Summary of H. R. 3355, The Homeowners Defense Act of 2007

Background

The increased frequency of and magnitude of storms in Florida, coupled with state actions limiting insurers' ability to price their products according to risk, restricting capital movement, and creating uncertainty over the legal and regulatory enforcement of contracts, has caused many private insurers to reduce their new underwriting in the state. To make up for the shrinking private marketplace, Florida has undertaken several attempts to create subsidized state-run insurance and reinsurance companies to lower property insurance rates for its coastal homeowners.

In 2002, Florida created Citizens Property Insurance Corporation as the state's "insurer of last resort" for property owners unable to secure wind coverage through the private market because of high hurricane risk. At its founding, Citizens had an estimated 600,000 policies and an exposure of $148 billion. Today it is Florida's largest property insurer, with more than 1.3 million policies and an exposure of around $440 billion.

Despite paying no taxes, after the 2005 hurricane season Citizens was more than $1.7 billion in debt, and the Florida Legislature was compelled to bail out the program by appropriating $715 million from the state treasury, as well as assessing private insurers and policyholders.

In addition to Citizens, the state maintains the Florida Hurricane Catastrophe Fund (FHCF), which incentivizes insurers to continue writing policies in the state by providing reduced-cost reinsurance. As a result of a state law passed earlier this year, the FHCF provides $32 billion in coverage despite having only $1 billion in assets.

Sponsored by Florida Democratic Reps. Ron Klein and Tim Mahoney, H. R. 3355 would create a Federal "National Catastrophe Risk Consortium" to pool state disaster risks, purchase reinsurance, and sell catastrophe bonds-all things states can do on their own today. It would also require Treasury to "loan" money to under-capitalized state insurance companies at subsidized rates. Florida's state insurance fund is the only program that would currently qualify for Federal largesse, although other states would be encouraged to create similar state reinsurance companies. H. R. 3355 was reported out of the House Financial Services Committee on September 26, 2007 by a vote of 36-27.

Concerns regarding H.R. 3355

The bill puts taxpayers at risk. Several states have been discussing pooling their risks for many years. It is unclear what additional value H.R. 3355 would add to that ongoing conversation other than an implicit Federal guarantee or backing. That amounts to a subsidized Federal loan program that Congress could be pressured to forgive after large-scale natural disasters. A relevant example is the National Flood Insurance Program (NFIP), the primary provider of the nation's flood insurance policies, which was forced to borrow nearly $18 billion from the U.S. Treasury to pay claims arising from the 2005 hurricane season.

The bill encourages overdevelopment in vulnerable coastal areas. At the legislative hearing on H.R. 3355, several witnesses questioned the wisdom of encouraging more states to create reinsurance funds similar to Florida's, which seeks to artificially limit the higher costs associated with increased building in environmentally vulnerable areas. Instead of moving towards a market-based insurance system that would require homeowners to pay a fair price for the risk they face, the new loans created by H.R. 3355 would mask the true cost of insurance in catastrophe-prone areas, creating a federal subsidy that encourages overdevelopment.

The bill contains no hazard mitigation requirements. A recent GAO report reviewed hazard mitigation strategies in place to lessen the impact of natural hazards that present a risk to life and property. It concluded that present hazard mitigation efforts are "fragmented," and that development of a "comprehensive framework" is necessary "to ensure that the federal government is effectively identifying hazard risks and that those undertaking mitigation efforts are working collectively." However, H.R. 3355 contains little in the way of specific mitigation directives, or possible consequences for states that fail to meet building codes or other guidelines.

The bill has too many unanswered questions. H.R. 3355 does not explain how state funds are to repay Federal loans, nor does it limit the number of loans a state may receive. It is also unclear whether most states would want to pool their risks with Florida, where real property values total more than $1.2 trillion, and 80 percent of Florida's 16 million residents live within ten miles of the coast. Congress needs to study and answer these critical questions before rushing another massive federal subsidy into law.