"TWENTY COUNTIES...ONE VOICE"

www.nc-20.com

TO: North Carolina Department of Insurance
RE: Beach Plan Reinsurance and Tax-Free Bonding

February 7, 2012

On Wednesday, February 1st, I met with Gina Schwitzgebel, the new General Manager of the FAIR and Beach Plans. Also attending the meeting with Ms. Schwitzgebel was Alvin Ashworth, Accounting Manager of the FAIR and Beach Plans. Duke Geraghty, Legislative Chair of the Outer Banks Home Builders Association and Michael Davenport, President of the Outer Banks Association also sat in on the meeting.

Ms. Schwitzgebel requested the meeting to discuss a particular issue that was raised in a memo I sent to the NC Department of Insurance by email on Monday, December 12th. The memo questioned why the Coastal Property Insurance Pool spent such a high percentage (68.75% - almost $209 million) of the $304 million in premiums earned last year on reinsurance and the impact that could have.

With the passage of House Bill 1305 – Beach Plan Changes, the Coastal Property Insurance Pool could no longer make distributions from the surplus and could only spend revenues (premiums/investment income) on claims, operating expenses and reinsurance. Prior to House Bill 1305 being ratified, the Coastal Property Insurance Pool surplus accrued by $95 million in fiscal year 2006; $135 million in 2007; and $145 million in 2008. Those involved in the passage of HB 1305 firmly believed that if the surplus continued to accrue at such a high rate - combined with higher premium rates and deductibles going into effect and distributions no longer being allowed - the Coastal Property Insurance Pool would be so fiscally strong in just a few short years of low losses that the threat of non-recoupable and recoupable assessments would be a moot point.

Ms. Schwitzgebel pointed out that modeled annual average losses are expected to be $200 million – this includes good loss years, bad loss years and "the Big One" losses averaged out over a long period of time. The Coastal Property Insurance Pool collected over $304 million in premiums last year. However, due to the high reinsurance expense, losses last year (especially those from Hurricane Irene) – which totaled less than $200 million – required monies to be withdrawn from the surplus to pay claims. Reinsurance could not be used to pay any of those claims because it does not even become effective until losses reach an inordinately high “catastrophic” amount. The 2011 attachment point for reinsurance was $1.3 billion in losses.

With a diminishing surplus (or one that is not accruing), the risk that NCIUA member companies would be assessed and policyholders statewide would be surcharged becomes greater. A diminishing surplus creates the need for a greater amount of reinsurance thus creating a cycle that would potentially lead to instability of the Coastal Property Insurance Pool.

Ms. Schwitzgebel stated that modeled potential losses show the Coastal Property Insurance Pool at risk of $4 billion in losses in any given year if a major hurricane, “the Big One”, hits the coast. According to Ms. Schwitzgebel, there is an approximate 3 percent possibility of having a storm of that magnitude - one that would exceed the ability of the Coastal Property Insurance Pool to pay policyholder claims without the purchase of reinsurance.

Although the risk is only 3%, the Coastal Property Insurance Pool needs to ensure that funds are available if and when “the Big One” does happen. Current surplus funds added to the $1 billion assessment companies pay in the event of a major catastrophe plus funds derived from a catastrophe recovery charge (recoupable assessment) do not total $4 billion. Therefore, the Coastal Property Insurance Pool purchases reinsurance to cover the difference. ***Not only are policyholders paying higher premiums in eastern NC if a major hurricane hits, but the Beach Plan itself is paying out a tremendous amount of money based on a “what if”, 3% chance scenario. This needs to change.***

Approximately $742 million has been paid by the Coastal Property Insurance Pool for reinsurance in just five years – almost three-fourths of a billion dollars out of the pockets of Coastal Property Insurance Pool policyholders that is gone for good. The majority of the money spent on reinsurance was sent overseas to foreign reinsurers. Coastal Property Insurance Pool incurred losses in the last five years – 2007 thru 2011 - have only totaled $219 million. Although recognizing that a modeled 3% catastrophic risk exists, there must be a better way to manage that risk than sending hundreds of millions of dollars out of the country year after year. There needs to be another revenue source tool in the toolbox, so to speak.

Ms. Schwitzgebel shared information on an option being used in other states to address this issue – a means that would allow monies spent on reinsurance to stay in NC. **Tax-free bonding** has been approved in California, Texas, Louisiana and Florida as a means to manage future potential catastrophic losses while reducing the dependency on costly reinsurance. With less spent on reinsurance, the Coastal Property Insurance Pool surplus could accrue each year thus creating stronger fiscal stability and further insulating member companies from a $1 billion assessment.

By purchasing reinsurance to cover potential catastrophic losses, the Coastal Property Insurance Pool essentially manages funds annually based on a “***what if the worst storm possible happens***” scenario. Tax-free bonding would replace the need to purchase such a large amount of reinsurance. Instead of ***“if”*** it happens, tax-free bonding would be utilized ***“when”*** the worst storm possible happens. A catastrophe recovery charge (CRC) could then be utilized for bond repayment, just as is permitted now with “recoupable assessments”. By allowing the Coastal Property Insurance Pool to utilize tax-free bonding and access a source of revenue ***after*** a catastrophic event has actually occurred, total reinsurance expense could be greatly reduced. Millions of dollars being spent on reinsurance could be added to the surplus each year.

To summarize, the heavy reliance on reinsurance is not conducive to the long-term health of the Coastal Property Insurance Pool. The cost of reinsurance continues to rise each year and is dictated by the foreign market. It is also of great concern that, unlike voluntary market insurers in NC, foreign reinsurance companies are not regulated by the NC Department of Insurance. Reducing the amount of reinsurance expense would greatly improve the overall sustainability of the Coastal Property Insurance Pool.

Tax-free bonding appears to be a "win" for all involved: the Coastal Property Insurance Pool becomes more stable; insurance companies become better insulated against a $1 billion assessment; the lower risk of assessment increases the market thus bringing about more competition; and, overall transparency is improved. A large amount of monies paid to foreign reinsurers would stay in North Carolina.

Legislation would need to be passed by the General Assembly to allow the use of tax-free bonding. On behalf of NC-20, the Outer Banks Association of Realtors and the Outer Banks Home Builders Association, I strongly urge the NC Department of Insurance to consider this option and support such legislation if in agreement with the above.

Willo Kelly
President, NC-20

705 Page Road Washington, North Carolina 27889
Office: (252)946-3970 Fax: (252)946-0849