PCI Property Casualty Insurers Association of America

Shaping the Future of American Insurance

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The Honorable Kevin McCarty
Chair, NAIC Catastrophe Insurance Working Group
Florida Office of Insurance Regulation
200 East Gaines Street, Room 101A
Tallahassee, FL 32399

Mr. Eric Nordman
National Association of Insurance Commissioners
2301 McGee Street
Suite 800
Kansas City, MO 64108-2662

Re: NAIC Proposed Natural Catastrophe Risk: Creating a Comprehensive National Plan

Dear Commissioner McCarty and Mr. Nordman:

The Property Casualty Insurance Association of America (PCI) appreciates the opportunity to submit comments to the Catastrophe Insurance Working Group on the draft document "Natural Catastrophe Risk: Creating a Comprehensive National Plan" dated September 3, 2008.

As stated in our earlier comments to the Working Group, PCI is pleased that the NAIC Catastrophe Insurance Working Group has shown interest in developing this proposal. Our country faces the prospect of increased frequency of natural disasters. Coupled with rising population growth and development, the economic cost of recovery from these events is expected to rise. PCI agrees that the role of all stakeholders – policyholders, the private market, and both state and federal government - should be examined in any discussion on the ability of the insurance market to respond to future natural catastrophes. However, PCI does not agree with the focus of the current proposal. The September 3, 2008 document attempts to move away from some controversial issues, but fails to take an in-depth look into the remaining aspects of the Plan, including issues associated with a mandated offer of an "all-risk" policy and the appropriate role of state regulation with respect to providing insurance against natural catastrophes.

PCI supports measures that enhance free markets, promote loss prevention, mitigation and recovery and encourage increased free-market capital formation and capacity. In addressing catastrophic losses, PCI supports long-term solutions that minimize cross-subsidies across lines of insurance and by insurer, maximize incentives for sound economic underwriting and pricing, and cover the exposures most seriously threatened. There should be an equitable distribution of costs based on geographical location and risk of loss, including potential losses to life, property and agriculture, and critical economic infrastructure. PCI endorses proposals to allow companies to freely and effectively underwrite and price policies for catastrophic losses. We note that the current version of the Plan still does not include any discussion related to private market incentives.

<u>The First Layer: Shaping the Risk, Enhancing Capacity, and the Insurance Contract</u>

PCI supports increased emphasis on mitigation and efforts to educate policyholders on the benefits of strengthening homes. While we believe that both the private market and the state should play a role in promoting mitigation, we do not support mandates to provide arbitrary discounts as incentives for retrofitting homes.

PCI continues to oppose creation of a mandatory “all-perils” policy. While the compromise proposed under this Plan (a mandatory offer of coverage) seeks to address concerns of affordability to the consumer, it does nothing to address the concerns of insurers. A mandatory offer of coverage that includes flood will still create enormous additional risk for insurers. Private insurers will be expected to settle the flood portion of any loss prior to reimbursement from the National Flood Insurance Program (NFIP). Adding flood coverage to a homeowners’ or other property insurance policy will also not meet the expectations of consumers” as intended by the Working Group. For example, NFIP coverage does not include reimbursement for additional living expense, while the homeowners’ insurance policy does. Policyholders will likely expect such coverage following a loss, meaning that insurers would either need to offer the coverage at an additional premium, offer the coverage and absorb the additional losses (eventually adding costs for all policyholders), or exclude additional living expense coverage. With respect to exclusions, the Plan reads, “Exclusions and coverage limitations should be disclosed to the consumer and explained to the consumer prior to the purchase of the policy.” It is ironic that the Plan proposes a mandatory offer of coverage (and mandatory coverage for those with federally backed mortgages) in order to avoid post-loss policyholder disappointment when a loss is excluded, and yet the mandatory offer itself would create the likelihood of numerous new exclusions, leading to even further confusion on the part of the policyholder.

For example, the NFIP coverage is limited to no more than $250,000 coverage for the dwelling, while the underlying homeowners’ policy may be written for considerably higher amounts. This NFIP limitation often leads to gaps in coverage which will be more confusing if occurring in the context of a homeowners’ policy with higher limits. In fact, there is a very real possibility that adding NFIP-backed flood coverage to a homeowner policy will result in additional confusion and an increased likelihood of litigation due to potential gaps between the NFIP limit and the policy’s Coverage A limit.

The Plan also calls for mandatory “all-perils” coverage for certain policyholders with federally-backed mortgages. This proposal would shift the burden for compliance upon the insurer, even though the insurer may not know which mortgages are federally guaranteed. This is a particularly troublesome point right now as it remains to be seen how the federal government will administer mortgages recently assumed from government sponsored enterprises (Fannie and Freddie) and from private lenders.

The September 3rd draft notes that a “majority of the working group decided not to include a checklist as part of the plan;” and PCI also opposed inclusion of a checklist as such documents are potentially confusing and may appear to contradict the full contract. Inclusion of the Florida checklist with the current draft Plan appears to over-ride the majority view of the Working Group. Going forward, the checklist should not be included.

The Second Layer: Beginning the Public/Private Partnership at the State Level

As stated in our earlier comments to the Working Group, PCI has concerns with the “requirement” that each state “decide” whether its exposures warrant creation of a state catastrophe fund or participation in a regional catastrophe fund. The decision to create or participate in such funds should be made on a state-by-state basis based on individual circumstances and market conditions and should not be a “requirement.” We commend the Working Group on recognizing that creation of state catastrophe funds should not be designed on a one-size-fits-all model by removing all references to a stated level of loss that should be handled by a state fund.

Any discussion regarding creation of a state or regional fund should be prefaced by an objective study of the private market, including identification and implementation of any necessary reforms to assure that the private market is permitted to adequately underwrite and appropriately price catastrophic risk. Without that step, a state or regional reinsurance fund may simply inappropriately shift exposures to those policyholders in less risky areas of the state or region; creating cross-subsidies and masking the true costs of living and building in high risk areas.

The Third Layer: The Role of a National Mechanism

The September 3rd draft Plan continues to promote creation of a federal reinsurance program as “the most economical solution” for creation of a federal insurance financing mechanism. PCI disagrees with this approach. PCI members have discussed, and we have commented to the Working Group in both 2005 and 2006, that there may be catastrophe exposures that are beyond the capability of the private market and individual state catastrophe funds to address. PCI believes that in these instances, it may be necessary for the federal government to offer liquidity protection (instead of a federal reinsurance program as described in the Working Group's proposal) to state catastrophe funds at the highest level consistent with the maintenance of stable markets and avoidance of widespread insurer insolvencies.

A federal catastrophe financing facility could offer credit financing to state catastrophe funds. This financing would be intended to provide the state catastrophe funds with access to additional liquidity to meet claim requirements in the event of a mega-catastrophe or a series of very large events. This would provide additional stability and soundness to the market following significant catastrophes. Additionally, any federal program must also include measures intended to promote freedom for markets to respond to these exposures, including meaningful limitations on the ability of participating states to control and/or suppress property insurance rates or to maintain other unnecessary restrictions. Some key ingredients for such a proposal include: 1) access to, for example, a federal line of credit by a state catastrophe fund that would be established in advance of a catastrophic event in order to prevent post-event political pressures from influencing the credit decision; and 2) as a condition to the extension of credit by the catastrophe financing facility, a state catastrophe fund must demonstrate, to the satisfaction of the Board of the federal facility, that its regulatory system provides the market freedoms necessary to attract private capital to the state's market and to prevent the extension of federal credit from crowding out private markets. In no event should a state catastrophe fund that fails to meet these requirements or that fails to charge risk-based, actuarially sound rates be permitted to participate in a federal catastrophe financing facility.

Currently only one state, Florida, has a state catastrophe fund in place. Creation of a federal reinsurance fund for the purpose of adding a layer of funding for one fund is objectionable as it would encourage cross-subsidies among taxpayers in other states who would likely shoulder the burden of providing reinsurance to Florida. Further, the availability of federal reinsurance to Florida without conditions would simply help to perpetuate a current system where rates are suppressed, Citizens rates are at an inadequate level and little is done to attract new private capital to the state.

Other Considerations:

Finally, we note that the current document is outdated with respect to federal legislation. For example, the draft Plan calls for a federal natural disaster commission (citing a dead bill), as the Senate incorporated this proposal into its NFIP reauthorization bill.

We suggest that the Plan be re-drafted from the beginning to remove outdated references, issues discussed and decided against, (e.g., the checklist), and to acknowledge the numerous options/proposals intended to address natural catastrophe risk, many of which have arisen from the private market since the Working Group began this process.

Sincerely,

Donald L. Griffin

Donald L. Griffin, CPCU, ARC, ARe, ARM, AU

cc: Deirdre Manna

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