U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

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TESTIMONY OF TREASURY ASSISTANT SECRETARY FOR ECONOMIC POLICY PHILLIP SWAGEL BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

WASHINGTON, DC -- Good afternoon Chairwoman Waters, Ranking Member Biggert, and Members of the Subcommittee. The effects of Hurricanes Katrina, Rita, and Wilma, with combined insured losses of $57 billion, are reminders of the potential scale and scope of the destructive forces of nature. Insurance for economic losses cannot undo the costs in human terms, but it can provide financial security and put families and businesses on a course to recovery. We all share the goal that families and businesses should have access to insurance coverage against natural catastrophes so that they can avoid devastating financial losses from future events. Some government actions, however, pose the risk of unintended consequences such as interfering with private insurance markets that would otherwise provide the desired coverage.

H.R. 920: The "Multiple Peril Insurance Act of 2007"

H.R. 920 proposes to have the National Flood Insurance Program (NFIP) offer optional coverage for wind damage in addition to the coverage it already writes for flood risk. The Administration opposes H.R. 920. A Federal insurance program for wind damage will displace the active private market and could give rise to a large new burden on Federal taxpayers. The Administration supports leaving wind coverage to the well-developed private market for such insurance and not creating a Federal program for wind losses.

The Private Insurance Market Provides Coverage for Wind Events

Competitive private insurance markets set appropriate prices for insurance based on the level of risk. The private sector is effective at providing insurance (and reinsurance) for damage from wind events. Private market coverage can be expensive in areas facing substantial risk of wind events. This is a reflection of the risk, not a defect of the market. For example, to limit rate increases and ensure availability, some states have established state-run insurers of last resort for high-risk properties or a state hurricane reinsurance facility. These efforts have, in some cases, resulted in the state-sponsored insurer becoming the largest insurer in the state—private insurers cannot compete with subsidized state policies. In one case this has resulted in a doubling of state exposure with limited capital in reserve. Although such government involvement may result in short-term savings for policyholders, such actions greatly increase the odds of future large tax increases or assessments on policyholders to cover shortfall from subsequent storms.

Federal involvement in wind insurance would further displace private coverage, lead to costly inefficiencies, and retard innovation in a private sector that is generally functioning well overall. A Federal program will face pressures to set aside risk-based pricing and offer subsidized government insurance. By lowering insurance prices below the actuarially-fair value, a Federal program would encourage people to take on more risk than if they faced the full expected costs of damages. Such a subsidy would encourage development in high-risk areas, potentially increasing future liabilities. A Federal role in bearing risk would have taxpayers nationwide subsidizing insurance rates for the benefit of a smaller population.

The experience of the NFIP illustrates some of the concerns about an expanded Federal role. For example, the program charges less than full actuarial rates for properties in high-risk areas as well as older, risk-prone properties that have experienced repeated flood losses.

If the use of the private market in the provision of wind coverage is abandoned, the same forces would be at work to move the Federal government—that is, all American taxpayers—in the direction of providing subsidized rates to at-risk communities. Supporting private market solutions avoids displacing an active private market and the creation of costly new Federal liabilities.
Requiring the NFIP to offer optional wind coverage in competition with private wind coverage further opens up the opportunity for private sector insurers to elect to cover only low-risk properties. In this case, the NFIP would turn into a de facto "market of last resort" where the riskiest properties will be turned away by private insurers and end up with the NFIP.

Conclusion
Allowing private insurance and capital markets to fulfill their role as risk bearers will contribute to the long-term financial soundness of our government and best maintain the economic sustainability of communities at risk of wind catastrophes. Federal government interference in the wind insurance market will displace private markets, promote riskier behavior, be unfair to taxpayers, and be economically costly. For these reasons, the Administration opposes H.R. 920. The Administration looks forward to working with the Committee as it considers other reforms of the NFIP.

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