CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

October 30, 2007

H.R. 3355
Homeowners' Defense Act of 2007

As ordered reported by the House Committee on Financial Services on September 26, 2007

SUMMARY

H.R. 3355 would authorize the appropriation of $120 million over the 2008-2013 period to establish a National Catastrophe Risk Consortium to help coordinate the availability of reinsurance contracts between state reinsurance entities and the private market. The consortium also would act as an information repository for states on the risk of natural disasters and research on the standardization of risk-linked securities (for example, catastrophe bonds). Assuming the appropriation of the specified amounts, CBO estimates that implementing this provision would cost $75 million over the 2008-2012 period.

The bill also would establish two new federal direct loan programs within the Department of the Treasury for state reinsurance programs facing certain levels of insured losses following a natural disaster. Loans could be made only if a reinsurer could not access capital in the private market and repayment was secured by the full faith and credit of the state. The Treasury Department would develop procedures for state reinsurance programs to prequalify for loans, including the assessment of fees to cover the cost of administering the program. CBO expects that such loans would be made very rarely and would involve a minimal subsidy cost under the terms specified in the legislation. As such, CBO estimates that loans made under the bill would have an insignificant cost over the next five years. Enacting H.R. 3355 would not affect direct spending or revenues.

This bill contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of this legislation is shown in the following table. The costs of this legislation fall within budget function 450 (community and regional development).

	By Fiscal Year, in Millions of Dollars				
	2008	2009	2010	2011	2012
Authorization Level	20	20	20	20	20
Estimated Outlays	3	12	20	20	20

Note: H.R. 3355 also would authorize the appropriation of $20 million in fiscal year 2013.

BASIS OF ESTIMATE

For this estimate, CBO assumes that the bill will be enacted in early fiscal year 2008 and that the necessary amounts will be appropriated for each fiscal year.

National Catastrophe Risk Consortium

H.R. 3355 would authorize the appropriation of $20 million for each of fiscal years 2008 through 2013 to establish the National Catastrophe Risk Consortium. The consortium would be a federal entity managed by a board of directors made up of designees from the Departments of the Treasury, Commerce, and Homeland Security, and members from each participating state. Responsibilities of the consortium would include: encouraging and facilitating different avenues for state insurers to enter into reinsurance agreements with the private market, conducting research and analysis into the standardization of risk-linked securities, and gathering insurance information. Assuming the appropriation of the specified amounts, CBO estimates that implementing this provision would cost $3 million in 2008 and $75 million over the 2008-2012 period for staff and research expenses.

Liquidity and Catastrophe Loans for State Reinsurance Programs

H.R. 3355 would establish two new direct loan programs within the Department of the Treasury for state reinsurance programs facing a certain level of insured losses following a natural disaster. Reinsurance programs insure primary insurers or other reinsurers against losses in excess of amounts specified by contract or law. Reinsurance programs eligible for the new loan programs created under the bill would only be those in which the authorizing state maintained a financial interest. Examples of such reinsurance programs include the Florida Hurricane Catastrophe Fund (FHCF) and the California Earthquake Authority. In cases where a state does not have a reinsurance program that meets the requirements for a loan under the bill, a state residual insurer (for example, wind pool programs) would be eligible to apply during the five-year period following enactment.

Procedures to Establish Loan Eligibility. H.R. 3355 would direct the Secretary of the Treasury to develop procedures for reinsurance programs to establish loan eligibility prior to a natural disaster. At a minimum, insurance entities covered by the reinsurer would be required to establish rate structures sufficient to cover expected annualized costs and ensure that any new construction or substantial renovation of insured properties comply with applicable state and local building codes. As a part of the precertification process, the Secretary would assess a fee on state reinsurance programs to cover the costs of administering the loan program. Those fees would be credited in the budget as an offsetting collection and would be available for spending upon subsequent appropriation of a loan subsidy.

Based on information about the characteristics of existing state reinsurance programs and on information from the Treasury, CBO expects that most state reinsurance programs would meet the eligibility requirements set forth under the bill and thus would be eligible to receive loans. In addition, other qualified reinsurance programs may be established in the future that also would be eligible to receive loans.

Liquidity Loans. Under H.R. 3355, a qualified reinsurance program would be eligible to receive a liquidity loan if the program demonstrates it is facing a liquidity shortage and is not able to access capital at a reasonable rate in the private market. The principal of such loans could not exceed the ceiling coverage level—the maximum amount of liability the program could incur under law. In addition, the full faith and credit of the state in which the reinsurance program is authorized would be required. Loans would be made at a rate of not less than 3 percentage points above the applicable Treasury rate and for a term of between five and ten years.

Based on information from the state of Florida, CBO expects that those loans would most likely be used to address short-term liquidity shortages and would be repaid once adequate capital became available through established reinsurance agreements or through the private market. In cases where a liquidity loan is held to term (which CBO expects would be unlikely to occur because of the high interest rate on the loan), CBO estimates that those loans would have no significant cost to the federal government. As of June 2007, rating agencies like Standard and Poor's have not issued a credit rating below 'A' for new general obligation bonds issued by a state. Based on historical default rates and the minimum terms specified in the bill, CBO estimates that the default risk associated with a state's general obligation bond rating would have to increase significantly before such a loan would be estimated to have more than a negligible subsidy cost. While the default risk of loans backed by the full faith and credit of a state would likely increase following a disaster, CBO expects that this increase would not be significant. (Following Hurricane Katrina, for example, Standard and Poor's announced it would adjust a state's credit rating for the first time as a result of a natural disaster by lowering Louisiana's rating from an A+ to an A.) As such, CBO estimates that any liquidity loan made under the bill would have an insignificant cost over the next five years.

Catastrophe Loans. Under the bill, a qualified reinsurance program would be eligible to receive a catastrophe loan following a disaster if insured losses exceeded 150 percent of the aggregate amount of premiums assessed (whether collected or not) for private property and casualty insurance issued in the state over the previous 12-month period. The principal of such a loan could not exceed the difference between the total insured loss and the program's ceiling coverage level, and repayment would be afforded the full faith and credit of the state. Loans would be made at a rate of not less than 20 basis points above the applicable Treasury rate and for a term of not less than 10 years.

Based on information from the states, CBO expects that few, if any, reinsurance programs would apply for a catastrophe loan following a disaster. State insurance commissions and rating agencies often require that primary insurers are able to cover at least a 100-year event to maintain their credit rating. As such, not only would losses exceeding the ceiling coverage level be outside the responsibility of the reinsurer, they likely would be covered through existing reinsurance agreements between the primary insurer and the private market.

For example, as a result of Hurricane Katrina, the Gulf Coast faced insured losses of over $40 billion. Such losses far exceeded the minimum eligibility threshold for a catastrophe loan under the bill. (Based on the aggregate amount of direct written premiums for private property and casualty insurance, CBO estimates that the threshold probably would have been around $12 billion for Louisiana in 2005.) However, CBO expects that there would have been little demand for a catastrophe loan following Katrina because a state reinsurance program (if one had existed) would not have been responsible for losses above its ceiling coverage level. Furthermore, such losses would have been covered by existing reinsurance agreements between primary insurers and the private market. For those reasons, CBO estimates that implementing this provision would have no cost over the next five years.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 3355 contains no intergovernmental or private-sector mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

ESTIMATE PREPARED BY:

Federal Costs: Daniel Hoople
Impact on State, Local, and Tribal Governments: Melissa Merrell
Impact on the Private Sector: MarDestinee C. Perez

ESTIMATE APPROVED BY:

Theresa Gullo
Deputy Assistant Director for Budget Analysis