TESTIMONY OF:

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BEFORE THE SENATE COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION

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Mr. Chairman, thank you for the opportunity to address the Committee on the need for natural disaster legislation. My name is Charlie Brown and I am Vice President of Baker Welman Brown Insurance in Kennett, Missouri. Kennett is a small town of approximately 11,000 people located in the extreme Southeast or "Bootheel" of Missouri. I am an independent insurance agent in this community and have the privilege of serving hundreds of homeowners with all different types and values of homes. Currently, I serve as the chairman of the Missouri Agents Earthquake Task Force and chairman of the Independent Insurance Agents of America's (IIAA) Natural Disaster Task Force. I am here today to testify in support of S. 1361 on behalf of the Independent Insurance Agents of America and the thousands of insurance agents and homeowners across America that have and continue to experience problems with their homeowners markets due to the threat of natural disasters.

Unfortunately, my town is located in what has been predicted to be one of the worst affected areas of the New Madrid fault. For those who are unfamiliar with the fault, it crosses five state lines and the Mississippi River in at least three places. Damage estimates for a major earthquake on the New Madrid fault run into the billions of dollars. A major event would devastate St. Louis and Memphis and impact thousands of homeowners in

Arkansas, Illinois, Kentucky, Tennessee and Missouri. Still, my insurance agency, since its beginning in 1939, has never seen enough damage to a home from a minor tremor to pay an earthquake claim. However, the ripples and tremors from the potential for enormous damage in the New Madrid fault area, coupled with the financial impact of Hurricane Andrew and the Northridge Earthquake on insurance companies, have been felt by my clients and all homeowners in Eastern Missouri and other states that share this fault zone.

As you are well aware, after Hurricane Andrew and the Northridge Earthquake, all insurance companies, reinsurance companies, and their rating agencies began taking another look at the potential for loss that major natural disasters could have on an insurance company's ability to pay claims. Even though these specific disasters did not happen in my area, attention has been focused on the potential for any natural disasters. Most potential hurricanes from Florida to Massachusetts and earthquakes in California pale in comparison to the potential insured property damage estimates from a mega New Madrid earthquake.

As a result, we have seen our markets for earthquake coverage on homeowners policies dwindle at an alarming rate. This change has been less dramatic than the market problems experienced in Florida or California, but I want to stress that the changes in our market are no less real to my clients. We have seen insurance companies cancel their homeowners policies, invoke moratoriums on writing new homeowners policies with earthquake coverage, change earthquake coverage to exclude all contents of a home, and increase premiums on either the earthquake coverage or the entire homeowners premium forcing many homeowners to reduce or cancel their insurance.

Let me further explain what has been happening in our Missouri homeowners marketplace. First, we have seen many companies simply withdraw from the earthquake prone areas of our state. For example, one national company canceled all of their agencies south of Cape Girardeau, Missouri. If all the insurance companies in Missouri had done this we would have seen an immediate crisis like California and Florida experienced. Instead our problem has not drawn headlines, partly because it has mainly affected Southeast Missouri and, only recently, has it begun to spread to the St. Louis area.

My insurance agency was visited by a major national insurance company we represented. The regional vice president from Chicago came to see us and three other Southeast Missouri agencies that represented this company. He told each agency that the company had examined their earthquake exposure in Southeast Missouri and there was just no way to charge enough premium for that exposure. It would take a 1400% increase in the rates to justify the exposure. He asked us to either take the earthquake coverage off of our homeowners policies and write that coverage separately or to move the policies to another company. I was even more astonished when he offered to pay us to move the business! My agency did decide to move our client's policies. We did so not for the money but, because this same company official had told us that they would be limiting coverage and raising their earthquake rates to a level that would not be affordable for most homeowners.

Most insurance companies have taken a different approach to eliminating, reducing, or maintaining their amount of earthquake insurance that they underwrite in Missouri. We have seen several different approaches used: 1) Blaming some other factor for leaving the market, 2) limiting coverage and/or increasing deductibles, and 3) increasing either earthquake rates or rates on their basic homeowners policy until consumers can no longer afford the coverage.

An insurance agency in Sikeston was told by a company they represented that their contract with that company was being terminated because the agency had too many losses. The owner of this agency did not believe his agency had a loss problem with this company and, after reviewing the loss results himself, spoke with company representatives. The agent was told he could keep his contract but that he would have to non-renew all his homeowners policies with that company. He was told that the real reason the company was canceling his agency and others in the area was to reduce the company's earthquake exposure. This agency decided that he could not non-renew his client's policies and, fortunately, was able to find another market to take the business.

The most widely used tactic of insurance companies to exit our homeowners insurance market has simply been price. By just increasing the base cost of your homeowners policy, increasing their earthquake rates on your homeowners policy, or increasing both rates, a company can easily see their business canceled. An outside observer might think that the homeowner, knowing of the potential for an earthquake in our area, would not like his homeowners premium increased, but would still keep the policy because of the need for coverage. What if your homeowners insurance cost $500 last year and you received a bill for the renewal with a premium of $1100? Naturally, you would look for other coverage which is exactly what many of my clients have been doing and will continue to do. The companies that increased their rates did not have to cancel any policies or withdraw from our area. The price increase accomplished this de facto.

I will share another example of how my agency faced this price increase tactic. We represented a small regional insurance company that was purchased by a large national carrier. The company had agencies in almost every town in Eastern Missouri. The national carrier decided to absorb the smaller company. Previously, this national carrier had only a handful of agents in our area (mainly because they did not write earthquake insurance on their homeowners policies in the area.) With the absorption of the small company business, no homeowners policies were canceled by the company. However, they raised their homeowner's premiums on all renewals over 100%. The result was that almost all of our clients canceled their homeowners insurance with this company. Again, a price increase rid that company of its potential problem.

Our Missouri Department of Insurance has been monitoring the cost of earthquake insurance for homeowners and the percentage of homeowners that have this coverage. When they released their first set of data on December 11, 1996, the headline of their press release read "Stateside earthquake insurance market relatively stable". This was based on data from 1993-1995. On August 4, 1997 after they analyzed their data from 1996, the Department issued a press release with the following headline: "Earthquake insurance rates up sharply in Bootheel; coverage there falls off." The last press release concerning earthquake rates from the department was on February 2, 1998 where the headline read: "Angoff orders exam of major increase in earthquake rate recommendations for Missouri businesses, homes," This press release went on to say that the residential rate hikes . . . reach 266 percent for some homeowners policies in southeast Missouri and metropolitan St. Louis, including part of the urban core, north St. Louis County and eastern St. Charles County.

I agree with the department's last assessment on August 4, 1997 that rates are up sharply and more and more homeowners are deciding not to buy coverage. The MDI data does not take into account the many companies that have increased not only their earthquake rates but may have increased both their basic homeowners policies and earthquake rates to exit the market totally. Unfortunately the MDI's data does not include the number of homeowners that have had to change companies for this reason. Also, not included in the last data are the number of companies that have exited our market like the company in my agency that asked us to move the business or the company that terminated agents for high losses (when in fact the true reason was to reduce their earthquake exposure.)

The third manner in which insurance companies have handled their earthquake exposure in our area is by increasing deductibles and/or limiting coverage to just the home itself, providing no coverage for outbuildings and little if any coverage for personal property. The standard earthquake deductible used to be 2%. Now we see deductibles starting at 10%, going up to 25%. One company our agency represents has stopped writing any new homeowners policies with earthquake coverage and, on their existing homeowners, has changed the coverage to the home itself and $10,000 on personal property. They did not increase their earthquake rates because by reducing what was covered, they took a 100% rate increase. Once again, this type of action by a company has never been reflected in any MDI data.

Many in the insurance industry will claim that companies increasing deductibles and limiting coverage is a partial solution to their problem with natural disasters like earthquake. I just wonder where these homeowners are going to obtain the money for their personal property or to manage a 25% deductible. This is no solution for the average Missourian, but rather a prayer that somehow it will cost 25% less to rebuild their home or that when their home falls to the ground that miraculously their furniture, clothes, and other items will remain intact.

The final manner in which companies are dealing with the potential mega catastrophe presented by the New Madrid fault is by simply not appointing any agents in earthquake prone areas.

When our agency first witnessed company's restricting coverage and knowing that we faced the possibility of our companies pulling out of our market or increasing rates to unaffordable levels, my agency contacted over 20 companies to see if we could find a company willing to come into our area to write homeowners policies. Only one company would seriously talk with us. We offered to give all of these companies over $500,000 of profitable business and write all lines of insurance for their company. We heard many excuses from these insurance companies on why they would not appoint our agency. At least a few were honest enough to tell us that their company was just not interested in writing any earthquake coverage. This same search for companies has been repeated by almost every independent agency in Southeast Missouri with similar results.

Still, we do have markets available in Eastern Missouri. But how long can the few remaining companies keep writing more business as other companies use tactics I described earlier to eliminate their homeowners policies?

The Missouri Department of Insurance in analyzing their premium date also noted in their last earthquake study that coverage was falling off in our area. Why are fewer homeowners purchasing earthquake coverage? The answer is price. Several years ago the earthquake premium on an a $80,000 home in my agency was $70. Now the average premium for a home can cost $300, in addition to regular homeowners premium. Before the problems began in our marketplace, I was proud to say that approximately 90% of my homeowners clients had earthquake coverage on their homes. Now this percentage has declined to roughly 70%. I fear that this number will continue to fall. If nothing is done to strengthen our homeowners marketplace, I can see the day when the only homeowners that carry earthquake coverage will be those that are required to do so by their lenders, and even so these homeowners will probably only carry a small percentage of what they really need. All one has to do is to look at flood insurance to see how this can and will happen if something is not done.

Missouri is by no means the only state that has, and still is, experiencing problems with our homeowners insurance markets. A fellow independent insurance agent from Louisiana, Don Beery, who currently serves as the President of the Independent Insurance Agents of Louisiana testified last year before the House Committee on Banking and Financial Services. To explain the problem that homeowners face in Louisiana, the following is a quote from his testimony:

> After Hurricane Andrew "we began having trouble placing and renewing homeowners business. . . . Eventually, the Louisiana Insurance Department authorized that the business which insurance companies refused to write could be placed into an insurance pool . . . know as the Louisiana Fair Plan. . . . The number of applications soared almost immediately. Between 1993 and 1997, the Fair Plan grew by more than 750%. The growth continues today, nearly a decade after Andrew, at a rate of more than 1,000 policies every month.

> The Estis Agency (Mr. Beery's agency) lives with the insurance availability problem every day even though homeowner's insurance rates are considered adequate and are the second highest in the United States. Most of the companies we represent have placed severe restrictions on the number of new policies that we can place with them. Many insurers will only allow us to write one or two policies a month. Some will only allow us to write three or four new policies a year! Several insurers will not write any policies for homes valued at more than $100,000. Other will not write any policies on homes worth less than $400,000. Many of our customers are caught in between. It is not unusual, for example, that the only source of insurance coverage we can find for a $125,000 home is Lloyds of London. We do not feel that a homeowner with a $125,000 mortgage belongs with Lloyds. Nevertheless, we have no alternative but to place them there."

Another independent insurance agent, W. Cloyce Anders, who serves on the executive committee of the Independent Insurance Agents of America, also testified last year before the Housing and Community Opportunity Subcommittee of the House Banking and Financial Services Committee. Mr. Anders related the problems that North Carolina homeowners are facing. The following is quote from his testimony:

> "We have a facility in North Carolina for homeowners who are unable to obtain traditional homeowners insurance coverage called the North Carolina Insurance Underwriting Association. . . In the last two years, the NCIU has grown 34%, the fastest rate in history. This is on top of double-digit increases nearly every year as far back as 1989. Demand is so great that the association can no longer keep up with the demand for applications. As a result, they now delay opening

> the office phone lines for two and a half hours every morning in order to process the previous days' business."

> Mr. Anders also stated that "It (the lack of homeowners markets) is also not a condition that is limited to beach communities and the affluent. In North Carolina, many insurance companies will not write hurricane coverage and many others will not write property coverage of any kind for any home which is located east of Interstate 95. In many places I-95 is as much as <u>150 miles from the Atlantic Ocean</u>. The NCIU accepts applications from residents in 18 counties. The vast bulk of the applications come from middle class families that live up to an hour's drive from the coast."

We are all aware of the problems faced by Florida homeowners because of the threat of future hurricanes. Mr. Alex Soto, an independent insurance agent and State National Director from Florida on the Independent Insurance Agents of America board, stated the problem succinctly in his testimony before the Housing and Community Opportunity Subcommittee of the House Banking and Financial Services Committee. The following is an excerpt from his testimony:

> "I am an independent agent and as such, represent numerous insurance companies. In fact, we work with more insurance companies than most of my peers. . . . Of all the companies . . . not one is openly writing homeowner's insurance policies in any of the communities I represent. Not a single company. . . . but it gets worse. Most companies are not only refusing new business; they are still actively non-renewing as many customers as possible, in order to reduce their exposure in Florida. This is not a trend which is reversing."

Mr. Chairman, other insurance agents from New Jersey and Massachusetts have also testified on the problems that homeowners in their states face in obtaining adequate homeowners insurance and if time would permit the same message could be told by scores of other insurance agents from California, Texas, Arkansas, Tennessee, Georgia, and South Carolina, just to name a few. The stories are all similar, as is the need for a solution to this problem. The fact is that homeowners across our great nation are not able to protect their homes in the manner that most of us take for granted.

I had the privilege to testify less than a year ago before the United States House of Representatives Committee on Banking & Financial Services as they were considering passage of the Homeowner's Insurance Availability Act (HR 21). In my testimony before that committee, I was asked if I expected Missouri to enact a catastrophic fund. At that time I stated that my goal was for the introduction of legislation in the next session of the Missouri General Assembly.

In 1999 the Missouri Association of Insurance Agents had a bill introduced in the Missouri State Senate to establish a fund similar to the Florida Hurricane Catastrophe Fund. The main reason for our support of this legislation was that we were unsure that any federal natural disaster legislation would be passed. This legislation had a hearing in the Missouri Senate insurance committee, however because the problem of availability at this time is mainly in the Southeast part of Missouri, it was difficult to convince senators to adopt our plan and the bill was not voted on by the committee.

After the Missouri General Assembly adjourned from that session, our agent's earthquake task force met again and decided that while we believe that our legislation was a good idea, the problem of availability of homeowners insurance would have to worsen further before we could see a bill passed. We were also encouraged by action in the U.S. House of Representatives Banking & Financial Services committee on H.R. 21 and thought our best course of action for our dients was to support federal legislation at this time. Since most of the major direct and independent agency companies writing homeowners insurance supported federal natural disaster legislation, we believe that this legislation will in turn help our clients.

This brings me to one of the arguments made against S.1361; that this bill will encourage the proliferation of state plans that compete against the private market. If our effort in Missouri is any example of what it takes to implement a state plan, I cannot see how this argument against S.1361 holds water. Because the threat that natural disasters pose to most states is usually not a state-wide concern, convincing a state legislature in most states to start a state plan will be extremely difficult—if not impossible—unless our markets continue to worsen. States like California, (where a large portion of the state is effected) and Hawaii and Florida (where virtually the entire state is at risk from a natural disaster) have already acted in forming state plans because their markets could not wait for a national solution. These states insurance markets were in a state of collapse. I believe that it will take a similar situation in other states for more state plans to be developed or expanded to handle our natural disaster exposure.

S.1361 should in fact help curtail the creation of additional state plans as it offers a true national solution to this problem. The need for state plans only exists when the market fails and S.1361 will revitalize the markets in our states that are currently worsening and, even more importantly, prevent what happened in Florida after Hurricane Andrew when the availability of homeowners insurance threatened every facet of the state's economy. Insurance companies and state departments of insurance do not lightly tread into state plans. If Congress fails to enact meaningful natural disaster legislation and we experience a 1-in-100 year mega catastrophe in any area of the U.S., cries from the citizenry will demand that states take action on their own and create more state specific plans.

The Independent Insurance Agents of America believe that the insurance market place has and will continue to have a problem in dealing with mega catastrophes. Insurers and reinsurers are well equipped to handle the normal types of losses that occur everyday from fires, theft and many other types of losses. But the losses that worst case 1-in-100 year can present to many regions of America are beyond our industry's capability to manage without assistance.

I am not here to testify on behalf of insurance companies. The insurance companies that support S.1361 can tell you why they believe this legislation is necessary. This bill is not about helping insurance companies. I come here today to represent average Americans that just want to protect their most valuable asset, their homes. These taxpayers are not looking for a hand out from Uncle Sam. They want the ability to purchase homeowners insurance so that they will not have to come begging to Congress for help after a mega catastrophes in the form of ad hoc disaster assistance.

This is not just a Florida or California problem. While California and Florida have received the most press about the problems that earthquakes and hurricanes present, the disaster prone states are much larger. When studying a map of the catastrophe prone states we are looking at the entire east and west coast, states on the gulf of Mexico and the states surrounding the New Madrid fault in the center of the US. As the Carolinas witnessed last hurricane season, many states can suffer from natural disasters. The problem posed by mega catastrophes is truly national in scope and not limited to those few homeowners living in Miami Beach or on the San Andres fault.

Some insurance companies and taxpayer groups have tried to paint this as a bailout for the rich that have been foolish to build expensive homes on the beach or on a earthquake fault line. Nothing could be farther from the truth. Most of my clients in Missouri live in modest homes ranging from $50,000 to $150,000. These homes are not mansions, but they are the most valuable asset they possess. Also, the exact path of hurricanes and fault lines for earthquakes can and do change. In recent hurricanes, homes far from the coast or beach have been damaged. How can one say that a homeowner in South Carolina living 50 miles from the coast has been foolish to purchase a home in that area. Unfortunately many of the fastest growing areas in America face a threat from these mega catastrophes. I could go on to site numerous examples but the fact is that natural disaster legislation will help all facets of our society.

I also want to address another misconception that opponents of natural disaster legislation have been promoting. These opponents claim there is sufficient reinsurance to handle this problem and those insurance companies supporting this legislation are just not practicing prudent risk management. Again, I will let the insurance company representatives tell their story. I want to relate to you how this “sufficient” reinsurance has failed to help the situation of many homeowners.

I previously related to you how many insurance companies withdrew or found other ways to eliminate homeowners clients in my area. After a couple of years without the enormous natural disasters like Hurricane Andrew and the Northridge Earthquake and without a major earthquake along the New Madrid fault, we still have companies that will not sell homeowners insurance is my area. With all this “sufficient” reinsurance there are still many insurance companies that will not write homeowners insurance in Southeast Missouri. Other companies still have a moratorium on writing new homeowners. And we have many other companies that have continued to take the approach of avoiding writing homeowners insurance by making sure their premiums are too high to consider. I really question the availability of “sufficient” reinsurance now and fear that the inevitability of a mega catastrophe will restrict reinsurance to levels that will send thousands of homeowners scrambling for a policy to protect their home.

I also want to address the benefit of this legislation to the taxpayers in both disaster prone and non disaster prone states. When I testified before the House Banking Committee on a similar bill to S. 1361, I was shocked to hear testimony from some of the groups representing “the average american.” Many of these groups say that S.1361 is not good for the taxpayers. I find the logic on this debate hard to comprehend. They suggest that S. 1361 will cost the taxpayers millions of dollars. I tell you that history has shown that if taxpayers cannot purchase homeowners insurance it will cost the federal treasury many more millions, if not billions, in disaster relief after the fact. S.1361 will give homeowners the opportunity to purchase insurance so they will not have to come begging to Congress for disaster aid. We have an opportunity with this bill to empower individual American homeowners in disaster prone states to exercise their responsibility to protect their property. What could be a more basic

responsibility? I hope you can see my position that assuring the availability of homeowners insurance to taxpayers will help save the federal government millions of dollars in disaster aid, all of which comes out of the pockets of taxpayers.

Some would also argue that while this bill will help disaster prone states, why should a Senator from a non-disaster prone state support it? The reason is that when a disaster strikes any area of America, it is never just the taxpayers in that area that pay for the disaster aid. All American taxpayers contribute their tax dollars in disaster relief. Therefore any money that we can eventually save in future disaster relief will reduce the tax burden of taxpayers all across America. The best way for Congress to shift the burden of paying for disaster relief to those that receive it is by making sure that those Americans in disaster prone states have the ability to purchase homeowners insurance and thereby pre-pay for the assistance they will receive from their homeowners insurance companies.

Homeowners across America are being forced to abdicate their individual financial responsibility to provide insurance protection for their homes because of a lack of markets and a severe increase in the cost of coverage. What will be our country's future disaster relief costs if this trend continues unabated? Will we continue to make homeowners in disaster prone areas rely on what relief they can get from their state and the federal government when mega a hurricane or earthquake strikes?

I find the abdication of individual responsibility to be one of the greatest threats that our nation faces and that is why I want to see this legislation enacted. There will always be a need for a level of disaster aid and the assistance of FEMA, but we have an opportunity to allow individuals to help shoulder burden of the costs of worse case natural

disasters by strengthening their homeowners markets. I am reminded of the old saying, "If you give a man a fish you feed him for a day. If you teach him how to fish you feed him for a lifetime." S.1361 is that lesson in fishing that will help our homeowners insurance markets revitalize and survive the mega disaster.