately- or publicly-owned, from charging rates commensurate with the insured risk undermine the efficiency and effectiveness of insurance markets.

An example of a successful private-public partnership is the Terrorism Risk Insurance Program, known as TRIA. Under TRIA, the Federal government helps cover losses arising from acts of terrorism, but only after insurers have satisfied a sizable deductible. The program also contains a co-share to limit adverse selection risk. In addition, the program does not impose any rate regulation on insurers. In contrast, the National Flood Insurance Program is structured by having the federal government directly insure flood risks, while private insurers merely sell the policies and administer the program. Moreover, the NFIP is not permitted to charge rates sufficient to cover the flood risk insured. Consequently, based on their last report, the NFIP is nearly $24 billion dollars in debt and there are very few insurers that directly write flood insurance.

The California Earthquake Authority (CEA) was established in 1994 following the Northridge earthquake. Private insurers participate in the program by facilitating the sale of CEA policies to California residents. The CEA is a publicly managed organization, and writes approximately two-thirds of the earthquake coverage sold to residential property owners. Unfortunately, very few California homeowners purchase earthquake coverage, in fact, only an estimated 12 percent of homes in the State are covered for earthquake damage. California residents and the CEA would be much better prepared financially for the next earthquake if there was greater participation in the program. PCI supports increasing consumer education efforts so that residents can make informed decisions about protecting their homes from earthquake damage.

b. The potential privatization of flood insurance in the United States.

Over 5.6 million homes and businesses rely on the NFIP for critically important flood insurance coverage. PCI supports measures that would transfer flood risk from the National Flood Insurance Program (NFIP) to the private sector. However, given the history, size, cost of the NFIP, it may be a challenge to completely privatize the program. As an interim step, PCI supports implementing the reforms contained in the Biggert-Waters Flood Insurance Reform Act of 2012, which aims to make the NFIP’s pricing more closely reflect the actuarial risks. Furthermore, the legislation allows for the NFIP to experiment with transferring risk to the private reinsurance market. Biggert-Waters rate reforms phase out subsidies on properties that act as a deterrent to private market participation. According to PCI research, the average true market risk rate for flood insured properties was found to be twice the average NFIP rate ($1,166 market vs. $585 NFIP).

Artificially suppressed rates have contributed to the $24 billion debt of the NFIP. Even before Superstorm Sandy, the NFIP was saddled with $18 billion in debt mostly due to claims payments made
after Hurricane Katrina. Superstorm Sandy flood claims compounded the debt problem, and forced Congress to raise the program's borrowing authority by $9.7 billion dollars. Some in Congress are now calling for a delay in the implementation of the critical Biggert-Waters rate reforms. PCI believes that it is in the best interest of all stakeholders, including policyholders and taxpayers, that these reforms are implemented without delay. The ability to accurately price flood insurance based on actual risk, and having the discretion to customize flood insurance products will encourage private market participation.

On behalf of over 1,000 member insurance companies, PCI wishes to express appreciation for the opportunity to provide comments as the FIO studies the current state of the market for natural catastrophe insurance in the United States. Again, PCI believes that responsible land use policies, strong building codes, mitigation, actuarial rates, and consumer education are key components to prepare for when, not if, the next natural catastrophe occurs. Please do not hesitate to call upon us if we can be of further assistance.

Respectfully submitted,

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Director, Personal Lines Policy