JUL 14 1972

MEMORANDUM FOR THE DIRECTOR

From : Samuel M. Cohn

Subject: Report of President's Study Group on Disaster Insurance

In one of Bill Morrill's recent memos to you on disaster relief, he observed that we were badly trapped by circumstances on Agnes and recommended, among other things, that remedial legislation be attempted next January. This advice makes eminent good sense to me.

Those who might work on such legislation should be aware of the February 1971 report of the President's Study Group on Disaster Insurance. A brief summary of it is attached. Copies of the full report are available if needed.

Attachment

cc:
Mr. Carlucci
Mr. Dam
Mr. Morrill
Mr. O'Neill
Mr. Rommel
Mr. Fischer
Mr. Young

Summary of the
President's Study Group on Disaster Insurance

****

"When disasters result in major economic losses, loss of life, and extensive suffering by their victims, then sound business management of disaster avoidance and relief quite expectedly tends to give way to the momentary sympathy generated by the event." -- From the Report of the Study Group on Disaster Insurance, February 8, 1971

****

In his April 22, 1970 disaster relief message, the President called for a "... comprehensive study of property insurance coverage for disaster situations ..." in an attempt to gain more deliberate and thoughtful consideration of longer term disaster relief remedies -- removed from the demands for expedient response to a given disaster. A Study Group on Disaster Insurance was organized to make the study and filed its report on February 8, 1971.

Major findings

The major findings of the report are:

1. Exposure to the most common disaster-type -- flood -- is largely avoidable through intelligent building and land use controls.

2. Private disaster insurance is unavailable for most disasters except windstorm. Both the extent and frequency of damage of natural disasters are highly erratic. And neither State insurance regulations nor Federal income tax laws are flexible enough to permit the accumulation of reserves needed to cover such large and uncertain contingencies.

3. Federal flood insurance program, enacted 1968, is soundly conceived, has contingent land use controls, subsidized rates for existing construction, and actuarial rates for new construction. Participation in program is still quite limited -- and may be undermined by continued and growing availability of Federal disaster assistance giveaways.

4. Local communities commonly carry fire and casualty insurance on public buildings and schools and could probably be induced to carry disaster insurance as well if it were available -- and if free Federal assistance were not.

Major conclusions:

-- Provision of financial protection should be designed to provide incentive toward reduction of future losses.

-- There are appropriate roles for both government and the private sector in mutual effort to reduce loss.

-- Insurance only reduces financial burden on immediate victim; it does not eliminate real loss. Essential emphasis must, therefore, be on reducing losses -- through wise land use and construction.

-- Some risks are unavoidable; total security is not a realistic goal for insurance or other programs.

Federal goals:

The study group identified three goals it thought appropriate for Federal Government:

(1) Facilitate the availability of disaster insurance for those willing and able to pay the premium costs for protection against natural disaster-type risks.

(2) Minimize damage from disasters by providing economic incentives (e.g., through actuarially sound variable insurance rates) for wiser property development decisions with respect to location and construction quality.

(3) Lessen reliance on disaster relief by persons already established in disaster-prone areas -- by requiring them to pay at least a portion of future disaster relief through prefunding mechanisms (e.g., insurance), and by requiring other damage reduction measures.

Recommendations:

The major recommendations of the report are:

General recommendations:

-- No new Federal disaster insurance program is necessary or desirable.

-- Most gaps in insurance coverage can be filled by: (a) effective implementation of current Federal programs (mainly flood insurance), (b) new and limited Federal initiatives, and (c) reasonable and prompt State action.

-- All Federal programs -- particularly those directly or indirectly involving new construction -- should be used to "encourage" State and local governments to develop land use requirements appropriate to disaster-prone areas.

Specific recommendations:

I. Federal programs -- particularly to aid new construction -- should be used to encourage State and local governments to set appropriate land use controls.

II. Disaster relief should be denied areas failing to adopt appropriate land use controls after a specified date.

III. HUD/FHA, Farmers Home, VA should restrict loans and loan guarantees in areas failing to adopt and enforce appropriate land use controls.

IV. Move cautiously on expanding relatively new Federal flood insurance programs until effectiveness can be measured -- then expand and improve, but without undermining sound features of programs.

V. Have HUD/FHA, Farmers Home, VA require flood insurance where available.

VI. Have insured banks and S&L's require flood insurance where available -- as a condition of conventional mortgages.

VII. If existing building, entitled to subsidized flood insurance rates, is destroyed, it should pay actuarial rate if rebuilt.

VIII. States should reduce regulatory inhibitions that prevent insurance industry response to public demands for casualty and disaster insurance.

IX. Tax code should be amended to permit 10 year carry forward of major disaster losses to insurance companies.

Comment:

The study group's findings and recommendations resulted in draft legislation (The Disaster Mitigation Act), a draft executive order, and extensive review and deliberations involving 30 Federal agencies. But the complexity of technical and administrative problems and the conflicts of agency views were too great to be resolved without undue effort or expenditure of "capital." At any rate, a decision to drop the matter was made informally (by White House and OMB) early in 1972.

While the study group's recommendations are not a perfect solution to the disaster relief dilemma, they were based on a thorough investigation of the problems and were carefully considered. They emphasize institutional adjustments that would put primary reliance on the private economy and on State and local government actions and hold Federal involvement at the practical minimum. While this is not a popular course so soon after Agnes, it merits serious consideration in designing long-term solutions.

One of the study group's conclusions -- that the Flood Insurance Program cannot be expanded rapidly without destroying its soundness -- ought to be questioned. This is basically the view of technicians close to the program, and their exacting standards could be excessive. Eighteen months have passed since the study group accepted this view of the Federal insurance Administrator. The program was only two years old then. Reconsideration of this position now would be worthwhile.

BRD:FAB 7/14/72