Republican Concerns Regarding H.R. 3355, "Homeowners' Defense Act of 2007"

Treasury and various consumer, environmental, and industry groups have voiced concerns that H.R. 3355 would expose taxpayers to massive liabilities and encourage further development along hurricane-prone coastlines. A critical Wall Street Journal editorial dated October 10, 2007 quoted Assistant Treasury Secretary Phillip Swagel, who testified at a September 6, 2007 Financial Services Committee legislative hearing on the bill, as saying `taxpayers nationwide would subsidize insurance rates in high-risk areas, which would be both costly and unfair.' On September 24, 2007, the National Wildlife Federation transmitted a letter to Chairman Frank and Ranking Member Bachus, opposing H.R. 3355 on grounds that the bill does not contain adequate mitigation provisions, could lead to increased building in vulnerable areas, and would unnecessarily burden taxpayers.

It is unclear whether Title I of H.R. 3355, which would create a voluntary Federal consortium to pool state catastrophe risk, securitize that risk, and broker reinsurance contracts for states, would offer any additional value other than providing an implicit Federal guarantee or backing. States already can and do purchase reinsurance and sell catastrophe bonds through their risk pools and funds. In fact, Florida raised money for the FHCF this way for the past two years. It is dubious whether regional pooling facilitated by a consortium would have any benefit in reducing costs over pooling through the global reinsurance markets. Florida and other states with catastrophe risks have already met and discussed on numerous occasions pooling their risks, but without generating any new synergies.

The ability of the consortium to dump billions of dollars into the catastrophe bond marketplace is also highly questionable. Catastrophe bonds are high-risk, but potentially high-yield, financial instruments that generally appeal to institutional investors wanting to hedge against other risks. Large, sophisticated investors find these securities attractive because the risk natural catastrophes pose differs, and is not correlated with, financial risks in the capital markets. The Committee has requested numerous Government Accountability Office (GAO) studies in the past on catastrophe bonds that have suggested the appetite for further cat bond issuance beyond its current slow annual growth is significantly limited by the sophistication required to analyze the offerings, the riskiness of the issues, and its cost disadvantages versus traditional reinsurance. At the legislative hearing on H.R. 3355, one witness, a hedge fund manager specializing in risk-linked securities, expressed doubts that the consortium would increase demand for catastrophe bonds.

Even more troubling is Title II of H.R. 3355, which mandates that Treasury offer below-market subsidized loans to state reinsurance funds. Two types of long-term loans would be available to states with a fund, although the FHCF is currently the only pure reinsurance fund and, thus, the only `qualified reinsurance fund' as described by the bill. Liquidity loans would be offered in amounts up to the ceiling coverage limit of state reinsurance funds that have a capital liquidity shortage and are not able to access capital more cheaply. Catastrophic loans would be available to state reinsurance funds after the state experiences a natural catastrophe resulting in insured losses of at least 150% of direct earned premium from the previous year for all lines of property and casualty insurance written in the state. While Title II has been criticized as a subsidized Federal loan, a recent GAO report on natural catastrophes questions whether Congressional disaster loans would ever be repaid. Although the event size trigger for the catastrophic loan was increased at Committee markup of the bill, minimizing the chance that taxpayers will be on the hook for relatively minor events, Republicans are concerned that this increased trigger does not apply to liquidity loans. State reinsurance funds would be eligible for liquidity loans upon suffering `insured losses,' with no prescribed loss amount or event size.

Despite receiving testimony from witnesses that H.R. 3355 lacks any real mitigation mechanism, little improvement has been made in this area since the bill's introduction. The lack of any additional mitigation mandates furthers the potential exposure for taxpayers. As reported, H.R. 3355 requires adherence to state building codes in order to be eligible for liquidity and catastrophic loans, but this fails to recognize that some states and localities lack effective building codes. Substandard codes would not bar the receipt of these Federal loans. Republicans also remain concerned that recipient states would not be required to retain any losses before becoming eligible for the loans. Without a retained loss requirement, state reinsurance funds will have little incentive to adequately capitalize prior to an event, relying instead on post-event debt financing from the Federal government and taxpayers. Instead of propping up bankrupt state programs that undermine the private market, some Republicans have suggested as a more efficient use of taxpayer dollars, encouraging `reverse' loans for `equity rich, cash poor' homeowners meeting a set of criteria, to help defray the escalating costs of private homeowners' insurance in the aftermath of a large catastrophe. The rising cost of homeowners' insurance in Florida has become a stultifying burden on many coastal homeowners. Congress needs to be responsive to this crisis by enacting thoughtful bipartisan reform that addresses the marketplace and regulatory dysfunction. Unfortunately, H.R. 3355 falls far short of these goals.

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