

## Debate continues over national catastrophe fund

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**Donna M. Greenspan and J.D. Dickenson, Edwards Angell Palmer & Dodge**

The 2004 and 2005 hurricane seasons produced more than just monster storms. They spawned a debate of monumental proportions over the need for a national catastrophe fund. This debate crashes through state, industry, and even national boundaries and reawakens the clash between two ancient adversaries: government versus the free market.

The battle has produced compelling arguments on both sides that ask fundamental questions about the role of government and the insurance industry.

The "six-pack"

On March 20, Florida Senators Mel Martinez and Bill Nelson introduced a "six-pack" of congressional proposals, renewing debate over a national catastrophe fund. Some of the "six-pack" proposals call for tax breaks for individuals who take steps to protect their property from damage or put aside money in special "catastrophe" savings accounts. One bill calls for streamlining regulations that govern how insurers allocate risk for major disasters, allowing foreign companies into the mix. Another provides tax breaks to insurers that set aside money solely to pay for major natural disasters.

The centerpiece of the "six-pack" is the Homeowners Protection Act of 2007. The act envisions a national fund that would serve as a "backstop" for state natural catastrophe insurance programs. It is primarily this act that has spurred the fight between those for and those against federal government involvement in insuring catastrophes.

On April 11, the Senate Committee on Banking, Housing, and Urban Affairs conducted a hearing on the availability and affordability of property and casualty insurance in coastal regions. The Florida contingent, including Gov. Charlie Crist, insurance company representatives, consumer groups, and homeowner groups all converged on Capitol Hill. The day's testimony reflected some strikingly discordant views.

The case for a

national catastrophe fund

The Florida contingent, consumer groups, and a number of property and casualty insurers argue the case for a national catastrophe fund. Pointing to Hurricane Katrina, the pro-fund group maintains that the federal government already plays a major role in responding to natural disasters.

They point out that a "catastrophe" under the act includes winter storms, tornadoes, earthquakes and floods, and they argue that the need for a national fund is not limited to hurricane risk. According to fund proponents, a federal catastrophe fund would protect American homeowners by spreading the risk across our country and strengthening the insurance markets.

Proponents point out that the cost of reinsurance is a significant factor driving the cost of property insurance. They claim that a national catastrophe fund would serve as a "backstop" for insurance companies to insure against mega catastrophes. In addition, a national fund would reduce the cost of insurance by selling discounted reinsurance that would trigger after an insurer's payment of a threshold amount for catastrophe losses. They argue that a national fund would stabilize markets in the aftermath of a catastrophe, and prevent insurance availability problems like those that have plagued Floridians.

Proponents of a national fund maintain that blindly throwing money at a catastrophe after it has occurred is fundamentally a disorganized and inefficient way to get markets and communities back on their feet. It would be better, they contend, to have the

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federal government prepared for a catastrophe, with funding in place beforehand.

The case against a national catastrophe fund

Those arguing against a national catastrophe fund include numerous insurance and reinsurance industry associations, as well as the chairman of the President's Council of Economic Advisers. This group warns that a federal insurance "backstop" would have a number of unintended and unwelcome consequences for the economy.

First, the opponents argue that government-backed insurance would displace insurance in the private market. They point out that the private market survived the 2004 and 2005 seasons with intact and even increasing capital. The fund opponents argue that the insurance industry is demonstrably capable of managing catastrophic risks without government assistance.

Detractors argue that a federal program would force taxpayers nationwide to subsidize low premiums for a relatively small group of people in high-risk areas. The existence of a national fund would undermine personal economic incentives to mitigate risk because the program would distort pricing from true actuarial values.

Finally, opponents call for market-based solutions to insuring catastrophes. They argue that those who build and live in risky areas should bear the costs of catastrophe insurance. They ask that government involvement focus on sensible civil planning and building codes that would reduce the costs of catastrophes.

The recent rash of catastrophes has brought these issues to the forefront and generated healthy debate. The outcome of the battle and the resulting form of any federal catastrophe initiative, however, is still up in the air.

Attorney Donna M. Greenspan (dgreenspan@eapdlaw.com) is an associate in the Insurance and Reinsurance Department of the national law firm Edwards Angell Palmer & Dodge. J.D. Dickenson (jdickenson@eapdlaw.com) is also an associate in the firm's Insurance and Reinsurance Department.



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