RAA

Who is the RAA?

The Reinsurance Association of America is the leading trade association of property and casualty reinsurers doing business in the United States. RAA membership is diverse, including reinsurance underwriters and intermediaries licensed in the U.S. and those that conduct business on a cross border basis. The RAA represents its members before state, federal and international bodies.

How Does Reinsurance Work?

Reinsurance is best thought of as "insurance for insurance companies" – a way for a primary insurer to protect against unforeseen or extraordinary losses.

- Reinsurance absorbs and distributes the effects of the insurance industry's losses so that no single company is overburdened with the financial responsibility of offering coverage to its policyholders.
- One of the most common purposes for utilizing reinsurance is for a primary insurance company to transfer risk of loss from catastrophic events such as hurricanes, earthquakes, and in the case of September 11, 2001, acts of terrorism.
- Without reinsurance, the effects of unexpected catastrophes, unanticipated liabilities or a series of large losses could be too great for an insurer to absorb, forcing it into insolvency.

The reinsurance community plays a vital role in the efficient functioning of the insurance mechanism. Without it, insurance companies would be capable of covering only the safest ventures, leaving them unable to insure many of the economic, personal or financial activities for which consumers seek protection.

Reinsurance serves to limit liability on specific risks, to increase individual insurers' capacity, to share liability when losses overwhelm the insurer's resources, and to help insurers stabilize their businesses in the face of the wide swings in profit and loss margins inherent in the insurance business.

Reinsurance is a global business. Its international nature reflects a further spreading of risk and access to broader capital markets to help cover losses. Spreading losses in this manner involves global cooperation in an international marketplace. As a result, insurers worldwide are linked through reinsurance agreements and transactions.

Together with the domestic U.S. reinsurance industry (which includes subsidiaries and branches of foreign carriers), the vast majority of the over 4,000 offshore companies participating in the U.S. market enable the domestic insurance industry to spread it risk beyond U.S. borders and provide the insurance capacity needed by the world's largest insurance market.

Despite the tumultuous financial markets in 2008 and 2009, and record making U.S. and worldwide natural catastrophes in both 2010 and 2011, the global reinsurance industry continues to provide needed capital and risk transfer capabilities to the U.S. market, including the U.S. catastrophe risk market.

2010 saw a record 247 natural catastrophic events in the U.S. that caused $13.6 billion of insured losses. Worldwide, there were 950 natural catastrophic events and $37 billion of insured losses.[1]

The first half of 2011 experienced significant catastrophe losses worldwide, including $27 billion in U.S. P&C insurer losses[2]. Nevertheless, the industry's capital levels remain plentiful. Even with these losses, U.S. catastrophe risk continues to be viewed as an essential component of reinsurers' diverse assumed risk portfolios.

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[1] Source: 2010 Natural Catastrophe Year in Review, Munich Re

[2] Source: AM Best survey, August 2011

OPPOSITION TO CREATION OF A CATASTROPHE FUND AS AN EFFECTIVE LONG-TERM ALTERNATIVE MARKET MECHANISM TO IMPROVE AVAILABILITY AND AFFORDABILITY OF COASTAL INSURANCE IN MARYLAND

The stated reason by proponents for creation of a state catastrophe fund is a belief that it would somehow make coastal insurance more available and affordable.

- **Is there an insurance availability problem in Maryland? Has a systematic analysis been performed** to determine if there is? Frequently perceived market availability issues can be corrected by formal or informal market assistance programs. A market assistance program can help match consumers and agents with insurers willing to insure their risks.

- If there is a problem, the drastic step of displacing a functioning private market with a government run program is not the answer.

- **Cat Funds do not work.** They are not a long term solution. **A Cat Fund is a political answer to an economic matter.** A Cat Fund, like the one in Florida, may charge lower reinsurance rates because there is no intent to pay for losses out of premiums alone. The Cat Fund is back loaded and is dependent upon bond debt. Under a Cat Fund, consumers could face 30 years of additional taxes.

- The Florida Cat Fund is the only reinsurance catastrophe fund in operation. The history of **the Florida Cat Fund is not a success.**

    - Despite over a decade to build up a capital cushion, the 2004 and 2005 Florida hurricanes left the Cat Fund **broke and in debt**.
    - The Florida Cat Fund had to issue bonds to meet its obligations to insurers.
    - **Insurers do not pay the bond debt. Consumers and businesses do.** They are being taxed on their policies to pay the debt. Consumers can face up to 30 years of taxes.
    - **Lower risk policyholders and commercial policyholders are taxed to subsidize those most at risk.**
    - **In essence, policyholders insure their insurance companies.**

- Policyholders purchase insurance to transfer unwanted risk to their insurers. A Cat Fund **defeats policyholder expectations by transferring the risk back to consumers.**

- **Cat Funds violate one of the fundamental tenets of insurance – Spreading the risk.** They concentrate the risk in the state, rather than spreading the risk throughout the world wide insurance and reinsurance markets. **Risk spreading helps keep insurance affordable.** Concentrating risk defeats the benefits of risk spreading and diversification.

- **A Cat Fund does not result in more available and affordable insurance.** Despite the existence of the Florida Cat Fund and its 2007 $12 billion expansion[3], **insurers continue to non-renew policies and prices continue to be high.**

- **There is no reinsurance availability problem.** After the massive influx of capital to the reinsurance sector since 2005, the temporary period of reinsurance demand exceeding supply has ended.

- Brokers report that:

    - Early 2011 saw a continuing (since 2007) **downward trend in reinsurance catastrophe pricing.**

        - Brokers reported **price decreases of 5% to 10%,** on a risk-adjusted basis, for U.S. property catastrophe treaties renewing at January 1 that include hurricane exposure. **These price drops follow decreases of 5% to 25%** (10% to 25% for Florida June 1 business) in 2010.

        - **Mid-year broker reports showed renewal pricing ranging from flat to up 15%**.

    - Brokers report that the effect on pricing from higher than average losses, and catastrophe model changes, has been mitigated by reinsurers' **strong balance sheets and a supply that continues to exceed demand** for reinsurance.

    - In addition, AM Best believes the **industry is sufficiently capitalized to absorb the shock.** Best also reports that the natural catastrophes in the first half of the year have **impacted the industry from an earnings perspective, not from a capital standpoint**.

- **Multiple policy assessments can be expected** under a Cat Fund as the IRS is likely to require a broad based tax to gain a federal tax exemption and bond investors want a large, secure revenue source to back their investments.

- **The economic stimulus from claims payments by insurers and reinsurers will be forfeited. In its place, the Cat Fund tax will create an economic drag, slowing recovery.**

- A **Cat Fund has no assets and is authorized to make partial payments**. Rating agencies are unlikely to permit insurers to fully rely upon the Cat Fund payments.

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[3] Florida is in the process of reducing the expansion.

This **may force insurers to purchase duplicative reinsurance or reduce their writings.** Alternatively, **it could lead to insurer insolvency.**

- There is **no apparent limit to the size of a Cat Fund.** It may vary by year, **destabilizing the property insurance market.**

- If a **Cat Fund suffers a loss that exhausts its capability, the insurance market may become unstable** due to insurers suddenly increasing demand for reinsurance.

- Politically driven inadequate pricing is likely. This will lead to **inappropriate economic and political decisions** by homeowners and government officials. Decisions regarding land use, building codes, disaster preparation and loss reduction will be significantly impacted by these subsidies.

- **Cat Funds do nothing to reduce the likelihood of loss or the amount of loss.** Only risk appropriate building codes and enforcement, land use, and retrofitting for earthquake resistance can reduce loss.

- **A Cat Fund will increase costs to consumers by reducing access to private market capital and requiring subsidies of those residents most exposed to catastrophic loss.**

Myth No. 1: The government should insure natural catastrophes because the private insurance market does not have the financial resources to cover disasters such as Hurricane Katrina.

Reality: The private insurance industry has insured wind and earthquake risks, including the unprecedented losses of the 2005 hurricane season.

- Of the top 10 most costly world insurance losses from 1970-2005, three are 2005 natural catastrophes (Hurricanes Katrina, Rita and Wilma) that occurred in the U.S. Despite record insured catastrophe losses that year of $72.7 billion (Hurricane Katrina alone cost insurers $40.6 billion), the insurance industry was profitable. Although the combined ratio for homeowners insurance averaged 111.8 from 1990 to 2006 (meaning insurers paid out [in claims and expense] an average of $1.12 for every dollar taken for premiums), homeowners insurers averaged a rate of return of 3.3 percent through 2006.

  Source: Dowling and Partners

- Although reinsurers have paid 61 percent of all the 2005 losses from Hurricanes Katrina, Rita and Wilma, the capital markets greatly enhanced reinsurance catastrophe capacity following these catastrophes. Since late fall 2005, an additional $43 billion of new capital entered the reinsurance business to support and underwrite U.S. natural catastrophe risk, including $12-$15 billion in new securities for catastrophe risk issued by the capital markets.

  Sources: Dowling and Partners, Company Press Releases
  Best Week
  Insurance Information Institute
  Insurers Insider

- Reinsurers, utilizing their global resources, play an essential role in the U.S. economy and help protect America by spreading the risk and impact of natural disasters among different market segments. For the unparalleled 2005 hurricane losses, U.S. insurers retained 38.9% of the loss, Bermuda reinsurers 24%, US reinsurers 11.5%, European reinsurers 12.6%, Lloyds 12.3% and all others .7%.

  Source: Dowling and Partners

Myth No. 2: As taxpayers, we all pay for natural catastrophes already through federal programs such as FEMA, so we might as well have government catastrophe insurance funds.

Reality: **Insurers pay the vast majority of homeowners' catastrophe losses. The bulk of government disaster assistance from FEMA goes to public infrastructure and local governments, not individuals.**

- After disasters, insurance payments and federal allocations have different purposes. The bulk of federal spending covers emergency response, public infrastructure, aid to local governments and cleanup. In contrast, only a portion of insurance payments goes to temporary living expenses, and the majority is used for long-term recovery and reconstruction.

- A comparison of FEMA and private market insurance payments for U.S. hurricanes from 1994 through 2006 shows insurers paid out more than $100 billion while FEMA paid a little more than $33.1 billion in relief to public entities and only $16.3 billion to individuals.

  Source: FEMA spending compiled by PIA adjusted for inflation by RAA

- Additionally, a comparison of FEMA and private market insurance payments for U.S. earthquakes from 1994 through 2006 reveals insurers paid out $17.3 billion while FEMA paid out $205 million in relief to public entities and about $86 million to individuals.

  Source: FEMA spending compiled by PIA adjusted for inflation by RAA

- Figures for U.S. wildfires losses from 1994 through 2006 show the private insurance market paid out more than $2.5 billion in insured property payments versus FEMA's payments of $968,703,568 to public entities and $69,996,944 to individuals, meaning only 6.7% of the total disaster payments went to individuals.

  Source: FEMA spending compiled by PIA adjusted for inflation by RAA

Myth No. 3: Creating a government reinsurance catastrophe fund, like Florida's fund, is a good way to help consumers lower their homeowners' insurance costs.

Reality: Florida's reinsurance catastrophe fund benefits insurance companies by giving them taxpayer-backed reinsurance while providing little relief to consumers for the cost of homeowners insurance.

- Florida is only the state catastrophe fund writing reinsurance. In effect, it makes consumers the reinsurers for insurers. The state fund offers insurers inexpensive reinsurance premiums up front, enabling insurers to off load substantial risk onto consumers. When a hurricane occurs that depletes the fund's cash reserves (as in 2004 and 2005), the fund issues bonds. The insurance companies who bought the state's cheap reinsurance do not pay the bond debt. The debt is paid by taxing Florida policyholders of other lines of insurance, such as automobile insurance and commercial insurance, including municipalities, daycare centers, school districts and small businesses via assessments.

- State catastrophe funds concentrate risk instead of spreading risk, a fundamental principle of insurance. The Florida fund has $1.8 trillion of insured values (Florida now retains nearly two-thirds of the reinsured property catastrophe risk within its borders). Instead of spreading that risk globally, the Florida fund concentrates that risk within the state and shifts the catastrophe costs from the private insurers to insurance-buying consumers including those not covered by the fund itself. The reality is low-risk policyholders pay for high-risk policyholders.

- Government funds, like Florida's fund, do not reduce the vulnerability of people to natural catastrophes and are not a proactive, disaster planning approach. These funds are a political response to an economic issue. The funds do not reflect risk, but create incentives for additional development in high-risk areas and diminish incentives for storm proofing further exacerbating the problem.

- Experience with state catastrophe funds shows they are susceptible to the political suppression of rates. The Florida fund is facing an $18 billion potential shortfall in 2010, and due to the current financial markets, the state is unable to borrow the money needed to covers its liability. Two key financial rating agencies, A.M. Best and Demotech, stated Florida legislators must shore up the fund before the June hurricane season or they will be forced to downgrade the financial ratings of dozens of insurance companies that rely on the state's cat fund which could trigger banks to invalidate mortgages that require qualified insurance coverage.

Myth No. 4: The federal government can help states lower the cost of homeowners insurance by adding wind coverage to the national flood insurance program and providing the states with government reinsurance and low interest loans.

Reality: Government proposals that transfer risk from insurers to taxpayers won't reduce the risk or cost, but will diminish the private market and encourage further development in hazardous areas leading to increased risk and cost in the future.

- Spreading the risk of natural catastrophes to the private sector, rather than using debt to finance risk in federal and state insurance programs, is the best long-term solution to addressing catastrophe exposures and cost issues. Most states, in fact, embrace this same goal of reducing the size of their state wind programs and residual market mechanisms. The growth in residual markets in a state often reflects a market that is not permitted to properly spread risk or which does reflect a premium based on risk exposure.

- The National Flood Insurance Program, NFIP, is a program already struggling with an inadequate cash flow and $18.8 billion in debt. Adding wind coverage to the NFIP will only increase the financial strains on the program and lower the overall amount of coverage available. Participation in the plan has also been an ongoing challenge.

    Source: GAO testimony, "National Flood Insurance Program continued actions needed to address financial and operational issues." April 21, 2010

- According to the Federal Emergency Management Agency, FEMA, only about 49 percent of single-family homes in special flood hazard areas nationwide are covered by NFIP. After Katrina, the number of flood insurance policies sold in the Gulf States did increase by 21.6 percent. Unfortunately, the number of flood policies not renewed since Katrina is surprisingly high – 23% in Alabama, 32% in Florida, 17% in Louisiana, 19% in Mississippi and 25% in Texas.

    Source: Robert P. Hartwig, Ph.D., CPCU, President, Insurance Information Institute
    P/C Insurance in an Era of Mega-Catastrophes, Overview & Implications,
    Institute for Business & Homes Safety Annual Conference (Orlando, FL, November 7, 2007)

Myth No. 5: Providing after-the-fact disaster relief and creating government catastrophe funds are the only options available to government in dealing with the financial impact of natural catastrophes on consumers.

Reality: A number of states have implemented a variety of proactive programs to address their unique natural catastrophe exposures and assist their citizens. In Congress, proactive bills are pending that direct federal assistance to consumers in the coastal regions.

- **Consumer Catastrophe Savings Account**

  South Carolina passed legislation allowing a state income tax deduction for funds contributed to a catastrophe savings account. The account may be established by a policyholder for residential property to cover insurance deductibles under insurance policies for the taxpayer's residence that covers rising floodwaters or catastrophic windstorm events.

- **Consumer Tax Credit for Low Income Households**

  The 2007 South Carolina legislature passed a measure giving a credit against the state income tax for excess premium paid for homeowners insurance if the premium paid exceeded 5% of the taxpayer's adjusted gross income.

- **Consumer Tax Credit for Mitigation Expenses**

  South Carolina's 2007 General Assembly enacted a measure giving individuals a credit against costs incurred to retrofit a residence to make it more resistant to catastrophic windstorm events.

- **Consumer Matching Grant Mitigation Programs**

  Florida and South Carolina created programs last year to provide financial grants to homeowners to help retrofit their properties to make them less vulnerable to hurricane damage. Both states required the grants to be matched on a dollar-for-dollar basis for a total of $10,000 for the mitigation project, but in South Carolina low income homeowners are eligible for grant up to $5,000 with no matching amount required.

- **Premium Discount for Mitigation Measures**

  During 2007, Louisiana, Mississippi and Connecticut adopted insurance premium discounts for insureds who make structural improvements to minimize damage from natural disasters.

- **Insurer Incentives to Increase Consumer Market Choices**

  Louisiana's 2007 legislature approved a measure, supported by Governor Blanco and Commissioner Donelon, which created a multi-million dollar matching grant program to encourage more insurance companies to do business in the state. Mississippi and South Carolina enacted bills in 2007 that encourage insurers to write more coverage in coastal areas by providing credits against premium taxes paid to the state.

- **Federal Assistance Focused on Consumers Versus Insurance Companies**

  In January 2009, Rep. Gus Bilirakis (R-FL) introduced the Hurricane and Tornado Mitigation Investment Act, H.R. 308, which amends the IRS code to provide a credit against tax for hurricane and tornado mitigation expenditures.

State Solutions to Coastal Homeowners Insurance Issues

Summary of practical and innovative solutions enacted in various states to address the affordability and availability of property and casualty insurance in coastal areas.

Building Code Reform

Louisiana SB 44 (2005)

- Enacted a statewide building construction code, adopting the 2003 wind and flood mitigation requirements prescribed in the 2003 International Building Code and the 2003 International Residential Code.
- Encourages use of construction materials of greater durability and lower long-term costs, with a goal of providing greater storm resistance.

Mississippi HB 1406 (2006)

- Requires its most southerly counties to enforce wind and flood mitigation requirements based on the 2003 International Building Code and 2003 International Residential Codes.

Florida HB 1A (2007)

- Adopts a true statewide building code by eliminating the "Panhandle Carve Out"
- Requires statewide compliance with wind-borne debris protection in accordance with the International Building Code (2006) and the International Residential Code (2006) in the wind-borne debris region.

Coastal Restoration for Storm Protection

Louisiana Acts 8 and 69 (2005)

- Recognizes the benefits of using natural defenses, such as coastal wetlands, as hurricane and storm surge protection.
- Creates and places all state coastal restoration and hurricane protection activities under the Coastal Protection and Restoration Authority
- Provides dedicated funding for coastal restoration from the state share of revenue from offshore drilling.

Tax Credits for Mitigation Expenses

South Carolina HB 3820 (2007)

- Individual taxpayers allowed a credit against state income tax for costs incurred to retrofit a residence to make it more resistant to hurricane, rising floodwater, or other catastrophic windstorm event.

- Tax credit for fortification measures not to exceed the lesser of 25% of the cost incurred or $1,000.

- Individual taxpayers allowed a credit from state income tax for state sales and use taxes paid on purchases of tangible personal property used to retrofit a residence. Maximum credit allowed is $1,500.

Matching Grant Program for Consumer Mitigation

South Carolina HB 3820 (2007)

- Grants to assist homeowners in retrofitting their properties to make them less vulnerable to hurricane damage.

- Grants must be matched on a dollar-for-dollar basis for a total of $10,000 for the mitigation project.

- Low income homeowners eligible for grants up to $5,000 with no matching amount required.

Florida HB 7057 (2006, amended 2007 and 2008)

- Creates the My Safe Florida Home Program to provide free home-retrofit inspections of site-built, single-family, residential property to be offered throughout the state to determine what mitigation measures are needed, what insurance premium discounts may be available, and what improvements to existing residential properties are needed to reduce the property's vulnerability to hurricane damage.

- Financial grants to encourage single-family, site-built, owner-occupied, residential property owners to retrofit their properties to make them less vulnerable to hurricane damage.

- Grants must be matched on a dollar-for-dollar basis for a total of $10,000 for the actual cost of the mitigation project with the state's contribution not to exceed $5,000.

Tax Deduction – Catastrophe Savings Account

South Carolina HB 3820 (2007)

- Individual taxpayer allowed a deduction from state income tax for amounts contributed to a Catastrophe Savings Account.

- Catastrophe Savings Account may be established by a policyholder for residential property in South Carolina to cover insurance deductibles under insurance policies for the taxpayer's residence that covers hurricane, rising floodwaters, or other catastrophic windstorm events.

- Total amount to be contributed to savings account may not exceed:

    1. \$2000 (for individuals with deductibles not more than \$1000)
    2. The lesser of \$15,000 or twice the deductible (for individuals with deductibles greater than \$1,000
    3. \$250,000 (for self-insured individuals)

Tax Credits for Premiums by Low Income Households

South Carolina HB 3820 (2007)

- Credit allowed against state income tax for excess premium paid for property and casualty insurance if the premium paid exceeds 5% of the taxpayer's adjusted gross income.

- Credit not to exceed \$1,250

Tax Credits for Insurance Companies

South Carolina HB 3820 (2007)

- Licensed insurers providing full property and casualty coverage that includes wind and hail coverage to property insurers in coastal areas may claim a credit against the premium tax in an amount equal to 25% of the tax due on the premium written for the property owners for the taxable year.

Mississippi HB 1500 (2007)

- Annual credit against state insurance premium taxes for insurance companies for new policies written for essential property insurance within coastal area of Mississippi. Credit not to exceed \$100,000 during calendar year.

Windstorm Residual Market Reform

Mississippi HB 1500 (2007)

- Wind pool is restructured to gain tax exempt status.
- Additional funds are provided to assist the Windstorm Underwriting Association in defraying expenses and cost for reinsurance.
- Provides for insurer assessments and policyholder surcharges.

Coastal Market Assistance Program

Connecticut HB 7300 (2007)

- Insurance Commissioner may establish a coastal market assistance program to assist homeowners in obtaining homeowners insurance for properties located in proximity to coastal areas.

Premium Discounts for Mitigation Measures

Louisiana HB 558 (2007)

- Insurers required to submit rates and rating plans shall provide discounts, credit, rate differentials and adjustments in deductibles to insureds who: (a) build or retrofit a structure to comply with the construction code or (b) who install mitigation improvements or utilize construction techniques to reduce losses from windstorm or hurricane.

Connecticut HB 7300 (2007)

- Insurers offering homeowners insurance policies for residential dwellings shall offer premium discounts to homeowners who install permanent storm shutters or impact-resistant glass

Mississippi Wind Pool (2007)

- The Mississippi Windstorm Underwriting Association approved (August 3, 2007) using credits against premiums for fortified construction designed to lessen damage from hurricanes.

Insurer Incentive Program

Louisiana HB 678 (2007), extended by SB 44 (2008)

- Insure Louisiana Incentive Program designed to encourage additional insurers to participate in the voluntary property insurance market.
- Individual matching grants to companies between $2 million and $10 million to be allocated by the Insurance Commissioner.
- Grants made only to insurers who satisfy minimum capital requirements (capital and surplus exceeding $25 million), stable financial conditions and adequate risk-based reinsurance program,
- Matching grants shall not exceed 20% of an insurer's capital and surplus.
- The new property insurance written by the insurers who receive a matching grant shall be residential, commercial, mono-line or package property insurance policies and must include coverage for wind and hail. New premium written must be at least two times the amount of the grant and the insurer's matching allocated capital.
- Funds remaining after 2008 grants will be used to create a homeowners policy premium assistance program.

Florida SB 1980 (2006)

- Appropriates $250 million to attract new insurers to the state to write homeowners insurance.
- Applicants have to provide matching funds and commit to writing at 2:1 net written premium to surplus for the duration of the surplus note.
- Notes would have to be paid back over 20 years, the first three years is interest only.