

Develop Smart Policies to Help Homeowners Deal With Natural Catastrophes

Natural catastrophes such as hurricanes, forest fires, earthquakes, and severe blizzards threaten nearly every state in the Union. Each year, such catastrophes impose billions of dollars' worth of costs on taxpayers, insurers, and governments; claim scores of lives; and destroy thousands of homes. Both the Democratic and Republican 2008 electoral platforms promised to do more to address these catastrophic events. So far, however, federal action has been lacking. Congress should:

- *Avoid policies that encourage unwise building.* During 2008, the House of Representatives passed measures that would have added wind coverage to the National Flood Insurance Program and established an implicitly government-backed entity to reduce reinsurance prices. Neither measure had much promise for providing coverage that would actually cost less than that in the private market. Instead, both would encourage development where it should not occur while sticking taxpayers with the bill. Thankfully, neither measure moved forward in the Senate, but such efforts are likely to come back. Congress should reject any measure that could involve the federal government in the insurance or reinsurance business in disaster-prone regions.
- *Help states decontrol homeowners' insurance rates.* States—not the federal government—

perform nearly all oversight of homeowners' insurance rates. In the long term, federal policy should encourage states to let insurers charge risk-based rates that take all relevant risk factors into account. Many state insurance bureaucracies, however, suppress rates in order to cater to homeowners who live in unsafe areas. (Often simultaneously raising rates for those who live in safer areas.) The federal government should offer tax credits over a phase-out period to homeowners in states that act properly and allow rates to rise. This would temporarily offset higher insurance premiums and allow homeowners to secure their homes against natural disasters. The tax credits should expire with the program.

- *Allow private insurers to reserve against catastrophes without paying taxes up front.* Current U.S. tax law makes it difficult for insurers and reinsurers to build up reserves against catastrophes. Larger reserves could make reinsurance more affordable. The United States should implement laws similar to those in Switzerland, Bermuda, and elsewhere that make it possible for insurers to build up “catastrophic” reserves. Money in these reserves could be held tax-free until spent to pay claims stemming from a major catastrophe.

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