

<b>Date:</b>	<b>November 9, 2015</b>
<b>To:</b>	<b>NAR Insurance Committee</b>
<b>From:</b>	<b>Henry Kammandel, Chair, Disaster Informal Work Group</b>
<b>Subject:</b>	<b>Natural Disaster Legislation Report and Recommendations</b>

**Charge:** To evaluate natural disaster legislation, identify any gaps in NAR policy and report back to the Insurance Committee.

**The Work Group recommends that the Committee:**

1. **In the near term, keep the focus on reauthorizing the National Flood Insurance Program (NFIP).**  
Reauthorization is critical to tens of thousands of property sales that occur each month.
2. **Continue an important, longer term discussion on natural disaster legislation.** This issue is more complex and multifaceted than it first appears. More in-depth research, analysis and discussions are necessary than is possible in the current time frame. Nevertheless, the Work Group made significant headway by meeting with some experts and identifying the following topics for further discussion:
  - a. *How could Congress structure natural disaster legislation to assure “all-perils” insurance?* Previous bills have offered what can be described as a “line of credit” for large losses if the state or private market agrees to provide insurance coverage; for some natural disasters, that’s a big ‘if.’
  - b. *If proposals rely on state participation, how could Congress ensure there is disaster insurance coverage in non-participating states?* In order to qualify for federal assistance under some proposals, each state must first create its own “all perils” insurance program and charge actuarial rates. It is unclear how many states would have the resources or capacity to do so.
  - c. *Should Congress consider a property insurance mandate for natural disaster coverage?* Without a requirement to participate, many property owners will opt out of insurance until only the highest risks remain. As a result of this “adverse selection,” risk-based premiums could become too expensive for the average household, resulting in a premium base that is not broad enough to cover catastrophic loss years. In California for instance, where insurers are required to offer earthquake insurance but homeowners can refuse, the current take-up rate is about 10%. Whether NAR would support requiring property owners to buy natural disaster insurance is a question that should also be considered.
  - d. *How does Congress design a natural disaster program that complements the NFIP?* Previous natural disaster bills excluded flooding because the unique challenges complicated program design. However, private flood insurers could also benefit from federal reinsurance.

**NAR policy:** No policy recommendations at this time; an informal work group would need to be re-established next year in order to spend more time and gather the data needed for policy development.

**Key Findings:**

- Insurance coverage for natural disasters tends to be expensive and few property owners will opt to pay or be able to afford the requisite full-risk premium rate.
- It is unclear how a federal backstop would change this, unless a) property owners are mandated to purchase insurance for those risks not now covered or b) are subsidized by taxpayers and/or other policyholders.
- A backstop may smooth out the volatility (peaks and valleys) of the losses so there is one constant yearly payment, but would not reduce the overall cost of natural disasters.
- Federal reinsurance however would be less expensive than turning to the private market that will demand a risk premium and has historically charged 2-6 times the expected loss according to RAND.

## Natural Disaster Legislative Approaches

### Federal Terrorism Risk Insurance Program (Current Law)

- Provides federal funding only for major attacks and after insurers cover an initial layer of losses
- Requires the private market to “make available” terrorism coverage up to a limit
- Doesn’t charge an upfront premium to insurers but the federal government recoups some of its spending on claims through an assessment on commercial policyholders after a payout

### Natural Disaster Backstop Legislation (HR 1101, 113<sup>th</sup> Congress)

- Provides a federal reinsurance fund and short-term loans only for qualifying states
- To qualify, the state:
  - Must create its own “all perils” insurance program *except floods*
  - Must charge actuarially sound rates and may not cross subsidize
- Charges upfront premiums to pre-pay the fund and provides for 100% loan repayment
- Provides mitigation grants for property owners to build stronger

### Windstorm Amendment to National Flood Insurance Program (HR 1264, 111<sup>th</sup> Congress)

- Provides a “multi perils” insurance policy
- Requires purchase of insurance for federally related mortgages in high risk areas
- Charges full-risk premiums for most properties; one in five is explicitly subsidized
- Borrows from taxpayers in above average loss years when claims exceed premiums

### Disaster Insurance Speakers & Experts:

- **Lloyd Dixon (RAND)** has extensively published on NFIP and the Terrorism Risk Insurance Program.
- **Ed Collins (Allstate)** co-wrote Federal Natural Disaster Backstop Legislation as part of the Protecting America Coalition.
- **Frank Nutter (Reinsurance Association of America)**, as a leader of the Smarter Safer Coalition, opposed backstop legislation because he believes there is enough capacity in the private market.
- **Staff experts led by Michael Newman (Federal Insurance Office, U.S. Department of Treasury)**
  - Manages the Terrorism Risk Insurance Program
  - Reports to Congress on state insurance programs

**Conference calls:** Sept. 23; Oct. 15, 22; and Nov. 5, 2015

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