

04-24-06 Draft

## THE UTAH CATASTROPHE INSURANCE PLAN

### Background

The 2005 national catastrophes i.e., Hurricanes Katrina and Rita illustrate the need for states and the nation to be prepared not only to provide emergency aid and relief but also to provide a mechanism to protect our citizens before a catastrophe occurs. That mechanism is catastrophe insurance. To provide effective protection, catastrophe coverage must be universal and provide meaningful protection.

The insurance commissioners of four large states, California, Florida, Illinois and New York, have proposed a national catastrophe insurance program. On December 4, 2005, the National Association of Insurance Commissioners (NAIC) passed a resolution approving, in concept, the development of a national catastrophe program. This program was heard at a meeting of the NAIC Catastrophe Working Group meeting in Orlando in March 2006.

At the March meeting Commissioner Michie of Utah outlined his view of a national catastrophe insurance program. In his view, any plan being considered should be a market based program rather than a government relief program.

### Purpose

The initial and foremost purpose of the Utah Plan is to protect the tax base of the Utah economy. In doing so, Utahns are assured fundamental services such as police, fire, schools and other important local government services will resume immediately after a catastrophe occurs.

Another significant purpose is to protect the credit worthiness of the State of Utah—its AAA bond ratings. The property tax base is the primary revenue source for the retirement of local government general obligation bonds in Utah. Utah's forty school districts have an aggregate total of approximately \$1.845 billion dollars of local school district bonds outstanding. Most, if not all, of these bonds are guaranteed by the state of Utah under the Utah School Bond Guaranty Act. The State's guarantee obligates it to ensure that these bonds are paid in full and on time. In addition, the State has approximately \$1.377 billion of outstanding general obligation bonds of its own, which, if not supported by the property tax base will affect the State's bond rating.

Other purposes that are achieved by the Utah Plan are: financial protection for the family residences of Utah's citizens at reasonable and low insurance rates; establish best practices in risk mitigation; promote best practices in risk transfer; and the availability of capital that becomes available immediately after a catastrophic event to homeowners to rebuild their homes which will stimulate the Utah economy.

### The Utah Multi-deductible Catastrophe Insurance Plan

The Utah Model is premised on utilizing the catastrophe insurance available in the market backed up by deductibles at multiple-levels with layers of reinsurance through a plan administrator.

The Utah Plan would provide all perils catastrophe insurance coverage on residential property only. The insurance coverage would be renewed on an annual basis subject to certain limitations on underwriting. All primary residential properties in the state would be required to be covered by catastrophe insurance. The annual premium would be paid by the state. The revenue to pay the annual premium would be generated by assessing an annual property tax on all residential and commercial property in the state. The insurance coverage would be provided by private insurance companies selected by the government administrator that would qualify the companies as providers of the catastrophe insurance.

One qualification that an insurer must meet to participate in the program is that it must assume the primary risk on the property and have reinsurance from a qualifying reinsurance company to mitigate the risk that it has assumed on all the property that is underwritten by the insurer.

Another qualified element of the insurance coverage is that it must provide appropriate coverage on the property at a reasonable premium. To ensure the reasonableness of the premium, the primary and reinsurance coverage must require large deductibles, including a deductible applied to the State. The plan must be structured to accommodate participation by the federal government, which would be a backstop provider of the third level of deductibles.

### **Utah Plan Cost Reduction Features**

The major problem facing homeowners and which causes them to choose not to insure their home from catastrophic loss is the relatively high cost of this type of insurance, particularly all perils coverage.

To lower the cost for citizens, the Utah Plan would use a “hedge row” multiple deductible system. The first deductible would be born by homeowners at approximately 10% of the value of their homes. The second deductible would be provided by the state of Utah as a fixed dollar deductible (\$100 million more or less). The third and final deductible would be provided by the federal government at a level of four times the amount that the state puts up (producing an 80/20 match). These three deductibles would significantly lower the cost of the state’s annual insurance premium.

The property tax supporting the Utah Plan is deductible from individual Federal income taxes, thus reducing the cost to residential property owners, offsetting their property tax obligation and producing an additional, significant Federal subsidy. This would be a significant incentive for residential property owners to accept the Plan.

All these features work together and result in an insurance program available at the lowest possible cost for residential property owners and to the state.

### **Utah’s Public Interest**

Utah’s major catastrophe risk is earthquakes but in some areas also, wildfire, flooding, mudslide, sinkholes, etc. risks. Following a 7.0 to 8.5 earthquake there could be significant loss of life, desperate behavior of our citizens, and fear of further catastrophic events in the future.

The biggest risk to Utah local governments arising from a catastrophe is that large portions of the property tax base could be wiped out in a single earthquake in the magnitude of 7.0 to 8.5 on the Richter scale. Thus, the State’s executive and legislative branches have a significant interest in protecting the Utah property tax base. All perils catastrophe insurance on all residential property in the State provides that protection.

While the Utah Model achieves the goal of protecting society's interest in maintaining the tax base, it also benefits individual residential property owners who can immediately access funding to rebuild their homes and give security to their families. Jump-starting home rebuilding and repair will reduce the amount of government assistance for shelter and associated relief.

The immediate stimulus to the construction industry would buffer the impact of a catastrophe on the State’s economy. The Utah Plan, after the initial 2–3 days of acute suffering, would generate a “boom” phase after the insurance funds begin flowing into the economy. The severe financial strain experienced in Southern Utah during the Santa Clara River Floods of 2005 by Washington County residents (only 2 of the 24 homes had flood insurance) would be avoided.

### **Post-Catastrophe Beneficial Impact of the Utah Plan**

Utah workers and families would be able to remain in Utah, because funds to rebuild their residences would quickly become available. Loss of earning capacity would be mitigated and homeowners would be able rebuild their homes.

The State’s tax base and credit worthiness would be protected. Individual homeowners would restore their homes and the economy would be protected against catastrophic risk. The availability of capital to rebuild after a catastrophic event will result in a boom recovery phase after critical services are restored. Local governments will be able to avoid bankruptcy.

### **The Utah Plan Administrator**

An administrative governmental agency would need to be created to administer the Utah Plan (to be known as the Utah Earthquake Authority, the Utah Natural Perils Risk Abatement Authority or the Utah Homeowners Catastrophe Insurance Plan). The Authority would be governed by a statutory nine-member board of trustees appointed by the governor with the advice and consent of the Senate. The members of the board of trustees would be composed of members representing the

State: the Director of Homeland Security, the Director of the Governor's Office of Planning and Budget, the Commissioner of Insurance, the Director of the Governor's Office of Economic Development and the State Treasurer plus four local government members representing counties, cities, special districts and local boards of education.

The Authority would be given power to contract, power to tax, general police powers, power to sue and be sued, to have a governmental seal, the power to issue debt as appropriate, the power to receive donations, bequests and grants, and other reasonable and necessary powers to carry out the purposes of the Utah Plan.

### **Risk Mitigation Policy**

Good public policy and management of risk requires public managers to be aware of a risk, and to put in place an effective plan that mitigates that risk. Sound risk management includes mitigation of known risks and the avoidance of future costs stemming from those risks in the future. Land and building development policy must foresee such risks and reduce development in high-risk areas. Such policy may require the review of local building codes to make sure that building permits are granted that consider, avoid and mitigate these risks.

This policy approach may include a statewide survey of all building risks, including earthquake, flood, wild fire, mudslide, sinkholes, etc., to document the risks and establish a database upon which local building code administrators may rely as they try to manage, avoid, and mitigate catastrophic risk.

### **Reasons to Pursue the Utah Plan**

Successful implementation of the Utah Model will bring a feeling of financial security to Utah families and workers, real and measurable financial protection of the Utah economy, protection of state and local government credit worthiness (our AAA bond ratings), long term cost benefits of risk mitigation, plus the benefits from Utah's reputation as a state with long range planning and execution capabilities. The Utah model removes the state from the risks associated with providing insurance coverage because our plan relies on the private sector to be the actual insurer.

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