LAW360 Insurance Authority

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Proposed $350B Federal Reinsurance Program Draws Scrutiny

By **Eli Flesch**

Law360 (January 19, 2024, 5:36 PM EST) -- A proposed national reinsurance program lacks important details for legislation that would dramatically change the federal government's role in insurance markets, experts said, while offering competing ideas about whether such a program is needed at all.

Consumer advocates and proponents of limited government split sharply over the premise of the bill itself: that a government-backed reinsurance program would provide relief from high insurance costs and a lack of coverage availability in high risk areas. Climate change has made urgent the need for a federal reinsurer, the bill's backers say. Its opponents see private reinsurers as crucial for adequately distributing risk.

Introduced **on Jan. 10** by Rep. Adam Schiff, D-Calif., the bill would set aside $300 billion for the program and a federal catastrophe bond system, while providing $50 billion for risk-mitigation grants and cash payments for low-income consumers.

Unlikely as the bill is to pass a divided congress, experts still pointed to considerable risks around its proposed discontinuation of the National Flood Insurance Program, its overall expense, and whether carriers would choose to opt into the program.

Thomas B. Alleman, a carrier attorney with Dykema Gossett PLLC, said the bill's phased-in coverage of climate catastrophes could potentially put insurance companies and the program itself under considerable stress before very long into the program. Within six years, the bill mandates that the reinsurance fund cover carriers for losses connected to flooding, windstorms, hurricanes, thunderstorms, and wildfires.

"My concern with it isn't that it's a bad idea — quite the contrary. I think it's a good idea, and it is the most out of the box we have seen in terms of setting up an alternative to the NFIP," Alleman said. "Is this discussion worth having? The answer is absolutely yes."

Still, the success of any new program wouldn't just depend on providing a solvent market for flood insurance or reinsurance, but on how that program is more broadly tied to the financial system, Alleman said. This bill doesn't address how mortgage lenders might transition to a new coverage system, a crucial shortcoming, Alleman said.

Robert Hartwig, director of the Risk and Uncertainty Management Center at the University of South Carolina, was critical of the bill, saying it didn't address what he described as the most pressing issues facing insurers. He said climate disasters were less to blame for insurance affordability and accessibility issues than challenging regulatory environments and high litigation costs for carriers, ignored by the bill.

"There's not really a need here," Hartwig told Law360 in an interview. "This is a bill that's trying to treat some symptoms, but isn't actually treating the underlying disease that's causing the disruptions in markets like Mr. Schiff's California, or states like Florida."

To qualify for Schiff's program, insurers would need to offer all-perils insurance for commercial and residential properties and participate in "loss prevention partnerships" that could involve carriers paying consumers to cover risk-mitigation activities.

The Treasury would then set premiums at no less than 50% of the amount an insurer would expect to lose in a year, based on its risk exposure, and the costs required to administer the program. Those premiums would be put into the newly established reinsurance fund, which would be held and invested in by the government.

There is precedent for a national reinsurance system. Following the September 11 terrorist attacks, reinsurers took on huge liabilities as insurers sought coverage for what was one of the industry's biggest single loss events. To help keep terrorism coverage affordable, lawmakers approved the Terrorism Risk Insurance Act of 2002, which made the government responsible for covering carrier losses if they exceeded a set limit.

A similar idea animates the Schiff bill. Should insurer premiums collected for the reinsurance fund be insufficient to pay carriers back for their losses, the Treasury would finance payments by issuing debt in the form of bonds and notes. Those securities, and interest earned on them, would not be subject to state or local taxes, per the bill.

The bill's catastrophe bond provisions are an element that has stirred debate among industry players. While opponents of the bill emphasized that a carrier and reinsurer-driven market for high interest rate catastrophe bonds already exists, supporters said government bonds could offer more favorable terms and strengthen the bond market.

A broader catastrophe fund has also been considered before Schiff's bill. In 2007, lawmakers on the U.S. Senate Committee on Banking, Housing, and Urban Affairs made it a focus as part of a hearing on insurance affordability in coastal regions.

"The insurance industry is split nine ways to Sunday," said Bill Nelson, then a U.S. Senator for Florida, according to a transcript of the hearing. "The insurance industry is at a war with the reinsurance industry. The reinsurance industry is saying that the private marketplace can solve the problem, and it cannot take on risk of this magnitude."

Franklin W. Nutter, who was then and now the president of the Reinsurance Association of America, told the lawmakers that state reinsurance funds, like Florida's, acted merely as a "cost-shifting mechanism financed by debt," with no clear affordability benefit.

Last year, insurance and finance experts further discussed the idea of a national reinsurer at congressional hearings focused on insurance availability and affordability. While those hearings were highlighted by discussions on housing costs, climate change, and carriers' consideration of environmental, social, and governance factors, the mentions of a national reinsurer indicated a continued interest in a program.

In one **July 2023 hearing**, Caroline Nagy, senior policy counsel with the progressive group Americans for Financial Reform, said lawmakers should consider a public reinsurer given that much of the reinsurance industry is global and outside U.S. regulatory powers. Experts estimate roughly half the industry is located abroad.

In an interview with Law360, Nagy said that while AFR hasn't officially signed on in support of Schiff's bill, the concept was good, even if there were outstanding concerns.

Ending the NFIP would open a "very large can of worms," given that the program has a big influence on how flood-prone areas manage their development, Nagy said. But she also said AFR was really excited about the bill's provisions for grants to low-income consumers for risk-mitigation activities. Historically, disaster relief and other forms of aid have benefited white people more than communities of color, she said.

"The math isn't mathing when it comes to property losses driven by climate change," Nagy said in an interview. "There's a very good argument to be made that damage caused by climate change is an area where we need the government to take a role."

Jerry Theodorou, policy director of finance, insurance and trade policy at the free-market think tank R Street Institute, took the opposite tack. He told Law360 that a national reinsurer like Schiff's would crowd out the market for private reinsurers. The global market, he said, is happy to take on U.S. risk, and notably did so in the hurricane heavy years of 2004 and 2005, when 50% of losses were borne by global reinsurers.

"If you set up some domestic reinsurance facility for catastrophes, and you underprice the business, as it normally goes, then it's going to socialize the losses, eventually, onto the ordinary taxpayers," said Theodorou, another congressional insurance witness. "I think it's ludicrous to attempt to establish a reinsurance facility with $300 billion of the Treasury's balance sheet put up against this over the course of the next five years."

Ultimately, the chances of Schiff's bill becoming law are slim. No Republicans have signaled support for the bill, and it is opposed by one of the insurance industry's leading trade groups, the American Property and Casualty Insurance Association.

Nat Wienecke, an APCIA government relations official, said in a Jan. 12 statement that a broad federal program couldn't overcome "the combination of climate change, accumulation of homes in hazard-prone regions, significant increases in labor and materials costs due to inflation, legal system abuse, and outdated regulatory systems."

Such a program could potentially be more expensive for policyholders and put families at a greater risk of losing needed coverage, he said.

While most experts agreed that the bill is likely to draw total opposition from the reinsurance industry, some suggested insurance companies might eventually come around to supporting a national reinsurance program if it promises financial gain.

The bill was endorsed by consumer advocacy groups, including United Policyholders, the Consumer Federation of America and the Center for Economic Justice. Amy Bach, the executive director of United Policyholders, told Law360 there's an imperative for the U.S. to develop a supplement to the private homeowners insurance marketplace.

"I think part of what insurers need is to really take seriously the possibility of there being competition from a government program," Bach said in an interview. "They've brought the market to a standstill [in California], and now they're pushing for all this deregulation, and frankly, I want to see a Plan B before we give them even more power."

Schiff's bill comes against a backdrop of a moderating reinsurance market. While renewal prices last year were **exceptionally high** — something reinsurers have blamed on catastrophe exposure — market analysts predict a softer market in 2024.

Carriers have cited the cost of reinsurance as one reason for raising rates in catastrophe-prone states like California, where industry lobbyists have strongly pressed regulators to allow them to pass on those costs to consumers.

Schiff's bill, H.R. 6944, will be considered by the House Committee on Financial Services.

--Editing by Amy Rowe and Nick Petruncio.

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