NCOILETTER

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HOUSE COMMITTEE DRAFTS "SILO" TRIA OPTION, FACES TIME CRUNCH

With the Terrorism Risk Insurance Act (TRIA) set to expire at year end, staff of the U.S. House Financial Services Committee has spent most of the last few months drafting legislation to replace or extend the program.

According to Westrick, Committee staff is working on several TRIA approaches so that lawmakers may move quickly once they settle on a final plan. Options that the Committee does not immediately pursue may be revisited in the future as possible TRIA replacements.

One of the plans being developed is the "silo" concept. Under the silo plan uninsurable risks such as those presented by nuclear, chemical, biological, and radiation would, to a large extent, be covered by the federal government. Other risks, such as those involving workers' compensation, would partially be covered by the federal government, while other insurance lines, such as commercial auto, would get little or no coverage.

The silo plan would protect smaller insurers, using what would be called "catastrophic coverage." Catastrophic coverage would create different levels of responsibility, yet to be determined, following a terrorist loss. The first level would be covered by the private market through creation of a risk pool comprised of contributors receiving tax breaks. The second level would be covered through state catastrophe funds using a mixed 90/10 percent state/private formula. The third level would be paid 90 percent by the federal government, ten percent by contributions from a mixture of private sector and state catastrophe funds.

One of the challenges facing TRIA lobbyists is the time crunch. Westrick said that many lobbyists thought the Supreme Court nomination of Federal Appeals Court Judge

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MEDICARE/MEDICAID FUNDING KEY TO CONGRESSIONAL BUDGET DISPUTE

As Congress confronts the costs of military operations and other expenditures, concerns regarding Medicare and Medicaid financing have reached the forefront of current budget talks, with federal lawmakers and the Bush Administration preparing to face off over Medicare prescription drug coverage.

The Administration is threatening to veto the Senate's Omnibus Budget Reconciliation Act (OBRA) of 2005 (S.1932) if proposed Senate Finance Committee cutbacks to the Medicare Advantage Regional Plan Stabilization Fund are enacted. The Fund, which was created under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, provides incentives for regional preferred provider organizations (PPOs) to offer prescription drug coverage in underserved areas. Coverage is offered through the Medicare Advantage program.

According to the Administration, the Stabilization Fund offers Medicare beneficiaries, namely in rural areas, greater choice regarding their coverage and represents a long-term investment in the Medicare Advantage system. Both Senate and House Democrats charge that proposed cuts to the program are aimed at offsetting a $70 billion Republican tax-cut.

Phasing out the Fund is part of the Senate Committee's attempt to cut $10 billion of Medicare/Medicaid funding over the next five years.

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NATIONAL CONFERENCE OF INSURANCE LEGISLATORS

Preserving State Insurance Regulation...

- By interacting with Congress on issues of critical importance to insurance public policy
- By educating state lawmakers on the solutions to their insurance-market crises
- By fostering relationships between state legislators
- By asserting the primacy of state insurance regulation under the McCarran-Ferguson Act of 1945

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TRIA

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Samuel Alito Jr. would keep lawmakers in Washington until late in December. However, the recent announcement that the nomination hearings would not start until January means that lawmakers will not be working late into the year, so time is particularly short.

Westrick stated that while there has been much talk in the media about the possibility of combining TRIA and natural catastrophe risk, he did not believe that was a viable plan. He stated that the House Financial Services Committee was an experienced and knowledgeable group on issues of risk management and that historically the joining of those two risks has never enjoyed support.

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Westrick also noted that TRIA activity has pushed work on the State Modernization and Regulatory Transparency (SMART) Act to the back burner. NCOIL strongly opposes SMART, asserting it would preempt state authority to regulate insurance.

TRIA establishes a temporary federal backstop for insurance against terrorism. Its reauthorization—at least in some form in order to give the private market time to craft its own approach—enjoys the strong support of legislative, regulatory, insurance industry, and other interested parties. Consumer groups are less convinced *(see sidebar)*.

In late 2001, NCOIL became the first legislative organization to publicly endorse such a program, noting that failure to ensure terrorism coverage would have devastating economic consequences. NCOIL has several times conveyed to Congress its support of a TRIA reauthorization.

Late last month, the National Conference of Insurance Legislatures (NCSL) joined the effort and urged members of Congress to extend TRIA in the short-term so that private insurers could find a long-term solution. In a letter sent by the chair and vice-chair of the NCSL Financial Services panel, the group said, "We also believe that TRIA should be extended cleanly and not used as a vehicle for other more controversial measures that will weigh it down and risk exposing our nation's economic security."

Consumer Group Renews Call For TRIA Rejection

In letters distributed November 2 to key federal lawmakers, the Consumer Federation of America (CFA) renewed its opposition to a TRIA extension, arguing that the time had come for the private market to develop its own terrorism-risk solution.

According to Robert Hunter, CFA director of insurance, "It's impossible to justify terrorism subsidies when insurance profits are skyrocketing, commercial insurance rates are sinking, and beleaguered taxpayers still face growing budget deficits." He said insurers and large real estate interests should no longer profit from what he called a "lucrative government program."

CFA further objects to inclusion of group life in any federal terrorism system. "There's not a shred of evidence," Hunter said, "that the life insurance industry needs taxpayer support in the event of future terrorist attacks. In fact, the group life market is highly competitive and insurers have many ways of spreading risk that don't involve government largesse."

In the event that Congress reauthorizes some form of federal terrorism backstop, CFA says the program should be more bare-bones. Travis Plunkett, CFA legislative director, commented that "by dramatically scaling back TRIA to cover only the most significant terrorism losses, the Senate would be spurring the private market to continue expanding its ability to offer terrorism coverage without taxpayer assistance."

NCOIL SPRING MEETING

February 23 through 26, 2006
Fort Lauderdale, Florida

HURRICANE SEASON: WINDS OF CHANGE FOR CAT MODELS?

The unusually active 2005 hurricane season has led some in the insurance industry to question the effectiveness of catastrophe storm modeling, noting that actual insured losses—particularly from Katrina—have far overstepped predicted damages.

Chief among the concerns are the models' ability to gauge storm frequency and the impact on certain commercial risks. Insurers have questioned whether the models appropriately accounted for the unique nature of New Orleans, including the city's propensity for flooding, its lax building codes, and the age of its structures. Add to that the likelihood of government-ordered evacuations, which led to many business interruption claims.

According to Thomas Motamed, vice chairman and COO of Chubb Corp., speaking during a recent earnings call, "It's clear we need to understand better whether there were flaws in the model we used or in its underlying assumptions." Chubb realized a $511 million loss as a result of Katrina.

Brokers and modeling firms, among others, stand by the strength of current cat models, saying that extenuating factors—such as political risk—exist in any hurricane situation that are difficult to foresee and may affect a model's accuracy. Ryan Osgaard of Guy Carpenter & Co. was reported recently as saying, "Anybody who did think that the models were going to be an all-encompassing view of any given event just don't *[sic]* know how these things are used."

Osgaard stressed that catastrophe models have clearly improved underwriting accuracy, but he did see benefit in reevaluating whether we are in a cycle of greater hurricane frequency. "It seems to boil down to this," he said. "Are we in some multidecadal pattern? There is some evidence in the last few years that something is happening. So, the big question is, is the 1-in-100 year event really a 1-in-50, or a 1-in-20?"

MEDICARE/MEDICAID

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The Committee says the money saved by eliminating the Fund would forestall a proposed cut in physician reimbursements. The Senate bill also would subject PPO services, health maintenance organizations, and other managed care plans to health-care taxes. The Senate adopted S.1932 on November 3.

On the same day, lawmakers in the House of Representatives approved their own reconciliation package, which significantly differs from the Senate version. The House bill would leave Medicare unscathed but would cut $9.5 billion from Medicaid over five years. Further, the House bill would introduce the option of Medicaid Health Savings Accounts, modeled on private health savings accounts.

Health savings accounts (HSAs) allocate direct cash benefits to a special account for health care costs. HSAs are associated with health insurance plans with very high deductibles. A consumer would make health care payments from the HSA up to the deductible amount, then health insurance would cover the remainder.

Despite differences, both the Senate and the House bills would change restrictions to Medicaid long-term care coverage. Specifically, they would revise the "spend-down" rules that encourage seniors, namely those of middle and upper incomes, to divest their assets so as to qualify for Medicaid long-term care, and the bills allow all states to incorporate public-private LTC partnerships into their state Medicaid programs.

Four states (CA, CT, IN, and NY) already have such programs in place, having been granted authority, prior to the OBRA of 1993, to establish these partnerships as pilot programs. OBRA of 1993 effectively discouraged creation of additional state partnerships by removing a major incentive for consumer participation.

Last year, NCOIL adopted a resolution supporting federal law to expand partnership programs, noting that they have led to sizeable taxpayer savings.

Both Senate and House Democrats charge that proposed cuts to the [Medicare Advantage] program are aimed at offsetting a $70 billion Republican tax-cut.

Phasing out the Fund is part of the Senate Committee's attempt to cut $10 billion of Medicare/ Medicaid funding over the next five years.

FEMA DIRECTOR: KATRINA IS NFIP WATERSHED EVENT

Following are excerpts from testimony of David Maurstad, acting director and federal insurance administrator of the Mitigation Division of the Federal Emergency Management Agency, before the U.S. House Financial Services Committee on October 20.

"This year's hurricane season represents a significant challenge for the NFIP. Hurricane Katrina was a monumental flooding event that was further exacerbated by the impact of Hurricane Rita. The magnitude and severity of flood losses related to these storms are unprecedented....

Since the NFIP's inception in 1968, $15 billion has been paid out to cover more than 1.3 million losses….Just last year the 2004 hurricane season resulted in over 75,022 claims totaling close to $2 billion dollars paid out in NFIP coverage. We estimate that Hurricanes Katrina and Rita will result in flood insurance claims that significantly exceed the highest number of claims filed from any single event in the NFIP's history, and well more than triple the total number of claims filed in 2004. Katrina and Rita-related NFIP claims could exceed $22 billion, far surpassing claims paid in the entire history of the NFIP….

Today, more than 20,100 communities in all 50 States and U.S. Territories voluntarily participate in the NFIP, representing about 95 percent of all properties in the Nation's Special Flood Hazard Areas. The NFIP provides these communities with maps that identify flood risks and help local government decision makers determine how flood-prone areas are used and how buildings in these areas should be constructed. These maps, which we are in the process of modernizing and making more accessible to homeowners, are also used to determine flood insurance rates….

Since 1986, the NFIP has been financially self supporting for the average historical loss year. During periods of high losses, consistent with the law, the NFIP has borrowed from the U.S. Treasury. These loans have been repaid, with interest, from policyholder premiums and related fees, and at no cost to the Nation's taxpayers. Last year's claims activity represented a significant loss year for the NFIP, and the program exercised its borrowing authority in the amount of $225 million. This was only the fourth time since 1990 that the Program was in a borrowing position….The total payout for Katrina alone may be as much as...20 times the program's average historical annual losses….

As Gulf Coast reconstruction gets underway,…FEMA will continue seeking ways to remove repetitive loss properties (properties with two or more $1,000 flood insurance claims within a 10-year period) from the NFIP policy base. FEMA will work with the States, local governments, and Community Rating System (CRS) communities to mitigate these properties through elevation, relocation, flood proofing, localized flood control, and acquisition/demolition. The Alabama and Mississippi areas affected by Katrina contain about 2,200 and 2,500 repetitive loss properties respectively (as of Oct. 5, 2005). The Louisiana Parishes affected by Katrina contain nearly 20,000 [such] properties.

Title I of the 2004 Flood Insurance Reform Act authorized FEMA to establish a Severe Repetitive Loss pilot program to address properties that flood more frequently and severely than the repetitive loss properties I just described. I am pleased that the FY 2006 Department of Homeland Spending bill that Congress recently passed authorized FEMA to transfer up to $40 million from the National Flood Insurance Fund to mitigate these properties. Louisiana Parishes affected by Katrina contain nearly 2,000 Severe Repetitive Loss Properties….

A significant part of FEMA's Gulf Coast Mitigation Strategy looks to encourage communities to rebuild stronger.…

Sound floodplain management planning and regulations save this country an estimated $1.1 billion in prevented flood damages annually, and structures built to NFIP criteria experience 80 percent less damage than structures not built to such standards…."

NCOILetter

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