PUBLIC HEARING OF THE
NAIC SOUTHEASTERN ZONE

INSURANCE ISSUES
IN COASTAL ZONES

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I'd like to begin by acknowledging the leadership provided by the hosts for this Public Hearing, the Commissioners of the NAIC. The 2004 and 2005 hurricane seasons provided a sobering illustration of the human toll and suffering, property devastation, and financial burdens that Mother Nature can impose on our society. The challenges that surfaced during those storms, and subsequently, have provided an opportunity for all of us to learn from experience and be better prepared for future events. We view this Hearing as a meaningful opportunity to share insights and develop plans to enhance our Nation's preparedness for future disasters. Thank you for including State Farm in this discussion.

I'd like to reflect for a few moments on the challenges State Farm and other insurers encountered arising out of the devastation caused by the four hurricanes (Dennis, Katrina, Rita, and Wilma) that made landfall in the U.S. during 2005. State Farm received over 600,000 claims from these storms. That's in addition to the hundreds of thousands of flood claims we also handled as a servicing carrier for the federal flood program and the more

than 11 million claims State Farm handles throughout the U.S. in a typical year. As with any loss, we recognize that each one of these claims creates great challenge and impacts families. To handle this extraordinary volume of catastrophe claims, we assembled a catastrophe claims force of nearly 6,000 State Farm agents, employees and independent adjusters, most of whom worked every waking minute, six to seven days a week well into 2006. They provided over $6 billion in policyholder benefits to our customers from the four hurricanes—NOT including payments made on behalf of the federal flood program.

Fortunately, State Farm and most in the industry had adequate financial resources to meet the claim obligations arising out of these events. That might not have been the case if Hurricane Rita hadn't weakened and turned east a few hours before it made landfall. When it was a Category 5 hurricane, bearing down on the Galveston-Houston area, the people of Texas were looking at devastation far beyond that experienced to date in the U.S.—devastation that would have exceeded the industry's financial ability to respond.

The real potential for devastation of this magnitude must be acknowledged and addressed by all, including those ultimately at risk, the American public. As many here today will recall, in November 2005, FEMA sent a directive to all servicing carriers participating in the federal flood program,

advising that until Congress acted, it had no more funds to pay federal flood claims. This further demonstrates the need for both the public and private sector to better prepare for mega catastrophes – <u>before</u> they occur.

Our challenges include:

- **the difficulty in predicting with accuracy the frequency and severity of natural disasters;**

- **the timing risk presented by the possibility that a 1 in 500-year event could happen next year;**

- **the political pressure exerted on the rate regulatory process which inhibits the industry's ability to earn sufficient returns to set aside capital for disasters; and,**

- **the current tax policy in the U.S. which requires payment of taxes on catastrophe loads.**

Adding to these challenges is the fact that:

- **insurers can face residual market and guaranty fund assessments following a major disaster;**

- **nonexistent and substandard building codes have permitted the construction of homes throughout America that aren't adequately prepared for natural disasters.**

The time to address preparation for mega catastrophes is now – before the unthinkable, but inevitable, occurs. We need a coherent, comprehensive, and coordinated approach involving the American citizenry, private insurers, and local state and federal governments. State Farm doesn't pretend to have all the answers, but we're convinced the solution needs to include:

- **the adoption across the United States of modern and effectively enforced statewide building codes. The experience from the 2004 and 2005 hurricanes, especially in Florida, demonstrated once again that building codes save lives and reduce property damage. We'd urge Congress and FEMA to establish federal incentives under their current grant programs to encourage the adoption of statewide building codes. Legislation to create such incentives is about to be introduced by Representatives Matsui (D-CA) and Diaz-Balart (R-FL) and we'd urge the Commissioners of the NAIC to support it individually and collectively. For states that are serious about addressing the root challenge—i.e. building homes that are**

hurricane resistant--this legislation will provide additional financial resources;

- **recognition by those that live in harm's way that they need to take steps to prepare for natural disasters rather than relying totally on private insurance and government;**

- **modernization of the federal flood program. Sadly, thousands of homeowners that lost their home to flood damage in 2005 hadn't purchased flood coverage. In coastal Mississippi, less than 20% had flood coverage, and for those that had some coverage, many found the amount purchased wasn't sufficient to cover their damage. Federal legislation to modernize the program, HR 3121, has been introduced with bi-partisan support and State Farm will be supporting those provisions in the bill designed to: (a) update the flood plain maps and administration of the federal flood program so that those that need flood coverage have it; and (b) increase the amount of coverage available for flood damage;**

- **the establishment of state catastrophe funds in CAT-prone states. The CEA and Florida Hurricane Catastrophe Fund have demonstrated the stability they can add to the marketplace. Other** catastrophe-prone states need to consider similar action to improve the protection provided to their homeowners; and,

- creation of a federal backstop for the state catastrophe funds. It's inevitable that we will experience disasters that exceed the capacity of the private sector and state catastrophe funds. Involving the federal government to help with pre-event funding for these disasters is vital to adequate preparation and helps protect taxpayers against unbudgeted appropriations for natural disasters. Representatives Klein and Mahoney have sponsored HR 3355, the Homeowners' Defense Act of 2007. In its current form, the bill authorizes loans to state reinsurance or residual market plans to ensure their solvency. We'll be urging the inclusion of a federal reinsurance program, similar to that included in HR 91, designed to help pre-fund such protection, thereby protecting future generations of taxpayers.

We believe a partnership among the American public, the insurance industry, and our governments built on these principles would:

- improve our preparation for mega catastrophes;

- provide increased capacity for insuring against such events;

- reduce the flow of subsidies from the current system;

- result in the construction of homes that are better able to withstand catastrophic events; and,

- provide additional protection against the drag on the economy that can occur when property insurance is scarce or there are inadequate resources to rebuild damaged homes.

Again, State Farm is honored to be invited to this Hearing and our appreciation to the hosts for providing the leadership to draw attention to the importance of this issue. Thank you.