S. HRG. 103-665

S. 1350, THE NATURAL DISASTER PROTECTION ACT OF 1993

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

NOVEMBER 17, 1993

Printed for the use of the Committee on Commerce, Science, and Transportation

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S. 1350, THE NATURAL DISASTER PROTECTION ACT OF 1993

WEDNESDAY, NOVEMBER 17, 1993

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The committee met, pursuant to notice, at 12 noon, in room SR–253, Russell Senate Office Building, Hon. Daniel K. Inouye, presiding.

Staff members assigned to this hearing: Moses Boyd, senior counsel, and Patrick H. Windham, senior professional staff member; and Sherman Joyce, minority staff counsel.

OPENING STATEMENT OF SENATOR INOUYE

Senator INOUYE. I would like to convey my apologies for this sudden change in the schedule, but as most of you are aware, the leadership scheduled seven votes this morning, making this hearing this morning impossible.

So, now we will begin our examination of ways in which to improve our Nation's response to natural disasters. Last year's devastation from Hurricanes Andrew and Iniki and this year's floods in the Midwest underscore the seriousness and vulnerability of homeowners to natural disasters.

While future disasters are unavoidable, preventative measures can be taken to reduce the loss of life, property, and the economic consequences of a catastrophic disaster.

In this regard, on August 4, with the help of many of you sitting here in this room, I introduced S. 1350, the Natural Disaster Protection Act of 1993, which we believe will respond to the unprecedented losses caused by the recent catastrophic natural disasters.

This bill establishes three interrelated programs that will reduce our Nation's reliance on Federal funded disaster assistance. First, the act establishes a mitigation program, with a strong emphasis on building code enforcement and enhanced emergency planning. This bill includes incentives for States and communities to adopt model building codes designed to make new structures safer and less prone to catastrophic disasters.

In addition, the bill establishes a self-sustaining mitigation fund that would provide resources to local and State governments to improve disaster planning and response.

Second, the measure establishes a primary insurance program which provides affordable comprehensive disaster protection for homes. Coverage on homeowners' insurance policies will be broadened to include perils not routinely covered under homeowners' insurance policies, such as earthquakes, volcanic eruption, and tsunamis.

Third, the measure establishes a national reinsurance program which would provide a source of insurance which insurers could purchase to better manage the risk from highly infrequent but extremely costly disasters. Mr. Chairman, your comments, please.

OPENING STATEMENT OF SENATOR HOLLINGS

The CHAIRMAN. I want to thank Senator Inouye for chairing this hearing to examine S. 1350, legislation introduced by Senator Inouye to establish a comprehensive Federal Disaster Program.

As a citizen of South Carolina, I am well aware of the need for disaster preparedness. Certainly the Federal Government, as well as State and local governments, must examine ways to minimize the costs and other adverse consequences of natural disasters. As I am sure everyone knows, in September 1989, the State of South Carolina was ravaged by Hurricane Hugo. The storm caused 29 deaths and an estimated $6 billion in property damages. Hugo, more than anything, revealed to us the importance of and the need for natural disaster preparedness and prevention programs.

I am glad that we are now considering our current national disaster policy and the potential need for reform measures. I commend Senator Inouye for his work on this issue. The committee has invited a number of witnesses who will provide very needed and helpful information. I thank them for appearing before the committee, and assisting us in our consideration of S. 1350 and related issues on national disaster policy.

Thank you, Mr. Chairman.

Senator INOUYE. Thank you, Mr. Chairman. I wish to extend my welcome to our witnesses today. And the committee looks forward to hearing your testimony on how our Nation's response to natural disasters can be improved. Like all of you here, I was disappointed to learn that representatives of FEMA and HUD are unable to testify today. However, it is my hope to obtain that perspectives on how to improve our Nation's response to natural disasters, especially in the wake of Hurricanes Andrew and Iniki.

I believe it is important that FEMA and HUD begin active dialog on this measure. And so I look forward to their participation at a subsequent hearing on this issue. Senator Pressler.

OPENING STATEMENT OF SENATOR PRESSLER

Senator PRESSLER. I shall be fairly brief, Mr. Chairman.

Thank you very much for holding this hearing. I want to place my statement in the record. But there are some questions that are of particular importance, and I am sure maybe the witnesses will address them.

I come from the State of South Dakota, which was devastated by continuous rainfall and flooding conditions during the past summer. How would S. 1350 address flood risks we will hear, I hope.

There is a question that we must ask concerning this legislation, if it could unduly burden the Federal Government at a time when we were in dire financial constraints. What are the financial aspects of this legislation regarding the Federal Government?

Taking into consideration the S&L crisis, is not this legislation possibly another bailout of an industry that is skirting the ragged financial edge?

However, on the other hand, how do we deal with this problem?

I am also concerned that citizens in low-risk States could pay an unfair share of the premium burden in comparison to the insurance benefit. And according to FEMA, and I hope they do testify, only 20 percent of the homeowners that have flood insurance actually have it. Why? Is it due strictly to the expense of flood insurance?

So, Mr. Chairman, these are just some questions that I am sure the witnesses will answer.

I want to thank you, because this is a very important bill. I am not yet a cosponsor, but I may well become a cosponsor. But I want to hear. And I have to go some place in about 10 minutes, but I am going to read the testimony very carefully.

[The prepared statement of Senator Pressler follows:]

PREPARED STATEMENT OF SENATOR PRESSLER

Thank you for holding today's hearing on the Natural Disaster Protection Act. As my colleagues know, our nation's midwestern states have had a very difficult year in terms of natural disasters. My home state of South Dakota is no exception.

Economists have projected that in terms of economic impact, South Dakota will be the state most affected by the midwestern flooding. At the same time, few South Dakotans were adequately insured to cover the flooding disaster. Therefore, I am particularly interested in efforts to meet the needs of the victims of natural disasters.

In my view, the unique needs of rural America must be considered carefully in any legislative proposals regarding natural disasters. While hurricanes and earthquakes are very serious disasters and receive considerable media attention, disasters that strike the midwest are equally as serious. Therefore, I will be particularly interested in learning more about how S. 1350 would affect rural states like South Dakota.

Again, thank you for holding today's hearing. I look forward to hearing from today's witnesses.

Senator INOUYE. I thank you very much, Senator.

The questions you have asked are foremost in our minds. And to prepare ourselves better, staff on both sides are now carrying on discussions with OMB and CBO and with HUD and with FEMA.

However, whether this bill becomes law or whether the status quo remains, the Federal Government will have to eventually get into the picture. It is either through some reinsurance program of this sort of Uncle Sam will continue to pick up a bulk of the tab, whether it be another Andrew or Iniki or Midwest floods.

I think it would be expecting a bit too much from our insurance companies to carry the full load, because we know it is not possible. And so what we are trying to do in this measure is to bring into the picture prevention. And, toward that end, we provide certain incentives. So, we will hear from the witnesses.

We have two panels today. Our first panel is made up of the commissioner of insurance of the State of Hawaii, Ms. Linda Takayama; the commissioner of insurance, the State of Louisiana, Mr. James H. Brown; and the director of the Pennsylvania Emergency Management Agency, Mr. Joe LaFleur.

Please step forward.

Welcome to the committee, Ms. Takayama. We are very pleased to have you here with us.

STATEMENT OF LINDA CHU TAKAYAMA, INSURANCE COMMISSIONER, STATE OF HAWAII

Ms. TAKAYAMA. Thank you, Senator.

I am Linda Chu Takayama, the insurance commissioner for the State of Hawaii. Fourteen months ago, Hurricane Iniki struck the Island of Kauai within our State and left $1.6 billion in insured losses, enough to be recorded, at that time, as the third most costly catastrophe in U.S. history.

For Hawaii, the storm is not yet over. In the months following the hurricane, insurance companies reevaluated their ability to cover the potential losses anticipated from the next hurricane and came up short. The result was massive disruption in the marketplace as companies began to withdraw.

Today, four major companies have gotten out of the homeowners' market entirely. Virtually all others have severely limited new applications or ceased taking them altogether. We estimate that the impairment to the property insurance market in Hawaii is currently running at about 33 percent.

Left to the private sector, we estimate that the impairment would deteriorate to about 60 percent of the market by the end of 1994.

Because of unusually severe catastrophes around the world over the last several years, insurance companies are reluctant to write policies in coastal localities. Unfortunately for us, Hawaii is viewed as 100 percent coast and 100 percent vulnerable to hurricane damage, although, except for Iniki, it has never been hit by a major hurricane.

The reasons for this reaction on the part of the insurance companies are varied and complex. One of them is reduced availability and high cost of reinsurance. The companies in our State are telling us that their reinsurance costs have escalated approximately 200 to 500 percent over pre-Iniki rates.

There is also increased scrutiny and demands by regulators and rating agencies to demonstrate financial solvency on the part of the companies. There is also concern about the inability of companies to establish their own catastrophe reserves due to Federal tax laws. And there are also certain disincentives to develop alternative financing mechanisms because of SEC and financial accounting standards.

Within its limited means, our State has taken action to bring stability and order to a fractured insurance market, including the enactment of legislation establishing a new hurricane relief fund that, for the very first time, limits the liability of companies for the hurricane risk. Through a complex system of new fees, industry assessments, financial lines of credit and higher rates, the fund intends to stabilize and regenerate the insurance market, and begin the buildup of a catastrophic reserve to pay for the next disaster.

As a regulator, I am torn between conflicting missions—the need to have insurance that is available and affordable to consumers while safeguarding the solvency of the company providing it.

Insurance policies are aleatory contracts. They are not worth the paper they are written on if the company behind them is not strong enough to pay off when the catastrophe hits.

It is for that reason that the continued financial strength of insurance companies is probably the most important consumer protection responsibility we State regulators have. It is also the most difficult to reconcile with the need to maintain insurance availability.

Without adequate insurance, homeowners cannot secure their biggest asset. Mortgage lenders will not provide them with the moneys to purchase homes. The real estate and development industries essentially come to a standstill. And the State economy is in jeopardy.

These are serious consequences that our State cannot ignore. Neither can the Federal Government. The strength of our Nation is the strength of the States. And there is no State in the Union today that can suffer a direct hit to a major population center without facing bankruptcy.

If that were to occur, Federal assistance would be necessary to provide the funding for the emergency needs, the physical reconstruction and possibly even the long-term hidden costs of recovery—benefits for unemployment, welfare, and Medicaid.

In every recent catastrophe, the Federal Government has stepped forward with emergency assistance. The establishment of a Federal program for natural disasters of all types would allow the creation of a reserve ahead of time to prepare for these catastrophes and avoid the multibillion dollar handouts that would otherwise be sought, and that we as a compassionate society cannot ignore.

As long as we are unable to control or even predict the whims of Mother Nature, it would be appear to be in the best interests of our Nation to plan ahead and prepare for the big one in a way that has the least impact on the Federal Treasury.

We in Hawaii urge your favorable consideration of S. 1350 as a responsible plan of action that buttresses local government and private sector efforts to provide an insurance solution to what could be financial ruin for many citizens.

Thank you very much.

I would be pleased to answer any questions you may have.

[The prepared statement of Ms. Takayama follows:]

Prepared Statement of Linda Chu Takayama

Mr. Chairman and members of the committee, 14 months ago Hurricane Iniki struck the island of Kauai and left $1.6 billion in insured losses—enough to be recorded at that time as the third most costly catastrophe in U.S. history. For Hawaii, the storm is not over yet.

In the months following the hurricane, insurance companies reevaluated their ability to cover the potential losses anticipated from the next hurricane and came up short. The result was massive disruption in the marketplace as companies began to withdraw. Today, four major companies have gotten out of the homeowners market entirely; virtually all others have severely limited new applications or ceased taking them altogether. We estimate that the impairment to the property insurance market in Hawaii at about 33 percent. If nothing further is done to alleviate the situation, we estimate that the impairment will deteriorate to about 60 percent of the market by the end of 1994.

Earlier this year when it became apparent that we were heading into an availability crisis in property insurance, our State took quick action by directing an industry funded and operated program, the Hawaii Property Insurance Association (HPIA), to provide homeowner insurance as a safety net to consumers across the State. HPIA was originally set up to provide property insurance only in the lava hazard zones near the volcano. Today, it has had to provide the coverage to more than 10 percent of the market.

The State also enacted legislation establishing a new Hurricane Relief Fund for the first time limits the liability of companies for the hurrican risk. Through a complex system of new fees, industry assessments, financial lines of credit and higher rates, the fund intends to stabilize and regenerate the insurance market in our State and begin the buildup of a catastrophic reserve to pay for the next disaster.

The fund may be able to pay for another Iniki. But it may not be able to pay for a bigger disaster—a direct hit on Honolulu. And it may not be able to pay more than once.

As a regulator, I am torn between conflicting missions: the need to have insurance that is available and affordable to consumers while safeguarding the solvency of the companies providing it.

Insurance policies are aleatory contracts and are not worth the paper they are written on if the company behind them are not strong enough to pay off when the catastrophe hits.

Therefore, the continued financial strength of insurance companies is probably the most important consumer protection responsibility State regulators have. It is also the most difficult to reconcile with the need to maintain insuracne availability. Without adequate insurance, homeowners cannot secure their biggest asset, mortgage lenders will not provide them with the moneys to purchase homes, real estate, and development industries come to a standstill and the State economy is in jeopardy.

These are serious consequences that our State cannot ignore. Neither can the Federal Government. The strength of our Nation is the strength of the States. There is no State in the Union today that can suffer a direct hit to a major population center without facing bankruptcy. If that were to occur, Federal assistance would be necessary to provide the funding for the emergency needs, the physical reconstruction and, possibly, the long-term hidden costs of recovery: benefits for unemployment, welfare, Medicaid.

In every recent catastrophe, the Federal Government has stepped forward with such emergency assistance. The establishment of a Federal program for natural disasters of all types would allow the creation of a reserve ahead of time to prepare for these catastrophes and avoid the multibillion dollar handouts that would otherwise be sought and that we as a compassionate society would be hard pressed to ignore.

As long as we are unable to control or even predict the whims of Mother Nature, it would appear to be in the best interest of the country to plan ahead and prepare for the big one in a way that has the least impact on the Federal Treasury. Hawaii urges your favorable consideration of S. 1350 as a responsible plan of action that buttresses private sector efforts to provide an insurance solution to what could be financial ruin for many citizens.

Thank you. I would be pleased to answer any questions you may have.

Senator INOUYE. Thank you very much, Ms. Takayama.

We will hear from the other members of the panel before we proceed with questions. May I now call on Mr. Brown.

STATEMENT OF JAMES H. BROWN, INSURANCE COMMISSIONER, STATE OF LOUISIANA

Mr. BROWN. Thank you, Mr. Chairman.

Mr. Chairman and Senator Pressler, I appreciate the opportunity. I am Jim Brown. I am the commissioner of insurance in the State of Louisiana.

I have submitted very detailed information about both our State and the gulf coast that will be part of your record. It lays out in detail the problems of the past and an evaluation of your bill, that we very much support.

Senator INOUYE. Your full statement is made a part of the record.

Mr. BROWN. Excuse me, sir?

Senator INOUYE. Your statement is part of the record.

Mr. BROWN. I would like to make a few personal observations, if you would allow me to do so. I have been an elected official in Louisiana for 23 years, and have lived through a number of natural disasters down that way. In the past, when the storms came in, Senator, as happened in your State, we would move inland, batten down the hatches, and deal with the $50 to $100 million hit that would take place in our State through the insurance that we purchased, some Federal help, and some State help.

That has dramatically changed in just the last several years. You mentioned Hurricane Andrew. Hurricane Andrew hit Louisiana but it missed our most populous areas. It was, from our point of view, a minor hit compared to years past. And yet, we suffered losses approaching $1 billion.

So, times have changed. Weather experts are telling us now that hurricane activity and intensity on the gulf coast are going to increase very dramatically.

The U.S. Corps of Engineers in New Orleans, gentlemen, have a model of the Mississippi River and can predict what could happen in a New Orleans situation. They do not talk about if it happens, they talk about when it happens. Based on their projections of weather changes, they are saying there is a possibility of 26 feet of water in downtown New Orleans.

So, you can imagine our concern and the concern of numerous insurance companies that are trying to protect themselves from insolvency in the months and years to come.

Like a number of other States we are dealing with our own problem. We have a FAIR plan for our cities. We have a coastal plan to deal with a number of coastal areas. Through these plans we have increased the amount of coverage available. We have included a hail and wind wrap-around policy. We have done quite a bit in the last several years to take care of our own problems.

We are looking very closely at what Florida just did last week. I am referring to their catastrophic fund. Hopefully we will move in that direction, within our State, to take care of those needs at that secondary level.

I met Monday in New Orleans with legislators from about 14 States to consider an interstate compact. We are spending a great deal of time looking at such a compact, particularly in the gulf coast area, where we can pool our resources to effectively deal with reinsurance problems at an intermediate level.

But no matter how much we do, the umbrella is just not wide enough. We just cannot do it alone. We just do not have the capacity. And, therefore, the appeal of S. 1350 is of great interest to us, because it gives us that broad protection we need when that big catastrophe that has been projected happens.

Companies are leaving Louisiana now. We do not have the problems we found, Senator, in your State or in Florida. But we are seeing more and more companies leaving us. Availability and affordability are the next big crises we have in insurance in the State of Louisiana today.

As far as the bill specifically, we are very encouraged, in reading over the bill, Senator, by your efforts to include mitigation and the building code provisions to put the buck back on States to increase dramatically the quality of building. We think that could go a long, long way in mitigating damages.

Senator Pressler, that is a tremendous stick and carrot over our heads, and even a hammer over our heads that, quite frankly, we need to increase the quality of building that will help mitigate some of the huge wind-related losses.

I think, as my distinguished colleague from Hawaii said earlier in her comments, that we will either pay now or pay later. And by paying now, it will be those of us affected paying into this fund and not the Federal Government bailing us out.

We want to do it ourselves, but we need some help. We are very supportive of your bill, Senator, and we really appreciate having the opportunity to come here to testify today.

[The prepared statement of Mr. Brown follows:]

PREPARED STATEMENT OF JAMES H. "JIM" BROWN

Louisiana is faced with serious availability and affordability issues due to Hurricane Andrew. However, Andrew was only a preview of the potential mega-disaster that I fear will some day hit a highly vulnerable New Orleans, or similarly situated coastal areas in other parts of the country. Unfortunately the question is not if, but when.

Are we prepared for a direct hit on Miami or New Orleans? The cost of Andrew to Louisiana, which generally hit the less populated areas of the state, was $1 billion, compared to the possible $25.6 billion in damages that a full force hurricane could cause with a direct hit on New Orleans.

Fortunately, our problems caused by the recent hurricane are not the monumental problems faced by either Florida or Hawaii.

If Andrew's landfall were a mere 40 miles to the east, over New Orleans, Andrew, a class 3 hurricane, could have caused over $14 billion in loss to Louisiana properties. That's 20 times the total of all property premiums written in Louisiana last year. And over 100 times that portion of property premiums allocated to catastrophic loss. (The $25.6 billion damage estimate is based on a direct hit by a class 5 hurricane on New Orleans.)

Do you think insurers would stick around after a beating like that? I don't think they would either. If insurers are two-stepping out of Florida's $3 billion property market there would have been a Cajun stampede out of Louisiana's property market.

This bleak outlook is not that far off according to hurricane experts. Scientists predict that it is not a matter of if but simply a matter of when.

It has become glaringly apparent that we regulators have failed to address the intrinsic dangers of natural disasters which await the property insurance industry. In Louisiana we are faced with severe market disruption due to $1 billion in Hurricane Andrew losses. Compare that to the disruption faced after Hawaii's $2 billion in Iniki losses or Florida's $16 billion in loss due to Andrew * * * and there is always the "BIG ONE" yet to come.

The issue is universal, affecting all states and covering all catastrophic perils whether hurricane, earthquake, flood, or wind & hail. Senators, there is no better time than now to enact sound legislation which will reduce loss of life and property, and effectively avert this unnecessary market chaos.

In 1992 we learned that * * *

- Good building codes aren't worth the paper they're printed on unless adequately enforced.
- A competitive market can naturally lead to unhealthy concentrations of business in catastrophe-prone areas.
- The current reinsurance market in US coastal areas has lower than anticipated capacity, no matter what the price.
- The insurance and reinsurance industries are prone to knee-jerk reactions which cause extreme and wide-spread market disruptions, e.g., affordable property insurance is no longer an available option for many of our citizens.

It has been more than one year since Hurricane Andrew struck its record shattering blow and we are still scrambling to find insurance markets once available and now gone. The complex culmination of 1992 catastrophic events has kept many Louisiana property owners, and even purchasers of non-property insurance, in the extremely uncomfortable position of not being able to adequately protect their homes and businesses at an affordable price. As regulators we must do everything we can to ensure that our citizens can find and afford the required protection they need.

In Louisiana, we are painfully aware of the disruption which is attributable to natural disasters. These events affected Louisiana policyholders, the agents who service these policyholders, and the insurers and reinsurers, both big and small alike, who provide the peace-of-mind we all have come to depend on.

I'd like to share with you information regarding the effect of Hurricane Andrew on Louisiana citizens and businesses. In Louisiana the post-Hurricane Andrew profile looks like this:

- Insurers collected approximately $700 million in property premiums. An estimated 20 percent of these premiums are earmarked for catastrophe related loss, or about $140 million.
- Louisiana experienced $1 billion in Hurricane Andrew related losses.
- Louisiana experienced no (0) insolvencies attributable to Hurricane Andrew.
- One (1) insurer has notified the department of partial withdrawal from the coastal Louisiana market due to its experience with Andrew.
- All insurers have re-thought market strategy and are reducing their Louisiana hurricane exposure by correcting geographic concentrations of business * * * they are diversifying their books of business.
- As existing insurers reduce writings, insurers with little exposure in the hurricane tier flatly are not entering the property market to pick up the slack.
- Increased costs to the property policyholders of Louisiana attributable directly to Hurricane Andrew are in the +5 to + 15 percent range.
- Increased costs to local insurers for reinsurance directly attributable to the aftermath of Hurricane Andrew have been reported as high as +300 percent.
- All increases in operating costs, direct or indirect, are passed along to Louisiana policyholders making insurance less available and less affordable through conventional means.
- Many Louisiana agencies are loosing significant amounts of revenue when their traditional carriers refuse to renew business or accept new business; loss of revenue roles over from property to other lines.
- The Louisiana joint House/Senate Insurance Subcommittee heard testimony last week from a score of agencies, some seeing the number of insurers willing to take property business drop from twelve (12) before Hurricane Andrew to none (0) post-Andrew.
- The strain on the voluntary market has put the involuntary markets in the spotlight. Coastal and FAIR Plans have seen growth in the year since Hurricane Andrew of up to +200 percent; these Plans have become the primary market for many coastal properties rather than a secondary market. The Coastal and FAIR Plans have served Louisiana by providing badly needed insurance for property unable to fit within the voluntary market, but are not designed to serve our policyholders in the manner a healthy, competitive market can.
- Exposure to the hurricane peril is great. 40 percent of all Louisiana properties are located in 10 coastal Louisiana parishes. Hundreds of thousands of properties are situated below the 1-10 corridor, a so called hurricane tier for the insurance industry. Approximately 60 percent of Louisianans live below this 1-10 line. These distributions are not a recent growth phenomena, but have existed for years.
- Recent scientific studies project losses from future hurricanes exceeding $25 billion at numerous locations in Louisiana.
- Leading meteorologists predict a sharp rise in the number and severity of hurricanes over the next decade. It is not a matter of whether a level 5 hurricane will pass over New Orleans, but a matter of when.

Over the next few months there will continue to be upward pressure on property insurance premiums. I expect to see Louisiana property insurance rates rise, particularly in the coastal parishes. Many carriers will raise rates because of increased pricing loads based on their own catastrophe experience in Louisiana, because of increased reinsurance costs, and because revised rating plans will recognize increased exposure due to hurricane in the coastal parishes. All these reasons are driven by the new awareness wrought by Andrew. My staff is very sensitive to these driving forces and will prevent any increase which is a knee-jerk reaction or not supported by hard data and sound actuarial analysis.

It is my position that proactive efforts on the part of regulators and the insurance industry will best serve the interests of our citizens. We legislators, regulators, and the industry can improve the stability and effectiveness of the insurance mechanism by preparing for the future. By Senate Bill 1350 you are demonstrating foresight and helping us states prepare for the next inevitable catastrophic event. I and my fellow insurance departments applaud you for your efforts.

No matter the solution we may choose to follow, it must meet these five objectives:

1. Maintain the solvency of insurance companies writing property insurance and exposed to catastrophic perils.
2. Ensure the availability of adequate coverage no matter what magnitude natural disaster occurs.

3. Maintain affordable catastrophic coverage.
4. Provide a fair premium for catastrophic coverage on the basis of sound actuarial analysis.
5. Reduce the frequency and severity of loss due to catastrophic peril through sound mitigation, prevention, and emergency efforts.

Though over simplified, we have two options in dealing with catastrophic issues:

1. Be passive and do nothing. Let the insurance industry adjust to the post-Andrew market realities and find a new equilibrium with new market rules. Historically this has worked over and over, but it has not always been in the public's best interest. As with Andrew, there has been a great deal of discomfort resulting from the inevitable market disruptions. As regulators we would like to better protect the policyholder from the turmoil of severe market disruptions and market inefficiencies.
2. Be pro-active and make changes which will permanently improve the effectiveness and efficiency of the insurance market. This path suggests that we have learned from history and apply what we've learned to improve our environment so that certain are less likely to repeat. There are various ways this can be done, but all involve the cooperation of government, regulators, and the insurance industry. Senate Bill 1350 is a good solution along these lines.

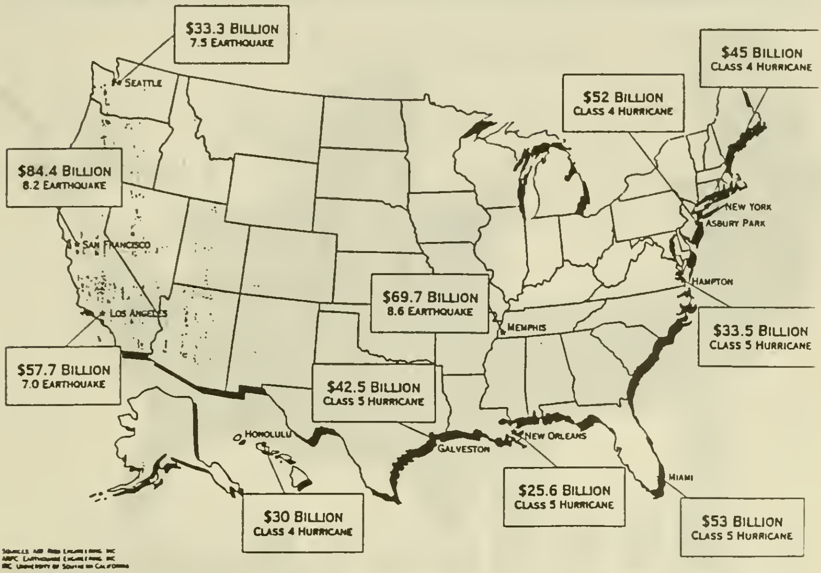
It is my opinion that a key element to any workable program involves a form of Federal reinsurance. This is because the catastrophe issue is bigger than just the hurricane problem we have in Louisiana. It includes exposure to hurricane, earthquake, flood, or windstorm found in every state. We are not asking for a handout, but assistance in paying our own way.

To demonstrate our commitment, NAIC formally and unanimously adopted a resolution to conceptually acknowledge the need for Federal assistance to address the issues we are discussing here today regarding natural disaster relief. Senate Bill 1350 is a good example of preventive legislation which provides neutral assistance to the States and its citizens. This bill addresses the catastrophe issues by eliminating or reducing the causes of market disruption through three types of programs:

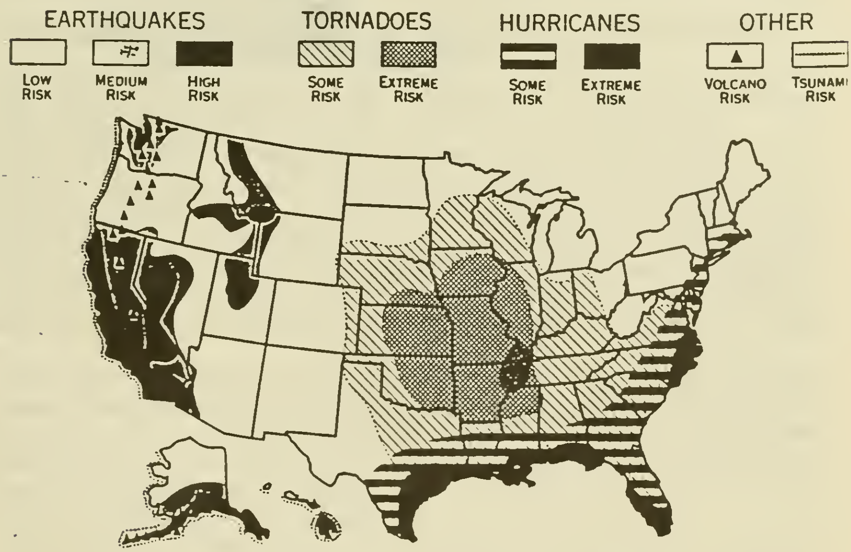
- It ensures that sound mitigation and prevention measures are put in place and enforced. A prime example of such measures are sound building codes which are enforceable and with specific provisions to withstand catastrophic winds.
- It provides sufficient capacity to the insurance industry to avoid the extreme market disruption attributable to accumulated catastrophes over short periods of time. It has become painfully apparent that existing insurance capacity and the existing insurance mechanism can not effectively or efficiently handle the BIG One. Because such capacity will require potentially many billions of dollars, it is our opinion that only the Federal government can readily fill this role. I'd like to point out an important characteristic of this program, and that is that there would be no cross-subsidization, i.e., policyholders who benefit from Federal coverage must pay their own way.
- If the insurance industry with the Federal reinsurance coverage still can not provide a stable and effective insurance market, the individual states along with the insurance industry (individually or jointly) should provide an intermediate layer of reinsurance. The purpose of this layer is to meet the individual needs of each state and ensure that no market disruption would occur no matter what magnitude catastrophe. It is in this intermediate layer that local availability and affordability issues would be addressed.

In summary, it is my belief that reducing market disruption due to catastrophic events for Louisiana policyholders means reducing or removing the risk faced by insurance carriers due to the catastrophe exposure on a national basis. To accomplish this end requires federal government, state government, local government, and the insurance industry to work together and change how the insurance mechanism protects our policyholders from catastrophic events. I encourage this Committee initiative in addressing these difficult issues and am willing to work with you in all possible ways to improve the effectiveness and efficiency of our insurance system. In my opinion, the bill before you, S.B. 1350, will go a long way toward rectifying the catastrophe dilemma this nation faces today.

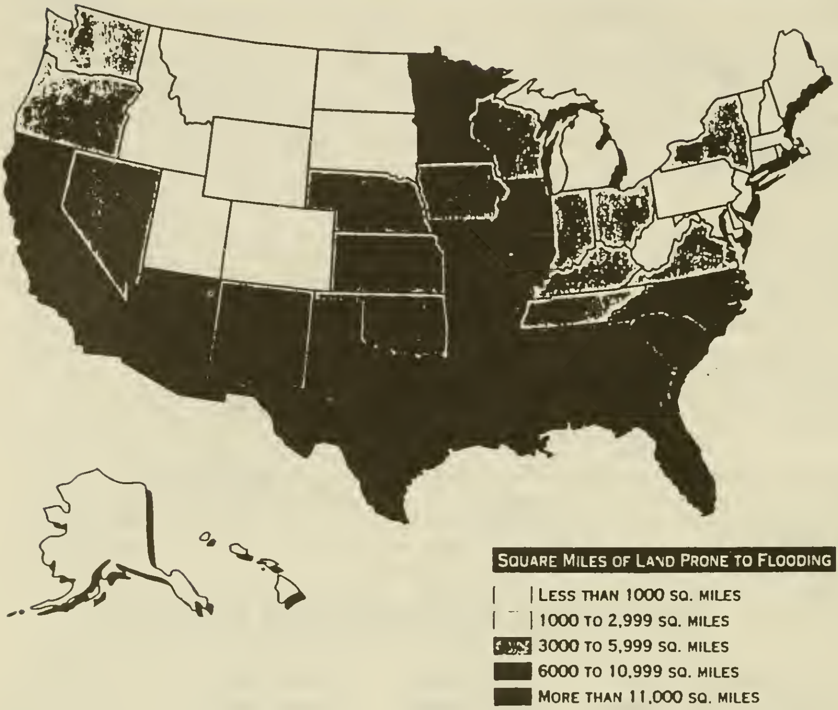
PROBABLE COSTS OF FUTURE NATURAL DISASTERS



NATURAL DISASTER RISK PROFILE

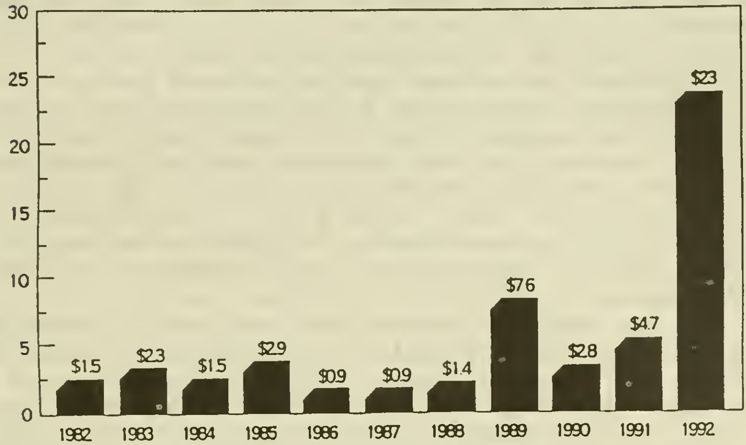


FLOOD RISK IN THE UNITED STATES



THE RISING COST OF NATURAL DISASTERS IN THE UNITED STATES

($ BILLIONS)



Senator INOUYE. Thank you very much, Mr. Brown. Mr. LaFleur.

STATEMENT OF JOE LaFLEUR, DIRECTOR, PENNSYLVANIA EMERGENCY MANAGEMENT AGENCY

Mr. LAFLEUR. Thank you, Mr. Chairman and Senator Pressler. I appreciate the opportunity to testify before your committee.

I am here as a representative of the National Emergency Management Association, an organization of the State Directors of Emergency Management. On behalf of NEMA, I would like to commend you for your leadership and your cosponsors for their vision in recognizing the need to formally adopt mitigation as an endorsed approach to hazard management, one that links the availability of insurance with a commitment to reducing risk from natural disasters.

Mitigation should no longer be a stepsister to her three siblings, already recognized by this Congress in policy, of preparedness response and recovery. Senator, in the interest of time, I would like to summarize a few of my remarks and ask that you include my formal testimony in the record.

Senator INOUYE. It will be done.

Mr. LAFLEUR. Thank you.

You might not have expected Pennsylvania to be here today to talk about catastrophic disasters, but I would just remind people of their history; that prior to the disasters of the last 5 years, the largest hurricane losses ever suffered by a single State in the United States was Pennsylvania in the aftereffects or during the effects of Hurricane Agnes.

It was not a storm that hit direct on the coast, as Pennsylvania has no direct coastline, but in fact came up from the gulf coast, all the way up the Alleghenies, and rained and rained and rained on us until we had such floods that the numbers of people who were handled are actually, by individual assistance and Federal programs, were exactly akin to the kinds of numbers that we saw in the four counties in Florida, and the situation in Louisiana. I have visited with your colleagues extensively from Hawaii and had some of them come and speak to my county emergency management directors about what had to be undertaken in Hawaii.

So, Pennsylvania has suffered multibillion dollar losses, in 1972 dollars, at that point in time, and it is of great concern to us. Further, we have had insurance companies as small mutual companies that perhaps were on a regional basis or a multicounty basis, who have not gone out of business because of disasters, but who have been so weakened that over a period of time, eventually went out of business after some tornadoes in 1985 that we had that went through the Erie and northwestern sections of Pennsylvania. They killed 85 people.

And I realize that this bill would not necessarily touch all of those kinds of situations, but I tell you that the same symptoms are present. And the same kinds of history is available to you as you look back further into the records and the history. After Hurricane Agnes, Congress passed a series of disaster laws, and actually, the foundation of what we as emergency managers now deal with for recovery, the Stafford Act, was formulated back in the seventies, after the Congress decided to react to Hurricane Agnes.

So, Pennsylvania is very interested in this situation. We are very much a part of that history. And my most significant concern in this bill is the mitigation section. We need a long-term mitigation program that has the vision of Congress, the leadership of Congress and, in some cases, the kick in the pants from the Congress to make us move forward on this commitment. We need that long-term effort. We need your leadership. Because without it nothing will happen for a long time.

We are 1 of 10 States that does not have a uniform building code, as was mentioned a few moments ago. Building codes are very spotty across our commonwealth. The bill that you have introduced, I think, will take a look at the lack of incentives and why we are not pursuing hazard mitigation.

I think it will introduce the issue of a technical capacity if we implement the legislation. The funding to the States that would be provided on an annual program basis will help us. We need that. Besides just response and recovery funding. But mitigation is only done when we have time to get around to it. And we do not have the people to put into that kind of program.

Right now we have a diffusion of responsibility for mitigation. The Government, the lenders, the developers, the professional associations, and the general public cannot seem to figure out who should be fostering a cohesive strategy for mitigation.

Again, in Pennsylvania and 10 or 12 other States, the voluntary nature of our building codes is a factor. And, really, the carrot-and-stick issue that Mr. Brown mentioned is important, because, really, there is a lack of disincentives for us to deal with and adopt mitigation measures.

So, I endorse your change. The National Emergency Management Association believes that your concepts and your approach are very important, and it will aid in the true comprehensive emergency management program that the National Governors Association determined was their policy back in 1979 when FEMA was formulated.

We hope that FEMA, as a newly energized and reorganized Federal organization will provide us leadership. It is to our chagrin in some cases that the Congress and others continue to shrink FEMA. It is down to about 2,000 people. We are not sure that that allows it the capacity to do what it has to do, at least under the disaster circumstances that we have seen in the last few years.

And your bill would certainly go a long way to creating a foundation in that arena.

Mr. Chairman, Senators, I appreciate your efforts in this approach. It is not only in the insurance section, which we also support, but very strongly support the mitigation section as well.

Thank you for the opportunity to make comments.

[The prepared statement of Mr. LaFleur follows:]

Prepared Statement of Joseph LaFleur

Thank you, Mr. Chairman, for the opportunity to testify before this committee on the need for natural disaster mitigation legislation.

I am here as a representative of the National Emergency Management Association (NEMA), an organization of the State Directors of emergency management. On behalf of NEMA, I would like to commend Senator Inouye for his leadership—and vision—in recognizing the need to formally adopt mitigation as an endorsed approach to hazard management—one that links the availability of insurance with a commitment to reducing risk from natural disasters. Mitigation should no longer be a stepsister to her three siblings already recognized by the Congress—Preparedness, Response and Recovery.

SCOPE OF THE PROBLEM—AND CHALLENGE

A convincing argument can be made that our nation is more vulnerable than ever before to the all too familiar consequences of natural disasters. Images of flood victims, hurricane victims, and earthquake victims are imprinted on our national consciousness; virtually everyone in this chamber knows someone whose life has been touched by disaster.

Statistics confirm the trend of escalating costs associated with disaster response and recovery. A multi-billion disaster is no longer an aberration, but rather the norm. Hurricane Andrew, alone, caused an estimated $18 billion in insured losses. The social costs and indirect economic losses are more difficult to measure, but are considerable. The six-o'clock news is rife with these stories.

The trend of escalating losses will continue, unless there is a dramatic form of intervention in our current practice of responding to the consequences of disaster, as opposed to anticipating the consequences of disasters—predictable consequences.

Communities that are experiencing the most rapid economic growth—particularly along the coastal areas of our nation—are also among the most vulnerable to disasters. As we speak, building permits are being issued for disaster prone areas; design and construction practices that do not incorporate hazard protection features further exacerbate the problem.

Finally, our population itself is more vulnerable to disasters than ever before. Our society is mobile, aging, and increasingly diverse in ethnic composition. The "special needs" groups—the elderly, the poor, the homeless, the handicapped—have enough difficulty coping on a day-to-day basis. Disasters place an additional burden on these groups—and local government services. Response and recovery staffs are small. They are stressed like never before at the municipal, county, state and Federal Emergency Management Agency (FEMA) levels.

In essence, the problem of escalating vulnerability to disasters is multi-faceted. It has cultural overtones; we have a frontier heritage that reinforces one's right to develop—within reason—where and how one chooses. It has political overtones; local government is often reluctant to impose land use and building restrictions. It has social and economic overtones; our nation is quick to help those in need. Disaster relief is always forthcoming. There is little incentive to undertake measures to minimize the consequences of natural disasters.

In this broad context, the challenge is to develop a national mitigation strategy that outlines a community based, incentive driven program that will systematically reduce the vulnerability of our nation to hurricanes, earthquakes, fires, floods, and other natural and technological hazards. To be successful, this strategy must address at least five interrelated, well documented barriers to adoption and implementation of mitigation:

1. *Lack of incentives to pursue hazard mitigation.* Hazard mitigation lacks a broad-based political constituency. Local officials are faced with immediate, pressing problems and priorities; mitigation is a long-term proposition, the benefits of pursuing mitigation are not well understood nor appreciated. We need a vision from the Congress.
2. *Lack of technical capacity to implement mitigation.* Mitigation can be a complex undertaking, involving multiple disciplines and multi-jurisdictional coordination. Many communities simply lack the technical and organizational capacity to implement meaningful mitigation measures. This bill would provide emergency management infrastructure funds for dedicated program time. Not in the vein of; when we can get around to it between response and recovery.
3. *Diffusion of responsibility for mitigation.* Responsibility for mitigation is shared among a broad range of groups—government, lenders, developers, professional associations and the public—this diffusion has served as an impediment to the development of a cohesive program and strategy to foster mitigation.
4. *Voluntary nature of building codes and other mitigation measures.* With few exceptions, mitigation is a local responsibility, and adoption of mitigation measures is largely voluntary. This legislation puts all states on a level playing field.
5. *Lack of disincentives to adopt mitigation measures.* Time and again, State and local government are provided with Federal disaster assistance following a declared disaster. Seldom is a community penalized for failure to adopt pre-disaster mitigation programs; it has not been in our political will or legislative agenda; until now. When we the taxpayer reward do-nothing hazard management there is no reason for good management. This must change.

NATURAL DISASTER PROTECTION ACT: A COMPREHENSIVE APPROACH TO THE PROBLEM

The Natural Disaster Protection Act (S. 1350), introduced on August 4, represents a comprehensive approach to overcoming the barriers to which I have alluded, and can be a major vehicle for implementing the Administration's proposed national mitigation strategy.

The concepts of S. 1350, which have the support of NEMA—and a broad and diverse coalition of other affected parties. It links the availability of primary hazard insurance with improved hazard mitigation and emergency management. It also provides for an industry-financed reinsurance program. Following is an overview of how S. 1350 can substantively address many of the recurring problems associated with reducing losses from disasters throughout the nation.

IMPROVED HAZARD MITIGATION AND EMERGENCY RESPONSE CAPABILITIES

The tools and techniques to reduce the impact of disasters—e.g. building code adoption and enforcement, siting, design and construction practices that incorporate mitigation features, etc.—have proven to be effective when consistently applied. What has been lacking is consistent, programmatic financial incentives and sustained political will.

The Natural Disaster Protection Act addresses these fundamental issues with a "carrot and stick" approach.

The "carrot" is a self-sustaining fund, which would be financed by a set aside of funds collected under the primary insurance and reinsurance programs of the bill, that could be used for mitigation. The trust fund, by some estimates, could over time apply hundreds of millions of dollars to mitigation. Not hundreds of millions of dollars to response and recovery after homes, lives and communities are broken.

The "stick" is a State compliance provision that outlines criteria for participation in the program, including the requirement that States adopt and enforce applicable building codes, as set forth in a five-year State Mitigation Plan.

On balance, S. 1350 provides a structured, but flexible framework for States to develop and carry out their own programs to effectively reduce the vulnerability of their communities to natural hazards. On the surface, the bill incorporates four key variables that are essential to achieving meaningful, measurable progress in risk reduction: 1) Sufficient funding to generate and sustain State administered mitigation programs; 2) Program standards (e.g. adoption of a State mitigation strategy, with clear goals, objectives, and standards for compliance); 3) Incentives (e.g. availability of funds to improve mitigation and emergency response capabilities); and 4) Disincentives (e.g. States or their subdivisions that do not participate in the mitigation program may not be eligible for certain categories of federal disaster assistance.

The bill will also facilitate the development and implementation of a national mitigation strategy. As called for in S. 1350, each State is required to establish mitigation priorities under a five-year plan; administer State mitigation grant programs; and monitor progress under the program. The bill, in effect, should serve as a catalyst, a raison d'etre if you will, to bring together the key State agencies and institutions that have a role in mitigation, preparedness, and response. In the process, the program should bring focus, cohesion, direction, and a coordinated approach to risk reduction activities.

IMPROVING STATE AND LOCAL EMERGENCY RESPONSE CAPABILITIES

The Natural Disaster Protection Act also provides an unprecedented opportunity to improve the "State and Local emergency management infrastructure" (personnel, computer communications, warning, and other components of an emergency management system that has heretofore been left adrift) in a balanced, State administered program that addresses all hazards in all four phases.

Previous disasters have underscored the need for an effective and timely emergency response capability. While the consequences of disasters are largely predictable, there are still significant gaps in what we know about disasters, and our abilities to respond and recover in a timely manner. With a newly energized and reorganized FEMA in a leadership role although much to our chagrin and need the Congress continues to shrink FEMA, many states would like to "retool" their emergency management systems. S. 1350 can accelerate this effort. The product should be a State administered mitigation and emergency management system that: 1) anticipates the consequences of disasters; 2) sets forth a five year program for reducing the effects of hazards; 3) establishes and sustains a response capability for worst case scenarios; and 4) establishes and sustains a predisaster program that addresses recovery problems and issues.

Mitigation is the long-term answer to reducing a community's vulnerability to natural disasters. Experience shows that in the short-term, a strong emergency management program can expedite the recovery process through pre-disaster coordination.

EXPANDED PRIMARY INSURANCE

The availability—and purchase—of affordable primary insurance on a widespread scale is the key to the short and long-term viability of a federally backed insurance and mitigation program for our nation.

Affordable hazard insurance—with premiums based on actual risk—is an essential component of a national mitigation strategy. However, the availability of insurance must be accompanied by: 1) State and community compliance with building codes and other mitigation measures; and 2) responsible action on the part of individual homeowners to protect their property from natural hazards. We saw an example of this recently in the California fires. If you cut the bush away from your home there was a chance firefighters could save it. No mitigation—no chance.

REINSURANCE PROGRAM

The National Emergency Management Association supports the provision of the bill that calls for the creation of an industry-financed national catastrophic disaster reinsurance program. This fund would provide a source of insurance which insurers could purchase to better manage the risk from infrequent, but extremely costly disasters. As proposed, the re-insurance would only be available after the private insurer or state insurance program had paid substantial multi-billion dollar losses.

One of the bi-products of the federal reinsurance program is that it will discourage insurers from withdrawing from disaster-prone regions, as is occurring in Florida and other high risk, coastal states. While state insurance pools, such as the one in Hawaii, are innovative initiatives, the fact remains that the marketplace capacity is not adequate to effectively cope with a catastrophic disaster that causes upwards of $30 to $50 billion.

Finally, the Natural Disaster Protection Act will have a significant long-term impact on reducing federal (and thus taxpayer) outlays for disaster assistance and recovery. The current reliance on federal disaster aid could be rendered supplementary to risk based insurance except for the most needy, in the long run. That is a more fair situation for all taxpayers.

Furthermore, the mitigation component of the bill should, in the long-term, result in a significant reduction in property damages and economic losses from a disaster. One of the clear lessons from recent disasters: building codes and other mitigation measures can pay dividends in the aftermath of a disaster in reduced property damages and economic losses. When insurance and mitigation programs are in force the recovery process is expedited.

SUMMARY

The trend of escalating costs of disasters is unmistakable. The causes are equally apparent; development continues at an unabated pace in disaster-prone areas of our nation. A bold, Congressionally led innovative approach is needed to address a problem that is so complex and multi-faceted.

The Natural Disaster Protection Act embodies an equitable, balanced, comprehensive approach to reducing the vulnerability of our communities to a broad range of natural disasters. In the final analysis, progress in the next several years in reducing the toll of disasters will be a function of how successful we are at integrating the principles and practice of hazard mitigation into the mainstream of community decision-making.

The National Emergency Management Association supports the efforts of and applauds the leadership of Chairman Inouye, this Committee, and the many co-sponsors in its pro-active efforts to make our nation safer from natural disasters.

Thank you Mr. Chairman. I would be pleased to answer any questions the Committee may have.

Senator INOUYE. All right. Thank you very much, Mr. LaFleur.

The question that Senator Pressler asked in his opening remarks is one that most of my colleagues are asking: What will it mean to the National Treasury? What impact would it have on our taxpayers?

I am certain it is not possible at this stage to make a definite assessment of the impact this measure will have, but making a few assumptions, if the mitigation provisions were in place and being implemented and the bill, in general, was the law of the land, what impact would it have had on the cost of Andrew? Can anyone give some assessment?

Mr. Brown.

Mr. BROWN. Senator, before I answer that, would you tell Senator Breaux that I gave up my 5 minutes on this testimony and praised him as to what a great Senator he was, since he is my Senator from Louisiana. He missed those comments. [Laughter.]

I have seen figures affecting the coastline of Texas, in particular, showing that if stronger building codes were in operation in that State, that you might have seen losses 70 percent less in many instances. After I saw that in Texas, we began a study in Louisiana to see what, in the case of Andrew, would have occurred with stronger building codes. I think that figure is 50 to 60 percent or less loss when the proper building codes are in effect and roofs are built like they should have been built.

You know, once the roof goes, all of a sudden you go from some minor repair to almost a complete loss in so many instances. So,I think that the amount of loss reduction is going to be sizable, although I do not know of any definitive studies over the whole area. But there should be a sizable impact if strong building codes had been in effect and enforced.

Senator INOUYE. Ms. Takayama, would that be the same for Iniki, if we had a strong building code in place?

Ms. TAKAYAMA. That is absolutely true. I think that is correct. Hawaii, like many other States, is a little bit behind in their adoption of or enforcement of the latest building codes that have been promoted by the State emergency managers. And, as you know, in Hawaii in particular, because of our climate, the typical house is a light frame structure, as opposed to, the concrete bunkers you see on Guam, for instance.

That is the solution they have gone to in order to protect themselves against the typhoons that occur there with some regularity.

There are ways, the structural engineers tell us, that even wood frame houses can be constructed to withstand hurricane-force winds. And that is something we need to look at. In conjunction with that, I believe very strongly that hazard mitigation also needs to include some responsible development plans.

We have allowed, in the past, building right up to the shoreline. Obviously, you are asking for trouble when that occurs. And we need to take a closer look at whether construction ought to be allowed right on the shoreline or, in recent history, in the path of a volcano.

Mr. BROWN. Senator, if I could pick up on that.

Senator INOUYE. Sure.

Mr. BROWN. You asked about cost. Senator Pressler raised that question and it is a very valid question. Senator, as we read the bill, the funds should come in at a rate that, over a number of years, would fully pay for the cost of this reinsurance. There, hopefully, would be no impact on the Federal Treasury.

I think the second part of the question you asked, though, was whether there is fairness across State lines? As the bill reads, it is a voluntary decision by a company to use this mechanism. But, say State Farm does use this mechanism, then for people in South Dakota, part of their premium would be used in this overall plan.

So, what you have got to decide is whether there is enough fairness in the bill for the people in South Dakota, who may not significantly benefit from this particular program. First let me point out that the people in South Dakota would pay a little bit of their premium, proportional to their derived benefits, into the overall plan. Second, they are probably paying too much now, as Linda said, through the general taxes they are now paying.

And as Senator Pressler commented when we include the flood peril, this could be a viable plan to be put in use in virtually every State in this country.

Ms. TAKAYAMA. The bill also provides that there would be actuarially based rates, dependent upon the kind of risks to which the particular State is exposed. So, conceptually, as part of the bill, only those States that are vulnerable to certain risks pay the additional premium, commensurate with that risk.

I would also note that under the concept of this plan, it really is a prevention measure to begin building up a catastrophic reserve out of private sector moneys to pay off the next disaster.

In the alternative, I feel very strongly that the Federal Government will be prevailed upon to provide disaster assistance, as they have in the past. Under this bill, even if that is required, if the catastrophe hits early, there is not enough money in the reserves, under this bill, the program can borrow money from the Treasury, but it gets paid back.

Mr. BROWN. With interest.

Ms. TAKAYAMA. And that is not the case today.

Senator INOUYE. Mr. LaFleur.

Mr. LAFLEUR. Thank you, Mr. Chairman.

One of the things that will be important to a Senator from Nebraska or a Senator from South Dakota is the point that in the Stafford Act—and the Congress agonized over funding for the Stafford Act, just before you went on your last recess, to appropriate some more money on the public assistance side, not the individual assistance, but the public assistance to the tax-supported roads, bridges, highways—of some sort and public buildings. Once the mitigation program and provisions of this bill kicks in, it will reduce the impact of the smaller disasters that do not reach the thresholds, the catastrophic thresholds that are talked about in this bill on the insurance side.

So, whether you are in Montana or Pennsylvania or Texas, you are going to be gaining over a period of time, because we will be strengthening those structures, we will be putting flood walls or retaining walls around sewage treatment plants. We saw the difficulties they had in Iowa in the Midwest floods, around the water treatment plants.

Pennsylvania has 45,000 miles of waterway. Most of our water that we take for drinking water is surface water. So, most of our treatment plants, most of our water intakes are along our waterways. So, if I can begin projects over a number of years, in a consistent, predictable program to build walls, flood walls, or to move them, to elevate them, I will not be coming, I hope, in the sense to my delegation and to the Treasury, and saying we need another $1 or $2 or $3 billion, as this Congress had to do again and again through the Midwest flood process.

So, it is not just the catastrophic effect; it is day to day to day, a big State, a small State, whatever.

Senator INOUYE. My final question. In situations such as this, it is very difficult to ask our people to voluntarily carry out the program, so we have incentives. Are the incentives set forth in this bill sufficient?

Mr. LAFLEUR. For mitigation, Senator?

Senator INOUYE. Yes.

Mr. LAFLEUR. I think from the perspective of 1 of those States that is in that unfortunate 10 or 12 that do not have building codes on a statewide basis, or at least a minimum code, as most States have, I have to answer in the affirmative. To get us on board and within the 5-year time line, as it is shown by the bill, and to have a mitigation strategy in every State, and to have a comprehensive view of that by the Federal Emergency Management Agency in this case, as it has been designated, I think does nothing but point out to people that you ought not to live along the coastline. You ought not to live along this waterway that every 100 years or less floods again and again. Or that our planning commissions, our zoning boards, and our insurance industry should say, if you are going to live there, it is going to cost you more. We cannot keep going back there.

So, from a management perspective, an organizational perspective, and an incentive perspective, at least why we ought to do it, I think it is there for those of us that need to do that.

Is there a financial incentive that is great enough?

I think that is too hard to answer at this point in time, depending on where the bill goes in your deliberations.

Ms. TAKAYAMA. I would say, Senator, that the bill provides that 5 to 10 percent of the premium taken in for primary insurance goes back to the States for hazard mitigation. This is new money that I think provides a very good encouragement to the States.

Certainly, in our State, one of the reasons why we have difficulty establishing new programs is for lack of money. And many other States are similar to ours in that we have some budget concerns right now.

Second, there are disincentives in the bill which are rather severe, particularly for States that are vulnerable to catastrophe. And those disincentives include withdrawal of Federal emergency assistance moneys in the event the State does not participate in hazard mitigation. And for the States that are most vulnerable to natural disasters, there is no way they can do without that kind of a safety net.

So, I think it would be almost a guarantee that the State would have to participate.

Senator INOUYE. Thank you very much.

Senator Pressler.

Senator PRESSLER. Thank you.

I think most of my questions have been answered. I do hope, Mr. Chairman, if we have another hearing, to get somebody in from a State where flooding and tornadoes are the big problem.

Just looking at this map of the natural disaster risk profile, and maybe I will just ask one question here and then yield. It appears to me that the States of Colorado, Wyoming, North Dakota, South Dakota, Michigan, Ohio, West Virginia, and Maine have almost no natural disaster risk profile, according to this map.

Now, let me ask the witnesses, if you were from one of those States—they will probably be asked to pay additional premiums even though they face a low risk of natural disasters—if you were talking to people in those States about this bill, how would you justify it?

Mr. LAFLEUR. Mr. Chairman, my commentary to them would be that first of all the insurance commissioners of the 50 States will no doubt insure, and as this bill moves along, that those premiums would be very low for those people in those States.

A second thing I would say to them is that any time there is a disaster in California, or Louisiana, or New Jersey, wherever that might be, that public assistance funding that I mentioned that comes from this Congress would, in fact, be reduced.

So, you may be paying *x* dollars more, or $2 more on a very low rate if you are from those States, but nonetheless your dollars, your tax dollars from the Federal Treasury will not keep going up and up, as we have seen how they have had to be appropriated just in the last—well, since 1989, since Hugo, and it has just gone up astronomically, and so I think there is a good balancing effect and it takes away the cost escalation that has been so difficult for the Congress to deal with.

Mr. BROWN. Senator, if I could pick up on that, if you would allow me, I think that the point made, and well made, was that rates have to be actuarially sound. Someone in those States would be paying a very low rate compared to someone in my State of Louisiana or Hawaii, who would certainly be paying more. There would be participation, but it would be a varying participation that hopefully would make sense in the States you listed.

Senator PRESSLER. Could a citizen of North Dakota, which is completely—according to this chart, if I am reading it correctly, is completely risk free, opt out of a policy coverage?

Mr. BROWN. No, you could not. But you could select a company, that has opted out. As I understand the bill, only a company may opt out. Let us assume I am insured by State Farm. They are about the biggest property and casualty writer in the State of Louisiana. If you were insuring with State Farm, and State Farm opted to participate in this Federal program, then an actuarially determined and fair portion of everybody's policy throughout this country would go into the fund.

Now, the portion of premium contributed to the fund would be much less in North Dakota versus, say, than in the State of Louisiana. It would not be as high. If this works, the people of North Dakota's taxes would not be used to pay for any of the hurricane damages we have experienced year in and year out. Hopefully, it would either be a washout or even a reduction. That is what we hope, but of course, only time will tell.

Ms. TAKAYAMA. Senator Pressler, I am told that following Andrew and the Federal aid that was provided as a result of that catastrophe, taxpayers, including those in North Dakota, paid $93 each as part of that Federal aid package, and so irrespective of whether there is a bill like 1350 or not, there is a price to be paid.

Senator PRESSLER. Thank you.

Senator INOUYE. Thank you. Senator Breaux.

OPENING STATEMENT OF SENATOR BREAUX

Senator BREAUX. Thank you very much, Mr. Chairman, and I applaud you for having a hearing and for pushing the legislation forward, and I thank the panel for being with us.

Jim Brown, we are delighted to have you and your support for this initiative. Jim is one of the, I think, more progressive insurance commissioners for the whole country, and has been doing a very good job in Louisiana about making the changes that I think perhaps should have been made a long time ago, and coming out with some really forward-thinking ideas about how we should go about solving some of our problems.

I am a cosponsor of the legislation, and in doing so I want to tell the chairman that I will have an amendment that everywhere we have volcano damage and earthquake damage we will try and amend that by adding hurricane damage as well. We do not have a lot of earthquakes in Louisiana, but we have a lot of hurricanes, and it really has been a big problem, I guess, in Louisiana.

Jim, could you explain to me, and maybe for the record, what is the situation in our State now? I mean, we have been hit regularly by major hurricanes, but are we just not able to write private insurance for the type of damage that is caused by these type of disasters in the private sector?

Mr. BROWN. I will very briefly summarize what I said before you got here. The point is, we are not in as bad a shape as our friends in Hawaii or Florida, but all of a sudden we are starting to feel a tremendous crunch as companies refuse to write any more policies, and they are starting to move away from Louisiana. As I told Senator Pressler and our chairman here today, we did not realize this impact in the past.

A $50 to $100 million loss is a pretty solid loss, but Hurricane Andrew, as you know, Senator, missed Louisiana. It did not really catch us, and yet we suffered almost $1 billion in losses, and that is just a tremendous number for a miss.

As you pointed out before, and as has Congressman Tauzin who had in his district the worst case predictions by the Corps of Engineers at a hurricane 5 level—the Mississippi being so warm, it is like a funnel. That is why, once those hurricanes get in the gulf we start moving out when it warms up. A direct hit on New Orleans means $26 billion and 26 feet of water in downtown New Orleans.

So, we have some deep concerns, and of course, this will not stop that from happening. Hopefully the worse case will not happen, and before the level that does happen, we will be there with a program like this that gives us the protection we need. If we do nothing, we will not have that protection.

Senator BREAUX. The bill also requires, Jim, that certain type of activities be undertaken by the State if they are identified as a State that is prone to these type of damages, and one of them is that the State would have to adopt a natural disaster mitigation portion of the newest building codes, and that they would have to certify that the local communities have adopted and are enforcing appropriate hazard mitigation building codes.

Now, we have national flood insurance. I know we have struggled over the years with the various parishes or counties on the coastal areas in finding out what those codes should be, what their elevation standard should be, and it has been a real bureaucratic nightmare in order to get people in compliance. What type of problems do you think we would have if this legislation were to require the enforcement of building codes in our coastal areas? Can it be done? I mean, how would it be done?

Mr. BROWN. I think it probably helps. Again, I mentioned earlier the carrot and the stick, that there will be a hammer over our heads to perform. There will be some moneys, up to 10 percent of all the moneys collected, which would come back and be available to the States, including Louisiana, for enforcement.

Senator, we had building codes down in La Place, LA, just north of New Orleans, where the building code called for wind defense fences that ought to be able to survive 110-mile-an-hour winds.

Hurricane Andrew came through with about 65 miles an hour in winds, and ripped just the roofs off. Once the roof went the water came in, and what could have been a loss of a few shingles ended up being a total loss of the houses.

So, building code enforcement is really critical to lessening the damages and keeping these losses down. We can pass them on a local level, but we all know the problem of local enforcement for something like that without some pressure on you. If we are going to participate and reap the benefits of this program on the back end, then we ought to also be able to stand up and enforce the building codes and gain its benefits on the front end, even if it is difficult to do.

I think that this forces us to do so, and it is something that, with all due respect, gentlemen, says, hey, the Federal Government forced this on us, we just have to do it, but those of us in State government need to be able to use that tool. I am an elected commissioner, Mr. Chairman, and so it helps us, quite frankly. The strength of your bill helps us to go back and enforce it, and it will make a big difference.

Senator BREAUX. Let me ask one final question, Mr. Chairman, if I may, and that is, again, Jim, or maybe Mr. LaFleur, or Ms. Takayama would comment on it, and that is, is the system broke to the point that we have to have a national insurance system?

I guess the question—I want to get some testimony on the record. Is private insurance either not available right now, or is private insurance only available at a cost that is prohibitive, and therefore to necessitate the Federal Government passing a national insurance program?

Ms. TAKAYAMA. This is a seminal question that you are raising. My own sense of it is that although for the number and the cost of the catastrophes that we have had in the past couple of years, they have been very significant, the worst in history, all of those claims are being paid.

The problem we have today is that it is not clear for either the companies nor we as regulators that the companies are going to be able to pay the next one, and I think we have to take what has happened including the disruption currently in the marketplace as a warning sign that the system is heading for a breakdown, and I do not believe that this is something we can ignore right now.

It certainly is not going to be an easy fix. Many of the factors that go into the crisis situation that Hawaii, Louisiana, and Florida are experiencing today are worldwide in nature, and are beyond our control, and the capital markets for the insurance industry exist primarily on the world markets and are not within our jurisdiction.

As long as the capital markets continue to retrench and the rates that are available for what little capital there is are essentially out of the reach of primary insurance companies, we are going to continue to have a major availability problem which has significance for State economies.

I think that is the reason we are here today, that we are coming to signal that this is indeed a very serious situation. We do not see any other simple solution in sight for the foreseeable future, and we are asking for help.

Mr. BROWN. Senator Breaux, if I could bring it home to the personal level just very briefly, Representative Jack Smith from down in St. Mary Parish came to see me last week with about 20 of his constituents, a member of our State house of representatives. They told me they cannot buy property insurance in St. Mary Parish.

AIG—the Audubon Co., a subsidiary of AIG has quit writing in St. Mary. State Farm is writing some there, but unless the agent loses a policy, he or she cannot add a new policy. They are in a stagnant situation and they have no place to turn in St. Mary Parish. So, all of a sudden, it is just not conjecture of what may happen with the next big one. We are starting every day to find people that say they have no place to turn.

It is not a question of cost, it is not a question of their premiums going up, it just is not written in certain areas of our State right now, and that is something we have got to deal with.

Senator BREAUX. Let me thank the panel, and particularly Louisiana's commissioner of insurance for being with us, Jim, and for a good presentation. Thank you.

Senator INOUYE. Thank you. Senator Burns.

OPENING STATEMENT OF SENATOR BURNS

Senator BURNS. Thank you, Mr. Chairman, and I apologize for getting here late, and I would like to put my statement in the record.

Senator INOUYE. Without objection.

[The prepared statement of Senator Burns follows:]

PREPARED STATEMENT OF SENATOR BURNS

Mr. Chairman, I want to thank you for calling this hearing today on a bill that I know has tremendous implications for you and the people of your great State. In fact, given the series of natural disasters that have occurred in the past 2 years, the legislation is timely and must be given every consideration.

I would first like to say I believe the bill is on target in trying to assure that States are prepared for pending natural disasters. Improving model building codes, emergency response to natural disasters, expanding research of safer building technologies and technology transfer, are admirable goals and should be pursued. The fact that States would receive mitigation funds to achieve some of these goals is a much better approach than the method used far too often by the Federal Government. That method being unfunded mandates.

I am certainly supportive of a careful examination of the Flood Insurance Program and am pleased that FEMA will be studying the feasibility of incorporating it into the multihazard insurance program created by S. 1350. Given the floods that devastated the Midwest this summer, and the questions regarding what the Government's role should be, a serious reevaluation of that program is certainly merited. Furthermore, additional participation in that program by those who reside in flood plains is a necessity and a worthwhile objective of this legislation.

Based on scientific research that future natural disasters will be far more frequent and catastrophic than previous ones, I applaud the industry for seeking out a solution to a problem that has not yet come to be. The insurance industry oftentimes takes the brunt of a great deal of criticism, but in this case, I think we can commend you on your efforts.

Mr. Chairman, I truly look forward to hearing what will be said here today. The bill certainly sounds promising and has an impressive number of committee cosponsors at this time. I am currently not on the bill because I want to make sure I am comfortable with what role the Federal Government will play, and what obligations, if any, we will be making to the industry.

As far as the Federal Government's role in natural disasters today, we can safely say it is a crucial one with billions of dollars pouring into those areas that have suffered severe losses. If we can examine ways to reduce the existing contingent liability with prefunded reserve accounts, I am fully supportive of a careful evaluation. However, I want to be assured that in order to accumulate these reserve funds, certain areas of the country will not assume an unfair amount of the burden.

One of the aspects we will be examining today is FEMA and the tremendous role they will assume in implementing the conditions of this bill. We are talking about a massive undertaking; determining the damages to be covered, limits, premiums, and a whole host of other factors, will require significantly more resources than what they have available today. If the agency requires more assistance in meeting the objectives of this bill, I would certainly like to know what additional resources they will need. Instead of finding out that more personnel must be hired or new departments must be created after the bill passes, I believe the agency has some idea at this time as to what they will require. We will get into this a little bit later but I feel it is an important issue and although not the most important, I strongly believe it should be addressed.

Another area of interest to this Senator is how both the Primary Insurance Program and the Reinsurance Fund will work in the event of a catastrophic disaster. As I have already mentioned, if we can reduce the liability of the Federal Government by creating these reserve funds then I look forward to hearing how this bill will do that. However, in reviewing those sections of the bill pertaining to the new funds, I see that the industry can borrow from the Federal Treasury in the event there are not enough reserves. Even though the amount borrowed will be paid back though premiums, it still places the burden on the Federal Government to come up with the money in a time of crisis. In the event that a number of catastrophic events occur within a short timeframe, and enough funds have not accumulated to cover all of the losses, the Treasury could take a substantial hit and the industry would be responsible for paying back, with interest, a tremendous amount of money.

Although I understand that the reserves will be replenished with premiums collected and, unlike what we are seeing today, the Federal Government would not be paying out billions of dollars without any likelihood of seeing that money again, I believe we must be aware that the Government might be assuming a substantial liability and we must at least explore the industry's ability to pay back that amount, whatever that amount may be.

I have spoke with my State insurance office and they asked that we approach this legislation with eyes open and that is what I intend to do. I do want to thank you Mr. Weber for having taken the time from your busy schedule yesterday, to talk with Frank Code. I know you were preoccupied with your testimony and this hearing today. Your willingness to discuss this with the folks back home is greatly appreciated.

Mr. Chairman, again my thanks to you for holding this hearing today and I look forward to hearing the testimony of these two distinguished panels.

Senator BURNS. Thank you for coming. I have one question for Mr. LaFleur that I would just like to clear up, and then as these hearings are held, we would probably get into a little more—a little deeper into this with a little more study.

As you know, with your primary concern, Mr. Brown, in Louisiana, and Mr. Breaux, is flooding, and I come from Montana. If you need some more water, let us know, because we are upstream from everybody. But then we got in this little tiff not too long ago about floating your boats down there, and you took all of our water out of our lakes to float your boats. So, we may not agree on everything as it comes down, but nonetheless, we are aware that problems exist.

Under the legislation as it is proposed right now, Mr. LaFleur—I come out of county government. I was a commissioner in Yellowstone County. I am aware of FEMA and the emergency procedures, and those offices.

This legislation requires you in the State of Pennsylvania and your county people to identify disaster-prone areas FEMA would evaluate the mitigation plan submitted by the States, review compliance by those States every 2 years, develop programs that carry out multihazard emergency management initiatives, audit the use of mitigation funds, establish a national multihazard insurance program, conduct. We can go on, everything down, and there is more. That is just the tip of the iceberg, what it asks you to do.

We reregulated cable television here last year. We appropriated $100 million to hire more folks so that we could regulate and ride herd on that industry. Now, have we made any effort to increase funding for FEMA and the States so that you can do everything in this bill that it calls for?

Mr. LaFleur. Senator, that is an important question, and I think it is multifaceted. You are correct in your statement that the Federal Emergency Management Agency has responsibilities and the State emergency managers will get responsibilities.

In the past 4 years, as the Congress has been amending the Federal disaster legislation, you have been placing more and more responsibilities on offices like mine, and asking FEMA through the regulatory process to delegate more and more procedures.

I am not a pass-through agency as I was before your amendments in 1988. I now have to administer, I now have to grant, I now have to go after the bad debtors, things that FEMA used to do.

The Congress has been reducing FEMA from about 3,600 people now down to 2,200 full-time employees. Can FEMA do this, what it asks in this bill with that number of employees? I think that is an important question to ask FEMA. I would be concerned about that. I think that is a very fair question.

Let me say to you that for the mitigation money that comes to the States in this bill, there is language in the bill which says that it can be used for the technical assistance, the administration of the program, and for the expertise to manage it and improve the infrastructure.

If that language is left in the bill, which certainly the State Emergency Management Association directors concur with, then I believe that we can put on some additional staff and that we can manage this program, dependent upon, of course, what FEMA might delegate down to us through the regulatory implementation or any other changes.

Without that ability and those provisions in the mitigation funds, besides the projects that this will create for building flood walls around water treatment plants, sewage treatment plants and other public facilities so that we can mitigate the effects of rising waters and other hazards depending on your State, if we did not have that, we would have great difficulty, there is no doubt about it. You have to give us a tool there. You cannot give us an unfunded mandate.

Senator Burns. Well, I am very sensitive to that. I think we have an obligation to fund those mandates that we send down to the States whether it be Hawaii, Louisiana, or Pennsylvania. Have you made an estimate of what it would cost you to implement this in the State of Pennsylvania?

Mr. LaFleur. We have been working on that recently, as a matter of fact, and I will give you an example of how I am working on it, and I cannot give you a final answer, but using Hurricane Emily just this past fall if it had come on shore. In the pathway that it was going on, it would have come up into south central Pennsylvania and over $4 billion, if it had been a category 4 hurricane—not a 5, not the worst case, but a category 4, over $4 billion of insurance that has been written just in the south central portion would have been in jeopardy in homeowners' policies.

So, yes, I am studying this on an extended basis. I cannot tell you exactly how many people it would take to do this, but I want to stress the importance in the bill that it would not take—that it is not, a tax dollar appropriation. It is part of the infrastructure money that comes from the insurance premiums that is going to put this program in place, it is not tax dollars, but if you took away the latitude for us to use the money from the insurance premiums for infrastructure, well, we would be hurting then. I know our local governments could not do the enforcement and the development of those plans without State-level technical assistance.

Senator BURNS. Well, I thank you for that answer, and I would just say, I am aware of unfunded mandates. For every State in the Union, what is driving our budgets, and why we are having a terrible time balancing our budgets and providing services for our people, is unfunded mandates that come down from the Federal Government. We should either stop doing it,or save the money to do it. Right now we do not have a lot of dollars running around town just looking for a home, I will tell you that.

I want to ask the chairman in the essence of time if I may submit some questions to our witnesses for written response for the record.

I appreciate the chairman—the chairman and I have worked together on a lot of issues, and it is a delight to work with him, especially on this issue, and I know it is very, very important to those people that we do have some protection for those people who are prone to have disasters, and I thank you for coming today.

Senator INOUYE. I join the committee in thanking all of you for participating in this panel. Thank you very much, and we will be sending you questions that require detailed responses, if we may. Thank you very much.

Our next panel consists of the executive director of the Natural Disaster Coalition, Mr. Jack Weber, a representative of the Consumers Union, Ms. Mary Griffin, and from the A.M. Best Co., Mr. John Snyder.

Mr. Weber, welcome, sir, and thank you very much for all your help.

STATEMENT OF JACK WEBER, EXECUTIVE DIRECTOR, NATURAL DISASTER COALITION

Mr. WEBER. Thank you, Mr. Chairman, for inviting our coalition to testify at today's hearing. I am Jack Weber, the executive director of the Natural Disaster Coalition, the largest, most diverse coalition of interests seeking legislation to better prepare our country for the risk of natural disasters.

We wish to commend Senator Inouye, Senator Stevens, and other members of the committee, for their leadership in sponsoring this most significant disaster protection legislation introduced in 15 years. We hope today's hearings will build a positive record leading to timely action on S. 1350, consistent with your pledge, Mr. Chairman, that this legislation pass during the 103d Congress.

Natural disasters and the devastation they unleash are not new for most members of this committee. Chairman Hollings' home was seriously damaged by Hurricane Hugo in 1989. Senator Danforth represents, as do other Senators of this committee, many millions of people that have been impacted by the Midwest floods. Senator Stevens knows the destruction of the Good Friday earthquake that hit in Anchorage, AK, and many other members of this committee represent States at risk to future events which could have grave consequences.

I would like to say to you that as a result of the painful lessons of these tragedies, we have made adjustments in the national plan to lessen the impact of future disasters. Regrettably, that is not the case. Our Nation's response to disasters continues to be a reactive one. We wait for our worst fears to be realized, and then we figure out how best to pick up the pieces. It is the most expensive, least efficient, and least humane way of approaching the problem.

We believe, as you do, that our country can do better. Instead of waiting for disasters to strike, our national policy should be premised on anticipating disasters before they occur, on mitigating against future losses, on educating the public, and making certain our public and private institutions continue to perform as promised, both before and after an event.

Are we making progress in these areas? Are we ready for the next time? We think the answer, regrettably, is "No."

Over the next 30 years, the U.S. Geological Survey forecasts that the chances of a major catastrophic earthquake in San Francisco or Los Angeles, an event that could cause losses two or three times greater than Andrew, is as high as 60 percent, yet in that State, less than one in five homeowners buys earthquake insurance. In other words, should such an event occur, the taxpayers of Montana and South Dakota and elsewhere in the country will be expected to provide necessary disaster assistance in lieu of private protection.

In coastal communities from Brownsville to Bangor we pay lip-service to the importance of adequate building codes, even as we discover that in Dade County, FL, the failure to enforce building codes magnified losses from Hurricane Andrew by as much as 30 percent.

We know from weather experts such as Robert Sheets at the National Hurricane Center that we almost certainly are entering a cycle of more intense, more destructive storms, storms which could inflict $35 billion in losses in Texas, $30 billion in losses in Hawaii, $50 billion in losses in Florida, $52 billion in New York and New England, but the question remains, What are we doing about it?

Natural disasters are not just the other guy's problem. As we have already discussed, earthquakes are very real threats in Oregon, Washington, Alaska, Utah, Idaho, Wyoming, and Montana. The most powerful quake in U.S. history was in what is now Senator Danforth and Senator Mathews' own backyard. Every State facing the Gulf of Mexico or the Atlantic Ocean faces the very real threat of hurricanes. The entire Midwest is prone to flooding and tornadoes. No place is immune and ultimately, everyone will pay.

The special appropriations passed this summer to aid victims of the Midwest floods totaled $5.7 billion. The total Federal aid package, including subsidized loans for Hurricane Andrew and Iniki was over $11 billion, and the relief funds appropriated for the

Loma Prieta earthquake in San Francisco topped $3 billion. Some are proud of these expenditures. We think they raise serious questions.

Since natural disasters are inevitable, what can we do? Well, Mr. Chairman, we can do plenty. We can see to it that in areas at risk to disasters, State and local communities do a better job of establishing and enforcing the necessary building codes.

We can see to it that every level of government has carefully thought through the risks we face in every part of the country, and that our plans for reducing exposures before an event and our first response afterward is as thorough and effective as the plans we rely upon when we send our brave men and women to the Mideast, or Somalia, or any other place of danger.

We can also see to it that the safety net under our citizens is adequate and fairly distributes the cost of that protection in proportion to the risk. It is simply not acceptable that those at risk to flood or earthquake do not protect themselves or the Federal taxpayer against potential losses, nor is it acceptable that those living in areas at risk find the necessary insurance coverage unavailable.

We can see to it that there is money available so that the States and local communities already overburdened and financially strained can spend the necessary resources to bring meaningful disaster planning and mitigation to reality, and we can see to it that if the worst should occur, if an event so horrible in its magnitude does happen, that we are ready and have set aside the funds necessary for the problems which will inevitably follow.

Thankfully, Senator Inouye and members of this committee, you see the same problems and opportunities that we do. Under S. 1350, States and local communities would be provided concrete incentives to adopt uniform building codes and fire safety standards to replace the patch quilt that exists today.

S. 1350 would provide incentives to States and local communities to prepare detailed disaster mitigation and response plans, and most importantly, the bill would provide a funding mechanism for these activities not from the taxpayer but from the private sector, principally insurance companies.

Under your legislation, States and local communities would be eligible for $150 million or more for disaster mitigation, a quantum leap in funding from current levels. This money, available year after year, will be used to prevent loss, not reimburse it. I might add that S. 1350 is the only legislation pending before Congress that does not depend on Federal tax dollars to pay for mitigation.

Properly enforced building codes and planning can make a tremendous difference. A 1985 study compared Hurricane Alicia, which struck the Texas coast in 1983, with Hurricane Diana, which slammed the North Carolina coastline with equal force a year later.

In West Beach, TX, which did not have a building code in place for most of its development and failed to enforce its code once one was adopted, 70 percent of the town's 3,000 homes were either damaged beyond repair or required major structural repairs. Yet in North Carolina, where a statewide building code was rigorously enforced, just 3 percent of a comparable number of homes sustained major damage.

S. 1350 will also encourage insurers to standardize their homeowners' policies to include coverage against earthquakes, volcanic eruptions, and other perils not currently part of standard protection, at dramatically lower costs than are presently available. In California, for example, we project that the average rates paid by homeowners for earthquake coverage we project would drop by as much as 67 percent. In other areas, the reductions are even more dramatic.

The bill seeks to increase participation in the Federal Flood Insurance Program and calls for a 1-year study concerning the possible integration of the flood program into comprehensive natural disaster coverage.

The legislation, finally, also includes the creation of a Federal reinsurance program to guarantee the availability of insurance both before and after a major disaster. Anyone who has seriously studied the insurance availability crisis, including 18 insurance commissioners from States not only represented here today but Florida, South Carolina, New York, Alaska, Kentucky, Tennessee, Mississippi, and South Dakota, agree that a Federal reinsurance trust fund is the best long-term solution to a potentially crippling event.

Under such a plan, insurers nationwide would pool their resources via premiums to a national catastrophic reinsurance trust fund. State-sanctioned insurance programs like the newly created Joint Underwriting Association in Florida and the Hurricane Pool in Hawaii could also purchase reinsurance protection under this plan.

Reinsurance coverage would only be available after the private insurer, or the State insurance program, paid substantial losses first. For example, we believe the insurance industry should only be allowed to qualify for Federal reinsurance after losing at least 15 percent of its surplus, approximately $25 billion, using today's estimates, or at least 20 percent of individual company surplus in a regional event.

Reinsurance premiums would be set by the Government and would be paid into a Federal account, much as it is in Japan, which as you know faces considerable exposure to catastrophic earthquakes.

This reinsurance fund should build quickly and create a large surplus as the annual premiums collected by insurers are projected to exceed $1 billion. However, if the trust fund were insufficient to pay all claims, Federal borrowing would be authorized conditioned upon repayment with interest from future premiums.

Some may ask whether such a plan exposes the taxpayer to greater risks. We do not believe this to be the case. Without a reinsurance mechanism and a plan which allows insurers to prefund future needs for a megacatastrophe, taxpayers will see an ever-rising level of disaster relief as the Government rushes in to protect homeowners whose companies are incapable of paying claims or writing new coverage.

Mr. Chairman, your legislation is supported by a broad-based group of interests affiliated with the Natural Disaster Coalition. Supporters include emergency management interests such as the National Emergency Management Association, the National Coordinating Council of Emergency Managers, the National Fire Protection Association, the National Association of State Fire Marshals, and the National Guard Association.

The legislation has also been embraced by a large number of consumer groups, including the National Consumers League, the United Homeowners Association, and the National Council of Senior Citizens. It is also supported by a task force set up by Governor Chiles in the aftermath of the insurance crisis in Florida, a group compiled largely of consumer representatives.

Finally, the bill is supported by every sector of the insurance industry, something quite unusual in insurance circles, as well as interests representing realtors, mortgage bankers, and many others.

Of course, no effort is without at least one or two critics. We have and continue to look for ways to improve upon this legislation. However, you may hear several charges today that strain credibility and mischaracterize the bill's intent.

For example, you may hear that this bill somehow asks taxpayers to pick up the tab for events like Hurricane Andrew and Hurricane Iniki. Nothing could be further from the truth. Those claims have already been paid by insurers and would be in the future even if S. 1350 became law. In fact, it would take an event nearly 50 percent larger than Hurricane Andrew before the first dollar of reinsurance would be paid by the Federal program.

Those reinsurance dollars come from the insurance industry, not taxpayers. If there were to be a shortfall in the fund at some point in the future, an event which is possible but not likely, any deficit would be repaid with interest by insurers. To charge otherwise is simply not true.

The preparedness strategies of S. 1350 save taxpayers substantial money by reducing our current reliance on disaster relief. The hazard mitigation and emergency response measures instituted by the bill will avert many of the losses that Federal disaster aid would otherwise pay.

The bill's prepaid insurance programs, furthermore, will cover more of the repair and rebuilding costs for which individual and family assistance grants and low-interest loans are currently used. The result is a more equitable, more rational, more realistic policy on natural disasters.

Finally, this bill will not increase the Federal deficit. In August 1993, analysis by the accounting firm of Coopers & Lybrand determined that S. 1350 will not cause a budget score. In fact, Coopers & Lybrand conclude that the bill would actually reduce the budget deficit by between $1.1 and $7 billion during its first 5 years of operation.

Thank you again, Mr. Chairman, for this opportunity to testify. S. 1350 is a forward-looking disaster preparedness approach that heeds the lessons of recent catastrophes. It is our hope that the worst events we know can happen never do. However, with your leadership and the passage of the Natural Disaster Protection Act, at least we will be ready.

Thank you.

[The prepared statement of Mr. Weber follows:]

Prepared Statement of Jack Weber

Thank you, Mr. Chairman, for inviting our coalition to testify at this morning's important hearing.

I am Jack Weber, the Executive Director of the Natural Disaster Coalition, the largest, most diverse coalition of interests seeking legislation to better prepare our country for the inevitable risk of natural disasters. We wish to commend Senators Inouye and Stevens and other members of the Commerce Committee for their leadership in sponsoring the most significant natural disaster protection legislation introduced in fifteen years. We hope today's hearing will build a positive record leading to timely action on S. 1350, consistent with your pledge, Mr. Chairman, to pass this legislation during the 103rd Congress.

Natural disasters, and the devastation they unleash, are not new for most members of this Committee. Chairman Hollings' South Carolina Isle of Palms home was seriously damaged by Hurricane Hugo in 1989. Senator Danforth represents thousands who are still recovering from this summer's great floods; additional flooding also occurred in southern Missouri over the weekend. Senator Inouye, the sponsor of S. 1350, saw the Garden Island of Kauai leveled by Hurricane Iniki last September. Senator Stevens knows all too well the lasting legacy of destruction from the 1964 Good Friday Anchorage earthquake. Five other cosponsors of the Inouye bill Senators Ford, Breaux, Gorton, Lott, and Matthews—also serve on this Committee and represent states prone to the destructive forces of nature.

The lesson from all these natural disasters, whether they be hurricanes, earthquakes, or floods, is that a disaster response policy based primarily on after-the-fact emergency aid is shortsighted.

Instead of waiting for disasters to strike, our policy should be premised on anticipating natural disasters before they occur. We should focus our efforts on prevention and preparedness by adopting and enforcing hazard mitigation measures (e.g., building codes) and employing more aggressive emergency planning. Both measures have proven to be effective in saving lives and reducing losses. We also need to tie relief to responsibility so those at risk bear their fair share of the preparedness and recovery costs. The Natural Disaster Coalition also believes the private sector must play an important role in the nation's disaster preparedness strategy by helping to reduce the growing reliance on federal disaster aid, providing affordable insurance, and serving as a source of funds for hazard mitigation measures.

THE PROBLEM

The individual natural disasters I have mentioned—Hurricanes Hugo, Andrew, and Iniki, the great Alaska earthquake, this summer's flooding, and now the wildfires in California—spotlight a larger natural disaster crisis faced by our entire country. Let me begin by summarizing the gravity of this problem.

Catastrophic Natural Disasters are Inevitable

Catastrophic natural disasters are as inevitable as death and taxes. Hurricanes, in particular, are recognized as nature's most destructive phenomena. Many atmospheric scientists, including Dr. William Gray of Colorado State University, and Dr. Robert Sheets of the Natural Hurricane Center, forecast that the Atlantic and Gulf coasts are entering a period of more frequent and intense hurricanes.

Seismologists also agree that a catastrophic earthquake will almost certainly strike somewhere in the U.S. within the next thirty years. The earthquake warning currently in effect for Parkfield is another sign of the building pressure on the fault lines in California. By the year 2020, the U.S. Geological Survey forecasts a 67 percent chance for a catastrophic quake in the San Francisco Bay Area and 60 percent chance for Southern California. Dr. Arch Johnston, a Memphis State University seismologist, has testified before Congress that the odds of a destructive earthquake striking central or eastern portions of the United States is at least 40 percent and as high as 97 percent within the same 30-year period.

Flooding is another natural peril which regularly inflicts substantial damages, as underscored by the Great Floods of 1993 in the upper Mississippi and Missouri River Valleys. Other natural disasters include volcanic eruptions; tsunamis; tornadoes and cyclones; forest, range, and brush wildfires, such as those spread by the Santa Ana winds of Southern California; land and mud slides; and sink holes.

All these natural disasters share a common trait: they will inevitably occur and cannot be prevented.

Nearly Every Part of the Country Is Vulnerable to Natural Disasters

Those living along the Florida coast, on an exposed Hawaiian Island, or on top of fault lines in Alaska or California are well aware of their vulnerability to natural disasters. But it's not well understood that nearly every other region of our country is susceptible to one or more major natural disaster peril. Indeed, our vulnerability to natural disasters is a nationwide problem that must involve a nationwide solution.

At least eighteen Gulf and East Coast states are hurricane-prone. From Texas to Maine, the Census Bureau estimates that 76 million Americans live in coastal counties where hurricanes are most destructive. Across the country on the West Coast, the states of California, Oregon, Washington, and Alaska are extremely vulnerable to seismic disasters, such as earthquakes, volcanic eruptions, and tsunamis.

Most of the Midwestern states are prone to earthquakes, tornadoes, and floods. Seven states in particular—Missouri, Tennessee, Kentucky, Illinois, Indiana, Arkansas, and Mississippi—are situated near the New Madrid fault which sustained the largest earthquakes in recorded U.S. history during the winter of 1811-1812. Several Midwestern states, including Kansas, Nebraska, Oklahoma, and Iowa, lie along "tornado alley" and most of the remaining Midwestern states are vulnerable to flooding.

The Rocky Mountain states of Utah, Idaho, Wyoming, and Montana are prone to damaging earthquakes. And Hawaii and the Island territories (e.g., Puerto Rico, the Virgin Islands, and Guam) are vulnerable not just to hurricanes, but also earthquakes, volcanic eruptions, and tsunamis. All told, just about every state and U.S. territory is susceptible to the real threat of natural disasters.

These Natural Disasters will Inflict Substantial Losses

Beyond the tragic human destruction, the economic losses from catastrophic natural disasters will be devastating. The United States, prior to 1987, had never experienced more than $1 billion in insured losses from a single natural disaster. Since then, we have had eight events that have exceeded $1 billion; last year alone, the toll was $23 billion.

As residents of Florida and Hawaii can testify, hurricanes can exact a staggering economic cost. Andrew resulted in the largest economic loss from a single natural disaster in U.S. history. Although Iniki resulted in smaller total losses, the hurricane significantly damaged nearly every structure on Kauai and wiped out the tourism industry. Despite this incredible destruction, south Florida and Hawaii were lucky. Two different studies conclude that if Andrew had tracked just 20 miles further up the coast into the Miami/Fort Lauderdale urban center, losses would have exceeded $75 billion in southeast Florida alone. Another study estimates that if Iniki had tracked just half-a-degree south and directly hit Oahu, the damage to Honolulu would have been $30 to $35 billion.

Other coastal regions could also suffer similar devastation from hurricanes. Hurricane loss-estimate scenarios prepared by Applied Insurance Research project insured losses as high as $43 billion for the Galveston-Houston area, $26 billion for southern Louisiana, and more than $52 billion for New Jersey, New York, and New England.

These economic loss estimates will only grow as more people move towards the coastline and property values increase. Already over half of all Americans live near a coast, as defined by the National Oceanic and Atmospheric Administration, and the coastal population is growing faster than regions less prone to risk. Insured property values for the first tier of coastal counties along the Gulf and Atlantic coasts is almost $2 trillion and has increased more than twice the inflation rate.

Earthquakes also have the potential for inflicting substantial economic losses. According to various studies, the loss projections for a catastrophic earthquake in the Memphis area is $70 billion; it's $84 billion for San Francisco and over $33 billion for Seattle. Eastern state earthquakes, although generally not as great in magnitude as West Coast quakes, can cause more damage because of weaker building codes and different soil and rock conditions which allow the shock waves to travel further.

Major natural disasters also impose an enormous cost in terms of emergency relief. It has become axiomatic that the President will request and Congress will appropriate vast sums in direct aid payments to areas stricken by natural disasters. The committee report accompanying the 1991 supplemental appropriations bill stated that "it has long been accepted that our Federal government owes it to the people of the Nation and to itself to meet dire emergencies which arise because of natural disasters". All taxpayers, including those far removed from the disaster area, pay for this relief.

The special appropriations passed this summer to aid victims of the Midwest floods totaled $5.7 billion. The total federal aid package, including subsidized loans, for Hurricanes Andrew and Iniki was over $11 billion and the relief funds appropriated for the 1989 Loma Prieta "World Series" earthquake topped $3 billion. Congress may also consider special disaster appropriations for the California wildfires.

Much of this disaster aid is for individual assistance and low-interest rebuilding loans—precisely the kind of loss which private insurance ordinarily covers. For instance, 41 percent of the Federal Emergency Management Agency's (FEMA's) disaster relief obligations from 1977 through 1990 were for individual assistance primarily in the form of individual and family grants and temporary housing. Considerable portions of this aid would not be required if individuals had adequate private insurance to cover disaster losses.

Specific Focus on the Insurance Markets

We will become increasingly reliant on taxpayer-supported disaster assistance unless we find a better way for insurers to manage catastrophic risks. A mechanism is needed to allow the private market to cure the current unacceptable situation which precludes consumers from getting affordable coverage.

Few homeowners purchase insurance for certain catastrophic disaster risks, such as earthquakes, because the rates are simply too high. In risk-prone areas like California, for example, only one in four homeowners have earthquake coverage; nationwide, only about ten percent purchase the coverage. Dr. Robert Litan, a former senior fellow with the Brookings Institute and now a senior anti-trust official at the Justice Department, concluded in a 1991 study that the private insurance market fundamentally fails to provide affordable coverage for those perils which occur infrequently but have catastrophic consequences. There is also poor coverage for more common risks such as flooding. In fact, less than one in five homeowners living in recognized flood plains actually purchase flood insurance coverage.

Of equal concern is the growing lack of insurance in disaster-prone areas. Florida and Hawaii offer case studies of this problem. Tom Gallagher, Florida's insurance commissioner, estimates that the insurance claims paid from Andrew total more than the combined homeowners premiums paid in the state over the past 23 years. According to the latest estimates, it would take 500 years of premiums in Hawaii to offset the losses from a category four or five hurricane were it to hit Honolulu.

Andrew and Iniki losses caused several Florida and Hawaii-based companies to fail, including Hawaii's third largest insurer, and forced others to stop writing new coverage and renewing homeowners' policies. Approximately 30 percent of Hawaii's homeowners' policies were impaired by Iniki with consumers forced to pay substantially higher premiums for limited amounts of insurance protection. Upwards of one million Florida homeowners, covering about one-fifth of the state's insured homes, have been at risk of losing their insurance coverage. Recently, Florida and Hawaii have enacted catastrophic funds to address these problems that even their proponents acknowledge are only temporary solutions until a federal reinsurance program is created.

The insurance availability crisis is not limited just to consumers in Florida and Hawaii. Property owners from Cape Cod to New Orleans report that coverage is harder to find and increasingly more expensive.

A major cause of the insurance availability crisis is the reduction in the availability of reinsurance. Due to a series of natural disasters worldwide, reinsurance availability has declined dramatically over the last three years. Many companies can currently reinsure only a small percentage of their catastrophic risks. Without this coverage, many companies have elected to reduce their exposures to more manageable levels so they can honor potential future claims.

THE SOLUTION

The Natural Disaster Coalition believes the solution to our country's vulnerability to catastrophic disasters is a comprehensive preparedness plan based on three elements: (1) improved hazard mitigation and emergency response; (2) expanded primary insurance coverage; and (3) an industry-financed federal reinsurance program.

Improved Hazard Mitigation and Emergency Response Capabilities

The cornerstone of any preparedness strategy is mitigating future losses. Although natural disasters cannot be prevented, we can certainly implement strong measures now to reduce the damages they cause.

The most important hazard mitigation measure is the adoption and rigorous enforcement of building codes. Our coalition strongly supports the adoption and enforcement of model building and consensus fire safety codes by all disaster-prone states and localities. Flood-prone local communities should also adopt and enforce the flood minimum performance standards under the National Flood Insurance Act.

Every major study conducted has found that the existence and enforcement of building codes can substantially reduce losses from future natural disasters. A 1985 study, for instance, compared Hurricane Alicia, which struck the Texas gulf coast in 1983, with Hurricane Diana, which slammed the North Carolina coastline with equal force winds a year later. In West Beach, Texas, which did not have a building code in place for much of its development and failed to enforce its code once one was adopted, 70 percent of the town's 3,000 homes were either damaged beyond repair or required major structural repair. Yet in North Carolina where a statewide model building code was rigorously enforced, just three percent of a comparable number of homes sustained major damages. Experts further conclude that last year's losses from Hurricane Andrew could have been reduced by as much as 30-40 percent had existing building codes in south Dade County—the toughest in the Nation—been properly enforced.

In addition to building codes, disaster-prone states should prepare and carryout hazard mitigation and emergency response plans to speed relief to stricken areas and enhance long-term recovery. A national study by Professors Timothy Beatley and Philip Berke published earlier this year in Issues in Science and Technology concluded that local planning is an effective tool in reducing earthquake losses and complementing other seismic mitigation measures. Unfortunately, few states and local communities have comprehensive preparedness plans in place.

Disaster-prone states should be encouraged to adopt and enforce building codes and develop disaster plans within a prescribed period, and we should provide them sorely needed funds to do it. Experience has taught us that the emergency response and loss-reduction measures will only be successful if they are carried out at the state and local level. Accordingly, our coalition proposes actively involving the states and local communities, and most importantly, proposes providing them a selfsustaining funding source to ensure compliance.

States that comply with these loss-reduction measures would receive an equitable share of monies drawn from the self-sustaining trust fund—which could total hundreds of millions of dollars—to help them pay for hazard mitigation enforcement. The mitigation trust fund would consist of a percentage of multi-hazard insurance premiums collected from property owners and the insurance industry. As a further incentive to encourage compliance, property owners in states which enforced building codes and prepared disaster plans should also pay lower disaster insurance premiums and deductibles. Finally, consistent with our philosophy of linking relief with responsibility, we believe local communities which fail to comply should have their eligibility for public disaster assistance funds carefully scrutinized.

Expanded Primary Insurance Coverage

The second element of our preparedness strategy is expanded and more affordable insurance protection for property owners. Private insurers should include supplemental natural disaster coverage for earthquake and related seismic perils in all their standard policies for homeowners living in hazard-prone states. The premiums should be risk-based so that homeowners living in low-risk areas would not be subsidizing those living in higher-risk regions. Homeowners could also choose deductible levels and types of coverage.

This additional insurance coverage will be much more affordable for everyone. A nationwide insurance program spreads the risk, significantly reducing the premiums. Computer models developed by professional actuaries conclude that such a federal primary insurance program should reduce earthquake insurance premiums by an average of 70 percent across the country. In California, for example, the average rates paid by homeowners for earthquake coverage could drop by 67 percent; in South Carolina the rate reduction is calculated at 76 percent and it's 63 percent for Missouri.

Our coalition also believes that participation in the existing federal flood insurance program should be improved. We need to do a better job of enforcing the insurance purchase requirement and informing those policyholders in flood plains of their obligation to have the flood coverage in order that those at risk bear the appropriate level of responsibility.

Industry-Financed Federal Catastrophic Reinsurance Program

The final element of our plan is the creation of a federal reinsurance program to guarantee the availability of insurance both before and after a major disaster. Anyone who has seriously studied the insurance availability crisis, including eighteen insurance commissioners from such states as South Carolina, Florida, Hawaii, Louisiana, Alaska, Kentucky, Tennessee, Mississippi, and South Dakota, agree that a federal reinsurance trust fund is the best long-term solution to a crippling catastrophe.

Such a program would allow insurers to purchase, with their own funds, excess federal reinsurance to help pay for losses arising from catastrophic disasters, such as hurricanes, earthquakes, volcanic eruptions, and tsunamis. State-sanctioned insurance programs, like the newly-created Joint Underwriting Association in Florida and the hurricane pool in Hawaii, could also purchase reinsurance protection under this plan.

Reinsurance would only be available after the private insurer or state insurance program substantial losses first. For example, we believe insurers should only be allowed to qualify for federal reinsurance after losing 15 percent of its surplus approximately $25 billion using today's estimates—or at least 20 percent of surplus in lesser events. Reinsurance premiums would be set by the government and would be paid into a federal account much as they are in Japan, which as you know, faces similar exposure to acts of nature—particularly earthquakes. This fund should quickly build up a large surplus as the annual premiums collected from insurers are projected to exceed $1 billion. But if the trust fund were insufficient to pay all claims, federal borrowing would be authorized, conditioned upon repayment with interest from future premiums. Some may ask whether such a plan exposes the taxpayer to greater risks. We do not believe this is the case. Without a reinsurance mechanism and a plan which allows insurers to pre4und future needs from a mega catastrophe, taxpayers will see an ever-rising level of disaster relief as the government rushes in to protect homeowners whose companies are incapable of paying claims.

THE LEGISLATION

The three elements of a comprehensive natural disaster preparedness plan just outlined have been included in Senator Inouye's legislation pending before this Committee. We strongly support this important legislation and urge the Committee, and Congress as a whole, to consider it expeditiously.

S. 1350 is supported by a broad-based coalition, the largest, most diverse group of interests ever to back comprehensive natural disaster preparedness legislation. Supporters include emergency management interests, such as the National Emergency Management Association, the National Coordinating Council of Emergency Managers, the National Fire Protection Association, the National Association of State Fire Marshalls and the National Guard Association. Consumer groups have embraced the legislation, including the National Consumers League, the United Homeowners Association, and the National Council of Senior Citizens. Organized labor, specifically the International Association of Fire Fighters (AFL-CIO) have also endorsed the legislation. Finally, the bill is supported by national trade organizations representing realtors and financial institutions, as well as insurance agents and companies.

The preparedness strategies of S. 1350 will also save taxpayers substantial money by reducing our current reliance on disaster relief. The hazard mitigation and emergency response measures instituted by the bill will avert many of the losses that federal disaster aid would otherwise pay. The bill's pre-paid insurance programs, furthermore, will pay more of the repair and rebuilding costs for which individual and family assistance grants and low-interest loans are currently used. The result is a more equitable policy since the insurance programs, in which property owners and insurance companies pay risk-based premiums, replace taxpayer-supported disaster aid.

Finally, this bill will not increase the federal deficit. An August 1993 analysis by the accounting firm of Coopers and Lybrand determined that S. 1350 will not cause a budget score. In fact, Coopers and Lybrand conclude that the bill would actually reduce the federal budget deficit by between $1.1 billion and $7.7 billion during its first five years of operation. This analysis employs conventional federal estimating assumptions and reasonably assumes that a reserve would be established to ensure sufficient trust funds are available in the event of a major disaster. Other positive deficit-reduction benefits of the proposal include the generation of additional corporate tax revenues and fewer casualty loss tax deductions taken by individuals.

This legislation, accordingly, is a fiscally responsible approach. Beyond the savings documented by Coopers and Lybrand, the bill will likely reduce the deficit further over time by reducing the implicit contingent liability to pay federal disaster relief. That is the conclusion of Dr. Elliot Mittler in a 1992 study in which he systematically compares this legislative concept with the principles of fiscal responsibility established by past federal disaster relief and insurance programs. Two studies conducted by the General Accounting Office have also determined that insurance is a far more equitable and efficient approach than disaster relief in compensating losses.

CONCLUSION

Thank you again, Mr. Chairman, for this opportunity to testify.

Our coalition strongly supports the Natural Disaster Protection Act, S. 1350, and urges this Committee to act on this bill early in the next session of Congress. This legislation not only offers the only long-term solution to the insurance availability crisis, it can save lives and will reduce losses from future disasters as well as speed recovery. The bill also reduces our nation's dependence on taxpayer-supported disaster aid and directly ties relief with responsibility. Above all, S. 1350 is a forwardlooking disaster preparedness approach that heeds the lesson of recent catastrophes by anticipating natural disasters, not simply waiting for them to strike.

I would be pleased to answer any questions the Committee may have.

Senator INOUYE. Thank you very much, Mr. Weber. May I now call on Ms. Griffin?

STATEMENT OF MARY GRIFFIN, CONSUMERS UNION

Ms. GRIFFIN. Thank you, Mr. Chairman. We appreciate the opportunity to testify today, and we also agree that there is no doubt that over the past few years this country has been devastated by some of the worst disasters in history, and there is also no doubt that the insurance industry suffered a great shock to their balance sheets from these losses, particularly certain companies with risks concentrated in the areas hardest hit.

But before the Federal Government becomes the insurer of first resort and the reinsurer of last resort, placing taxpayer money at risk, we need an analysis to determine whether the Federal Government should be involved in providing disaster assistance of this kind, and if so, what form that assistance should take.

As part of that inquiry, it must be determined whether the private sector is providing and can in the future provide the assistance. Unlike the flood insurance program, which the private market did not write, private insurers do write disaster insurance.

The availability of insurance from certain companies has become an issue in those parts of the country hardest hit by the disasters. For the rest of the country disaster assistance is readily available, and the causes of the availability problems do not rest solely with the losses from disasters.

It is clear that mismanagement, overconcentration of risk, inaccurate risk prediction, and a lack of proper capitalization, all played a major role in the downfall of many companies. While we debate whether a Federal insurance program is an appropriate response, stronger regulatory oversight clearly is.

Reports indicate that the reinsurance market is bouncing back, reducing prices and increasing availability. Although the market is clearly experiencing a restructuring, lessons learned from the recent disasters by companies and regulators alike will help strengthen the market in the future. However, if it is determined that the private market can no longer insure against such disasters, the next area of inquiry is, what form of assistance is needed?

This assistance may take the form of a Federal loan, grant, or insurance program, or a private program overseen by the Federal Government such as setting up special insurer reserves for certain catastrophes. The assistance may be interim or short term in nature, and it may involve the entire country or only certain at-risk areas such as the coastal States, and any Federal assistance program must have as its primary goal the mitigation of losses from these disasters.

The nature of such mitigation measures should not be the subject of political forces, but must be determined through independent scientific analysis. That is why we believe a feasibility study is needed to address issues such as what level of risk or geographic cross-subsidization is appropriate, and how should it be accomplished? Should a farmer in Iowa subsidize a homeowner on a fault line in San Francisco, and, for that matter, should new construction in certain disaster-prone areas be permitted at all? What land use and building code requirements should be mandated? These are just a few of the issues.

While the Natural Disaster Protection Act of 1993 includes some positive measures such as have been discussed here regarding the mitigation plans, we do have some concerns with the bill.

First, we believe the mitigation program does not go far enough because it fails to include older housing stock, and it places primary responsibility with the States. Since areas at risk of disaster do not necessarily follow State borders, we believe it is more appropriate for the Federal Government to determine which areas are most at risk and how best to mitigate against such risk.

Second, under the proposal, the primary insurance program commits the Federal Government to pay for all losses from earthquakes and volcanic eruptions, not just those of catastrophic proportions. By committing the Government to future mandatory, not discretionary spending, funds needed for relief efforts to States, local communities, and individuals may not be available.

In addition, private insurers are allowed to underwrite under the program, leading to cherrypicking by private companies of the best risks, with the possibility that the Federal Government can expect to insure the worst.

Third, the reinsurance program provides insurers with protection without the incentives to accurately price their products or institute loss reduction measures. This serves as a disincentive for insurers to reinsure themselves, and may create incentives for insurers to underprice their products, thereby depleting surplus and forcing a dip into the pool more quickly.

Finally, we believe that before the Government contemplates a program which commits resources to protect an industry, it should be in a position to regulate and oversee that industry. Toward that end, we believe that Federal legislation to regulate the insurance market must be enacted before any Federal assistance program is developed.

We thank you very much for inviting us here today, and would be happy to answer any questions you have.

[The prepared statement of Ms. Griffin follows:]

Prepared Statement of Mary Griffin

Mr. Chairman and Members of the Subcommittee, Consumers Union appreciates the opportunity to present our views on important consumer issues relating to legislation which creates a federal natural disaster insurance program. In Consumer Reports, we have written extensively about insurance products, most recently with our issue on homeowners insurance. We have also been involved in efforts before Congress and at the National Association of Insurance Commissioners to dismantle the laws and traditions that have long shielded the insurance industry from fundamental rules of fair play and consumer protection.

In this testimony, we would like to discuss the concerns we have about involving the federal government in what may end up being a bailout of the insurance industry. There may be a need for federal involvement to protect against losses from catastrophic disasters. But whether that involvement should be in the form of a joint federal-private industry effort needs further analysis. We are concerned that the proposal before you, The Natural Disaster Protection Act of 1993 (S. 1350), which includes some positive measures, focuses on protection of the insurance industry rather than preventing and protecting against losses from catastrophic natural disasters.

The Natural Disaster Protection Act of 1993 establishes a federal insurance program for losses resulting from earthquakes and volcanic eruptions. It also provides a reinsurance program in which the government acts as the reinsurer for the private insurance industry for certain losses resulting from a variety of natural disasters. To minimize losses from these disasters, the bill also establishes a mitigation program, the responsibility of which is placed largely with the states.

There is no doubt that this country has suffered huge losses because of natural disasters. And the insurance industry has borne a great deal of that loss. But that does not mean that the federal government should now become the insurer of first resort for certain natural disasters and the reinsurer for the industry, an industry which has thus far been averse to any federal regulatory involvement. Before any proposal committing federal taxpayer dollars to an insurance/disaster assistance program, there needs to be further study including the following: [1]

- An analysis conducted by the federal government on the nature and scope of disasters and the most effective mechanisms for managing and distributing losses from catastrophic disasters, including mitigation proposals and how best to ensure their implementation.
- An objective independent review of the causes of losses from Hurricanes Iniki and Andrew, and other disasters, including the effect of these disasters on the primary insurance market and the capacity of the current market to provide for future disasters.
- A detailed study by an independent entity on the reinsurance market and the effects of various catastrophes on it.

I. The federal government should not be involved in providing disaster assistance insurance or assisting the private insurance market in providing such protection unless it is determined that 1) the private market can no longer insure against such losses and 2) a federal insurance program is the most appropriate way to provide disaster assistance.

Before the federal government embraces a new program which will involve substantial commitment of resources and future Treasury obligations, it must determine whether a need for federal assistance exists and, if so, what form that assistance should take. The federal government has been involved in providing disaster relief in several forms, such as assistance from the Federal Emergency Management Agency, the flood insurance program, and loans provided through the Small Business Administration. There are a variety of ways the government can participate in disaster assistance, all of which should have as a primary goal reducing loss through mitigation measures. But before a decision is made that the government should become involved in disaster assistance as contemplated in S. 1350, an independent analysis of the adequacy of the private insurance industry's capacity to provide protection must take place.

The state of the current insurance market. There is no doubt that 1992 was "the year of the disaster" for this country. On the heels of Hurricane Hugo, the California earthquake and the Oakland fires, Americans were faced with the havoc wreaked Hurricanes Andrew and Iniki. For the insurance industry, losses totalling $20 billion were a shock to their balance sheets and represented some of the largest losses in insurance industry history. But is the private insurance market continuing to write insurance to protect against losses from natural disasters? The answer is clearly, yes. Though availability of insurance from certain companies has become an

[1] In a study published by the Federal Emergency Management Agency and the National Earthquake Hazards Reduction Program in July of 1992, it was recommended that future research be conducted to determine the impact of different types of insurance arrangements and disaster assistance programs on distributional burden of future catastrophic earthquakes, including the role of mitigation in reducing losses; the effects of catastrophic earthquake on the primary and reinsurance insurance markets; and whether earthquake insurance should be mandatory or voluntary. "Indirect Economic Consequences of a Catastrophic Earthquake," a study conducted by Development Technologies, Inc. under a grant from Federal Emergency Management Agency, page 94-95.

issue in those parts of the country hardest hit by the disasters of 1992, for most of the country disaster assistance is readily available.[2]

While many argue that the disasters of 1992 caused catastrophic losses to the industry and therefore the industry needs protection, the extent and causes of such unavailability do not rest solely with the disasters. Inaccurate pricing, concentration of risks in certain geographical areas, and mismanagement of insurance companies all played a role in contributing to the effects of the disasters of 1992. The insurance industry failed to underwrite accurately for the extent of damage caused by the disasters. This situation has improved, however, as insurers have gathered data from the hurricane experience. Many of these problems, however, are regulatory, not economic, in nature and need to be addressed with improved regulation, not simply financial assistance.

While 1992 no doubt had an effect on the primary insurance market, lessons learned from the disasters will only serve to strengthen the market in the future. One positive outcome of the industry's miscalculation of losses is the renewed interest insurers have in their actuaries' ability to estimate losses—new models for predicting the extent of damage from winds are being churned out by the experts and information obtained from the hurricanes will enable more accurate underwriting in the future. In other words, insurers are learning more about their job: to assess the risks and appropriately underwrite and price for such risks.

The evidence currently available does not warrant the federal government becoming the primary insurer for all damages resulting from certain disasters. Instead, the federal government should conduct an assessment of the availability of insurance to protect against natural disasters and the way in which this insurance is regulated, as well as the causes of the losses and insolvencies. In addition, the federal government needs to assess the most appropriate ways to provide disaster assistance for earthquakes and volcanic eruptions, including private mechanisms such as special reserves set up to pay for damages from catastrophic earthquakes. Ways to improve such regulation, including the enactment of federal standards and ways to deconcentrate risks (for individual companies) in disaster prone areas, should be included in such an inquiry.

Reinsurance—the critical link. One of the ways in which primary insurers protect themselves is through the mechanism of reinsurance, which is designed to spread the risk as far as possible to minimize losses on particular companies or sectors of the industry. At the time of the 1992 disasters, the reinsurance industry had already been hit hard by losses from the California earthquake and fees and other disasters that were not sufficiently underwritten or priced. Reinsurance rates reportedly rose and the availability of reinsurance contracted. In addition, the way in which reinsurance contracts were written subjected reinsurers to losses they did not think possible until Andrew and Iniki.

Although the losses from Andrew and Iniki depleted much of the reinsurance market's surplus, there are reports of new capital being infused into the catastrophic reinsurance market. Reinsurance availability is in fact making a comeback, a natural response to a market whose supply has been depleted. According to a report of the Insurance Information Institute in August of 1993, "[a]t present, all signs point to an expanding market, with reduced rates and added availability of reinsurance."[3] Furthermore, as a result of Andrew and Iniki, reinsurers learned many lessons about their exposure and how to underwrite and contract for it in the future. The nature of insurance is being able to assess the risk and plan for it; the information from any natural disasters only encourages and helps insurers better predict losses in the future.

But it is difficult to determine the extent and nature of reinsurance available in the domestic and international market because reinsurance is not subject to direct regulation in the same way that insurers in the primary market are. Much of the information about the reinsurance market comes from the industry itself. Before the federal government becomes involved with providing reinsurance, an independent assessment of the reinsurance market, domestic and international, should be conducted to determine whether or not the private market is capable of underwriting catastrophic losses of a certain scope and kind. If the reinsurance market does not have the ability to underwrite, for what kinds of risks or catastrophes is this true? Only if these questions are answered can the government then go on to determine

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[2] As stated in a report issued by the Insurance Information Institute, "[i]t is important to note that while individual companies may pull back from coastal areas, the property insurance industry as a whole continues to supply insurance to practically every property in the United States." The Catastrophe Reinsurance Crunch, August 20, 1993, page 5.

[3] The Catastrophe Reinsurance Crunch, at page 1.

the most appropriate mechanism to provide the disaster assistance. These may or may not entail a private-public insurance program.

And finally, before the government commits resources to protecting an industry or embarking in a joint effort with such industry, it should be in a position to regulate and oversee that industry. We believe that federal legislation to regulate the insurance market needs to be enacted to ensure federal oversight over an industry that taxpayers may end up supporting.

II. The scheme provided for in the Natural Disaster Protection Act of 1993 casts too wide a net of protection for the insurance industry without assuring that the goals of disaster assistance are met.

The goals of any federal disaster assistance program should include notions of equity and consistency in the treatment of victims, as well as minimizing loss. To achieve these goals, the program's assistance should not vary according to income classes and should treat victims of similar disasters who endure similar losses alike. Disaster assistance must also distribute the burden of loss and limit the potential for loss as much as possible. Toward this end, such assistance should have an effect on where individuals decide to locate structures to minimize losses in the future.[4] By including a variety of disasters in the program and obligating the federal government to cover all losses from certain disasters without providing assurances of appropriate mitigation measures, S. 1350 falls short of achieving the goals of an effective disaster assistance program.

The mitigation measures do not go far enough to ensure the reduction of loss from natural disasters. Though the mitigation program outlined in S. 1350 represents a positive step in mitigating against losses, we have serious concerns including:

1. *Assessment by independent entity:* We believe that before the federal government establishes a mitigation program, the government should study what the mitigation measures should be and how best to achieve mitigation.

2. *Effect on older housing stock:* The mitigation measures do not address older housing stock, which may suffer the most extensive damage. Much of our older housing stock is concentrated in the urban cores and provides housing for much of our low income population. While certain measures may not be cost-effective, we are concerned that if mitigation measures are not applied to older housing stock, insurance premiums on such property may be more expensive and have a debilitating effect on low-income neighborhoods, some of which may go unprotected as the result of high premiums.

3. *Enforcement:* The proposal does not provide a mechanism that will ensure mitigation measures are put in place. We understand the intent of holding states responsible for complying with the mitigation program. But we are concerned that states will vary dramatically in their ability (financial and otherwise) and intent to carry out the mitigation plan. We are also concerned that local communities, particularly low-income, will be unfairly penalized if the politics and state bureaucracy are such that those communities are not helped to be brought into compliance. In addition, the bill places responsibility with the states to develop ways to verify compliance and to identify areas within the state which are at-risk. In order to ensure uniformity of compliance and risk-area standards across the country, it may be more appropriate for a federal entity to determine the specific areas at risk as disaster zones do not necessarily follow state borders.

4. *Incentives for insurers not included:* If the federal government becomes the primary insurer for these disasters and insurers have access to reinsurance from the federal government, what incentives to mitigate will insurers have? Insurers can play a key role in loss reduction but the scheme presented in S. 1350 fails to provide sufficient incentives.

The Primary Insurance Program represents open-ended liability for the federal government, which could be massive. Under S. 1350, the federal government is not only responsible for natural disasters of such catastrophic proportions that they wipe out the private insurance market—the federal government will be responsible for all losses resulting from the covered natural disasters. The Treasury, the states, local communities and victims who are in need of federal relief but unable to get any because the federal government has obligated itself already to mandatory. not discretionary expenditures will all be hit hard.

We are concerned that the primary insurance program will enable private insurers to profit at the expense of the public. Although one part of the primary insurance program states that private insurers will participate "on other than a risk-sharing basis," (sec. 301(b)) another section provides that an insurer can provide "coverage on its own behalf" (sec. 303(d)(2)). This sets up a situation which enables

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[4] United States General Accounting Office, "Federal Disaster Assistance: What Should the Policy Be?" June 16, 1980, page ii.

the private market to "cherry-pick" the best risks, leaving the worst risks for the federal government to pick up.

The Reinsurance Program provides insurers with complete protection, with no incentives to accurately price their products or to institute loss reduction measures, while leaving the federal government holding the bag. The reinsurance program puts the government in the role of reinsurer, subjecting the Treasury to future obligations without getting anything in return from private insurers. We have several concerns about the scope of the reinsurance program, including:

1. *Role of federal government in providing reinsurance:* The purpose of reinsurance is to distribute losses as far and as widely as possible. Currently, that is done through a domestic and international reinsurance market. If the federal government becomes the catastrophic reinsurance pool, the chain of distribution will be brought to a halt at the Treasury's door. This could have severe economic consequences for the generation of capital into the private reinsurance market, particularly in the international market.

2. *Regulatory oversight by the federal government is needed:* Prior to any federal involvement in providing disaster assistance in any form to the private reinsurance market, the federal government must first have regulatory oversight over the market.

3. *The reinsurance program may create disincentives to accurately price and institute loss reduction measures:* If the private reinsurance market can rely on a federal government bailout, companies have an incentive to underprice. This would allow them to use the money to pay out dividends to shareholders and later have taxpayers pick up the bill. In addition, if reinsurers have protection of the federal purse, what incentive is there to implement or require loss reduction measures? There are no such requirements in the bill.

4. *Setting the appropriate trigger:* Before the federal government takes on future obligations, it should determine, through an independent analysis, at what point this undertaking is appropriate. The trigger currently relates to the amount of "gross losses" the industry is "likely to incur" rather than the amount of loss to surplus companies actually pay out. At what point the reinsurance fund is triggered is a critical element of the bill and must be analyzed before the government agrees to paying for losses in excess of it.

5. *Bailout of individual companies is not an appropriate role for the federal government:* The program provides for two important triggers, one is for the industry and one for individual companies. This minimizes the incentives for insurers to reinsure each other. If taxpayers are expected to pay for liabilities in excess of the fund, this should be done only on an aggregate industry basis.

By combining several natural disasters in the program, the program creates perverse disincentives. One of the goals of any disaster assistance program is to affect locational decisions and minimize loss. One of the reasons for providing disaster assistance through an insurance mechanism is to serve as an incentive to reduce losses because the individual is charged for the risk through the premium. Cross-subsidization of risks, however, is contrary to the purpose of insurance. By combining hurricanes, tsunamis and earthquakes, the positive incentives to locate in a less risky area or to take specific measures to reduce loss are lost because a consumer is not charged for a particular risk but for a number of risks. As stated by GAO, "assistance programs should be designed to minimize incentives for poor locational decisions."[5]

The program includes risks that are not of similar predictability or of similar severity. Catastrophic earthquakes occur infrequently relative to hurricanes and windstorms. More information is available about hurricanes; hurricane exposure is more limited in its geographic scope; and advance warning systems play a role in minimizing damage from hurricanes but not from earthquakes. These risks are not similarly predictable or severe and combining them creates a cross-subsidization which is antithetical to the goals of an insurance program.

The Advisory Committee has a great deal of responsibility and authority and its make-up is biased toward the insurance industry. The membership of the Advisory Committee is substantially tilted in favor of insurers; four out of the seven slots would conceivably represent insurer interests. Considering the major role given this Committee under the proposal and the fact that it will be financed by taxpayers and consumers, a majority of the membership must represent an ethnically and geographically diverse cross section of the public.

Thank you for the opportunity to testify today.

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[5] GAO Report, at page iv.

Senator INOUYE. Thank you very much Ms. Griffin. Now, may I call on Mr. Snyder?

STATEMENT OF JOHN SNYDER, SENIOR VICE PRESIDENT, A.M. BEST CO.

Mr. SNYDER. I would like to begin, Mr. Chairman, by providing the committee with a brief comment on what A.M. Best is and the role we play in the insurance industry and the public.

A.M. Best is the leading independent rating agency in the insurance industry and monitors the financial health of over 2,400 property-casualty insurance companies which represent virtually all the operating insurance companies in the United States. Our role is to provide an independent evaluation of the financial health of the industry and its companies, and to assign financial strength ratings reflecting a company's ability to honor its policyholder claims in the future.

A.M. Best is considered a consumer advocate specializing in the insurance industry. Our primary goal is to encourage companies to be financially prudent by using our rating process in interaction with management to constructively evaluate a company's underwriting and investment exposures and capital structure.

In contrast with other consumer advocate organizations, we take a long-term view of the industry's role and are primarily concerned with its ability to meet its financial obligations to policyholders.

Our role as a rating agency is not necessarily concerned with other consumer issues such as policy features or the availability and affordability of insurance coverages. We believe, though, a competitive industry with financially strong companies is in the long-term best interest of the public.

The catastrophe events of 1992 and the first 10 months of 1993 have put the property-casualty industry in a predicament. The industry did not anticipate the magnitude of claims brought on by Hurricanes Andrew and Iniki, and it was stunned and largely unprepared. In the wake of these hurricanes 11 companies became impaired or insolvent and were seized by State regulators. Many other companies, like the household name Prudential Property and Casualty Insurance Company, or PRUPAC, was financially damaged, and required large capital infusions from its parent company to ward off insolvency and restore it to financial health.

To further underscore the fact that the industry is in turmoil all one has to do is look at the vast number of management changes and restructurings that have occurred since Andrew within the insurance industry.

The $22 billion of insurance catastrophe damages in 1992 alone drained the industry of financial strength and particularly affected just 200 companies and their reinsurers. Although some will question this assertion by pointing to the fact that the industry reported statutory surplus actually increased 2.5 percent in 1992 to $163 billion is an accounting improvement and does not capture the economic reality of the industry's underlying financial condition.

Fortunately, the industry was blessed with declining interest rates and a strong bond market, and the hurricanes prompted many companies to realize substantial unrealized gains that were embedded within their bond portfolios. This cherrypicking generated $10 billion in capital gains for the industry, but it came at the expense of liquidating approximately two-thirds of the industry's $400 billion bond portfolio.

The $240 billion of bonds that were sold were subsequently reinvested at substantially lower rates which will reduce the industry's investment income for years to come, and concurrently its ability to offset future underwriting losses.

Furthermore, this massive liquidation has substantially reduced the industry's position of unrealized gains which represent a hidden strength within its balance sheet. If it were not for the $10 billion of capital gains combined with an addition $5.5 billion of contributed capital that entered the industry in 1992, the industry's surplus position would have declined by almost 5 percent to $151 billion. The surplus decline was even more severe with the 200 most affected companies.

In response to these events we have reduced the financial strength ratings of over 60 companies due to their diminished financial strength or because they face ongoing catastrophe exposures from either wind, hail, or earthquake that they cannot prudently support with their combined capital and reinsurance resources.

More downgrades may occur depending on the outcome of a number of individual company and State initiatives to reduce catastrophe exposures, such as the one we are discussion today.

At the risk of making some broad generalizations, many insurance companies found themselves in a predicament because they mismanaged the growth over the last decade in rapidly developing catastrophe sensitive regions of this country, and their property exposures became overly concentrated.

This was compounded by the fact that many standard catastrophe computer models utilized by the industry substantially underestimated the potential cost of catastrophes. Catastrophe modeling is critical to determining how much catastrophe reinsurance a company should purchase, and mistakes or poor models can be fatal.

These two factors combine to leave many companies overexposed and under-reinsured for catastrophes. The situation was recently made worse with the sharp contraction of catastrophe reinsurance capacity and its sharp rise in price following Hurricanes Andrew and Iniki.

Due to the industry's realization that hurricane exposures are much greater than previously thought, combined with a weakened financial condition for many companies, the industry is making a fast retreat from hurricane-exposed States, and to a lesser degree earthquake-prone regions, in order to bring in line their property exposures with their financial and reinsurance capacity to prudently support them, which we believe is necessary and support in order for them to honor their future obligations to policyholders.

In particular this action has led to availability problems as already cited in Hawaii and Florida, and to a lesser extent Texas, New Jersey, Long Island, and Connecticut. Companies have or they are in the process of completely reexamining their internal risk management controls, catastrophe modeling, and reinsurance programs.

Many individual company decisions that have been made to date have collectively created emerging availability problems that have become a nightmare for regulators, mortgage lenders, and politicians. As we have seen, these groups have taken this problem into their own hands and have implemented or proposed a number of solutions. Many of these solutions are politically expedient. They may only mask the problems or postpone them.

I would like to share with you some brief observations on political insurance solutions that have been put before us in the past. On the surface many of these programs simply shift catastrophe exposures from the private insurance sector to the public sector. However, the insurance sector continues to remain exposed through backdoor assessments.

The defensive position that the industry has taken over the last 12 months has created a vacuum that has forced the regulators and legislators to step in, which may result in a permanent loss of traditional property business to State and federally administered facilities.

Although the ability to underwrite and control this business may have been permanently lost to the private industry, the exposures have not, since some form of assessments to the companies remain.

Potential exposures that could accumulate in these newly formed or proposed facilities are immense. This is due to the motivation of the private insurance sector to insure only low to moderate property risk with the high-risk accounts ultimately finding themselves in some State or Federal facility. As most State or federally administered programs have proven over the years, the rate structure within these facilities has not fully covered their costs and deficits are invariably generated.

Ultimately, these programs may indirectly jeopardize the solvency of companies through the indiscriminate, and in some cases, unlimited assessment features. More importantly, they do very little to mitigate our better managed catastrophe exposures that exist. In fact, some actually encourage commercial and residential development in highly exposed areas since insurance availability is guaranteed.

Now, I would like to make some observations, too, with respect to today's hearing on just the Natural Disaster Prevention Act. The hazard mitigation program within the act includes many features that will mitigate the future claim severity and cost of disasters. They include better building codes, stricter enforcement, more prudent development in coastal areas, flood zones, and earthquake fault lines, better disaster response, and postdisaster property preservation measures. These issues get at the core of reducing the cost of catastrophes through incentives and better risk management of property.

The long-term savings that can be realized from these measures are immense, even though it will take decades to develop and implement. They are a critical component, though, of any serious national catastrophe plan.

However, within the primary insurance program of the act a shortcoming of its design is that the purchase of the primary insurance coverage is not mandatory. This may lead to adverse risk selection within the primary program where only the highest exposed property owners purchase the coverage and leave the program underfunded.

This is consistent with the experience with the National Flood Program, where only 2.5 million out of the 8 million known universe of homeowners that live in flood plains purchase flood insurance. Of the 2.5 million of homeowners that do purchase coverage, many are in high-risk flooding areas, resulting in an underfunded position.

Within the national reinsurance program of the act, a shortcoming of its design is the inclusion of a second trigger that allows companies to use the Federal reinsurance facility if they experience losses from a catastrophe that exceed more than 20 percent of their surplus. This second trigger applies if a 12-month period of catastrophes does not exceed the threshold of the first industrywide trigger of 15 percent of the industry surplus, which is approximately $25 billion at today's levels.

This second company specific trigger, I believe, is not necessary, in that it would only apply to smaller, single State, or regional insurance companies that do not have immense catastrophe exposures that cannot be adequately protected by catastrophe protection in the current reinsurance market.

Over the last 12 months, approximately $5 billion of capital has been committed to the formation of 13 catastrophe reinsurance facilities offshore, primarily in Bermuda, with the ability to write up upward of $10 billion of catastrophe reinsurance premiums. This new capacity should be able to provide approximately $125 million of catastrophe protection for a single company's program.

Existing market capacity can provide approximately $200 million of catastrophe protection, which when combined with this new capacity can provide approximately $300 to $325 million of catastrophe protection for a single insurance company.

This recent expansion in the amount of coverage available in the catastrophe market should satisfy the reinsurance needs of most smaller, single State and regional companies where the second trigger primarily is involved.

Furthermore, with the single company trigger the reinsurance facility, the Federal reinsurance facility would be activated on a regular basis since many smaller companies lose 20 percent or more of their surplus through the course of many normal, "catastrophe" years from snow, hail, windstorm, as well as cold snaps in various parts of the country. This feature would put the Federal facility into the reinsurance business on a regular basis and would preclude the private reinsurance industry from underwriting catastrophe exposures it is capable of handling.

In conclusion, the overall concept of the act is good and will reduce the cost of disasters and will improve the stability of the insurance industry. However, as I briefly outlined, the act does have its share of shortcomings that could be detrimental to its effectiveness and to the private reinsurance industry.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Snyder follows:]

PREPARED STATEMENT OF JOHN H. SNYDER

The A.M. Best Company is the oldest independent rating agency in the insurance industry and monitors the financial health of over 2,400 property/casualty insurance companies, which represent virtually all actively operating companies in the United States.

Our role is to provide an independent evaluation of the financial health of the industry and its companies, and assign financial strength ratings reflecting a company's ability to honor its policyholders' claims in the future. A.M. Best is considered a consumer advocate specializing in the insurance industry. Our primary goal is to encourage companies to be financially prudent through our rating process and interaction with management, by evaluating underwriting and investment exposures and capital structure. In contrast with other consumer advocate organizations, we take a long term view of the industry's role and its ability to meet its financial obligations to policyholders. Our role as a rating agency is not necessarily concerned with other consumer issues such as policy features, or the availability and affordability of insurance coverages. We believe a competitive industry with financially strong companies is in the long term best interest of the consumer.

The catastrophic events of 1992 and the first ten months of 1993 have put the property/casualty industry in a predicament. Since the industry did not anticipate the magnitude of claims brought on by Hurricanes Andrew and Iniki, it was stunned and largely unprepared. In the wake of these hurricanes, 11 companies became impaired and were seized by state regulators. Many other companies like Prudential Property and Casualty Insurance Company, or PRUPAC, were financially damaged and required large capital infusions from their parent companies to ward off insolvency and restore them to financial health.

The $22 billion of insured catastrophe damage in 1992 drained the industry's financial strength, and particularly affected 200 companies and their reinsurers. Although some will question this assertion by pointing to the fact that the industry's reported statutory surplus actually increased by 2.5 percent in 1992 to $163 billion, this is an accounting improvement and does not capture the economic reality of the industry's underlying financial condition.

The hurricanes prompted many companies to realize the substantial unrealized gains that were embedded within their bond portfolios. This cherry picking generated $10 billion in capital gains for the industry, but it came at the expense of liquidating approximately two thirds of the industry's $400 billion bond portfolio. The $240 billion of bonds that were sold were subsequently reinvested at substantially lower rates, which will reduce the industry's portfolio yield for years to come. Furthermore, this massive liquidation has substantially reduced the industry's position of unrealized gains, which represent a hidden strength within its balance sheet. If it were not for the $10 billion in gains, combined with $5.5 billion of contributed capital that entered the industry in 1992, the industry's surplus position would have declined by 4.5 percent to $151 billion. The surplus decline was even more severe for the 200 most affected companies.

We have reduced the financial strength ratings of over 60 companies due to their diminished financial strength or because they face ongoing catastrophe exposures from wind, hail or earthquake that they cannot prudently support by their combined capital and reinsurance resources. More downgrades may occur depending upon the outcome of a number of individual company and state initiatives to reduce catastrophe exposures.

At the risk of making broad generalizations, many insurance companies mismanaged their growth over the decade in catastrophe sensitive regions of the country and their property exposures became overly concentrated. This was compounded by the fact that many standard catastrophe computer models utilized by the industry substantially underestimated the potential cost of catastrophes. The catastrophe modeling is critical in determining how much catastrophe reinsurance a company should purchase. These two factors combined to leave many companies overexposed and underreinsured for catastrophes. The situation was recently made worse with the sharp contraction of catastrophe reinsurance capacity and its sharp rise in price following Hurricane Andrew.

Due to the industry's realization that hurricane exposures are much greater than previously thought, combined with a weakened financial condition for many companies, the industry is making a fast retreat from hurricane exposed states, and to a lesser degree in earthquake prone regions, in order to bring in line their property exposures with their financial and reinsurance capacity to prudently support them. In particular, it has led to availability problems in Florida and Hawaii and to a lessor extent in Texas, New Jersey, Long Island and Connecticut.

Companies have, or are in the process of, completely reexamined their internal risk management controls, catastrophe modeling and reinsurance programs. Many of the individual company decisions that have been made to date have collectively created an emerging availability problem that has become a nightmare for regulators, mortgage lenders and politicians. As we have seen, these groups have taken the problem into their own hands and have implemented or proposed a number of solutions. Although many of these solutions are politically expedient, they may only mask the problems or postpone them.

On the surface, many of these programs simply shift catastrophe exposures from the private insurance sector to the public sector. However, the insurance sector continues to remain exposed to backdoor assessments. The defensive position the industry has taken over the past twelve months has created a vacuum that has forced the regulators and legislators to step into and may result in a permanent loss of traditional property business to state or federally administered facilities. Although the ability to underwrite and control this business may have been permanently lost to the industry, the exposures have not, since some form of assessment remains.

The potential exposures that could accumulate in these newly formed or proposed facilities are immense. This is due to the motivation of the private insurance sector to insure only the low-to-moderate property risks. The high-risk accounts ultimately will find themselves in some state or federal facility. As most state or federally administered programs have proven over the years, the rate structures within these facilities may not fully cover their costs and deficits are invariably generated. Ultimately, these programs may indirectly jeopardize the solvency of companies through their indiscriminate and, in some cases, unlimited assessment features. More importantly, they do very little to mitigate or better manage the catastrophe exposures that exist. In fact, some actually encourage commercial and residential development in highly exposed areas since insurance availability is guaranteed.

With respect to today's hearing on the Natural Disaster Prevention Act (S. 1350), the hazard mitigation program within the Act includes many features that will mitigate the future claim severity of disasters. They include better building codes with stricter enforcement; more prudent development in coastal areas, flood zones and on earthquake fault lines; and better disaster response with post-disaster and property preservation measures. These issues get at the core of reducing the cost of catastrophes through better risk management of property. The long-term savings that can be realized from these measures are immense, and even though it will take decades to develop and implement, they are a critical component of any serious national catastrophe plan.

However, within the primary insurance program of the Act, a serious shortcomings of its design is that the purchase of the primary insurance coverage is not mandatory. This may lead to adverse risk selection within the primary program whereby only the highest exposed property owners purchase the coverage and leave the program underfunded. This is consistent with the experience of the National Flood Program whereby only 2.5 million out of the 8 million known universe of homeowners that live in flood plains purchase flood insurance. Of the 2.5 million homeowners that do purchase the coverage, many are in high risk flooding areas.

Within the national reinsurance program of the Act, a shortcoming of its design is the inclusion of a second trigger that allows companies to use the federal reinsurance facility if they experience losses from a catastrophe that exceeds more than 20 percent of their surplus. This trigger applies if a 12-month period of catastrophes do not exceed the threshold of the industry-wide trigger of 15 percent of its surplus, or $24 billion at current levels. This second company specific trigger is not necessary in that it would only apply to smaller single state or regional insurance companies that do not have immense catastrophe exposures that cannot be adequately protected by the catastrophe protection available in the reinsurance market. Over the last twelve months, approximately $5 billion of capital has been committed to the formation of thirteen catastrophe reinsurance facilities in Bermuda with the ability to write upwards of $10 billion in catastrophe reinsurance premiums. This new capacity should be able to provide approximately $ 125 million of catastrophe protection for a single company's program. Existing market capacity can provide approximately $200 million of catastrophe protection, which when combined with the new capacity can provide approximately $325 million of catastrophe protection for a single company. This recent expansion in the amount of coverage available in the catastrophe market should satisfy the reinsurance needs of most smaller single state and regional insurance companies. Furthermore, the single company trigger would be activated on a regular basis since many smaller companies lose 20 percent or more of their surplus through the course of many "normal" catastrophe years from snow, hail and windstorms as well as cold snaps. This feature would put the federal facility into the reinsurance business on a regular basis and would preclude the private reinsurance industry from underwriting catastrophe exposures it is capable of handling.

In conclusion, the concept of the Act is good and will reduce the cost of disasters and will improve the stability of the insurance industry. However, as I have briefly outlined the Act does have its share of shortcomings that could be detrimental to its effectiveness and the private reinsurance industry.

Senator INOUYE. Thank you very much, Mr. Snyder. This panel is a very important one because the staff, with some deliberation, arranged this to make certain that all of the possible viewpoints can be expressed here, because those of us who had the privilege of introducing this measure are well aware that it is not perfect, that there are shortcomings as Mr. Snyder has pointed out, and we would like to make certain that when we do present this to the Senate it will be a measure that most members can support.

Mr. Weber, you played a major role in bringing this about. What are your comments to Ms. Griffin's suggestions?

Mr. WEBER. Well, Senator, I think that in this hearing today we have all learned that this is a very complex issue, and I think there are a lot of misperceptions about what this legislation does and what it does not do.

For instance, I recall that Senator Breaux mentioned that he was concerned about whether this legislation deals with the issue of hurricanes and it absolutely does because the fundamental problem in the areas that face the hurricane risk is the unavailability of insurance in these disaster prone regions.

Standard homeowners insurance already covers the peril of hurricanes, so that the way that the legislation addresses the hurricane issue is through the creation of this reinsurance program that we have talked about.

In terms of Ms. Griffin's comments directly, the point about the mitigation not going far enough, we think that this legislation is the most comprehensive, far reaching effort to improve mitigation in this country that we have seen in the last 15 years, and I would say that I would allow the emergency managers and the firefighters and those other groups to answer her comments about whether or not it goes far enough.

In terms of the issue of reinsurance and the incentives that this will have for companies to underprice the market, let me first say that companies would be buying reinsurance based upon their own risk profiles, and that companies would be paying a greater premium for reinsurance in those areas of the country where they were exposed to natural disasters.

But for the most part, companies want to do business in these disaster-prone areas as long as they can protect themselves against that worst case event. And that is precisely what this reinsurance program is intended to do. It is not intended to transfer the risk to the Federal Government. It is intended to create a mechanism that companies can use to set aside their own funds through this reinsurance program for the unlikely event that this major event were to occur.

If the major event does not happen, if an event that is $25 billion or greater does not occur, then the market continues to operate as it has and continues to today. This is only intended to provide that catastrophic level of coverage.

Senator INOUYE. Ms. Griffin.

Ms. GRIFFIN. Just a couple of things. On the issue about the reinsurance, the whole point of reinsurance is to spread the risk as far and wide as possible. If the Federal Government becomes the reinsurer of last resort, even if it is at a trigger as high as $25 billion, our concern is that it may serve as a disincentive to spread the risk far and wide. And I think Mr. Snyder had mentioned that, too.

And with regard to the mitigation program, we obviously see it as a good step forward, but we do not believe we are in the position to determine whether or not it is the best kind of mitigation. We think before the Federal Government moves forward with the bill that we should get it right. And this is another reason why we are asking for further independent analysis of what mitigation measures are most appropriate, and how should they be brought about.

Under this proposal, the States are allowed to determine which risk areas or which areas in a particular State are most risk-prone and are also able to set up standards for compliance. We think that there has got to be some uniformity to that or some Federal minimum standards because we are concerned that certain disasters across State lines are going to be treated very differently depending on the State, and perhaps there is a role for the Federal Government to be determining those areas and determining what is needed in those areas, not just to determine whether a State is earthquake-prone or other disaster-prone.

Senator INOUYE. Ms. Griffin, do you look upon this measure as an insurance bailout program?

Ms. GRIFFIN. One of the problems that we see is in the primary insurance program. In the reinsurance program, despite the fact that I understand that there is going to be borrowing authority and that they are supposed to be paying back there is always the risk that the payback will not be that easy and that the fund will have to dip into taxpayer money.

Also, the primary program commits. I mean, these are contracts that the Federal Government is going to be writing. I do not see how they can just say, "Sorry homeowner, we cannot pay any more." They are going to have to pay the claims as they come in because they are under contract as an insurance provider.

Mr. WEBER. I would like to respond to that. In terms of the reinsurance elements, if you take a look at the situation in the aftermath of Hurricane Andrew in Florida which caused $18 billion in insured loss, which was approximately four times greater than any other event in U.S. history. In that situation, some of the very largest insurers in this country paid extraordinary amounts in claims.

Several of those companies faced technical insolvency as a result of an $18 billion insured loss from a storm which missed the major metropolitan area of Miami and Fort Lauderdale. The strongest sustained winds in the Miami area were only about 85 miles per hour. Most of the damage was done south of Miami, and we now know that had that storm moved just 30 or 40 miles north, we would have been looking at closer to $50 billion. The map that we have here shows some of the projections that have been generated in terms of some of the other exposures that exist.

If we have a $70 or $80 billion disaster, I can assure you that the insurance industry will not be capable of sustaining those kinds of blows. And what will end up happening is that the Federal Government will have to step in, not only to provide liquidity to the industry, but also to make sure that the claims from homeowners are, in fact, paid.

Now, we have two ways to handle that problem. One is that we can begin setting aside money so that if this event does occur, that there are funds already building up for that eventuality. The other alternative is that we do nothing. And if we do nothing and that $85 billion event were to occur, then we will be starting from scratch, we will not be starting from the advantage of having money set aside in advance. And that, I think, is the whole point of a Federal reinsurance program.

Senator INOUYE. Mr. Snyder, what are your thoughts?

Mr. SNYDER. I agree with Jack Weber that the industry does need a supercatastrophe reinsurance facility to address some of these numbers that are up here on this board. The $45 billion, the $52 billion, the $53 billion, those are staggering sums that the current reinsurance industry, the global reinsurance industry cannot absorb unless substantial capital comes into the business, which is not foreseeable in the near future.

It is a question of, you know, where you put the trigger. The trigger is set right now at 15 percent or approximately $25 billion. The bill itself is supported by the RAA, which is the Reinsurance Association of America, so I have to assume that the reinsurance industry is kind of content with the fact of not getting into the business above that trigger point. And clearly it cannot, at the moment, given its capacity.

Some of the problems or some of the potential problems in—I guess maybe I am a pessimist in this regard, is will the business be—will the reinsurance that the Federal Government effectively takes on or writes contractually, will it be priced correctly? Will it be actuarially "sound"?

You look at some past experience of when the industry got into—when the Federal Government, or the States for that matter, get into the insurance business, they have a tendency to be a little cheap, so to speak, in their pricing, and it generates deficits over time or is not maybe terribly realistic. That is definitely an area that has to be safeguarded against.

As far as that second trigger, though, that I mentioned, that clearly would put the business of reinsurance in the Federal facility's hands on a day-to-day basis. That would be activated on a month-to-month basis, if not weekly, because you have events, whether it be hail or wind or whatever, throughout the country where it damages a smaller insurance company within that area that potentially would trigger that 20 percent.

Mr. WEBER. Jack, that is not accurate. The language in the bill states that the only events that would be eligible for reinsurance would be those in excess of $1.5 billion for that second trigger. To date, we have only had eight such events in the history of the United States, and in most of those cases the majority of the losses were incurred by companies that would not trigger under that second 20 percent. So, this is not a reinsurance program intended to handle routine losses from hail, wind, rain, or anything like that. It would only count if an event was over $1.5 billion.

Mr. SNYDER. OK, that was my misunderstanding.

The last piece that I touched upon was the compliance issue. In order to make this primary program sound on an actuarial basis, it does require voluntary participation on the part of the companies which would, in turn, be able to access the Federal reinsurance facility. And you have the potential of companies not participating, and therefore having products that do not have this extended coverage, but would be cheaper in price.

We have a public that is very cost conscious. Unless there is a serious educational campaign, you would potentially have a number of homeowners that either unknowingly or unknowingly buying the cheaper policy, so to speak, not having this coverage, and it could be quite widespread.

The Federal flood program, interestingly enough, by law, forces commercial banks and institutions to require that homeowners that are in these flood plains, designated flood plains, purchase the Federal flood insurance. There is actual enforcement within the Federal flood program, although, as you know—as we note to date, even though there is that power, that enforcement is there, it still has had some lackluster results in that only 2.5 out of roughly 8 million homes are purchasing flood insurance.

So, we can only speculate what would be the percentage of people participating in the program. Clearly as you get into the more catastrophe prone regions of the country, whether it be earthquake or hurricane, the pricing component within the primary program is going to be quite substantial. This is not, you know, a couple of dollars a year for someone living in Dade or Broward County, or for that matter Hawaii. It is going to have to be significant dollars. You potentially have companies that are not in the program being a magnet for this kind of business because they offer a less expensive policy, albeit without the expanded coverage.

Senator INOUYE. Ms. Griffin, you have made some recommendations here on conducting analysis.

Ms. GRIFFIN. Yes.

Senator INOUYE. What agency should be responsible for that? You speak of an independent entity in one case, and then you speak of the Federal Government?

Ms. GRIFFIN. Well, in terms of conducting an analysis, a scientific analysis, possibly the National Academy of Sciences could conduct a feasibility study. Unfortunately, as you know, the Federal Government has, up until this time, not been really involved in the regulation of insurance, and that is one problem in terms of finding the expertise. But I know that GAO had done a report on disaster policy in 1980, and perhaps GAO could conduct another analysis, or FEMA and the National Earthquake Hazards Reduction Program.

I think there is a variety of options. I am not sure exactly where it belongs. But before we jump in and before we just get information from the industry itself, that some analysis take place.

In fact, as I mentioned in a footnote in my testimony, in a study published under a grant from FEMA last year they specifically said that future research should be conducted in a variety of areas, including the reinsurance market, the primary insurance market, whether or not earthquake insurance should be mandatory or voluntary, and how best to distribute the loss across varying segments of society and geographic areas. I think that really needs to be addressed. I think it is time for that. But I would like to see that done before a program is established.

And I understand there are certain States, and Hawaii is very much—in some ways is very unique. Because you have 218,000 policyholders, it is very difficult to spread the risk, and I understand that. But I think there may be alternatives that may not involve the entire country; for example, maybe a Coastal States program, or something like that. But I think we really need to look at the alternatives before we jump in full scale.

Senator INOUYE. Well, with that I would like to thank all of you for participating in this hearing.

This will not be the last hearing. I would expect that there will be other hearings following this. I am certain that we will have before us FEMA and HUD. I hope to have a panel of insurance companies. And as I indicated when this matter was introduced, I hope to have this bill considered by the Senate and House sometime during this session. So, hopefully a year from now, something akin to this measure will be on the President's desk.

With that, I would like to thank all of you.

Ms. GRIFFIN. Thank you.

Mr. WEBER. Thank you, Senator.

Senator INOUYE. This hearing is adjourned.

[Whereupon, at 1:45 p.m., the hearing adjourned.]

APPENDIX

Prepared Statement of Senator Gorton

I am a cosponsor of the Natural Disaster Protection Act and pleased that the Commerce Committee is holding a hearing on this important measure. From floods to volcanoes, this bill takes a constructive, comprehensive approach to the many natural disasters that face our country.

As measured by property damage and loss, 1992 was by far the worst year ever for natural disasters. Hurricanes Andrew and Iniki caused losses approximating $20 billion. As those in the Midwest are only too well aware, 1993 has also been a terrible year causing massive losses due to floods. Each area of the country is vulnerable to different types of natural disasters. This bill takes a regional approach to these different types of risks by providing state and local governments incentives to enhance their disaster planning and mitigation efforts to meet their own particular needs.

I am particularly interested in this legislation because my state is very vulnerable to seismic activity—both volcanoes and earthquakes. Many homeowners in Washington state do not carry earthquake coverage. They may not realize how much at risk our state is to earthquakes, they may think that their regular homeowner's policy covers earthquake damage, or they may have checked and found that the coverage is too expensive. For whatever reason, too many homeowners are vulnerable to financial devastation if a severe earthquake hits Washington State.

The legislation before the committee today directs the Federal Emergency Management Administration (FEMA) to establish a multi-hazard insurance program to cover losses sustained by homeowners as a result of seismic perils. Private insurers would participate in the program by providing to all their policyholders living in risk areas seismic coverage as directed at the coverage level determined by FEMA. With coverage extended to all policyholders, the cost would drastically decrease.

Mr. Chairman, this is a very complex and technical bill. And, while it is important that we examine the details with great care, I believe the bill provides a sound foundation to begin to examine this important issue.

Questions Asked by Senator Pressler and Answers Thereto by Consumers Union

Question. As I mentioned, South Dakota was devastated by the continuous rainfall and flooding conditions during the past summer. How would S. 1350 address flood risks?

Answer. The programs contemplated by S. 1350 include a Primary Insurance Program which would cover earthquake and volcano risks for residential property only and the Reinsurance Program which includes a wider group of perils and commercial property. In the mitigation section of S. 1350, the proposal appears to envision a coordination of effort between the National Flood Insurance Program (NFIP) and the multi-hazard program with regard to the implementation of mitigation plans. This section also directs FEMA to identify states that are flood-prone and states to include the flood performance standards of the National Flood Insurance Act (NFIA) in their mitigation program. Although NFIP would continue to be administered separately, in section 301(e) the Director is directed to study the feasibility of including flood as a covered peril under the Primary Insurance Program. In addition, section 301 attempts to strengthen the flood program by requiring agents to notify FEMA if a policyholder refuses to purchase required flood insurance. It is unclear, however, how that portion of the program will be implemented or enforced.

The proposal contained in S. 1350 contemplates the eventual merging of the flood insurance program with the multi-hazard program. While both programs would be under the control of the Federal Emergency Management Agency, we would have the following concerns if these programs were joined: 1) As we stated in our written testimony, cross subsidization of risks is contrary to the purpose of insurance. The incentive to reduce loss may be lost as homeowners are not charged premiums based on a particular risk but a myriad of risks. This may create disincentives to locate in less hazard-prone areas. Flood and earthquake risks are extremely different in their predictability, frequency and severity. Combining them would result in a substantial cross-subsidization of risk. 2) The flood program has been operating for a number of years. The program is currently being reviewed as several problems, including participation rates and setting appropriate premium rates, have intensified. We do not think it would be appropriate to add the flood insurance program to a new multi-hazard program as it may serve to exacerbate the problems. 3) The flood insurance program is subsidized and all rates are not actuarially sound. And yet, the participation rate for flood insurance is low, due, in part, to the cost. Adding more insurance costs could further subvert the program. 4) There is no reason to believe that the Primary Insurance Program would not suffer from some of the same problems as the flood program.

As the federal government currently underwrites the flood program and private insurers do not carry the risks, flood risks would not be included in the lines covered by the Reinsurance Program.

Question. Other than the issue of flooding, how else would S. 1350 affect South Dakota?

Answer. Not knowing the particular risks and degree of risks that South Dakota is exposed to, we cannot state exactly how the proposal would affect South Dakota. In general, however, residents of any states assessed with any level of risk from these catastrophes will have to pay for more insurance. While some argue that this insurance for low-risk states will amount to only "pennies per policy," those pennies add up to billions of dollars which will be drawn away from consumers much needed discretionary incomes. In addition, much of the money paid will go to fund insurance companies' expenses rather than to pay claims.

Question. I am very concerned that this legislation could unduly burden the Federal Government at a time when we are in dire financial constraints. Is this a fair statement?

Answer. The programs will obligate the federal government to mandatory not discretionary expenditures. It is fair to say that these obligations could be massive, which could severely burden the federal government. There is borrowing authority under the bill with a requirement that the funds be paid back to the federal government but, depending on the amount borrowed, this may burden the Treasury's resources and taxpayers for a number of years.

Question. Taking into consideration the S&L crisis, isn't this legislation another bailout of an industry that is skirting the ragged financial edge?

Answer. The insurance industry in general and certain companies hardest hit by disaster costs, mismanagement, and over-concentration of risks are looking to the federal government to help bail them out of a situation they did not adequately prepare for. This request, however, comes without the full picture of the financial condition of the industry. We would urge the federal government to conduct further study and analysis to determine just what the financial state of the insurance and reinsurance industry is before it commits itself to providing such insurance and risking taxpayer dollars. In addition, it must be ascertained whether a private response or a non-insurance response is the more appropriate avenue to pursue if it is determined that there is a need for more extensive disaster assistance.

Question. I am concerned that citizens in low-risk States could pay an unfair share of the premium burden in comparison to the insurance benefit. Won't this legislative proposal increase the cost of insurance premiums for all policyholders?

Answer. As stated in the response to a previous question, to the extent that states are assessed risk at all, it will increase the cost of insurance premiums for all policyholders. The Primary Insurance Program will assess costs directly to the policyholders. Under the Reinsurance Program, which includes more risks, those costs can be expected to be passed on to all policyholders as well. Since there are a number of risks included in the programs, it is our understanding that most states will be assessed some level of risk, although that level may be quite small. Therefore, most, if not all, policyholders will be called upon to pay higher premiums.

Question. According to the Federal Emergency Management Administration (FEMA), only 20 percent of homeowners that should have flood insurance actually have it. Why? Is it due strictly to the expense of flood insurance?

Answer. While we have not studied this issue, it is our understanding that many homeowners choose not to purchase flood insurance because 1) the cost; 2) lenders do not always enforce the requirement that affected homeowners purchase flood insurance; and 3) some homeowners may believe that the risk does not need to be covered. This situation exists despite the fact that tide flood insurance program is mandatory. We are concerned that these same problems may plague the multi-hazard program of S. 1350.

QUESTIONS ASKED BY SENATOR PRESSLER AND ANSWERS THERETO BY MR. WEBER

Question. As I mentioned, South Dakota was devastated by the continuous rainfall and flooding conditions during the past summer. How would S. 1350 address flood risks?

Answer. Vast numbers of South Dakota residents experienced unreimbursed flood losses because they lacked flood insurance coverage. Flood insurance is not covered under standard insurance policies, and must be purchased as supplemental protection. Many homeowners are unaware that they are not automatically covered for flood losses. Others allow their supplemental coverage to lapse because it is not automatically renewed with their standard insurance policy.

S. 1350 calls for a 1-year study considering the feasibility of incorporating flood insurance coverage as part of comprehensive natural disaster insurance protection. Such a study would consider issues including how best to preserve flood plain management incentives and reduce Federal subsidies.

In the interim, insurance companies and agents would be required to do a better job of educating homeowners of the limitations of existing coverage and the need to purchase supplemental flood coverage in regions prone to flooding.

Question. Other than the issue of flooding, how else would S. 1350 affect South Dakota?

Answer. S. 1350 reduces taxpayer-supported disaster insurance. South Dakota taxpayers, along with all other taxpayers nationwide, paid an average of $93 toward relief costs in the wake of Hurricane Andrew, even though much of that loss was due to Florida's failure to enforce the local building code.

Indeed the single biggest threat to residents of South Dakota comes not from natural disasters directly, but rather from taxpayer-financed assistance to other regions of the country prone to such events. Since residents of these disaster-prone States will rely more on insurance and less on taxpayer-supported disaster assistance under this legislation, taxpayers in South Dakota will benefit.

I should point out that the reinsurance programs in S. 1350 also protect South Dakota residents by providing market stability in the aftermath of major disasters. Without such protection, companies doing business in South Dakota, who suffer losses from disasters elsewhere in the country, may be forced to curtail coverage in the State because of a weakened financial condition.

Question. I am very concerned that this legislation could unduly burden the Federal Government at a time when we are in dire financial constraints. Is this a fair statement?

Answer. S. 1350 should reduce the Government's financial burdens.

First, reinsurance premiums that companies will pay should add in excess of $1 billion each year to the Federal Treasury. Those revenues, including investment income, accrue directly to the Federal Government and count against the budget deficit.

The only time the Federal Government faces any added financial exposure is if a natural disaster occurs which exceeds the thresholds of reinsurance coverage, defined as approximately $25 billion, plus the accumulated surplus in the reinsurance fund. Such an event would be larger and more destructive than any in U.S. history.

The reinsurance fund is intended to prevent insurance company failures and the snowballing effect of unpaid claims in the aftermath of major catastrophes. Without such a plan, the Federal Government will still be liable for disaster assistance costs and none of these obligations will be prefunded, as they will be under S. 1350.

S. 1350 recognizes the reality that the Federal Government is already at risk, financially, to some future catastrophe. We believe it makes sense to recognize the inevitability of these costs, and to begin setting aside the money to deal with them NOW.

I might add that the Natural Disaster Coalition has commissioned an independent budget scoring analysis by the accounting firm, Coopers & Lybrand, which concludes that S. 1350 will be scored budget neutral, even under the most conservative application of scoring rules.

Question. Taking into consideration the S&L crisis, isn't this legislation another bailout of an industry that is skirting the ragged financial edge?

Answer. S. 1350 is the antithesis of an insurance industry bailout. Without a federally backed reinsurance program, a major catastrophe causing $50–$80 billion in insured losses will result in widespread insurance company failures. The snowballing effect of such failures would necessitate the type of bailout that you envision.

Under the reinsurance program as outlined in the legislation, insurance companies would set aside their own funds in a reinsurance trust fund, intended to grow until some future date when our worst nightmares are realized. In the unlikely event that there are insufficient dollars in the reinsurance trust fund to cover eligible claims, the fund may indeed borrow money from the Federal Government. But these loaned amounts must be paid back by insurers through future premiums paid into the reinsurance fund.

Question. I am concerned that citizens in low-risk States could pay an unfair share of the premium burden in comparison to the insurance benefit. Won't this legislative proposal increase the cost of insurance premiums for all policyholders?

Answer. Section 304 of the legislation mandates that all citizens, including those residing in relatively low-risk States pay actuarially fair premiums which accurately reflect the risk in that State. The bill also requires FEMA to minimize "cross-subsidization" in setting premiums so that low-risk areas will not subsidize the rates of high-risk regions.

The primary program will only increase insurance premiums for those homeowners living in earthquake or volcanic eruption-prone States who don't already purchase the supplemental coverage. Since South Dakota is not a seismic-prone State, no rate impact should be expected for your constituents. For those who end up purchasing the coverage in the approximated 39 earthquake-prone States of the country, the rates charged will be on average about 70 percent less expensive when compared to today's rates.

For the reinsurance program the reinsurance premiums are paid by insurers—not homeowners—and by themselves reinsurance should have no impact on what an individual policyholder pays.

Question. According to the Federal Emergency Management Administration (FEMA), only 20 percent of homeowners that should have flood insurance actually have it. Why? Is it due strictly to the expense of flood insurance?

Answer. The high cost of flood insurance is certainly one factor explaining why so few purchase the coverage. But perhaps the most important reason relates to the flood insurance compliance mechanism which depends on lending institutions informing policyholders of their obligation to purchase the coverage. For a number of reasons, the lending institutions often do not provide adequate information on the flood risk to policyholders.

S. 1350 addresses this problem by having insurance agents and FEMA inform those policyholders in flood plains of their obligation to have the flood coverage. FEMA is also required in section 301(f) of the bill to take necessary steps within 6 months to ensure that those noncompliant policyholders living in flood plains purchase the coverage.

Prepared Statement of Senator Akaka

Mr. Chairman and Members of the Committee, thank you letting me sit in on today's Committee hearing on S. 1350, the Natural Disaster Protection Act of 1993.

I am pleased to be a cosponsor of S. 1350, introduced by the distinguished senior Senator from Hawaii. This measure would amend the Earthquake Hazards Reduction Act by requiring States to establish disaster mitigation plans in order to be eligible for Federal disaster relief under the act.

S. 1350 would also establish an insurance program for disaster-prone States funded through premiums collected by participating insurance companies. The third component of the bill would set up a reinsurance program for private insurers and reinsurers.

The need for such legislation is great. Only last year, the island of Kauai suffered an estimated $1.6 billion in property losses when Hurricane Iniki struck a few months after Hurricane Andrew slammed the coasts of Florida and Louisiana.

Because of the staggering losses in Hawaii, four major insurers pulled out of the homeowners insurance market, while the remaining companies severely limited new policies or stopped taking new ones entirely. Approximately 70,000 homeowners were left without homeowners insurance. The State legislature, assisted by its most able insurance commissioner who is here today, established the Hawaii Hurricane Relief Fund to provide wind damage coverage separate from existing policies. The State also retooled the existing Hawaii Property Insurance Association—originally established to insure homeowners in lava hazard zones on the island of Hawaii—to cover those unable to obtain conventional homeowner policies.

Despite efforts by States to protect consumers from lack of homeowners insurance, there remains the simple fact that natural catastrophic disasters occur, most of the time without warning. Since Hurricanes Iniki and Andrew, there have been devastating floods throughout the Nation's Midwest and wild fires in southern California.

When natural disasters strike, the Federal Government is there to help primarily through the Federal Emergency Management Agency, the Department of Housing and Urban Development, and the Small Business Administration.

But, because of the unpredictability of such disasters, Congress generally must appropriate additional funds. The American taxpayer, however, cannot and should not, foot the bill for these disasters. We need a Federal program that addresses the problems associated with natural disasters. I believe S. 1350 represents a good start.

Prepared Statement of Jordan Clark, President, United Homeowners Association

Mr. Chairman and members of the Committee, the Natural Disaster Protection Act of 1993 (NPDA) is a long awaited and necessary step forward in addressing the loss of life and property and the social and economic consequences brought about by natural disasters.

In establishing the hearing record toward passage of the act, the committee will undoubtedly seek testimony from: local, State, and Federal Government representatives; emergency managers; the building industry; academia; environmental organizations; insurers; public utilities; the mortgage banking community; consumer groups and all others who have an interest in mandated federal programs dealing with natural disasters.

The United Homeowners Association (UHA) wants to make sure that you also hear from those most effected by the legislation and the ones who will end up paying for it, namely homeowners.

In economic and personal terms, homeowners are the primary victims of natural disasters. Homeowners also purchase more insurance than any other group and supply 90 percent of the tax base for relief and reconstruction before and after disasters strike. In short, the 63 million homeowners across the country have the most to gain or lose when Congress is debating natural disaster legislation.

After years of encouraging Congress to address the extraordinary social and economic liability this country faces when disasters strike, the UHA feels strongly that the quick passage of the NDPA is necessary for the protection of homeowners as disaster victims and as taxpayers.

As potential victims, the legislation will finally provide affordable insurance coverage for tens of millions of homeowners whose are not insured. Under the NDPA, homes in the 35 plus states with earthquake zones will be covered. Currently, over 95 percent of the homes in those states do not have earthquake insurance. Even in California, fewer than 25 percent are insured against earthquakes.

In real terms, if the predicted "great quake" strikes a heavily populated urban area before the passage and implementation of NDPA, damaged or destroyed homes will neither be repaired nor rebuilt. Without insurance, those who have mortgages on their destroyed homes will be forced to default, destroying the local tax base and the jobs of those who rely on homeowners to buy their goods and services.

Unfortunately, the economic after shocks of major disasters are not contained locally. They will be felt across the country. The destruction of tens of thousands of uninsured homes will have a drastic effect on the mortgage banking industry and in particular the secondary mortgage market. The value of mortgage backed securities could plummet quickly and mortgage interest rates across the country could sky rocket. Since the Federal Government has a vested interest in the secondary mortgage market, Congress has an additional reason to pass the NDPA.

It should also be pointed out that those homeowners in the disaster area whose homes are not destroyed or who have insurance will find out quickly that the value of their homes has declined substantially. Many, especially retirees and the elderly, will have lost their life savings (home equity) in a matter of minutes.

The UHA is also pleased to see that the legislation addresses the insurance problems faced by homeowners who live in the areas already visited by natural disasters, such as hurricanes Andrew and Iniki. Fortunately for homeowners and the taxpayers across the country, the great majority of homes in the path of Andrew and Iniki were insured. If they were not, the rebuilding and the $20 billion that the insurance industry paid to victims would have been the responsibility of the Federal, State, and local governments.

Unfortunately, as a result of the record setting losses suffered by the insurance companies, a number of smaller companies went out of business and those who weathered the storm are faced with a reinsurance problem. For the citizens of Florida and other States the reinsurance dilemma has resulted in policies not being renewed, limitation of coverage and higher premiums for lesser coverage.

The reinsurance section of NDPA is an equitable solution to the insurance problems facing homeowners in disaster prone areas today. Without the reinsurance provisions of the bill, sound business decisions will force insurers to continue limiting their exposure in disaster prone areas, increase their premiums or get out of the business. The result, homeowners will not be adequately covered or covered at all.

The NDPA also addresses an area that has been almost entirely neglected by the Federal Government—mitigation. Unless Congress and the administration through legislation and regulation establish safer building codes and insist that those codes are enforced, property loss will continue to sky rocket and the loss of life will climb as disasters hit. The fact that we are the only industrialized nation without a national building code is brought home after every disaster.

Surely, the construction of our homes deserves the same attention to safety that we have mandated for our cars, highways, trains, planes, and workplace.

No doubt, there will be those who oppose the NDPA because it helps the insurance industry out of a major reinsurance problem, or they philosophically oppose Government intervention in the private sector. My offer to them is a tour of Homestead, FL, a ride down the Mississippi, and a visit to the earthquake center at CALTECH.

As the only national homeowners association, the UHA supports the legislation because it provides a solution to the insurance problem facing millions of homeowners who will be picking up the tab as consumers and taxpayers.

Our homes are this Nation's greatest economic and social investment. We hope that Congress and the President recognize that fact and quickly pass the Natural Disaster Protection Act.

The United Homeowners Association appreciates the opportunity to comment on this important legislation and will continue to support its passage and monitor its progress.

QUESTIONS ASKED BY SENATOR PRESSLER OF MR. SNYDER

Question. As I mentioned, South Dakota was devastated by the continuous rainfall and flooding conditions during the past summer. How would S. 1350 address flood risks?

Question. Other than the issue of flooding, how else would S. 1350 affect South Dakota?

Question. I am very concerned that this legislation could unduly burden the Federal Government at a time when we are in dire financial constraints. Is this a fair statement?

Question. Taking into consideration the S&L crisis, isn't this legislation another bailout of an industry that is skirting the ragged financial edge?

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Question. According to the Federal Emergency Management Administration (FEMA), only 20 percent of homeowners that should have flood insurance actually have it. Why? Is it due strictly to the expense of flood insurance?

[At the time of printing, August 25, 1994, no response had been received.]

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