Introduction

While a man-made event, the BP oil spill was a stark reminder of the risks that can come with living on the coast. The lives disrupted by its effects show the substantial price we can pay for the life we choose.

We have long enjoyed the benefits of coastal living and, as a society, thought we understood the risks associated with building along the coast. But in recent times we have seen an exponential increase in the value of land, the construction costs to build along the coast, the cost to rent or own the property constructed on it, and the value of the contents with which we have filled our homes. In addition to higher property values and construction costs, the rate of development in Alabama's coastal counties has been more than anyone, save perhaps the most ambitious developer, could have ever imagined. The combination of increased development and more expensive development has raised the risk significantly -- more than most people realized.

Rapid coastal development has been a national phenomenon. According to the National Oceanic and Atmospheric Administration, 270 people per square mile live near the nation's coastline, more than double the national average of 93. There are 8.5 million people who, aside from being exposed to the effects of hurricane-force wind, reside in the 100-year coastal flood hazard area, about 3 percent of the U.S. population.

Hurricane activity is cyclical. In the decades before 1995 we were in a period of reduced hurricane activity. In this period of increased activity, we have repeatedly witnessed the destructive power of hurricanes. Combined with coastal growth, the return of this active hurricane phase does not bode well for communities situated along the Gulf coast. Hurricane catastrophe models, including those used by the insurance industry, suggest that major hurricanes are not only more likely, but could cause far more damage than previously recognized. The future outlook is more grim with evidence of environmental climate change, which brings rising sea levels, warmer sea surface temperatures, and uncertainty about how this will impact our coastal communities.

(Breakout: Map of historic path of hurricanes.)

Hurricanes Ivan in 2004 and Katrina in 2005, in particular, changed the perception of risk in the region. In the aftermath of these catastrophes, the public and private sector recognized that they had underestimated the risks of living along the Gulf coast. After significant losses sustained by insurers and reinsurers as a result of those storms, the insurance industry reevaluated its exposure to unsustainable risk and adjusted premiums to reflect the recalculation. That upward readjustment rekindled the debate over strategies for coastal planning and development, over subsidies to achieve relative affordability for residents and business, and over mitigation to reduce risks -- and, therefore, premiums.

Achieving an acceptable balance of risks and costs for insuring coastal property is only possible if the responsibility is shared among property owners, government, and the insurance industry. Homeowners must try to toughen their homes, spurred by governments who must adopt stronger standards for construction. The insurance industry also has a vital part to play, working together with individuals and government to form a three-pronged approach.

The recommendations submitted by the Coastal Recovery Commission's insurance subcommittee can help stabilize the cost of insurance and even lower insurance premiums. This will help workers live closer to their jobs and save to educate their children. It will help the coastal economy thrive. And it will help limit the number of people who are without property insurance or who are under-insured, reducing uninsured losses so that individuals and communities can recover more quickly from storms.

An Unsustainable System

Since Ivan and Katrina, coastal Alabama residents have struggled to find affordable, comprehensive insurance for their homes. A convergence of factors – including model changes, fear of another storm, and demand for insurance exceeding available supply (although now in better balance) – has led to the current situation. Since those storms, we have also seen the value of beachfront properties peak and then significantly decline in the last few years, which has complicated how insurance is priced. Underlying all these changes has been a marketplace consisting of small regional companies and a lack of competition.

Some insurance companies ceased writing insurance in the region, or are now offering significantly higher premiums or deductibles based on the realization that the exposure and risk is greater than previously estimated. The most expensive and least available insurance in the private market is coverage for damage caused by wind. Some insurers have stopped offering wind policies on the coast or have instituted strict underwriting guidelines. More than 52,000 wind policies in Baldwin and Mobile counties have been dropped by insurers since Katrina, driving homeowners to purchase wind insurance with the insurer of last resort, the Alabama Insurance Underwriting Association (AIUA).

Other homeowners have obtained policies from "surplus-line" insurance companies that are unregulated by the State of Alabama; these non-admitted carriers offer higher-cost insurance but are important participants in a market with limited choices. And some homeowners are going without coverage; they are "functionally uninsured," a category that includes homeowners who are going without a portion of property insurance, or may have comprehensive coverage but they do not have the money in the bank to pay their deductibles.

Should a major hurricane strike Baldwin and Mobile counties, losses and claims are expected to be significant. Insurers that have continued to write policies in coastal communities may decide to significantly reduce their exposure, or leave the coastal market if they cannot charge actuarially sound rates. Such a development would further diminish competition and consumers' choices. The shrinking supply of insurance would have the added effect of moving more homeowners to higher-priced policies offered by the AIUA.

The number of homeowners with wind pool policies under the AIUA has grown substantially since Ivan, from about 3,500 policies to 18,865 as of October 31, 2010. Private insurers voluntarily helped create the wind pool in the early 1970s, and it exists to provide an option for owners of property along coastal Baldwin and Mobile counties who are unable to obtain coverage from private insurers. To limit interference with the private market, the wind pool generally charges insurance rates higher than the average rate offered by private insurers. Despite this, the pool's share of coastal residential premiums and number of policies have been growing since 2004.

Continuing this trend is a risky proposition. Should Alabama's wind pool suffer large losses due to a storm, licensed insurers who participate in the wind pool will be required to cover losses above what would be paid by funds the AIUA has retained and has purchased in reinsurance to cover a 1-in-100-year storm (which has a 1 percent probability of being equaled or exceeded in any given year). Though the AIUA's share of residential policies is smaller relative to similar insurance pools in other coastal states, the amount of losses for which some insurers would be responsible could result in their insolvency.

Licensed insurers in the state do not want an increasing number of homeowners resorting to Alabama's non-subsidized wind pool, but they also would not want to compete with a subsidized property insurance pool as exists in other states.

Are Subsidies Sustainable?

Some states have made public policy choices to subsidize policies offered by state-run insurers, pricing them below what the private market can offer. Subsidies hide true actuarial pricing and risk-based pricing, distorting the market. Regardless of the subsidy, the ultimate cost to rebuild still must be paid by someone, either now or in the future.

These subsidized insurance pools have become the "insurer of first resort" for coastal homeowners and, in some cases, their only resort. Most private insurers, unable or unwilling to compete against the state program, have all but stopped writing property coverage in these coastal markets. If the overriding policy goal is to foster a competitive private market and give consumers more choice, subsidizing policies with taxpayer dollars should not be considered a viable, long-run option. **[Note: Sentence will be highlighted for emphasis.]**

In Florida, it is an open question whether subsidizing residential insurance was in fact intended or was simply necessary. In any case, the state's government-created Citizens Property Insurance Corporation and related Florida Hurricane Catastrophe Fund have been operating without adequate capital to cover losses from a major hurricane. In the event of catastrophic storms, the state would have to assess taxpayers to make up the difference. After a rate freeze at 2005 levels ended in 2009, Citizens was told it could not raise overall average rates more than 10 percent annually to avert a large hike to actuarially sound levels.

In Mississippi, the decision to subsidize its wind pool after Katrina was facilitated by an infusion of FEMA relief money. The Mississippi legislature has decided to discontinue the subsidy, and now consumers are bracing for a potential increase to risk-based market rates.

On the federal level, the National Flood Insurance Program (NFIP), created in the late 1960s as a government-provided insurance alternative to recurring natural disaster assistance, illustrates how a program formed out of necessity has led to multiple adverse consequences. It has encouraged people to build and live in areas susceptible to catastrophic perils, and it pays time and again to fix properties with repetitive losses to the tune of $200 million annually. Originally intended to be self-supporting, the NFIP is currently $20 billion in debt and regularly requires an infusion of federal tax dollars to stay afloat.

Insurance Industry Developments

After a series of large catastrophe losses for insurers and reinsurers, prices for insurance on a global basis rose in 2007 as the industry worked to replenish its capital and more accurately reflect risk in its prices. So that shareholders, rating agencies and regulators would continue to allow insurers to do business in disaster-exposed regions such as coastal Alabama, the industry passed some of these costs to the consumer.

Recently, consumer prices on a global basis have declined again, as insurers and reinsurers have successfully replenished their capital during a period of few natural catastrophes. Yet this current period of price softening could change quickly if large property losses are sustained from a catastrophic event or series of events, as we saw in the middle of the last decade.

As long as the insurance industry lacks confidence in the mitigation efforts in coastal regions, these regions and their consumers will not reap the benefits from increased insurance capital and competition. [**Note: Sentence will be highlighted for emphasis.]**

How can we do better?

Our collective efforts must focus on strategies for risk management and improving competition. This will create a sustainable insurance market and improve insurance prices. We can achieve this by building and rebuilding stronger homes, encouraging people to mitigate properties with fortifications and retrofits to better withstand hurricanes, improving our understanding of the insurance industry, and fostering a robust private market. Individuals, industry and government at every level have an important role to play.

Principles of Sustainability

The Coastal Recovery Commission's insurance subcommittee has focused its attention on the effects of previous and future natural disasters, and on developing strategies to make the coastal insurance market sustainable. The recommendations that follow fall under three principles of sustainability: adaptation, awareness, and market forces.

Adaptation is better universal risk management through our ability to prepare and protect ourselves against disaster; we can encourage property owners to mitigate their homes and local jurisdictions to strengthen and enforce building codes.

Awareness occurs when we have a better understanding of our insurance system in Alabama and about ways to make it more sustainable; we can increase transparency in the insurance market and embark on public and professional awareness campaigns.

Market forces contribute to affordability and sustainability when we foster a competitive private insurance market and enable innovative approaches and products to provide a range of options. The idea is that more competition and more choices will help stabilize insurance rates before and after a disaster, so that the cost of insurance accurately reflects the risk associated with potential property losses in specific places and circumstances.

[GRAPHIC: Recommendations visual prepared by Nikhil]

Highlighted Recommendations

A number of recommendations emphasize the importance of adapting to coastal risk by fortifying homes and buildings against the effects of storms. The benefits of mitigation measures are many: consumers obtain premium discounts or credits for fortifying new homes or retrofitting existing homes to certain standards, thereby lowering the cost of insurance. Communities and citizens benefit from limiting the short and long-term economic and psychological damage from a catastrophe, speeding recovery and growth. Private insurers, meanwhile, will want to insure mitigated homes, invigorating the market.

The insurance subcommittee recommends commissioning a mitigation study to collect data on thousands of homes in the coastal region. The data could be shared with insurers and catastrophe modeling firms to show the actual physical condition of the housing stock in coastal communities. Because insurers price policies based in part on modeled risk characteristics, the more detailed the data, the more granular the insurers view on local catastrophe risk. To the degree that this detail supported the view that coastal homeowners were building to good codes, then a perception of better quality would be reflected in the catastrophe models used by most insurers. This would lead to lower rates.

The mitigation study would help develop new strategies for a comprehensive mitigation-assistance program. Such a program could involve the Coastal Mitigation Trust Fund, another recommendation by the subcommittee. The revolving trust would help homeowners finance mitigation measures through means-tested grants and low-interest loans guaranteed by the trust.

Similarly, stronger building codes and diligent enforcement programs adopted by communities will not only limit economic loss, they can lower insurance costs, as well. Through the Building Code Effective Grading System (BCEGS) rating program, some insurers recognize communities that achieve certain ratings with premium discounts for residents. To ensure involvement by communities and insurers, we should require insurance carriers recognize the ratings and provide related discounts. Adopting a stronger, uniform building code for the coastal region that goes beyond the 2006 International Residential Code would save residents money and more importantly save lives.

Other recommendations call for further examination of ways to limit disincentives for insurers to enter the coastal market and create new incentives for participation. One idea worth studying would allow licensed insurers to recoup mandated assessments that would apply should the Alabama wind pool suffer losses that extend beyond what it has retained and purchased in reinsurance. The assessment increases insurers' potential exposure to losses and thus has been a disincentive for insurers to enter or remain in the state. Other ideas in need of more examination include ways that the premium tax structure in the state could be used to increase competition, and the possibility of utilizing a captive insurance company to provide consumers with short-term relief from the cost of insurance.

Of course, the most important stakeholders in the process are consumers. Only they can choose to protect their properties, and their unified voice can persuade lawmakers to adopt better building standards and support mitigation as a solution. But there is a role for everyone in creating a sustainable insurance system. Insurers, governments, nonprofits, and professionals involved in the construction, sale, appraisal, and financing of homes can help raise awareness about the insurance system and what we can achieve.

Insurers are already funding an innovative and recently publicized effort to demonstrate how a fortified home can withstand hurricane force winds. State lawmakers in 2009 enacted mandatory discounts for homeowners who fortify new homes and retrofit existing ones. And nonprofits such as Habitat for Humanity and Smart Home Alabama have led by example, constructing Fortified For Safer Living Homes with the help of donations from insurance companies.

Recommendations to advance the study, development, and communication of various efforts could be achieved by creating a new Alabama Insurance Institute through an executive order from the governor. A public education campaign coordinated by the insurance institute could collect and disseminate data to inform consumers and various professional stakeholders about the insurance system in Alabama and strategies to lower risk. The institute could drive research about mitigation and building standards. It could study the effectiveness and viability of innovative market-oriented ideas that have potential to improve the situation, such as public-private partnerships and specialized captive insurance products.

Any education program will need quality information to share. We should increase transparency by providing easier public access to both insurers' rate filings and their aggregate historical data, with the purposes of educating consumers, increasing competition, and understanding the risk of exposure at the local level. In addition, we can require that insurers offering multi-peril policies show the separate premiums charged for wind and non-wind portions of policies on their declaration pages, a requirement that would help consumers understand the composition of their policy premium. The Department of Insurance could then ensure that consumers who qualify are receiving the appropriate amount of wind mitigation discount on their policies.

Other practical recommendations also protect consumers. One would require licensing of contractors and subcontractors to help ensure that mitigation measures are properly installed and construction standards are met. Another would enact an insurance fraud bill to protect consumers from unscrupulous agents and insurers and from consumers who defraud the insurance system. Estimates by the insurance industry show that insurance fraud raises rates between 15 and 20 percent nationwide. A proposal is already on the table in the state legislature.

State Legislative Efforts

Much of what we can accomplish can be done at the state level. A review of state legislative efforts this year to address insurance issues show that lawmakers do not lack ideas or innovative ways to accomplish policy goals, whether to encourage mitigation, improve transparency, or place controls on insurers.

Alabama took an important step in 2009 when it passed a law requiring insurers to provide discounts to homeowners who build, rebuild or retrofit homes against hurricanes. The wind pool took that first step in 2007, recognizing mitigation discounts established by the Institute for Business and Home Safety (IBHS), an insurance industry group, as well as BCEGS discounts for community code and enforcement ratings.

Yet Alabama remains one of two states without a comprehensive state-wide building code requirement. Cities can voluntarily adopt codes, and in fact some of the strongest codes in the state are in coastal communities. But enforcement is generally inconsistent across the state. The Alabama Building Commission does have building code requirements for state-owned buildings, and some commercial structures, such as hotels and movie theaters.

Since Ivan and Katrina, the state has also adopted legislation allowing residential and commercial property captive companies to form in the state, but thus far a captive for such purposes has not been created. Captives organize like-minded individuals or entities, such as doctors or nursing homes, to form their own insurance company to insure their risks. Recently, a regional commercial captive for coastal communities was advanced with support from the South Alabama Regional Planning Commission, but the most recent economic recession limited the ability of local communities to provide public money for the cost of initial capitalization.

Many of the legislative initiatives that follow had a companion bill in the other chamber of the Alabama State Legislature:

- Two pieces of legislation to encourage mitigation did not pass during this year's legislative session. One would require insurers to provide notice to consumers of potential discounts and other benefits for mitigation (SB 208). Another utilizes the tax code to subsidize consumers' cost to strengthen homes, establishing that a consumer can claim a state income tax credit for the lesser of $1000 or 25 percent of the costs incurred to retrofit their home; a tax credit up to $1500 for the sales tax paid on materials used to retrofit the home. It would also subsidize consumers' premiums with a tax credit up to $1250 for "excess premium paid" for insurance (SB 207 and HB 454).

- Several bills to improve awareness in the marketplace also did not pass; the subcommittee believes that more support could come if lawmakers can find ways to balance the needs and concerns of various stakeholders. One piece of transparency legislation would break out the total cost of policies by types of peril, such as wind and fire, on the declaration page that shows basic information about an insurance policy (SB 199); another would make insurers' rate filings with the state and related actuarial data public information available on the Department of Insurance (DOI) website (SB 200); another would require insurers supply aggregate data on total policies, claims and premiums by zip code (SB 713); and another would allow the department to provide consumer assistance in comparing coverages offered in various insurance products (HB 219).

- A bill aimed at reducing the number of policies in the wind pool would have offered insurers a one-time credit against premium tax liability for providing coverage on a property currently insured by the AIUA (SB 198). A related bill would provide a new formula for credits against wind pool assessments on insurers for losses after a storm (SB 197).

- Other legislation considered but not passed would have realized some of the subcommittee's consumer-related recommendations, such as a bill that would establish an insurance fraud law (SB 3), and a bill that would establish tax-preferred catastrophe savings accounts for individuals to cover an insurance deductible and other uninsured losses (SB 6).

- The Alabama legislature also considered measures to place limits and requirements on insurers. A bill would have limited deductibles to named storms and require insurers offer consumers an opportunity to lower their deductibles by paying a higher premium (SB 5). And a trio of measures would have required insurers write all-risk policies and limits. One of those would have also required a uniform insurance rate sold statewide (HB 248). The other two would also require a price ceiling on the highest rates that could be offered in the state (HB 249, HB 250).

Moving Forward With Recommendations

Discussion: Mitigation and Building Standards Recommendations

Mitigated homes lower insurance costs for homeowners, encourage private insurers to write more policies, and limit the economic damage from storms. Stronger building codes not only help limit damage, they help lower insurance costs for homeowners through discounts mandated by the state and offered independently by insurers.

According to the Federal Emergency Management Agency, past natural catastrophes show that "proper zoning, foundation, design, engineering, construction, and maintenance practices are important factors in the ability of a building to survive a hazard event with little or no damage."

Risk management models weigh the benefits of taking measures against their costs. The idea is to reach an optimal balance that protects residents and their property while acknowledging that the cost of additional safety measures may not be worth the benefit. That said, evidence shows that the minimal initial costs for additional mitigation measures have many long-term benefits. These include saving lives, reducing premiums and limiting losses.

The potential for consumer savings could be significant, especially if discounts for mitigation (IBHS discounts) are combined with separate discounts for residents in communities that earn high ratings for strong building codes and enforcement (BCEGS discounts).

The recommendations aimed at proliferating the mitigation of homes in coastal Alabama amount to a basic strategy; they consider funding mechanisms, data collection, and the need to elevate consumer awareness about the benefits and costs of safety measures for homes.

The recommendations aimed at better building standards recognize the need for enforcement resources, sustainable local land-use policies, and cooperation across the region and among various industries to develop and implement stronger standards.

(TWO GRAPHICS: 1) A chart illustrating examples of how much consumers in south Alabama can save through mitigation discounts, and 2) A chart or sidebar highlighting examples of mitigation measures and their cost v. benefits.)

Mitigation Recommendations

- Establish a trust fund to provide incentives and financing for homeowners to take mitigation measures. The coastal mitigation trust concept could be funded with public money to offer homeowners in Alabama's two coastal counties a grant or a loan to complete mitigation on their homes. Grants covering the cost of inspections and mitigation measures would be based on a means test, and low-interest loans provided by banks would be guaranteed by the revolving trust fund. To limit fraud, default, and poor workmanship, the state should develop a mitigation model that incorporates best practices by states with similar programs. To create more incentive, the interest on a loan could be state tax deductible. The insurance department would ensure that consumers receive insurance rate discounts;

  [GRAPHIC: Coastal Mitigation Trust concept and visual]

- Commission a study of what hurricane models suggest that mandated mitigation discounts should be for homeowners in Alabama. In addition to helping consumers get the correct amount of discount, the study would collect detailed information about the condition of the housing stock in coastal counties. The data could help reduce homeowners' insurance costs when supplied to insurers and their reinsurers;

- Require consumers, Realtors and builders to identify to potential home buyers all the wind mitigation features on a home, in order to make mitigation measures a factor for home buyers to consider and spur sellers to install those measures;

- Evaluate whether to require admitted carriers to obtain proof of wind and flood coverage from consumers located in flood zones A and V in order to offer non-wind coverage to those consumers;

- Develop a nonprofit entity to utilize the Hazard Mitigation Grant Program (HMGP) of the Federal Emergency Management Administration;

- Strengthen local inspection programs for mitigation measures by developing sources of funding to increase the operating budgets of local building code departments;

- Encourage accurate mitigation inspections by requiring they be conducted by trained and licensed professionals, including certified local building officials;

- Eliminate sales tax on materials used to retrofit homes against the effects of storms;

- Educate consumers and other stakeholders about the potential insurance cost savings and return-on-investment that can come from fortifying and retrofitting their homes against storms. The education campaign could be led by a new Alabama Insurance Institute.

Building Standards Recommendations

- Develop a strong statewide building code, or at minimum a strong, uniform code for local jurisdictions in Alabama's coastal counties to adopt. The codes should be based on the 2006 International Residential Code, with no reductions and with enhancements for wind, flood, and other perils that make sense for the coastal region. In addition, the codes should require retrofits during the reconstruction of existing homes to meet the new standard;

- Develop and implement a uniform process for localities to review construction plans and to inspect homes and buildings; adopt a series of recommendations from code officials to achieve uniformity;

- Work with various stakeholders in the construction, sale, appraisal, and financing of homes and buildings to develop and implement the prior two recommendations. Stakeholders should include consumers, home builders, engineers, Realtors, appraisers, bankers, and local governments and their building code departments;

- Strengthen inspections and enforcement at the local level by developing sources of funding to increase the operating budgets of local building code departments;

- Strengthen and develop programs to train and license local building code officials to increase effectiveness of code enforcement throughout the coastal region;

- Require insurance carriers to recognize industry-established Building Code Effectiveness Grading Standards (BCEGS) ratings and provide related discounts for communities that achieve certain rating levels;

- Develop and implement higher standards for freeboard levels for flooding, set backs from water, and flood proof requirements;

- Adopt and implement more restrictive local land use policies that recognize risks associated with structures in flood-prone areas, with particular emphasis on properties that have suffered repetitive losses; local policies could incorporate rebuilding to the FEMA Coastal Construction Guidelines, which are enhanced design and construction standards for strengthening homes against wind and storm surge;

- Encourage code uniformity by establishing that changes to local building standards will be adopted uniformly by all of the jurisdictions in Baldwin and Mobile counties;

- Publicize information about stronger building standards with consumers and other stakeholders;

- Develop entities and resources needed to gather data on the quality of construction of homes and buildings in the coastal region;

- Develop ongoing involvement and dialogue among stakeholders through a new Alabama Insurance Institute, a body that could be established by the governor's executive decree to lead public education and information campaigns around insurance issues.

Discussion: Transparency and Education

Without adequate information, the public and public officials cannot properly assess the insurance system to determine what actions are needed for improvement. Regulatory and statutory efforts to increase transparency in the system would provide the data necessary to educate consumers, ensure fairness, and even boost competition.

For instance, a recommendation to make insurers' rate filings public information would educate consumers about how carriers arrive at rates for non-wind portions of homeowner policies. With guidance provided by the Department of Insurance, consumers could see what each licensed carrier has indicated as their history of premiums and losses by geographic territory and how they determined their rates. The rates charged in different parts of the state could be compared, which would shed light on a common concern among consumers involved in the subcommittee's discussions, that rates for fire coverage in the coastal counties are unwarranted relative to rates in other geographic areas. For consumers looking to compare the price of property insurance across the state, the DOI website makes available examples of premiums being charged by a handful of insurers in many major cities. In addition, the data could help identify jurisdictions with a high rate of fire or water damage claims, which may indicate a need to boost enforcement and inspections.

Consumers would not learn as much from the rate filings about how wind policy prices are determined. That's because while fire rates are still determined in large part by historical claims, rates for wind coverage are now driven by computer catastrophe models. Selected aggregate data from insurers, such as Total Insured Value by zip code, could help interested parties identify concentrations of property exposure in areas of the state. And making public certain types of aggregate data could also encourage new insurance companies to enter the state because the data would help them determine where their best potential profitability would be.

Transparency and Education Recommendations

- Increase transparency by making both insurers' rate filings and their aggregate historical data public information, with the purposes of educating consumers, increasing competition, and knowing local risk of exposure;

- Require through regulation or statute that insurers offering multi-peril policies show the separate premiums charged for wind and non-wind portions of policies on their declaration pages. Such a requirement would help the Department of Insurance identify the effect that a mitigation discount has on the wind portion of a policy, and would help consumers understand the composition of their policies;

- Require insurance companies provide consumers with a uniform disclosure form, or check list, showing what is included and not included in a residential policy;

- Establish a new Alabama Insurance Institute by governor's executive decree to develop research, encourage dialogue, and coordinate public education campaigns around aspects of a sustainable insurance system. The entity would provide ongoing study of insurance models and products in other states and countries. It would include the participation of various stakeholders -- consumers, agents, insurance companies, government officials, and various professionals involved in the construction, sale, appraisal, and financing of homes.

(SIDEBAR: Detailing role for the Insurance Institute)

Discussion: Market Forces and Alternative Products

Increased competition not only gives homeowners more choices, it helps to stabilize insurance rates. As previously described, more competition can be achieved by changing government policy and regulation over the insurance industry, as well as public and private investment in mitigation strategies, data collection, and education. Studying the advantages and disadvantages of potential policy and regulatory adjustments may provide the intellectual balance needed to form proposals that could make insurance more affordable and available.

Alternative products offer consumers fresh choices and make the market more competitive. One frequently mentioned idea would establish a form of insurance captive company, a private-market option that would bring like-minded entities together to form their own company to insure their risks. Recently enacted legislation has made it possible to form a residential or commercial property captive in Alabama.

Possible proposals for establishing a captive insurance company should be carefully studied. The subcommittee did not recommend a captive because the major challenge facing a regional property insurance captive would be its limited ability to sufficiently spread risk, which would help keep reinsurance costs and policy prices low. There is also concern among a plurality in the subcommittee that a residential captive would not have sufficient initial capital -- likely supplied by public funds -- to pay for losses that could result from a severe hurricane. As a result, the captive would need to go 5 to 10 years without a severe storm in order to sufficiently build its capital reserves.

But captives can be adapted, such as an idea to further spread risk by forming partnerships with other residential captives located in states not along the Gulf Coast. Captives can also serve different purposes. For instance, a so-called "reciprocal captive" could be developed for a special purpose: to encourage homeowners to take their policies out of the wind pool. Under this specialized captive, homeowners with wind pool policies could enter the captive only if they have mitigated their homes. Homeowners would be encouraged to mitigate their homes if the captive could offer a discounted rate guarantee.

Market Forces and Alternative Products Recommendations

- Conduct a study on the concept of "recoupment," which in general would allow admitted insurance companies participating in the wind pool to recoup mandated assessments should the pool suffer losses that extend beyond what it has retained and purchased to cover losses. A recoupment mechanism would help alleviate the impact of this assessment on insurers. For example, a recoupment mechanism, such as a fee on policies for a period of time, could pass on the assessment statewide or only on policies in affected areas. Although insurers are able to pass the cost of assessments to consumers by increasing the price of policies, insurers are reluctant to increase rates for such purposes due to competition;

- Conduct a study of premium tax revenues, with the idea that once the study is complete to formulate recommendations for how the premium tax structure in the state could be used to increase competition in the property insurance market, improve property insurance availability, and reduce insurance costs for homeowners in south Alabama;

- Conduct a study on the possibility of utilizing a captive insurance company to provide homeowners with short-term relief from the cost of insurance;

- Encourage insurers to offer multi-year homeowners insurance policies, which would protect consumers against annual spikes in the cost of their insurance;

- Invite insurance companies to Alabama for an annual symposium to attract new carriers to the coastal market.

Other Legislative and Regulatory Recommendations

- Require licensing of contractors and subcontractors to help ensure that mitigation measures are properly installed and state or local construction standards are met;

- Enact an insurance fraud bill to protect consumers from unscrupulous agents and insurers and from consumers who defraud the insurance system. Estimates by the insurance industry show that insurance fraud raises rates between 15 and 20 percent nationwide. Enforcement would be conducted by agents with the Department of Insurance. The law would include an appropriate threshold for initiating investigations;

- Enact a reasonable statute of limitation for reporting property claims; the current limitation is six years under state contract law;

- Enact and promote at the state level tax-free funds for individuals to help homeowners save for the cost their insurance deductibles and the cost of taking mitigation measures;

- Encourage Alabama lawmakers in Washington, D.C., to reform the National Flood Insurance Program, addressing issues such as cap limits, lack of coverage for loss of business income, and lack of coverage for loss of use;

- Encourage Alabama lawmakers in Washington, D.C., and Montgomery to find a resolution to wind and flood claim settlements, such as a mandate for property owners in flood zones to have wind and flood insurance, and to increase transparency on all property coverage;

- Encourage Alabama lawmakers in Washington, D.C., to support and pursue a tax-deferred catastrophe reserve for insurance companies to lower their cost of capital.

Strategies for Moving Forward

The subcommittee recognizes that some recommendations face significant political and organizational challenges. There are many reasons why we have not yet adopted stronger building codes, or adopted ways to improve transparency in the system. Stronger building standards will require the support of industries that traditionally have been at odds with insurers and consumers who often advocate them. Similarly, insurers will need to work with regulators and consumer-advocates to advance transparency measures. And consumers must be involved to improve their understanding of insurance issues and advocate for a balanced insurance system. What's needed is ongoing communication among stakeholders to air concerns, debate ideas and educate each other. It's why the recommendation to establish Alabama Insurance Institute is so important.

Finally, the subcommittee emphasizes that these recommendations toward a more sustainable insurance system should be pursued even if oil spill money never arrives. It should be no surprise that the process of sorting through recommendations was invigorated by the possibility that the region and state might have funding for new initiatives. Some important recommendations, though, would have a minimal effect on government budgets and could be acted on while the penalty assessment and allocation process continues.