

Oral Testimony
Kevin McCarty
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Government Sponsored Enterprises of the
House Committee on Financial Services
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Chairman Baker, Ranking Member Kanjorski, and members of the Subcommittee, I thank you for the opportunity to testify here today on the role of insurance commissioners in stabilizing the coastal insurance market, and thank you for your leadership on this important issue.

My name is Kevin McCarty, and I am the Insurance Commissioner for the State of Florida. I am also the Chairman of the Property & Casualty Insurance Committee of the National Association of Insurance Commissioners (the "NAIC") as well as chair of the Committee's Catastrophe Insurance Working Group.

We are not here because of Hurricane Katrina, or as the direct result of the remarkable 2004-2005 hurricane seasons in the United States. As I testified in June, catastrophic events are the great equalizer. Hurricanes, earthquakes, floods, and tsunamis do not discriminate against rich or poor, inland or coastal, Democrat or Republican. The issues in the market today affect all Americans, and solving the problem is going to require a broad bipartisan effort.

Today I would like to provide my perspective on issues I feel must be considered before we can set about developing a systematic local, regional, or national plan for managing natural catastrophes:

- First, what are the factors that contribute to the availability and affordability of insurance in coastal areas?
- Second, what is the current state of the insurance market in these high-risk areas?
- Third, what types of mechanisms exist in the states to manage catastrophic risk and to make insurance available and affordable?

- Finally, what are the merits of pre-disaster concepts like tax-deferred catastrophe reserving, mitigations tools, catastrophe savings accounts, and state and federal reinsurance programs?

The Markets have spoken and the Message is Clear:

- The Cost of Catastrophic Insurance has undergone an unprecedented rise, and shows no signs of abating any time in the foreseeable future.
 - Drivers include better understanding, through science and modeling of the nature and potential for catastrophic risk, including the current stage of the multi-decadal hurricane cycle
 - Increased capital requirements on insurers and reinsurers by market rating agencies, reflecting the increased exposure concerns
 - Increasingly attractive market opportunities for investment capital globally.
- Much has been written about the impact of regulation on the affordability and pricing of insurance. The term “price controls” has been widely used by those who prefer total deregulation of the insurance market to refer to rate regulation. *In actuality, insurance companies, not regulators, develop the rates and rating systems in 49 of the 50 states.* The role of state regulators is to review the rates to ensure they are actuarially sound. Their goal is not to tell an insurer what to charge, but rather to verify that consumers are not being charged rates that are excessive, inadequate, or unfairly discriminatory. My colleague from South Carolina, Director Eleanor Kitzman, is behind me here today. South Carolina, a state not impacted directly by the 2004-2005 hurricanes, is seeing the same sort of market behavior as the rest of the coastal states, yet South Carolina’s rate review system, employing flex-band ratings, is a model held up by the industry as being a model for so-called competitive rating.
- The Market is financing all of the catastrophic risk it cares to under current conditions
- The availability of capital to support catastrophic risk insurance is more uncertain than it has been and this uncertainty will also remain
- The net result for coastal states (Gulf and Atlantic):

- While the average cost of reinsurance throughout the US rose by 76% for the 2006 market, most of this was driven by catastrophic coverage, especially in the coastal states
- Price increases of 300, 400 and in some cases over 1000% have been evident
- A number of areas are finding it impossible to find catastrophic coverage at any price
- The effect on regional economic activity has become real and tangible

Empowering the Consumer and Creating Choice:

- As a long-term response, empowering the consumer will mean that state and local governments will have to adopt and enforce building codes and land use management plans that truly incorporate the impact of catastrophic exposure. This is an integral part of the national catastrophic plan concepts being developed by the NAIC. NCOIL has issued a resolution supporting this concept. Industry is actively involved with this effort as well.
- Mitigation techniques work and are cost effective. While new building codes can alleviate the effect of catastrophic events, a substantial portion of our national housing stock predates any development in codes. Florida has allocated \$250 million this year for mitigation matching grants and inspections. This is just a beginning. Also devoting a \$100 million HUD block grant to retrofit and mitigation programs.
- These efforts will bear fruit, but will take time effort and resources.

New Paradigms for Financing Catastrophic Risk in the Private Market

- Create meaningful forward-looking reserves to spread the economic consequences of catastrophic events over time. Under our current system, there is no opportunity to let good underwriting results from a year with no catastrophic loss to carry over to finance losses in years when catastrophes do occur. The cost of catastrophic risk exposure must be fully priced and funded every year. While this works for most property lines of business, such as automobile insurance, it just does not match the cycle of loss attributable to catastrophic risk. Rep. Foley's current bill would do that. The NAIC has long supported the concept and has developed a reserving model as well.
- Allow consumers the opportunity to take a more active role in financing their personal catastrophic exposure. A tax advantaged catastrophe

savings account, such as that proposed by Rep. Feeney, would allow consumers to set aside funds for paying for catastrophic losses, or to invest in mitigation. These funds would go toward paying “first dollar losses,” typically the most frequent and the most expensive to finance in the insurance market. An alternative would be to create tax credits for effective mitigation investment.

- **Expand Market Capacity:** Within the NAIC, there is current debate ranging on a variety of issues related to ensuring that risk capital is being provided to the market in the most efficient manner, especially within the realm of reinsurance. Currently in Florida, a number of proposals are being debated to expand the role of alternative risk transfer mechanisms to bring capital to the private market in the most efficient manner. Many of these considerations are based on innovations and opportunities in the market that have occurred only within the last few years.

National Commission on Catastrophe Preparation

- I strongly endorse the immediate creation of this commission. The NAIC has endorsed this as well. Among the questions I would ask the Commission:
 - What should be the form of state involvement (e.g. our Cat Fund? Other devices, to what level, which states?)
 - What should be the role, if any, of the federal government in the financing of catastrophic risk?
 - If there is a role, what is the best way to accomplish the financing with minimal exposure to the American taxpayer?