

THE
SCOTT GROUP

Confidential - Attorney/Client Privilege

MEMORANDUM

August 31, 2006

TO: STACY STATHOPOULOS, CMSA

**FROM: SCOTT A. SINDER
JOHN P. FIELDING
DUSTIN J. PAINTER, KELLEY DRYE COLLIER SHANNON**

**RE: FEDERAL LEGISLATION FOR CATASTROPHIC RISK INSURANCE
PROGRAMS**

I. INTRODUCTION

In the wake of the Gulf Coast hurricanes and the ensuing economic fall out last year, several Members of Congress have introduced legislation in an effort to address the perceived problems related to insuring against such risks. This memorandum summarizes the status, provisions, and prospects of each of the natural catastrophic risk insurance bills currently pending before the Congress: H.R. 4507, the *Natural Catastrophe Insurance Act of 2006*, introduced by Representative Carolyn Maloney (D-NY); H.R. 4366, the *Homeowners' Insurance Protection Act of 2005*, introduced by Representative Ginny Brown-Waite (R-FL); H.R. 846, the *Homeowners' Insurance Availability Act of 2005*, also introduced by Representative Brown-Waite; H.R. 2668 and S. 3116, the *Emergency Reserve Fund Act of 2005*, introduced by Representative Mark Foley (R-FL) and Senator Ben Nelson (D-FL) in the House of Representative and Senate respectively; H.R. 4836, the *Catastrophe Savings Account Act of 2006* introduced by Representative Tom Feeney (D-FL); and S. 24, the *Emergency Reserve Fund Act of 2005*, introduced by Senator Kay Bailey Hutchinson. In addition, this memorandum reviews the current political landscape and looks to the factors leading to introduction of these bills and assesses the political appetite for their passage.

**II. POLITICAL ENVIRONMENT FOR CATASTROPHIC RISK INSURANCE
LEGISLATION**

In the past few years, the United States has been bombarded with a bevy of natural disasters the likes of which have left both localities and capital markets in disarray. In 2004, four major

hurricanes hit the United States, and each was among the 10 most costly hurricanes in the Nation's history. The 2004 storms were quickly eclipsed in magnitude by the nation's most costly storm in its history, Hurricane Katrina. That storm caused insured losses estimated at between \$40 billion and \$60 billion. Two additional storms hurricanes, Wilma and Rita, also wreaked additional devastation in 2005.

The resulting costs of these storms have left many people in areas prone to these events, unable to find homeowners and commercial insurance. Recognizing the very real threat of insufficient insurance capacity, Congressional support for a federal program to improve the nation's ability to mitigate losses and finance large insured losses from catastrophic events has gained traction.

III. SUMMARY AND ANALYSIS OF INTRODUCED BILLS

a. H.R. 4507, the *Natural Catastrophe Insurance Act of 2006*

Summary of Bill

Representative Maloney introduced legislation that directs the Secretary of the Treasury to create a program to make reinsurance coverage available for purchase by eligible State programs. The program would be designed to improve the solvency of markets for homeowners insurance and business insurance by facilitating the pooling, and spreading the risk, of catastrophic financial losses from natural disasters, thereby improving the availability and affordability of homeowners' insurance and insurance for businesses.

Under the bill, the Secretary would offer reinsurance coverage through contracts with eligible State-operated insurance or reinsurance programs. It is intended that the bill would thus spur creation of state catastrophic insurance and reinsurance programs, would improve the effectiveness of current state program and would increase the likelihood that claims will be paid in the event of a natural disaster. The contracts for reinsurance under the program would be required to cover residential and business property losses that are proximately caused by:

- Windstorm (hurricane, cyclone, or tornado);
- Earthquake (including any fire following);
- Winter catastrophe (snow, ice, or freezing);
- Fire;
- Tsunami;
- Flood;
- Volcanic eruption; or
- Hail.

Before a State insurance program could be eligible to purchase these contracts, it would be required to first certify that it is a State-operated program that offers coverage for homes and the

contents of apartments, or business properties and business contents. The program would also have to certify that it is authorized by State law. Similarly, a State-operated reinsurance program would also be eligible to purchase contracts upon certification that it offers coverage for homes and the contents of apartments, or business properties and business contents.

The bill would not intend that the contracts for reinsurance displace or compete with the private market insurance or reinsurance markets. Accordingly pricing for the contract for an eligible State program would be one percent greater than the lowest amount for which the State program could obtain equivalent coverage in the private reinsurance market. In the event that a private market is unavailable and a market rate is thus not demonstrable, the price for reinsurance under the contract would be one percent greater than the lowest amount for which a private insurer with an equivalent risk portfolio could obtain equivalent coverage in the private reinsurance market.

In furtherance of its intention not to displace private market insurance, the bill would also require the Secretary of the Treasury to establish regulations that create a competitive process by which qualified entities could offer to provide, in lieu of the reinsurance coverage provided by the Secretary, reinsurance coverage that is substantially similar to coverage otherwise made available by the contract. As a condition precedent to the award of a contract, qualified entities would be required to demonstrate that they have capital sufficient to satisfy the terms of the reinsurance contracts.

Program Funding

The bill would create a Disaster Reinsurance Fund (“DRF”) within the Treasury of the United States for use for payments to covered purchasers under contracts for reinsurance coverage for eligible losses. The DRF would be comprised of amounts received annually from the sale of the contracts, any amounts earned on investments of the DRF, any amounts credited to the DRF, and any amounts borrowed by the DRF. With respect to borrowing, the bill would authorize the Secretary to issue debt obligations for amounts necessary to pay claims and expenses (where the DRF has insufficient amounts to pay the claims and expenses). Those obligations would be treated like other bonds and would be repaid with interest from the premiums charged for reinsurance contracts.

Minimum Level of Retained Losses and Maximum Federal Liability

The bill would require that State programs sustain at least \$50 billion of retained losses from a single event before the coverage from the reinsurance contracts would be made available. But the bill views that amount as a minimum level of retained losses. The bill would authorize the Secretary to establish levels even higher and authorizes the Secretary to make annual increases that reflect the annual rate of inflation or increases in exposures.

The bill would also set the maximum aggregate federal liability for a single year at \$25 billion. Like the level for retained losses, the bill would permit the Secretary to adjust the aggregate liability limit to provide for inflation.

b. H.R. 4366, the *Homeowners' Insurance Protection Act of 2005*

Summary of Bill

Representative Brown-Waite's *Homeowners' Insurance Protection Act of 2005* ("HIPA") would create a federal reinsurance catastrophe fund (HELP fund) that insures against any losses covered (and only those losses covered) by a state's catastrophe fund (CAT fund), such as:

- Earthquakes;
- Perils from earthquakes such as fires and tsunamis;
- Hurricanes and typhoons;
- Tornadoes;
- Volcanic eruptions;
- Catastrophic Winter Storms; and
- Other natural catastrophes (not including floods).

Because the HELP fund sells reinsurance only to a state that has its own catastrophic events fund, the creation of state catastrophe funds are encouraged under this legislation. The HIPA would require that the Treasury Department sell reinsurance to individual states provided that each state meets certain criteria, on a yearly basis. In effect, the catastrophe HELP fund is designed to be a federal backstop to the state funds. The state catastrophe fund would be able to purchase federal reinsurance every contract year but would only be able to tap those funds as a last resort -- after all private insurers and state fund financial obligations were met.

The HELP fund would be created within the Department of the Treasury and managed by the Treasury Secretary. In addition, the HIPA bill would create the National Commission on Catastrophe Preparation and Protection to aid the Secretary in the management of the fund. The Commission would be composed of a broad combination of professional and industry experts as well as consumers. The Commission would also assist states in developing mitigation, prevention and rebuilding programs, a required step for the state to become eligible to buy the federal reinsurance contracts. With a group representing various interests comprising the Commission, the HIPA attempts to meet the best interests of the consumer and private insurers in a financially responsible manner.

The HIPA reinsurance program is designed with three main stages of coverage. The first stage states that private insurers are responsible for losses under insurance contracts up to a specified amount determined on a state-by-state or regional basis. Once that level is reached by private insurers, the second stage is initiated allowing for state catastrophe funds to be provided for losses up to funding capacity. It is only when the state fund has reached maximum payout ability

August 31, 2006
Page 5

that the third stage is triggered and the federal Consumer HELP fund disburses money for claims that have not been paid.

Program Funding

Like the DRF in Representative Maloney's bill, the Consumer HELP fund would be paid for by portions of insurance premiums, interest earned on those premiums, amounts credited to the fund and any amount borrowed by the fund. The fund would be protected and backed by the US Treasury. If a catastrophe occurred and the HELP fund had not collected sufficient premiums to pay for all outstanding losses, the fund would issue debt obligations to pay the state. Like other Treasury issued securities, the debt obligations would be required to eventually be paid back by the fund with interest.

Prevention and Mitigation

Unlike the *Natural Catastrophe Insurance Act of 2005*, the HIPA would require States to meet prevention and mitigation requirements in order to be eligible to participate in the program. The prevention and mitigation requirements would be comprised of the following components:

- Encouraging awareness of general risk factors and methods to reduce or eliminate those risk factors;
- Studying the location of risk in a State or region; and,
- Ensuring that proper construction is enforced through mandated building codes appropriate for the risk and that proper building materials and methods are used suitable to the risk in the area.

States would be required to contribute at least \$10 million or up to 35% of invested income from current catastrophic risk insurance funds to these prevention and mitigation measures.

Minimum Losses and Maximum Liability

In order to receive payouts from the HELP fund, private insurers and state insurance programs must reach their total claims paying capacity. Additionally, the state fund capacity would be based on the amount no less than the eligible losses projected to be incurred once every 50 years (1:50). This projected cost would be used to determine that minimum state insurance fund capacity. Each participating state's claims-paying capacity would be reviewed and adjusted, if needed, on an annual basis.

Following an event and after the state threshold has been reached, the federal fund program would be triggered up to the stated maximum liability. Maximum liability is based on a one in fifty to one in 500 year event and would provide 100% protection of eligible losses in such an event. Specifically, the federal Consumer HELP fund would be capable of covering losses from a catastrophic event that should occur only once every 500 years. In dollar terms, this requirement translates into a maximum aggregate liability for the federal fund of \$200 billion per contract year.

c. H.R. 846, the *Homeowners' Insurance Availability Act of 2005*

Summary of Bill

Also introduced by Representative Brown-Waite, the *Homeowners' Insurance Availability Act of 2005* ("HIAA") would create a Disaster Reinsurance Fund (DRF) similar to that of Representative Maloney's bill. And like Representative Maloney's bill, the HIAA focuses on the sale of contracts to private and state insurers and reinsurers. Each contract for reinsurance would cover the following perils:

- Earthquakes;
- Perils ensuing from earthquakes, including fire and tsunamis; and
- Hurricanes and Typhoons.

As in the HIPA and Representative Maloney's bill, the DRF and the reinsurance program fall under the auspices of the Treasury. The Treasury Secretary would issue regulations and set the guidelines that state insurers must follow in order to apply for the federal reinsurance program. The basic regulations would require:

- (1) public officials on the board of directors of state programs;
- (2) state insurance and reinsurance coverage not supplanting the private market in any way;
and
- (3) that the state programs must have laws against price gouging.

To aid the Secretary and provide recommendations on the appropriate cost of reinsurance contracts, the HIAA bill would establish a National Commission on Catastrophe Risks and Insurance Loss Costs.

Auctions

The Treasury Secretary would be responsible for the sale of reinsurance contracts through an auction process. These contracts would provide federal reinsurance coverage above a minimum level of retained losses. The auction process would be open to state and private insurers and reinsurers and would be divided into at least six geographical regions. Regional auctions would permit the Secretary to consider what kind and level of risk each region faces within the United States. Accurate evaluation of the risk of each region would result in a reserve price appropriate to each region's risk. This should prevent state and private insurers in less risk-prone areas from subsidizing more risky areas (such as coastline communities).

The reserve price (set minimum price that must be met during the auction) of the contract is determined by four main factors: risk-based price, risk load, administrative costs and mitigation.

In determining the reserve price of the contract, the Secretary would ensure that the risk-based price reflects the anticipated annual payout of the contract. Additionally, adjustments can be made to the overall contract price based on mitigation efforts by state and private insurers. Mitigation price incentives would reduce the loss and damage to property, and therefore, lower the overall insurance claims following a catastrophe. On top of the mitigation price incentive, the HIAA would require each purchaser of a contract to contribute up to 5% of the price of the contract towards pre-disaster prevention and mitigation programs and construction.

Minimum Losses and Maximum Liability

A minimum level of loss must be reached by state programs, as stated in the contract, before they are eligible for federal funds. The minimum level, or coverage trigger, is between the estimated cumulative amount of loss equal to a single catastrophic event that is projected to occur once in every 100 years and 250 years (1:100-1:250). In the case of multiple events, the minimum loss provision would apply to each event. The Secretary would make annual adjustments to the minimum loss range based on a number of factors, including changes in the capacity of public and private insurance and reinsurance programs or changes in the market value of properties in particular regions.

According to the legislation, the estimated federal aggregate liability would most likely not exceed \$25 billion per contract year. The maximum level of liability would be between the amount of loss equal to a disaster anticipated to occur once every 100 years and once every 500 years. Moreover, as a further protection against liability, up to 50% of eligible losses in excess of the trigger would be covered for each specific region. For example, the Committee on Banking and Financial Services report on HIAA uses the following illustration as to how the HIAA would work:

The 1/500 year-event for State A is \$20 billion and the 1/100 year-event for State A is \$12 billion. The difference between the two estimates is \$8 billion. Assuming State A purchases the entire amount of coverage it is allowed (\$8 billion), if State A suffers a \$20 billion loss, it collects on its entire contract and receives \$4 billion after accounting for the required 50% copay rate (50% of \$8 billion is \$4 billion).

The DRF would be credited with amounts received annually from the sale of contracts, amounts borrowed by the fund and any amounts earned on investments. Unlike the Consumer HELP fund of the HIPA, the DRF money does not have any special tax status. The use of fund money is limited to contract payments, operating costs and administrative expenses only. If enacted, the HIAA would sunset in 10 years; however, if there is insufficient growth of capacity in the private insurance market (as this bill attempts to generate), the Secretary could extend the legislation for additional 5 year periods.

d. H.R. 2668 and S. 3116, the *Emergency Reserve Fund Act of 2005*

Summary of Bill

Representative Mark Foley introduced H.R. 2668 in the House of Representatives and Senator Bill Nelson introduced S. 3116 in the Senate, companion bills that would change the tax treatment of catastrophic risk insurance reserves held by private insurers, enabling them to create tax-deductible reserve funds for catastrophes. The first bill of its kind was first introduced in the House in 1999 and was developed in conjunction with a working group of the National Association of Insurance Commissioners. The rationale for the change in tax treatment is that by allowing tax deductions for catastrophic risk insurance reserves, insurance would become more widely available, and the risk of insolvency in the event of a major catastrophe or multiple catastrophe would be significantly reduced. Proponents of this legislation argue that the current treatment of reserves has restricted insurers' ability to expand their capacity to underwrite catastrophic risk insurance policies.

Operating outside of the federal legislative process, the National Association of Insurance Commissioners (NAIC) created a Catastrophe Reserve Subgroup in 1995 to develop a proposal for a tax-deductible pre-event catastrophe reserve. The NAIC group had a working model in place by 1997 and revised it several times based on public and industry comments. In 2000, the Catastrophe Reserve Subgroup presented its final proposal. The NAIC has chosen not to accept the proposal, however, until Congress changes the tax law to allow insurers to establish reserves for future catastrophic events on a tax-deductible basis with no offsetting tax increases.

The proposal developed by the NAIC working group is similar to H.R. 2668 and S. 3116. However, there are various differences between them. For instance, the NAIC proposal would make development of reserves by private insurance companies compulsory, whereas H.R. 2668 and S. 3116 makes them optional. The NAIC proposal stipulates a specific dollar target for industry reserves (approximately \$40 billion after a build up period of 20 years), whereas H.R. 2668 and S. 3116 does not put a dollar value on the reserve target. Both plans also have many similarities. For example, both plans enable firms to receive a tax deduction for contributions to a catastrophe reserve, and both plans mandate that distributions from this reserve be fully taxable.

The benefit from both proposals is derived from the tax-deferral. Distributions from the reserve funds would be included in the insurers' gross income and would be taxable. The amount of distributions would be determined by a complex set of rules, but in general they are tightly linked to actual catastrophic losses. Under H.R. 2668 and S. 3116, qualifying catastrophes include:

- Windstorm (hurricane, cyclone, or tornado);
- Earthquake (including any fire following);

- Winter catastrophe (snow, ice, or freezing);
- Fire;
- Tsunami;
- Flood;
- Volcanic eruption; and
- Hail.

e. S. 24, the *Emergency Reserve Fund Act of 2005*

Summary of the Bill

Like many of the proposals discussed above, Senator Hutchinson's bill would create an "Emergency Reserve Fund" (the "Fund") within the Treasury of the United States. Amounts in the fund would be made available to meet emergency funding requirements of domestic disasters and security emergencies. Unlike the other proposal, the funds would only be available for disasters and emergencies that were either designated as such by a joint resolution of Congress or were declared by the President pursuant to the Robert T. Stafford Disaster Relief and Emergency Assistance Act.¹

Funding

Funding for the Fund would come from a direct appropriation from Congress. The bill would require that the Fund receive an appropriations of 1.2 percent of the total "operating expenditures" of the Federal Government. The bill would define "operating expenditures" to be the "average domestic, non-defense, discretionary spending by the Federal Government over the last five years."

The bill would include the appropriation to the Fund among the list of permanent statutory appropriations. By designating the appropriation to be a permanent appropriation Senator Hutchinson's bill would expressly require that the appropriation is to be made available continuously, year in, year out.

¹ The "Robert T. Stafford Disaster Relief and Emergency Assistance Act" (the Stafford Act) authorizes the President to issue major disaster declarations that authorize federal agencies to provide assistance to states overwhelmed by disasters.

f. H.R. 4836, the *Catastrophe Savings Account Act of 2006*

Summary of Bill

H.R. 4836, introduced by Representative Feeney, would create tax exempt catastrophe savings accounts (CSAs) which would allow for tax-free distributions from the CSAs to pay expenses resulting from a presidentially declared major disaster.

Unlike the tax free reserves authorized by the Emergency Reserve Fund Act bills, Representative Feeney's bill would authorize the insured to create the reserve account. The CSAs would be structured similarly to Health Savings Accounts whereby the accounts could be opened to cover current and future catastrophe-related expenses and the earnings from the money deposited would be tax-free. Any unused balances would roll over from year-to-year.

H.R. 4836 would limit CSA balances to either \$2,000 (for individuals with homeowner insurance deductibles of not more than \$1,000) or the lesser of \$15,000 or twice a homeowner's insurance deductible (for individuals with deductibles of more than \$1,000).

The money that a homeowner contributes to and earns in their CSAs could be withdrawn to cover qualified disaster expenses tax-free. Under H.R. 4836, qualified expenses would include: deductibles, uninsured losses, flood damage and structural upgrades for future storms.

IV. POLITICAL STATE OF PLAY

a. Congressional

Congress has been reluctant to enact federal disaster insurance legislation. While many supporters of a program fail to reach a consensus on exactly what components are necessary for a successful federal program, others remain opposed to such a program, viewing it as an unnecessary government intrusion into markets being served by private market participants.

In fact, in the 106th Congress (1999-2000), legislation similar to Representative Brown-Waite's HIAA bill was reported by the House Banking Committee. But the bill proceeded no further as the House leadership did not bring bill to the floor. Congressional reluctance to approve a program may have much to do with concerns that such a program would interfere with the competitive insurance marketplace and would undermine the benefits of the private market such as cost efficiency and rate competition.

But the philosophical opposition to a federal program by many in Congress may not prove to be an absolute bar to passage of a program if the private market proves it cannot undertake certain

risks. The federal government has already demonstrated, at very least, a willingness to assume risk where the private market has demurred. Examples include risk-bearing for environmental disasters, nuclear disasters, terrorism and flooding.

b. Interest Group Positions

Insurance industry advocacy organizations have expressed their positions on a number of the provisions contained in the legislation discussed above. A summary of those positions follows.

ProtectingAmerica.org (Allstate, State Farm and others)

Staunch supporters of a federal program have banded together to press for such a program's enactment. Lead by insurers Allstate and State Farm, the coalition Protecting America (also known as "ProtectingAmerica.org") has called for the establishment of privately funded catastrophe funds in catastrophe prone states to serve as backstops to private market insurance and for a federal program to serve as a backstop to new state catastrophe funds. To that end, the group is pushing for enactment of Representative Brown-Waite's HIPA bill (H.R. 4366). The group believes that the bill will ensure that adequate resources are in place to cover losses from a natural catastrophe. They contend that the bill will increase capacity and market certainty which will, in turn, reduce rates for homeowners' insurance in catastrophe prone areas.

As discussed above, the plan supported by Protecting America calls for a national catastrophe fund to serve as a backstop to state catastrophe funds in the event of extremely large losses resulting from a catastrophic event. Under this scenario, the state funds would be financed by mandatory contributions from private insurance companies in each of those states in an amount that reflects the catastrophe risk of the policies the companies write in each state. Protecting America is advocating that the funds would be required to set aside a minimum of \$10 million up to a maximum of 35% of investment income for prevention and mitigation programs. The qualified state programs would be eligible to purchase the reinsurance offered by the federal program once they had achieved the minimum set aside for prevention and mitigation programs.

Protecting America claims that because the program is a state-by-state program based entirely on risk, the likelihood of a taxpayer subsidy is virtually eliminated. They also claim that because the program authorized by H.R. 4366 relies on the traditional private market for paying claims, inefficiencies innate to federal bureaucracies would be nonexistent.

Like other interests groups, Protecting America also supports public education program for homeowners and stronger building codes. They have also called for effective retrofitting programs to improve the integrity of catastrophe prone structures and increases in first responder funding.

American Insurance Association

The American Insurance Association (AIA) has voiced opposition to provisions of Rep. Brown-Waite's HIPA bill. Specifically, AIA has contested the underlying assumption of the bill: that large-scale natural catastrophes are uninsurable by the private sector, and that the government should step in to provide capacity. AIA contends that, despite record-breaking losses in the 2005 hurricane season, the private market's capacity for dealing with natural disasters has grown. They cite approximately \$28 billion in new capital entering the market since Hurricane Katrina. They contend that the private market capacity is adequate to spread and manage risk.

AIA contests the value of a new government program for natural catastrophic risk. They fear that such involvement will encourage and lead to inefficient allocation of capital, unfair subsidization, and increased (and unwise) development in natural disaster prone areas.

AIA is not completely opposed to Brown-Waite's HIPA bill, however. They support the bill's provisions that make price gouging a federal offense. Furthermore, AIA supports the creation of a national commission which would be charged with not only a review of insurance coverage, but also public education and mitigation efforts.

The AIA has proposed changes to current federal regulations which they believe will enable the private market to manage catastrophic risk without a federal program. Specifically, they have proposed the following changes:

- Stronger building codes and enforcement of codes;
- Risk base pricing not subject to state insurance regulators;
- Use of computer-based disaster models;
- Legal reforms that uphold contracts (thus eschewing potential for future "wind versus water" type litigation); and
- Tax incentives such as tax-exempt Catastrophe Savings Accounts for individuals (like the bill introduced by Rep. Feeney), and federal or state income tax credits that encourage homeowners and business owners to invest in protective measures.

Reinsurance Association of America

Like AIA, the Reinsurance Association of America ("RAA") that private market reinsurance capacity to cover catastrophic risk is adequate. The RAA does not believe that market conditions warrant the creation of a federal program.

The RAA believes that natural disaster risks are insurable in the free market and that state catastrophe funds significantly displace the private market and do so on the backs of taxpayers and policyholders of other insurance lines.

The RAA has expressed opposition to Rep. Brown-Waite's HIPA bill. Specifically it has opposed the following provisions:

The \$25 Billion Trigger: RAA contends that H.R. 4366's trigger level for federal reinsurance is too low and will interfere with the private market. The RAA has stated that the private market participants are currently providing capacity at that level.

No Requirement to Offer Homeowner's Coverage: Unlike the Terrorism Risk Insurance Act's "make available" requirement, H.R. 4366 would not require insurers to offer homeowner's insurance thereby undermining assurances that the federal program would result in an increase in the availability of homeowner's insurance.

No Risk Load to Reflect True Cost of Capital: RAA believes that the federal reinsurance offered under H.R. 4366 will be under priced because the legislation does not include language that requires the federal government to add a risk load reflecting the true cost of capital when pricing the reinsurance. In the private reinsurance market a catastrophic risk load is required on all pricing, thus there is no way the private reinsurance market can compete with the federal government.

No Private Market Protections: RAA believes that private market protections such as a "private market right to compete" should be an element of any federal plan. H.R. 4366 contains no such provision. Rep. Maloney's H.R. 4507 does offer private market participants the right to bid on reinsurance contracts.

Like the AIA, RAA believes that removing certain regulatory constraints will further facilitate private sector capacity for natural catastrophe risk bearing. The RAA advocates removing price controls, coverage mandates, and involuntary residual market facilities and associated assessments.

Property and Casualty Insurers Association of America

Unlike, AIA and RAA, the Property and Casualty Insurers Association of America ("PCI") is not as adamant about private market capacity for natural catastrophic risk. In fact, PCI believes that there may be a role, properly structured, for the federal government to play in financing coverage for natural catastrophic risk. Accordingly, the group believes that there may be cases and states where a catastrophe fund could be part of a catastrophe funding regime.

PCI has stated that it believes that private markets may not always have the capacity to fund more frequent and more severe "mega catastrophes." To that end, PCI would support certain state funds under specific sets of circumstances. PCI suggests that a review be made of whether private markets have the freedom to respond to market conditions, whether the state catastrophe

fund would damage private markets or prevent new capital from entering the market; and that the funding for the state funds does not rely on cross-subsidies across lines of business.

Unlike AIA and RAA, PCI contends that there could be a proper role for federal involvement in risk financing. They contend that a proper role would be a federal catastrophe financing facility which could offer credit financing to state catastrophe funds to provide access to liquidity to meet claim requirements in the event of a catastrophe. PCI believe that this role would limit the potential disruption to private markets.

Independent Insurance Agents and Brokers of America, Inc.

The Independent Insurance Agents and Brokers of America, Inc. (“the Big I”) has stated that it will support any “reasonable” idea and plans that lead to a healthy and competitive insurance marketplace in which consumers have choices and companies are vying for their business. To that end, the Big I believes that the best solution is for a federal role to be in place before another catastrophic natural disaster.

That being said, the Big I has stated that it supports Brown-Waite’s H.R. 846 but has not made a decision on H.R. 4366 or Rep. Maloney’s H.R. 4507. The Big I supports the tax-free reserve funds proposal proposed by Rep. Foley’s H.R. 2668 and the tax-free personal “Catastrophic Savings Accounts” proposed by Representative Feeney.

Like a number of the trade groups discussed above, the Big I also supports enhanced building codes and the use of financial incentives to mitigate risk.

V. CONCLUSION

There remain very few legislative days in Congress for the remainder of this election year. Barring a catastrophic natural disaster in these waning days of the 109th Congress, federal catastrophic insurance legislation will not be passed by Congress.

But the issue is not dead. The House Financial Services Committee has directed the Government Accountability Office to perform a study on the need for federal legislation targeted at protecting insured losses from natural disasters. The study, due September 30, 2006, is to review whether any government program should include any or all of the following components, tax-free capital reserves, voluntary mutual reinsurance pools, and distinctions between sophisticated and non-sophisticated commercial purchasers from certain regulations.

We will keep you abreast of any legislative developments regarding catastrophic insurance as they occur.

August 31, 2006
Page 16