



*Independent Insurance Agents
& Brokers of America, Inc.*

**STATEMENT OF ALEX SOTO
ON BEHALF OF THE
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA**

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATION

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

February 11, 2008

Good afternoon Chairman Watt, Ranking Member Miller and Members of the Committee. My name is Alex Soto, and I am pleased to be here today on behalf of the Independent Insurance Agents & Brokers of America (IIABA) to provide my association's perspective on efforts to reform how our nation insures against natural disasters. I am the immediate past President of IIABA and have served on our national association's Executive Committee for several years. I am also President of InSource, Inc., an independent agency based in Miami, FL which offers a broad array of insurance products to consumers and commercial clients in South Florida and beyond.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, and we represent a nationwide network of more than 300,000 agents, brokers, and employees. IIABA represents independent insurance agents and brokers who present consumers with a choice of policy options from a variety of different insurance companies. These small, medium, and large businesses offer all lines of

insurance – property, casualty, life, health, employee benefit plans, and retirement products. It is from this unique vantage point that we understand the capabilities and challenges of the insurance market when it comes to insuring against catastrophic risks.

Background

Whether it is the possibility of earthquakes on the West Coast or along the New Madrid Fault or threats posed by hurricanes, just about every corner of the United States is subject to the effects of a devastating natural catastrophe. And just when Hurricane Andrew was starting to pass from our collective memory, Hurricane Katrina and the other storms of 2004 and 2005 reminded us, with devastating effect, of the deadly and sweeping impact that such catastrophes can impose on a society and economy. Although Katrina was an unprecedented event in many ways, the reality is that similar and even more powerful storms will inevitably strike the Atlantic and Gulf Coasts.

This unfortunate and regrettable certainty has created a property insurance crisis in my home state of Florida, and it also affects nearly every other coastal state to some degree. I have seen the effects firsthand.

By many measures, the insurance industry is a highly competitive one. There are multiple distribution channels, and purchasers can typically buy coverage from many different direct, captive, or independent agent options. But, coastal regions of this country do not have a vibrant or competitive homeowners insurance marketplace today, and the commercial marketplace is facing some of the same challenges. It is important to point out that, after two years of relatively calm hurricane seasons, the homeowners' insurance market has yet to stabilize in many parts of the United States.

Like Trusted Choice independent agencies nationwide, I represent and have the ability to provide my customers with insurance policies from many different companies. My agency sells a wide variety of insurance policies – from personal lines products such as auto and homeowners insurance to commercial lines insurance for businesses, and from life insurance to employee benefits – and, overall, we represent 50 different companies.

Unfortunately, there are only a handful of insurers that are able or willing to provide catastrophe coverage in my community, and communities throughout the Southeast face similar difficulties. Consumers today find it incredibly difficult and in many cases impossible to secure affordable insurance coverage for their homes and businesses. As an independent agent, I cannot serve my clients if I do not have insurance company partners willing to provide coverage, and that is the challenge I face today.

There are hundreds of companies providing property and casualty insurance in other lines and in other parts of the country – and actively competing with one another for business – but the brand of vibrant competition that exists elsewhere does not exist in South Florida and other areas today. In my area – as elsewhere – the situation has been a crisis for a number of years.

In order to fully appreciate the crisis we face today, I believe it can be helpful to look at a few of what may be the root causes. Consider the following:

- Seven of the nine costliest hurricanes in our nation's history occurred in 2004 and 2005, and experts expect this trend to continue. Respected meteorologists believe the frequency and intensity of hurricanes will continue to grow over the next 15 to 20 years.
- Despite now two years of relatively low hurricane frequency, homeowners insurance has yet to stabilize in many parts of the Gulf Coast.
- In its report on Natural Disasters published in November 2007, the Government Accountability Office (GAO) estimated that the federal government made about \$26 billion available to homeowners who lacked adequate insurance in response to the 2005 Hurricanes Katrina, Rita, and Wilma.
- There has been unprecedented population growth and significant development in coastal and disaster-prone areas in recent decades, and total property exposures have increased dramatically. According to AIR Worldwide, a leading risk modeling and technology firm, in 2004 the value of insured coastal properties in the 18 East Coast and Gulf states exposed to hurricanes totaled \$6.9 trillion, or 16 percent of insurers' total exposure to loss in the United States. Not unlike other disaster-prone areas, AIR also estimates that property values in coastal areas of the United States have doubled over the last decade.
- Wall Street firms and agencies that rate insurer financial stability have changed their evaluations and more heavily consider the effects of Probable Maximum Loss and Total Insured Value on the financial strength of insurers. This reality is forcing insurers to reduce catastrophe exposures.
- Insurance companies purchase reinsurance to help manage their catastrophe exposures, and reinsurers have increased the premiums they charge insurers to cover catastrophe claims. However, the prices and terms of property insurance offered by insurers remain highly regulated, and insurance companies are unable to pass along those costs. This reality has further decreased the amount of catastrophe risk insurers can accept.

National Problem

I would particularly like to stress that this issue is not simply a Gulf Coast problem – it is a national problem. Our members live across the country, serving and living in a wide variety of communities – large and small – and so many of them have been impacted by natural disasters. Certainly, the most devastating natural disasters in recent years have resulted from hurricanes, which have had the greatest impact on the homeowners' insurance market. However, hurricanes are only one of the many catastrophic risks our

nation faces. According to the Insurance Information Institute, tornadoes, earthquakes, mudslides, blizzards, and other catastrophe events combined have accounted for over half of the U.S. catastrophe losses in the last 20 years. The 3rd most costly natural disaster on record was the Northridge Earthquake in 1994, with \$16.5 billion in losses. Whether it is tornadoes in the Midwest, earthquakes in California, or ice storms in the Northeast, we all face some risk of natural disaster, and it often takes only one or two events in a particular area for the homeowners' insurance market to be dramatically affected.

Two important developments that illustrate just how national in scope this crisis is are the decisions by Allstate and Cameron Mutual to completely withdraw over time from the residential and commercial earthquake market along the New Madrid Fault line, which would encompass all earthquake policies in Missouri, Iowa, and Arkansas. Cameron Mutual is the largest regional writer of homeowner insurance coverage for independent agents in these earthquake areas, and as many as 70,000 customers could be affected by their decision alone.

In some cases, of course, states have set up entities in an effort to prevent insurance availability crises, such as the California Earthquake Authority (CEA) and the Florida Hurricane Catastrophe Fund (FHCF). The CEA was created in 1996 to offer a basic level of residential earthquake coverage to Californians. The FHCF was created in November 1993 after Hurricane Andrew to protect and advance the state's interest in maintaining insurance capacity in Florida. These programs are certainly useful, but ultimately, even if they are carefully constructed and managed they may not be enough to handle the particularly severe events. For example, even with the CEA, an A.M. Best 2006 study shows that only 12 percent of Californians bought residential earthquake insurance in 2005. Meanwhile, AIR Worldwide estimates that if there were a 7.9 Magnitude quake in San Francisco, CA, the losses could top \$100 billion.

The plain truth is that some natural disasters will exceed the financial capacity of state catastrophe funds – only a program that is national in scope will be able to generate enough capacity to cover the most devastating events.

This issue is national in scope in another regard as well, and that is its impact on the U.S. Treasury. As mentioned, GAO estimates that the U.S. Government spent \$26 billion in 2005 alone on homeowners' who lacked adequate insurance. They speculated that many consumers go without adequate natural disaster insurance because "they may not believe the risk justifies the expenditure." With homeowners' insurance considerably more expensive than pre-2005, there is a real possibility even more consumers are underinsured, which in turn will make the next mega-catastrophe even more expensive for U.S. taxpayers.

Put simply, insuring against natural disasters is a national problem that requires a national solution. Despite our longstanding position that the insurance market is best served by limited federal involvement, we believe that a federal solution to the issue of natural catastrophe insurance is necessary to help provide capacity and fill a void that the private market cannot and will not service. However, it is important that the day-to-day

regulation of insurance remain at the state level, where state insurance departments are best equipped to serve the special needs of local consumers in local markets. As such, given the absence of affordable coverage and the exposure that both consumers and taxpayers face, we believe that there is a very limited and appropriate role for the federal government, and we are open to supporting proposals that increase insurance availability and affordability in catastrophe-prone areas.

IIABA is comprised of thousand of small businesses and as such, we always prefer market –driven solutions to problems and are suspect of new government programs. In short, we do not adopt a position like this lightly. We do so only because we see no other available course of action to resolve this availability crisis. There is currently a clear case of market failure.

IIABA Perspective on the Homeowners Defense Act of 2007

As a Floridian, I first would like to thank Representatives Ron Klein and Tim Mahoney for their efforts to address this natural disaster crisis. I'd also like to thank the House of Representatives for passing the Homeowners Defense Act of 2007 and providing momentum that this issue so desperately needs. The IIABA is extremely grateful for all of your work on this issue and for the opportunity to share its views on what we feel is a matter of critical importance.

Our members approach the issue of natural disaster insurance from a very simple perspective: we are here to serve consumers' needs, whether it is helping them secure coverage to protect their families, their homes, and their businesses prior to an event, or assisting consumers after an event to ensure that claims are paid quickly and fully. As the intermediaries between consumers and their insurers, our members cannot and will not walk away from consumer needs as long as they demand coverage for these risks. We strongly believe our industry must come together with policymakers to find a common solution that will encourage participation in at-risk markets.

In short, we welcome all proposals and support any and all reasonable ideas and plans that lead us to a healthy and competitive insurance marketplace in which consumers have choices and companies are vying for their business.

We believe the Homeowners Defense Act provides a number of provisions that could have a positive impact on the availability and affordability of natural disaster insurance.

The creation of a National Catastrophe Risk Consortium would create an organization that states can voluntarily join for the purposes of transferring catastrophe risk. The risk transfer would be achieved through the issuance of risk-linked securities or through reinsurance contracts. The goal of the consortium seems to be to offer both states and private market participants an opportunity to benefit from a pooling of catastrophic risk diversified by type of peril and geographic region.

If a number of states elect to participate in this Consortium, and if the private market determines that the risk-linked securities are an attractive investment, there is the possibility that the Consortium could offer reinsurance contracts to private participants at a lower cost than is currently available. However, the IIABA does have concerns that some states that may not consider themselves to be high-risk may decline to participate in the Consortium, which would diminish the diversity of the risk-linked securities and negatively impact their value to potential buyers.

The creation of a National Homeowners' Insurance Stabilization Program, meanwhile, would potentially provide for a mechanism for liquidity loans and catastrophic loans for state and regional reinsurance programs, which could provide for a level of stability for such programs that is absent at this time. The loans would come in three distinct categories, Liquidity Loans, Catastrophic Loans, and Catastrophic Loans to States without Qualified Reinsurance Programs. Perhaps most encouraging about this proposal is that it seems to offer an incentive for more states to adopt their own reinsurance CAT programs in order to be considered "qualified programs," which states would have to have in order to receive the catastrophic loans after an initial 5 year transition period.

Finally, during House consideration of the bill, a provision was added that would create a federal reinsurance fund for state catastrophe funds. The IIABA has supported a federal reinsurance fund for natural disaster insurance for a number of years, and we are encouraged that Congress is seriously considering such a solution. However, we do feel that a federal reinsurance fund may be more effective if it is a federal fund that auctions off reinsurance to state funds, private carriers, and reinsurers as opposed to the current proposal that is only available to state funds. The Homeowners' Insurance Availability Act (H.R. 330), sponsored by Rep. Brown-Waite (R-FL) utilizes this approach. The legislation would allow private insurers to purchase, at auction, reinsurance contracts directly from the U.S. Treasury to cover natural disasters that are equal to or greater than a one-in-100-year event. We believe this is a strong proposal because it will encourage more companies to enter at-risk markets, thus increasing availability and market stability, while limiting federal involvement to only the most devastating catastrophes. In fact, the November 2007 GAO report states that one of the "disadvantages" of the Federal Reinsurance for State Catastrophe Funds is that "Federal reinsurance could compete with private reinsurance sector." By allowing the private insurers and reinsurers to purchase federal reinsurance at auction, we believe the federal reinsurance fund could avoid displacing the private market, and we encourage Congress to examine this possibility.

Other Solutions

The strength of the Homeowners' Defense Act of 2007 lies in its attempt to have a plan in place to encourage greater availability of reinsurance for the private markets (through the Consortium) before a storm hits as well as its attempt to have a line of stability available to state catastrophe reinsurance funds in the event of liquidity problems after a catastrophic disaster. These goals are consistent with the Big "I's" long-standing belief that the best solution is for a program to be in place before the events happen – to have a

clear, well-structured mechanism that encourages the private sector to handle as much of the risk as possible, and only trigger federal involvement as a last resort upon private marketplace failure. We believe that it is important to have such a structure in place to protect both consumers and taxpayers living in all areas across the country – especially when history has proven that more tax dollars are going to be spent on disaster assistance without such a structure to encourage the private sector to take on additional risk.

IIABA is also looking beyond federal reinsurance proposals to other possible solutions, and in that vein we are encouraged by the introduction of H.R. 164, the Policyholder Disaster Protection Act, introduced by Rep. Bobby Jindal (R-LA). This bill would permit insurers to create tax-free reserve funds for natural disaster claims. We support the goal of this legislation, which is to build up insurance capacity in at-risk markets.

Congressional Attention Is Needed

Achieving a consensus within the insurance market for a solution to this growing problem has proven elusive, which has complicated public and private efforts to address this issue. However, Members such as Representatives Klein and Mahoney have made a concerted and responsible effort to achieve the difficult to reach consensus, and we applaud them for their efforts.

There seems to be a growing recognition that a solution is needed, and needed now. Private insurers are thankfully proposing plans on natural disasters, and we'd like to especially applaud Travelers', Allstate, and Nationwide for each spending considerable time and resources to attempt to propose a solution. The IIABA plans on working with each of these companies, and welcomes any other that would like to come to the table and work on a solution that can benefit both consumers and the industry.

We thank this Committee and the Members of Congress mentioned above for their leadership on these issues, and we look forward to continuing to work with this Committee on legislative proposals to the problem of natural disaster insurance.

In conclusion, we commend you for convening today's hearing, and we hope that the Committee will continue its thorough examination of legislative solutions for the catastrophe insurance availability crisis.

The Big "I" is committed to an open dialogue with all interested parties in the public and private sector to address these important issues that consumers face. We stand ready to assist your efforts in any way we can.