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The Honorable John Carona
The Honorable John T. Smithee
Co-Chairmen
Joint Interim Committee to Study Seacoast Territory Insurance

Re: Remarks on Florida perspective regarding state insurance pools

September 12, 2012

My name is Christian Cámara, and I am the Florida State Director for the R Street Institute.

R Street is a newly established public policy think tank devoted to free markets; limited, effective government; and responsible environmental stewardship.

We are based in Washington, DC with offices in Columbus, Ohio; Austin, Texas; and Tallahassee, Florida. We aim to advance free markets in a pragmatic, common sense fashion. R Street's founding staff members all previously worked for the Heartland Institute and, under the R Street banner, we continue to research and outreach in a wide variety of insurance-related fields.

I am here today not just as a policy analyst for R Street, but also as a Floridian to offer you the perspective of a state that has already implemented a plan similar to the one you are considering.

Based on our research, there is not a single state that has ever implemented a general purpose, multi-peril catastrophe pool. The closest things I can refer you to are the California Earthquake Authority and Florida's Hurricane Catastrophe Fund, which acts as a reinsurer that kicks in after a certain amount of loss resulting from a named storm.

Since 1993, Florida law has required that all admitted property insurers in the state purchase a minimum amount of their reinsurance coverage from the CAT Fund, as it is popularly known. Some purchase all their reinsurance from the CAT Fund; others supplement it with coverage from the private market. Regardless, Florida law essentially requires insurers to treat coverage from the Cat Fund as equivalent to private coverage, even though the CAT Fund cannot by its own account pay all claims that it could potentially receive.

The CAT Fund's financial advisors estimate the fund's obligations for its mandatory coverage are $17 billion, plus an additional $317 million in obligations for the optional "temporary increasing in coverage" layer, or TICL. The fund's current cash reserves hover around $8.56 billion, leaving it with roughly $8.76 billion that would need to be borrowed to make good on its obligations.

If completed all at once, an $8.76 billion bond issuance would top the largest all-at-one-time municipal bond issuance in history, the $6.54 billion issued by California in 2009. Even if broken up into smaller issuances over the course of a year, major underwriters estimate the CAT Fund could only borrow about $7 billion, which would leave it with a $1.76 billion shortfall. Under that scenario, hurricane victims would get their claims only partially paid.

But then even if the fund was able to raise sufficient money to fully cover its obligations, any bond issuances require assessments that would dramatically increase the cost of insurance in the state for many years until those bonds are paid off. And the state would still be subject to additional hurricane strikes in those years to compound the situation. In short, the liabilities imposed by the CAT Fund can bring the state's economy to a screeching halt.

Rather than serving as a force to stabilize the state's insurance and reinsurance markets, therefore, the Florida Hurricane Catastrophe fund—through the risks it imposes on the state—serves to destabilize the market and introduce new uncertainties. Its own management and the state's chief insurance regulator both support reform of the CAT Fund that would scale it back and shrink its size and scope. Quite simply, the CAT Fund has not worked and it threatens to bankrupt the state.

But Florida's failure in this arena is not atypical. Our research has shown that National and state governments are quite simply ill-suited to play a role in property and casualty reinsurance. Although frequently packaged, presented and sold as reducing rates for consumers or stabilizing insurance markets broadly, government-run reinsurance programs tend to do just the opposite.

Although they do not function perfectly, global reinsurance markets distribute risks broadly across international borders, thus allowing the risks of hurricanes in Florida to be grouped with the risks of cyclones in Australia, industrial accidents in Japan and flooding in the United Kingdom. Because of the near impossibility of all these catastrophes happening simultaneously, it allows reinsurers to make a profit on one set of risks while making payouts on another.

The plan being discussed here today, on the other hand, focuses the risk in Texas rather than spreads it around the country and the world. Even if this proposal ultimately calls for purchasing

reinsurance coverage from the private market, it would not have much more purchasing power than any insurer would.

Furthermore, as we have seen in Florida, these state-run programs are unfortunately subject to abuse by subsequent politicians who weren't around when they were being designed and implemented. Such was the case in 2007 when a political opportunist governor (Charlie Crist) arbitrarily lowered and froze rates, and dramatically expanded the CAT Fund further beyond its paying capacity as a gimmick to lower insurance rates for consumers.

The result was insurance rates went down slightly, but the cost was enormous: most insurance companies fled the state and took their capital with them, several other insurance companies have gone out of business even in hurricane-free years, and the state has been placed just one hurricane away from fiscal calamity.

Luckily for Florida, no hurricanes have struck the state since those changes, but every year that goes by we play a game of Russian Roulette. It has taken the Legislature years to even nominally reverse some of these ill-conceived reforms, and we're not even halfway there yet.

Private reinsurance companies, on the other hand, are not subject to, nor concerned by this sort of political pressure. Their goal is to stay in business by diversifying their risk, investing their capital, and competing with one another.

I am not attempting to foist Florida's cynical political realities on Texas. I am merely giving you our story. Regardless, I would urge the committee to proceed with caution and keep the following in mind:

Government is not necessarily incompetent, slow-moving or bureaucratic (although it often is all of these things) but it is hampered in its ability to diversify risk on a global scale. To simply break even in the long run, a government-run reinsurer would have to both diversify its underwriting exposure—meaning, cover risk outside its boundaries--and invest its capital in a manner that produces returns similar to those that private companies can earn. To do that would leave taxpayers on the hook for disasters in other parts of the world and for any unsatisfactory investment returns. It would literally be a matter of taking very large gambles with taxpayer money. And it's unlikely to work.