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Testing the Waters: The South Carolina Coastal Captive Insurance Act as Part of Multifaceted Approach to the Coastal Insurance Conundrum

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TESTING THE WATERS: THE SOUTH CAROLINA COASTAL CAPTIVE INSURANCE ACT AS PART OF A MULTIFACETED APPROACH TO THE COASTAL INSURANCE CONUNDRUM

I. INTRODUCTION

Since Hurricane Katrina collided with the Gulf Coast of the United States in August 2005, the storm has proven to be the most expensive hurricane in United States history.[1] In addition to the personal losses resulting from the storm, Hurricane Katrina also resulted in the largest loss the insurance industry has ever seen, more than doubling the losses that resulted from Hurricane Andrew in 1992.[2] The Insurance Information Institute estimates that insurance companies have paid out approximately $40.6 billion in claims resulting from Hurricane Katrina.[3]

The insurance effects of Hurricane Katrina are reaching coastal homeowners throughout the country. Some fifty-five percent of the United States population lives in coastal areas.[4] In the aftermath of Hurricane Katrina, these coastal homeowners have found it more and more difficult to obtain home insurance at an affordable rate, if at all.[5] Many coastal states have undertaken various measures to try to remedy this problem;[6] South Carolina is no exception. Governor Mark Sanford recently signed into law a coastal insurance bill[7] with the goal of improving the ability of South Carolina coastal homeowners to obtain affordable insurance coverage.[8] The South Carolina Coastal Captive Insurance Company Act (Coastal Captive Insurance Act) was signed into law on June 11, 2007, as part of the Omnibus Coastal Property Insurance Reform Act of 2007 (Omnibus Act).[9]

While the Coastal Captive Insurance Act is a valuable step in addressing soaring insurance costs in coastal areas, it is not, in and of itself, enough. A multifaceted approach is crucial to effectively address the coastal insurance problem. Tax incentives for homeowners who make their homes more resistant to coastal storms and additional tax incentives for insurance companies will hopefully

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1. INS. INFO. INST., HURRICANE INSURANCE FACT SHEET, http://www.iii.org/media/research/hurricanefactsheet/ (last visited Feb. 3, 2008).
2. *Id.* Hurricane Andrew resulted in losses of $15.5 billion, approximately $20.9 billion when taking into account inflation. *Id.*
3. *Id.*
4. Carole Fleck, *Home Insurance Hell: Why Your Rates Are Out of Control*, AARP BULLETIN ONLINE, July–Aug. 2007, http://www.aarp.org/bulletin/yourmoney/home_insurance_hell.html.
5. See discussion *infra* Part II.A.
6. *See* discussion *infra* Part III.
7. *See* Omnibus Coastal Property Insurance Reform Act of 2007, No. 78, 2007 S.C. Acts 313.
8. Press Release, Mark Sanford, Governor, State of South Carolina Office of the Governor, Bill Aimed at Alleviating Insurance Costs for Coastal Homeowners (June 11, 2007), *available at* http://www.scgovernor.com/news/releases/june_07/june_11_07-01.htm
9. Omnibus Coastal Property Insurance Reform Act of 2007, § 16, 2007 S.C. Acts at 346–53 (to be codified at S.C. CODE ANN. §§ 38-90-810 to -890).

attract more captive insurance companies[10] to the South Carolina coast. Effectively addressing the coastal insurance crisis will require both state and federal regulatory schemes. Such schemes should be directed towards curbing the pace of coastal development and mandating an increase in the quality of development.

Part II of this Comment addresses the background behind the Coastal Captive Insurance Act, including the issues underlying its enactment, the history behind beach plans, the types of captive insurance companies in South Carolina, and the basic requirements of the Act. Part III evaluates Florida, Mississippi, and Louisiana as a sampling of what other states are doing to address the coastal insurance problem. Part IV analyzes the various state solutions by arguing that the state solutions introduced thus far can be divided into two approaches—a government-centered approach and an industry-centered approach. This Comment argues that a multifaceted approach should be taken to address the coastal insurance problem. Part V discusses federal involvement in the coastal insurance solution, including the reform of flood insurance and the implementation of a federal catastrophe fund. Part VI discusses the need for responsible coastal building to ensure coastal homes are as safe as possible. Finally, Part VII concludes by summarizing the suggestions for how South Carolina and other coastal states can comprehensively address the coastal insurance problem through a multifaceted approach.

II. BACKGROUND

A. *The Post-Katrina Conundrum*

Coastal homeowners across the United States are finding it difficult or impossible to obtain home insurance. In the last two years, approximately 3 million homeowners in the U.S. had their homeowner's insurance policies cancelled.[11] Of those policies cancelled, more than two-thirds were in the Southeast.[12] Allstate alone is working toward cancelling approximately 290,000 policies in states prone to hurricanes.[13]

For those lucky enough to have insurance on their coastal-area home, the rates are soaring. New Orleans exemplifies the coastal insurance problem. Top insurers, such as Allstate and State Farm, are not writing new policies for most neighborhoods in New Orleans.[14] Those homeowners in New Orleans with an existing policy are seeing premium increases of up to fifty percent.[15] The coastal insurance problem, however, stretches far beyond New Orleans. Coastal property owners throughout the country are seeing "double- and triple-digit rate increases

10. A captive insurance company is a special type of limited purpose insurance company that insures specific risks. 3 LEE R. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE 3D § 39:2 (1995). Captive insurance companies are discussed further in Part II.

11. Liam Pleven, *As Premiums Rise, Homeowners Drop Wind Coverage*, WALL ST. J., Sept. 4, 2007, at B1. This study was conducted in May 2007 for the Independent Insurance Agents & Brokers of America. *Id.*

12. *Id.*

13. *Id.*

14. John Simons, *Risky Business*, FORTUNE, Aug. 20, 2007, at 77, 77.

15. *Id.*

for less coverage."[16] In South Carolina, some condominium owners have seen a sevenfold increase in insurance costs.[17]

B. Historically Speaking—The History of Beach Plans

In the late 1960s, when insurance companies began pulling out of areas prone to riots, states began creating programs to facilitate insurance coverage for specific homes.[18] Congress passed the Housing and Urban Development Act of 1968,[19] which made riot reinsurance funds available for states that instituted property insurance pools specifically for these urban areas.[20] As a result, states began creating Fair Access to Insurance Requirements (FAIR) Plans.[21] FAIR Plans are currently in existence in thirty-two states and the District of Columbia.[22]

After hurricanes Camille and Celia wreaked havoc on coastal areas in 1969 and 1970 respectively, several southern states passed legislation that created pooling arrangements in an effort to keep coastal homeowners insured.[23] These plans, commonly referred to as Beach and Windstorm Plans (Beach Plans), are residual markets that provide insurance for homeowners in certain coastal areas.[24] The South Carolina Wind and Hail Underwriting Association (Wind Pool) is the result of 1971 legislation[25] requiring a Beach Plan in South Carolina.[26] Before purchasing coverage through the Wind Pool, homeowners are urged to shop around.[27] Even more, if homeowners purchase coverage through the Wind Pool and later find a lower-cost insurance provider, they may cancel their Wind Pool policy without penalty.[28] The Wind Pool in South Carolina only covers damage caused by wind and hail,[29] which is similar to Beach Plans in Mississippi and Texas.[30] Plans in North Carolina and Alabama, however, cover fire risks in addition to wind and hail.[31] A hallmark of Beach Plans in every state, with the exception of Alabama, is that participation by insurance companies doing business in the state is mandatory.[32]

While the urban and coastal plans in states choosing to implement such programs are generally operated separately, at least two states have decided to

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16. Fleck, *supra* note 4.
17. *Id.*
18. *See* INS. INFO. INST., RESIDUAL MARKETS (2007), http://www.iii.org/media/hottopics/insurance/residual/ [hereinafter RESIDUAL MARKETS].
19. Pub. L. No. 90-448, 82 Stat. 476.
20. RESIDUAL MARKETS, *supra* note 18.
21. *See id.*
22. *Id.*
23. *See id.*
24. *Id.*
25. Act of June 17, 1971, No. 412, 1971 S.C. Acts 744.
26. S.C. WIND AND HAIL UNDERWRITING ASS'N, ABOUT US, http://www.scwind.com/about.html (last visited Mar. 5, 2008). All insurance companies that do business in South Carolina must participate in the wind pool and "share in any losses or profits." *Id.*
27. *Id.*
28. *Id.*
29. *Id.*
30. *See* RESIDUAL MARKETS, *supra* note 18.
31. *Id.*
32. *Id.*

merge their plans.[33] In 2002, Florida combined its wind pool with its joint underwriting association and created a unique residual market.[34] Louisiana also combined its FAIR Plan and coastal pool under one umbrella in 2003.[35]

C. Types of Captive Insurance Companies

A captive insurance company is a special type of limited-purpose insurance company that insures specific risks.[36] South Carolina law recognizes many variations of the captive insurance company: "a pure captive insurance company, association captive insurance company, captive reinsurance company, sponsored captive insurance company, special purpose captive insurance company, or industrial insured captive insurance company formed or licensed under [chapter 90 of title 38]."[37]

Each type of captive insurance company described in section 38-90-10(8) has unique characteristics. Pure captive insurance companies insure the risks of any parent company, any companies that are affiliated with the captive, any "controlled unaffiliated business," or any combination of these risks.[38] Association captive insurance companies insure the risks of the companies and associations that compose the particular captive association.[39] Captive reinsurance companies are stock corporations owned completely by a parent company.[40] Sponsored captive insurance companies have an entity or entities which "sponsor" the captive by creating the company and providing capital.[41] Industrial insured captive insurance companies specifically insure the risks of the members of the industrial insured group and any affiliated members.[42]

Finally, a special purpose captive insurance company is a catchall category which covers all remaining captives that are not defined by any of the other categories.[43] All captive insurance companies in South Carolina must fit into one of these categories.[44]

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33. *See id.*
34. *Id.*
35. *Id.* These distinctive plans are discussed further in Part III.
36. *See* RUSS & SEGALLA, *supra* note 10, § 39:2.
37. S.C. CODE ANN. § 38-90-10(8) (Supp. 2006).
38. *Id.* § 38-90-10(24).
39. *Id.* § 38-90-10(4).
40. *Id.* § 38-90-10(9).
41. *Id.* § 38-90-10(27)–(28).
42. *Id.* § 38-90-10(17). An "industrial insured" must meet three criteria. *Id.* § 38-25-150(8) (2002). First, it "procures insurance by use of the services of a full-time employee acting as a risk manager or insurance manager or utilizing the services of a regularly and continuously qualified insurance consultant." *Id.* Second, the insured's "aggregate annual premiums for insurance on all risks [must] total at least twenty-five thousand dollars." *Id.* Finally, the insured must have "at least twenty-five full-time employees." *Id.*
43. *Id.* § 38-90-10(26).
44. *See supra* text accompanying note 37.

D. The South Carolina Coastal Captive Insurance Act and the Omnibus Coastal Property Insurance Reform Act

The Coastal Captive Insurance Act is part of the Omnibus Act.[45] The Omnibus Act started as House Bill 3820.[46] After Governor Sanford signed the Omnibus Act on June 11, 2007, the Coastal Captive Insurance Act took effect.[47]

The goal in enacting the Omnibus Act generally, and the Coastal Captive Insurance Act specifically, is to make South Carolina a more attractive place for insurance companies to do business.[48] South Carolina does not want to make the Wind Pool competitive with the private insurance market.[49] The act is intended to keep the Wind Pool as a market of last resort as it was originally intended.[50] Thus, private insurance companies can better compete with the tax-exempt Wind Pool and make South Carolina a more attractive place to write policies.[51]

The main objective of the Coastal Captive Insurance Act is to provide affordable property insurance coverage against wind and storm surge hazards for coastal homeowners.[52] The act allows for the creation of coastal captive insurance companies, of any of the forms described statutorily, to underwrite wind and storm surge risks.[53] The coastal captive insurance companies may only underwrite these two specific risks and may do so only in South Carolina.[54] Generally, coastal captive insurance companies must have and maintain at least $1 million in unimpaired paid-in capital and $1 million in free surplus.[55] The only exception to these requirements pertains to coastal captive insurance companies organized as sponsored captive insurance companies.[56] For sponsored captive insurance companies that do not assume any risk, the unimpaired paid-in capital and the free surplus cannot be lower than $500,000 each.[57]

One of the more controversial aspects of coastal captive insurance companies under the Coastal Captive Insurance Act is that these companies are not guaranteed by state insurance insolvency funds.[58] On each application for insurance and on the declaration page of every policy, coastal captive insurance companies must state the following notice: "This policy is issued by a South Carolina coastal captive insurance company, which is not subject to all of the insurance laws and regulations of the State of South Carolina. State insurance insolvency guaranty funds are not available for a South Carolina coastal captive insurance company."[59] The act also

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45. Omnibus Coastal Property Insurance Reform Act of 2007, No. 78, § 16, 2007 S.C. Acts 313, 346–53 (to be codified at S.C. CODE ANN. §§ 38-90-810 to -890).
46. *See id.* No. 78, 2007 S.C. Acts at 313–17.
47. *See id.* § 17, 2007 S.C. Acts at 353.
48. Press Release, Mark Sanford, *supra* note 8.
49. *See* § 10, 2007 S.C. Acts at 328 (to be codified at S.C. CODE ANN. § 38-75-330).
50. *See* Press Release, Mark Sanford, *supra* note 8.
51. *See id.*
52. *See id.*
53. *See* § 16, 2007 S.C. Acts at 346 (to be codified at S.C. CODE ANN. § 38-90-830).
54. *Id.*
55. *Id.* at 349–50 (to be codified at S.C. CODE ANN. § 38-90-840 to -850).
56. *See id.*
57. *Id.*
58. *Id.* at 352 (to be codified at S.C. CODE ANN. § 38-90-880(A)).
59. *Id.*

requires the following acknowledgment on every application and policy: "'I have read the Notice contained in this application (or policy) and understand that State of South Carolina insurance insolvency guaranty funds are not available for a South Carolina coastal captive insurance company.'"[60] Moreover, the act requires that the above acknowledgment appear immediately above the signature line on all applications and policies.[61] This mandatory language highlights the unique nature of coastal captive insurance companies and also emphasizes that there are some risks involved for those homeowners that use captives.

The Omnibus Act, as a whole, takes additional measures to make South Carolina a more attractive place for insurance companies to do business. The Omnibus Act allows for the creation of Catastrophe Savings Accounts.[62] These accounts allow homeowners to save money in a special savings account, labeled as a "Catastrophe Savings Account," to be used when there is a major storm or catastrophe.[63] Funds deposited into the savings account must not exceed specified amounts that depend upon an individual's insurance status and deductible.[64] Deposited funds are tax deductible and interest earned on the account is tax exempt.[65] In addition, the "[a]ccount is not subject to attachment, levy, garnishment, or legal process in this State."[66]

The Omnibus Act provides financial incentives for both homeowners and insurance companies. Tax credits are available to homeowners who make their homes "more resistant to loss" that may be suffered due to coastal storms.[67] The Omnibus Act provides homeowners who protect their homes with a tax credit in an amount equal to the lesser of twenty-five percent of the cost of the fortifications or $1,000.[68] Individuals may also receive a tax credit for any sales tax or use tax paid on the purchase of items used in the fortification of the property.[69] In addition,

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60. *Id.* (to be codified at S.C. CODE ANN. § 38-90-880(B)).

61. *Id.*

62. *See id.* § 2, 2007 S.C. Acts at 318–19 (to be codified at S.C. CODE ANN. § 12-6-1620).

63. *Id.*

64. *Id.* at 319 (to be codified at S.C. CODE ANN. § 12-6-1620(B)(3)). Specifically, the Omnibus Act states,

> The total amount that may be contributed to a Catastrophe Savings Account must not exceed:
>
> (a) in the case of an individual whose qualified deductible is less than or equal to one thousand dollars, two thousand dollars;
>
> (b) in the case of an individual whose qualified deductible is greater than one thousand dollars, the amount equal to the lesser of fifteen thousand dollars or twice the amount of the taxpayer's qualified deductible; or
>
> (c) in the case of a self-insured individual who chooses not to obtain insurance on his legal residence, two hundred fifty thousand dollars, but shall not exceed the value of the individual taxpayer's legal residence.

Id.

65. *Id.* at 318 (to be codified at S.C. CODE ANN. § 12-6-1620(A)).

66. *Id.* at 319 (to be codified at S.C. CODE ANN. § 12-6-1620(B)(2)).

67. *See id.* § 3, 2007 S.C. Acts at 320 (to be codified at S.C. CODE ANN. § 12-6-3660)

68. *Id.*

69. *Id.* at 321 (to be codified at S.C. CODE ANN. § 12-6-3665(A)). This credit may not exceed $1,500. *Id.*

homeowners may receive a tax credit of up to $1,250 for "excess premium."[70] Rating plans will also take into account factors that make a home more resistant to storm damage and reward homeowners accordingly.[71] Matching grants may also be available for homeowners meeting specific qualifications who want to retrofit their home to make it more resistant to coastal storm damage.[72] Furthermore, insurance companies that provide full insurance coverage, including wind and hail coverage, for coastal area homes can receive a tax credit of up to twenty-five percent of the tax amount that would be due on a specific policy.[73]

III. HOW STATES ARE ADDRESSING THE COASTAL INSURANCE PROBLEM

States in hurricane-prone areas such as the Southeast and the Gulf Coast have been the first to respond to coastal insurance problems with various measures and initiatives. Just as the coastal insurance problem is increasing, so is the number of states looking for solutions. Even coastal states in less hurricane-prone areas are taking measures to evaluate the coastal insurance problem and find appropriate solutions.[74] Plans from Florida, Mississippi, and Louisiana are described below as a sampling of how states are addressing the coastal insurance problem.

A. Florida

The coastal insurance problems in Florida are severe. The value of coastal property in Florida as of 2004 was $1.94 trillion, or more than seventy-nine percent of the value of all insured property in the state as of 2004.[75] No other state has a higher potential for loss if a storm should occur.[76] In 2002, Florida created the Citizens Property Insurance Corporation (CPIC) by combining the once separate Florida Residential Property & Casualty Joint Underwriting Association and the Florida Windstorm Underwriting Association.[77] The CPIC is regulated by the State

70. *Id.* (to be codified at S.C. CODE ANN. § 12-6-3670). "Excess premium" is defined as "the amount by which the premium paid exceeds five percent of the taxpayer's adjusted gross income." *Id.* (to be codified at § 12-6-3670(B)).

71. *See id.* § 9, 2007 S.C. Acts at 326 (to be codified at S.C. CODE ANN. § 38-73-1095(C)). Some of the factors considered in the rating plans include storm shutters and roof tiedowns. *Id.*

72. *See id.* § 11, 2007 S.C. Acts at 339–41 (to be codified at S.C. CODE ANN. § 38-75-485). The Omnibus Act created the South Carolina Hurricane Damage Mitigation Program, which will seek financial grants to help homeowners with the costs of fortifying their homes. *See id.* An owner-occupied single family homeowner that has received a homestead exemption, undergone an acceptable wind inspection, and whose home is worth less than $300,000 may receive matching funds up to $10,000 ($5,000 from the state) to retrofit the home. *Id.* at 339 (to be codified at S.C. CODE ANN. § 38-75-485(C)(1)).

73. *See id.* § 5, 2007 S.C. Acts at 323–24 (to be codified at S.C. CODE ANN. § 38-7-200(A)). The credit may be used only once per property, even for properties with multiple policies. *Id.* at 324 (to be codified at S.C. CODE ANN. § 38-7-200(D)).

74. For example, Massachusetts is using a committee to evaluate the problem and decide how to proceed. RESIDUAL MARKETS, *supra* note 18.

75. INS. INFO. INST., RESIDUAL MARKET PROPERTY PLANS: FROM MARKETS OF LAST RESORT TO MARKETS OF FIRST CHOICE 9 (2007) [hereinafter PROPERTY PLANS], *available at* http://server.iii.org/yy_obj_data/binary/ 774480_1_0/ResidualMarketWhitePaper.pdf.

76. *Id.*

77. *Id.* at 20.

of Florida and is tax-exempt.[78] Insurance is provided in areas where access to insurance from the regular market is either unavailable or severely limited.[79] Insurance is available primarily for residential properties, but insurance is provided for some businesses on a limited basis.[80] Examining the effects on businesses and other commercial enterprises and properties, however, is beyond the scope of this Comment.

The CPIC has become the largest insurer in the state of Florida.[81] The CPIC currently has more than 1.4 million policyholders.[82] The number of policyholders has increased significantly from the 2002 figure of 658,085 policies.[83] The CPIC receives approximately 18,000 applications for policies each month.[84] As these figures indicate, participation in the CPIC is continuing to rise.

B. Mississippi

Mississippi has two state plans—the Mississippi Windstorm Underwriting Association (MWUA) and the Mississippi Residential Property Insurance Underwriting Association (MRPIUA).[85] The MWUA underwrites wind and hail coverage in the state's coastal areas.[86] Similar to Florida's CPIC, the MWUA is taking on more and more risk. In 1990, the MWUA's total loss exposure was $352.9 million.[87] By the end of 2006, the MWUA's exposure to loss reached $5.4 billion.[88] Hurricane Katrina alone cost the MWUA approximately $700 million.[89]

In March 2007, the state legislature passed the Mississippi Economic Growth and Redevelopment Act of 2007.[90] This Act creates a reinsurance fund in the state treasury to allow the MWUA to defray the costs of reinsurance.[91] The legislation has increased the MWUA's reserves and will allow the MWUA to build up its reserves in years when payouts to homeowners are limited.[92] In many ways, the recent legislation allows the MWUA to act in a fashion similar to a private insurance company.

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78. *Id.*
79. *Id.*
80. *Id.*
81. RESIDUAL MARKETS, *supra* note 18.
82. *Id.*
83. PROPERTY PLANS, *supra* note 75, at 16.
84. RESIDUAL MARKETS, *supra* note 18.
85. PROPERTY PLANS, *supra* note 75, at 25.
86. MISS. WINDSTORM UNDERWRITING ASS'N, MANUAL OF RULES AND PROCEDURES (2007), http://www.msplans.com/mwua/index.htm (follow "Manual of Rules and Procedures" hyperlink). The coastal area consists of six counties. *Id.*
87. PROPERTY PLANS, *supra* note 75, at 25.
88. *Id.*
89. *Id.* at 26.
90. 2007 Miss. Laws Ch. 425, § 6 (codified at MISS. CODE ANN. §§ 83-34-1 to -39 (Supp. 2007)).
91. *Id.* § 2 (codified at MISS. CODE ANN. § 83-34-37 (Supp. 2007)).
92. RESIDUAL MARKETS, *supra* note 18. The Act also requires any new construction on new or existing homes to be in compliance with building codes. *Id.*

C. *Louisiana*

In 2003, Louisiana combined its FAIR Plan and coastal plan under one umbrella, the Louisiana Citizens Property Insurance Corporation (Citizens).[93] The plans continue to offer separate coverage under Citizens.[94] During 2005, Citizens sustained losses of $1.07 billion.[95] Louisiana is searching for solutions to address the insurance crisis in the state. One attempt at a solution involves the Insure Louisiana Incentive Program.[96] The goal of the program is to attract insurance companies to write polices in the state by providing matching grant funds for some insurance companies that meet specific requirements.[97] Within the first two years, twenty-five percent of the policies written by these insurance companies must come from the Citizens pool.[98] These measures may reduce the number of individuals participating in Citizens both currently and in the future.

Louisiana also has a statute that encourages its citizens to fortify their homes from potential coastal storm damage. For any property meeting the new statewide building codes, insurance companies must provide some sort of monetary remuneration on premiums.[99] This measure should encourage homeowners to build, update, and remodel homes to the statewide standards. Meeting statewide building standards may not only make these homes more attractive to private insurers but may also provide financial incentives on premiums for homeowners. Homes built to meet more stringent building codes are also more likely to withstand damage from storms than homes not built to the more stringent statewide standards.

IV. THE APPROACHES

A. *Overview*

In examining the plans initiated by South Carolina and various other states, this Comment suggests that two main approaches to the coastal insurance problem have developed thus far. First, some states have taken a government-centered approach.[100] This approach relies on the notion that the state itself is in the best position to repair the coastal insurance problem by taking a larger role as an insurer. Second, some states take a more industry-centered approach.[101] This approach attempts to make it more attractive for insurance companies to write policies for coastal homeowners, in hopes of attracting insurance companies to the state and encouraging competition among insurance companies to write policies. Each

93. PROPERTY PLANS, *supra* note 75, at 22.
94. *Id.*
95. *Id.* at 23.
96. *See* LA. REV. STAT. ANN. §§ 22:3301–:3311 (Supp. 2008).
97. *See id.* §§ 22:3302–:3303.
98. *Id.* § 22:3309.
99. *Id.* § 22:1426.
100. Florida is an example of a state that has taken a government-centered approach. *See* discussion *supra* Part III.A.
101. South Carolina is an example of a state that has taken an industry-centered approach. *See* discussion *supra* Part II.D.

approach has elements that make each approach attractive to various states for a myriad of reasons.

Most arguments made thus far advocate accepting one approach over the other as the correct way to solve the coastal insurance conundrum. This Comment argues that each state should choose the approach that works best in addressing its unique state concerns, but argues further that each state should employ a multifaceted approach that incorporates its state plan along with federal involvement and responsible coastal building.

B. Government-Centered Approach

Some state legislatures apparently believe that the coastal insurance problem is best handled by having the state act as the primary insurance company. Florida is perhaps the most recognizable example of a state taking a government-centered approach.[102] The government-centered option is attractive to states because it ensures that homeowners can obtain insurance. In addition, states can quickly implement plans themselves instead of having to wait for insurance companies to infiltrate the state. Some states may not be willing to wait for insurance companies to take action when there is no guarantee that insurance companies will be willing or able to solve the problem. This is almost certainly true in states where some insurance companies have stopped writing insurance policies in the state altogether.

Providing the majority of a state's homeowner's property insurance, however, requires a state to take on significant financial burdens. States may find themselves in an unenviable financial position should a major storm occur. As discussed above, Florida's CPIC is a strong example of a state taking a government-centered approach to the coastal insurance problem.[103] As a result of high property values and exposure to windstorms, Florida faces the highest potential losses of any state.[104] As of March 2007, the CPIC's exposure to loss was $434.3 billion.[105] Compared to the 2002 exposure to loss of $154.6 billion,[106] the CPIC has seen a dramatic increase in risk exposure in only five years. Despite the very large exposure to loss, as of July 2007, the CPIC will only be able to pay out $9.4 billion in claims in the event of a major catastrophe.[107]

Government-centered approaches also impact the voluntary market. When a state's insurance market of last resort becomes the state's top insurer, private insurers in the voluntary market may find it less appealing to do business in that particular state. States originally insulated themselves from this potential problem by making rates for state insurance companies higher than rates available in the voluntary market.[108] This encourages homeowners to find lower rates with private companies and only use the state insurance company if absolutely no other insurance option is available. With more Florida residents using the CPIC than any

102. *See* discussion *supra* Part III.A.

103. *See* discussion *supra* Part III.A.

104. PROPERTY PLANS, *supra* note 75, at 9.

105. *Id.* at 16.

106. *Id.*

107. RESIDUAL MARKETS, *supra* note 18.

108. *See* S.C. WIND & HAIL UNDERWRITING ASS'N, ABOUT US, http://www.scwind.com/about.html (last visited Feb. 12, 2008).

other insurance company,[109] legislators are trying to lower the CPIC insurance rates with new legislation. While homeowners using the CPIC will have better rates in the short term, the recent Florida measures arguably could close the door on the possibility of private insurers coming into the state to write policies because doing so will not be profitable.[110]

C. *Industry-Centered Approach*

States that take an industry-centered approach to coastal insurance—such as South Carolina—hope to make the state more attractive to private insurers, thus creating a ripple effect in the benefits to homeowners. If the state is more attractive to private insurance companies, that attractiveness will increase the number of private insurers writing policies in the state, which should in turn increase competition. Increased competition will then give homeowners more options, thus driving down the cost of premiums.[111]

South Carolina is one state that has decided to take an industry-centered approach to the coastal insurance problem. South Carolina Insurance Director Scott Richardson, whose insurance company recently dropped the policy on his coastal area home,[112] recently stated, "I don't believe that government will ever be able to [repair the coastal insurance problem] as well as private entities."[113] States taking an industry-centered approach may offer tax incentives to insurance companies to attract these companies to write coastal area insurance.[114] States may also offer tax incentives for homeowners to make their homes more resistant to storms as a way to mitigate damages and attract insurance companies.[115]

Notably, initiatives such as tax incentives are not a quick fix for the coastal insurance problem. Insurance companies will need to set up captives in South Carolina and other states, and it will certainly take time for enough companies to come to the state and generate competition. For states looking for an immediate response to the coastal insurance problem, an industry-centered approach may not be attractive for this reason. In addition, states opting for an industry-centered approach are still reliant on insurance companies to solve the coastal insurance problem. This also may be a negative aspect of the industry-centered approach for states that have lost confidence in insurance companies.

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109. PROPERTY PLANS, *supra* note 75, at 20.

110. There is also a public policy concern to consider for states taking a government-centered approach: Individual insurance policy holders without property damage may be required to pay higher insurance premiums to cover the losses of the state insurance program for other coastal property owners if a storm should cause major damage.

111. *See* Press Release, Mark Sanford, *supra* note 8 ("[The Omnibus Act] is aimed at increasing the availability of private insurance—which will promote competition, ultimately the key to driving down premiums.").

112. Jeremy Hsieh, *Insurance Chief Loses His Policy*, STATE, Sept. 4, 2007, at A1.

113. Amber Craig, *Federal Help Sought for Coastal Insurance Problem*, GULF LIVE, Sept. 25, 2007, http://gulflive.com/printer/printer.ssf?/base/news/1190726193218370.xml (internal quotation marks omitted).

114. *See generally* Omnibus Coastal Property Insurance Reform Act of 2007, No. 78, 2007 S.C. Acts 313 (providing various tax incentives to private insurance companies in an effort to entice them to do business in the state).

115. *See supra* text accompanying notes 67–73.

D. A Multifaceted Approach

Given the holes left by both approaches, perhaps states should consider a more multifaceted approach to the coastal insurance problem in order to effectively address coastal insurance issues. Every state has unique issues to consider when addressing the problem of coastal insurance. One plan developed by one state likely will not fit every state's unique coastal insurance concerns. Because each state is unique, each state should develop a tailored coastal insurance plan, adopting elements from either the government-centered or industry-centered approaches. However, in order to take an even more comprehensive approach, federal assistance and more responsible coastal building practices should be implemented in addition to the adopted state plans.

V. FEDERAL ASSISTANCE

Some insurance companies are encouraging the federal government to step in to address the coastal insurance problem.[116] Because the coastal insurance crisis is such a pressing issue, the federal government will likely need to assist states and the insurance industry in addressing coastal insurance issues. Although the federal government does not have express constitutional authority to intervene during times of natural disaster, the federal government may complement state efforts, because "some emergencies exceed states' remedial capabilities."[117]

Arguably, something will have to be done at the federal level to address the coastal insurance problem. Instead of refusing federal involvement to address the coastal insurance problem, many leaders are looking upon this option more favorably.[118] The question of federal involvement should not be one of "if" but rather a question of "how much." A recent article pointed out that "Mississippi Insurance Commissioner George Dale said that although he has never been in favor of any federal involvement, there might be room for it to become involved in a limited way."[119]

At a recent public hearing before the National Association of Insurance Commissioners, insurance companies including Allstate, State Farm, and Travelers agreed that some level of support from the federal government is necessary to solve the coastal insurance problem.[120] These companies advocate varying degrees of involvement from the federal government, but all agree that some level of involvement needs to be in place.[121] For the insurance industry, the issue seems to

116. *See* Craig, *supra* note 113.

117. Christine M. McMillan, Comment, *Federal Flood Insurance Policy: Making Matters Worse*, 44 HOUS. L. REV. 471, 477 (2007).

118. *See* Craig, *supra* note 113.

119. *Id.*

120. *Id.*

121. *Id.* State Farm representative David Hill suggested "a modernization of the federal flood program that would prevent people from unknowingly being underinsured" as one element of a comprehensive plan that also included "statewide building codes" and greater homeowner accountability. *Id.* Allstate is a member of a coalition called Protecting America that promotes many insurance-related issues, including federal involvement in the way of funding. *Id.* Allstate's managing counsel, Edward T. Collins, testified on behalf of Protecting America and explained that the insurance industry cannot effectively deal with another disaster like Hurricane Katrina. *Id.*

turn on how much federal involvement there should be, not whether there should be federal involvement.

This Comment argues that the federal government should take two specific actions as part of a multifaceted approach. First, flood insurance must be reformed federally. Second, a national catastrophe fund should be developed to supplement insurance when severe storms cause major damage. With the costs associated with major storms increasing, state legislators may have to look to federal alternatives to assist states when disasters occur.

A. Reform Flood Insurance

Congress is currently considering the Flood Insurance Reform and Modernization Act of 2007 (Flood Bill).[122] The Flood Bill cleared the House by a vote of 263 to 146 and, as of November 2007, is residing with the Senate Committee on Banking, Housing, and Urban Affairs.[123] The Flood Bill, which attempts to revamp the National Flood Insurance Program (NFIP), has several components. The bill requires the Federal Emergency Management Agency (FEMA) to inform individuals of the availability of flood insurance for their property and to write information explaining policies in clear language that policyholders can understand.[124] The Flood Bill also requires FEMA to keep and maintain updated flood maps.[125] The ultimate goal of these provisions is to ensure that property owners in flood-prone areas are aware of the availability of flood insurance for their property so that these individuals are familiar with the risks and mitigation possibilities.[126]

Perhaps the most controversial aspect of the Flood Bill is that one senator wants to increase the scope of coverage of the NFIP to include windstorm damage.[127] The White House is opposed to any expansion in risk coverage that would include windstorms and will likely veto the Flood Bill if the final version includes such an expansion.[128] Those who oppose increasing coverage of flood insurance to include windstorm damage do not want—because of the possible fiscal results—the federal government insuring a risk that is insurable in the private sector.[129] Federally backed flood insurance originally started because the risk was too high for private insurers to provide flood insurance on their own.[130] Possibly, windstorm risks for coastal homeowners may also become too expensive to insure privately, thus requiring insurance on a federal level.

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122. H.R. 3121, 110th Cong. (2008).

123. *House Passes Flood-Insurance Bill*, MORTGAGE BANKING, Nov. 2007, at 12.

124. *Id.*

125. *Id.*

126. *Id.*

127. *See id.* at 13.

128. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, STATEMENT OF ADMINISTRATION POLICY: H.R. 3121—FLOOD INSURANCE REFORM AND MODERNIZATION ACT OF 2007 (2007) [hereinafter STATEMENT OF ADMINISTRATION POLICY], *available at* http://www.whitehouse.gov/omb/legislative/sap/110-1/hr3121sap-r.pdf.

129. *See id.* ("Shifting liabilities for windstorm damage from the private sector to the NFIP would be fiscally irresponsible.").

130. *See* Michelle E. Boardman, *Known Unknowns: The Illusion of Terrorism Insurance*, 93 GEO. L.J. 783, 828–29 (2005).

The Bush Administration is opposed to the windstorm provision in the Flood Bill because it believes that federal involvement in that market would create inappropriate reliance on government and result in risky building practices.[131] An additional concern is that all taxpayers would be responsible for funding windstorm coverage for those individuals choosing to live in high-risk areas.[132] While some individuals choose to build expensive homes along the coast—and have done so without federal windstorm insurance—characterizing all coastal homeowners as individuals who simply choose to live in high-risk areas is not completely correct. This characterization is incorrect for many homeowners living in South Carolina's coastal areas, where many families have lived in the same area for generations.[133]

Despite the controversial nature of expanding flood insurance coverage to include windstorm coverage, the remaining elements of the Flood Bill seem less controversial. The final level of change agreed upon by political leaders, however, remains to be determined.

B. National Catastrophe Fund

Another idea for federal assistance comes in the form of a national catastrophe (CAT) fund that would provide funding to specific areas when major disasters occur. While still in the planning stages, the basic idea is similar to the plan already in place for floods—"Policyholders around the country would pay into a pool that can help cover losses after a major disaster no matter where it occurs."[134] This idea has been advocated and supported by many leaders, especially those from disaster-prone states.[135] Although the White House is opposed to federal assistance in the form of a national fund,[136] some state legislators are urging that the federal government start a national fund to insure insurance companies.[137] To do so would hopefully lower premiums for coastal homeowners by spreading the cost of disasters across the country.[138]

Those opposed to federal involvement in the form of a CAT fund argue that insurance has traditionally been within the realm of the states.[139] Individuals with

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131. *See* STATEMENT OF ADMINISTRATION POLICY, *supra* note 128.

132. *See id.*

133. *See* Dahleen Glanton, *Ex-Slaves' Land Heirs Feel Island Shift*, CHI. TRIB., July 11, 2006, § 1, at 5.

134. Brendan Farrington, *National Cat Fund Gains Congressional Support . . . but Is It Enough?*, INS. J., May 30, 2007, http://www.insurancejournal.com/news/national/2007/05/30/80108.htm.

135. *See, e.g.*, Jeb Bush, Op-Ed., *We Need a National Catastrophe Fund*, TAMPABAY.COM, Oct. 21, 2005, http://www.sptimes.com/2005/10/21/Opinion/We_need_a_national_ca.shtml ("The time has come to consider creating a national catastrophe fund to deal with [the coastal insurance] issue."). Other Florida leaders also support a CAT fund, including U.S. Representatives Ginny Brown-Waite and Clay Shaw, as well as Florida's Chief Financial Officer, Tom Gallagher. *Florida's CFO Gallagher Backs National Catastrophe Fund*, INS. J., Nov. 25, 2005, http://www.insurancejournal.com/news/southeast/2005/11/25/62517.htm.

136. *See* Farrington, *supra* note 134 ("Edward Lazear, chairman of the White House Council of Economic Advisers, testified before a Senate committee that the Bush administration opposes the idea because it would displace the private market and have unintended economic consequences.").

137. *See* John Gramlich, *Home Insurance Woes Mount in Coastal States*, STATELINE.ORG, Sept. 4, 2007, http://www.stateline.org/live/details/story?contentId=236708.

138. *See id.*

139. *See id.*

this view may be concerned with how federal involvement would affect an industry that is accustomed to only state involvement. A CAT fund, however, would constitute only limited and sporadic federal involvement in true emergency situations.

Those opposed to increased federal involvement with the coastal insurance problem also point to the idea that states with little or no coastal insurance issues will likely oppose a federal mandate addressing the coastal insurance problem.[140] However, aid from the federal government in the form of a CAT fund could be available to address damage arising from a myriad of disasters, including earthquakes, mudslides, terrorist attacks, wildfires, and tornadoes.[141] Once in place, funds would be available for any state facing any type of major disaster, not only for storm damage to coastal states.[142]

The idea of a federal CAT fund embodies many complicated issues. It may take a long time for a CAT fund plan to reach a viable state in Congress. Indeed, some leaders have been working on and advocating a national CAT fund for years.[143] Still unresolved, a national CAT fund could likely be a topic of interest for many individuals in upcoming federal and state elections in 2008.

VI. RESPONSIBLE COASTAL BUILDING

Beyond the insurance-related approaches that states take to address the coastal insurance problem, all states should take additional measures to ensure that coastal homes are built in responsible locations. The number of coastal homes continues to increase each year because the coast is a desirable place to live. As more people continue to build along the coast, the cost of repairing damage after storms also increases.[144]

All states have adopted one or more types of mandatory building codes;[145] South Carolina is one such state.[146] States should strengthen these building standards as much as possible to ensure coastal homes are built to survive storms. The location where coastal homes are built is also a crucial consideration. Regulating coastal construction to ensure homes are built in more responsible locations provides protection to precious coastal and inland habitats.[147] South Carolina's coasts and barrier islands are an important natural resource in many

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140. *See* Farrington, *supra* note 134 ("The argument against [a CAT fund] is that property owners in places like Nebraska shouldn't have to pay more to help homeowners along Florida's hurricane-prone coast.").

141. *See id.*

142. *See id.*

143. *See id.* (noting that Florida Representative Ginny Brown-Waite "has pushed for the fund since her election in 2002").

144. *See* Ellen P. Hawes, *Coastal Natural Hazards Mitigation: The Erosion of Regulatory Retreat in South Carolina*, 7 S.C. ENVTL. L.J. 55, 56 (1998) ("[A]s population and investment in coastal communities grow, natural events pose serious threats to safety and economic security and sustainable development.").

145. *See* INT'L CODE COUNCIL, INTERNATIONAL CODE ADOPTIONS, http://www.iccsafe.org/government/adoption.html (last visited Feb. 13, 2008).

146. *See id.*; Hawes, *supra* note 144, at 63–64 (noting that South Carolina law requires local jurisdictions to adopt and enforce the Standard Building Code).

147. *See* Emily Bruce, Book Note, 19 STAN. ENVTL. L.J. 293, 295 (2000) (reviewing CORNELIA DEAN, AGAINST THE TIDE (1999)).

ways—aesthetically, economically, and environmentally. In addition to protecting coastal areas, another "overriding goal of coastal construction regulation is to protect structures from storm and beach damage."[148]

The high costs associated with coastal building is not a new phenomenon. More than fifteen years ago, Elise Jones noted, "Growing coastal populations and demands for shoreside homes have resulted in increased construction and higher property values on both mainland and barrier coasts. When combined with coastal hazards, the result, not surprisingly, is escalating costs of property damages."[149] By regulating the locations on which coastal homes are built, states will be able to minimize some of the costs associated with coastal storms.

VII. CONCLUSION

It is certainly too early to tell if any single method employed thus far by any state will effectively address the coastal insurance problem. The Coastal Captive Insurance Act will hopefully attract a number of captive insurance companies to South Carolina to write coastal area insurance, lowering prices for all coastal homeowners and making insurance readily available for coastal homes. Many of the potential issues and concerns with South Carolina's plan and the various plans of other states are discernable. However, the divisiveness of this issue makes it unlikely that one state holds the best or only solution.

A more comprehensive approach that combines multiple methods of addressing the coastal insurance problem will allow every coastal state to fill any voids that any one approach would leave. A combination of government assistance at both the state and federal level, as well as requirements ensuring that coastal homes are built to safe standards and in a responsible manner, is needed to effectively address the coastal insurance problem.

Elisabeth A. Ondera

148. Kenneth E. Spahn, *The Beach and Shore Preservation Act: Regulating Coastal Construction in Florida*, 24 STETSON L. REV. 353, 359 (1995).

149. Elise Jones, *The Coastal Barrier Resources Act: A Common Cents Approach to Coastal Protection*, 21 ENVTL. L. 1015, 1026 (1991).

