October 26, 2016

TO: NAR Insurance Committee
FROM: David McKey, Chair, Disaster Policy Work Group
SUBJECT: Disaster Insurance Research Proposal

Purpose: Conduct research and analysis into an "all perils" approach to natural disaster insurance, and report back to the Committee with any findings and/or recommendations for NAR policy.

The Concept: An all-perils approach would cover all major natural disaster risks (earthquakes, hurricanes, wildfire, etc.) under one insurance policy. The idea is to keep rates affordable for the high risk properties by expanding the policyholder base over which to spread the cost of coverage. In theory, a sufficient number of policyholders might enable a program to charge substantially less of those at higher risks while at the same time, charging only slightly more of the others.

Recommendation: The Work Group contacted the Milliman consulting firm to investigate the cost and distribution of impacts under an all-perils plan. While Milliman's initial research proposal offers a good starting point for additional discussion and refinement, the Work Group recommends:

- Continuing a work group in 2017 to further develop the Milliman proposal and discuss other alternatives to post-disaster relief payments, such as national reinsurance.
- Broadening the proposal's scope beyond earthquakes and storm surge to include other perils (e.g., windstorms and inland floods), ensure geographic representation and vary coverage limits.
- Explore partnering with other interested groups to share the cost of this important research.

Initial Findings & Conclusions:

- Private natural catastrophe or cat coverage can be very expensive for most properties.
- Due to the unpredictable nature of the risk, insurers must set rates that exceed losses in most years in order to build reserves to cover the potential of anticipated catastrophic years.
- Without some level of government involvement, there may not be a price at which private cat insurers can continue to function <u>and</u> property owners are able and willing to pay the premiums.
- While not reducing the cost to insure high-risk properties, an all-perils approach could bring down the price for some by expanding the policyholder base over which to spread the cost.
- Given low voluntary purchase rates for flood insurance (<8% in LA counties) and earthquake insurance (15% across CA), a mandatory purchase requirement would need to be considered.
- To some extent, all insurance can be viewed as a transfer payment from those who don't make claims to those who do; it's more a question of degree.
- If there is a way to charge less of some without charging too much of others, and encourage an insurance alternative to federal post-disaster relief, such an approach is worth exploring.
- Covering multiple natural disasters may also reduce the number of claim disputes and litigation over whether one peril or another (e.g., the wind vs. water) drove the property damage.
- While it may be possible to sustain such a program over the long run, how much the program would actually have to charge and how those charges would be distributed across policyholders are both empirical questions that require research and study.
- The Work Group contacted the Milliman actuaries who recently studied flood insurance for NAR about the possibly of conducting the needed all-perils research.
- Milliman has provided a promising initial research proposal to investigate both the cost and distribution of the impacts under an approach and requested feedback.

Additional Considerations:

1. What is justification for federal involvement in state regulated insurance markets? Is that involvement something that NAR members and their state associations could accept?
2. Should the policy goal be to combine all natural disasters into one all-perils insurance policy?
   a. Would enough people want to voluntarily buy coverage they could consider to be nonessential (e.g., earthquakes in Florida or hurricanes in California)?
   b. Would the Committee support mandating purchase of an all-perils policy in order to increase participation?
3. To make insurance more affordable, would the Committee support requiring some to pay more so others can pay less?
   a. …If some are required to pay $50 more than full price? $500 more? $5,000 more?
   b. …If it is truly cost prohibitive to insure some properties because of the risk?
   c. …If it keeps lower income families in properties located in harm's way?
   d. …If the property has already been damaged once by a natural disaster? More than once?
   e. …If it is a high income owner or a high value property?
   f. …What if instead the buyer couldn't afford the mortgage or the property taxes, would the committee still support cross subsidization?
4. If an owner truly cannot afford the total cost of the property (mortgage, interest, taxes and insurance), who should pay more in order to make up the shortfall?
   a. Other policyholders?
   b. American taxpayers?
   c. Neither?
5. Would your answer to Question 4 change if it is not the current owner who cannot afford the property including insurance, but a prospective owner considering purchasing that property?
6. Do the benefits of all-perils insurance outweigh the costs?

Work Group Members:

- David McKey, LA - Chair
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- Donna Smith, SC
- Frank Kowalski, FL
- Gary Thomas, CA
- Greg Larson, ND
- John Sebree, MO
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- Matt Meister, NE
- Mike Schoonover, WA
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- Maria Wells, FL
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