Consumer Federation of America

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NEW STUDY: AMERICANS PAY MORE FOR WEATHER CATASTROPHES AS INSURERS INCREASINGLY SHIFT COSTS TO CONSUMERS AND TAXPAYERS

--Insurance Commissioners Should Block Unjustified Homeowners' Insurance Rate Increases--

The Consumer Federation of American (CFA) today released a new study with insurance industry data that found that insurance companies have significantly and methodically decreased their financial responsibility for weather catastrophes like hurricanes, tornados and floods in recent years, shifting much of the risk and costs for these events to consumers and taxpayers. The report is being released as insurers in eleven states have requested large homeowners' insurance rate increases of 18 percent or more.

"Insurance commissioners should block many of these pending rate increases because they place an unwarranted financial burden on homeowners, many of whom are coping with severe financial difficulties in a bad economy," said J. Robert Hunter, CFA's Director of Insurance and former federal insurance administrator and state insurance commissioner. "In the last twenty years, insurers have been so successful at shifting costs to consumers and taxpayers that they are currently overcapitalized and cannot justify higher homeowners' rates."

Insurance executives frequently remind the public and regulators of the frequency and severity of catastrophic events. CFA's study, "The Insurance Industry's Incredible Disappearing Weather Catastrophe Risk," found that some of the savings insurers have achieved are legitimate, the result of the use of reinsurance and wise risk diversification strategies.

However, the study found that the bulk of the savings that insurers have realized has been through shifting costs to taxpayers and consumers. Insurers have hollowed out the coverage they offer to homeowners by increasing deductibles and capping the amount they will pay if the home is damaged or destroyed. These coverage reductions expose taxpayers to higher disaster assistance payouts because homeowners have less money available to help themselves. Additionally, insurers have significantly raised rates over the years, sometimes using questionable computer rate "models" developed by other companies. Insurers have also used fine print tricks, such as the "anti-concurrent causation clause," which allows insurers to refuse to pay for wind losses if any flood damage occurs at about the same time, even if the wind losses occurred first. Finally, insurers have shifted coverage for homes in high-risk areas to state insurance pools.

When insurers do not pay, consumers do. To demonstrate how much more consumers are paying for catastrophe coverage in recent years, the study offered a hypothetical example of how much the owner of a home worth $100,000 with a typical policy would have paid for losses after Hurricane Katrina in 2005, compared to after Hurricane Andrew in 1992. Assuming that the home had a $500 deductible under Andrew and a 5 percent deductible during Katrina, if $10,000 in damages occurred, the homeowner would have paid $500 to repair the damage after Andrew, but $5,000 after Katrina. If the homeowner had to upgrade the home's electrical system, the insurance policy would have fully paid for these costs after Andrew, but paid nothing after Katrina. If some water damage occurred at the same time, the policy would have fully covered the wind claim of $9,500 after Andrew, but paid nothing after Katrina.

The study provided extensive data showing that insurers today are significantly overcapitalized. The traditional measure of adequate financial solidity for property/casualty insurers was whether they carried $1 of surplus for every $2 they made in premiums. Most observers think that the appropriate ratio today, given the risk of catastrophic weather events, should be $1.50 of surplus to $1 in premium. At 78¢ of premium for every dollar of surplus, insurers now have about double the required surplus. Even if insurers had to pay for all of the ten most costly catastrophic events in United States history, the property/casualty industry surplus would still be at an ultra safe ratio of 1.2 to 1. (This would include the cost of the September 11, 2001 attack, the Northridge Earthquake, and the eight most expensive hurricanes, a total of $162 billion in after-tax 2010 dollars.)

"Insurers' surplus would have risen by $15 billion in 2011 even with the tornadoes and floods that caused huge losses, if they had not paid stockholder dividends," Hunter said.

The study concludes that the insurance industry has moved from its historic role as a calculated risk-taker to one of a risk-avoider, exposing consumers and taxpayers to much higher costs. Not only have insurers insulated themselves from their historic share of hurricane risk, they have made no serious effort to cover risks associated with floods or terrorism, which are entirely backed by federal taxpayers.

State Solutions

The study recommended that state insurance departments take several actions to stop insurers from unjustifiably shifting costs and risk to consumers and taxpayers, including:

- Carefully examine national data on limited catastrophe losses and excessive surplus before approving any insurer requested rate increases.
- Be on guard against unwarranted attempts by insurers to use catastrophe losses as part of their rationale for jacking up rates.
- Ban use of fine print tricks that unjustifiably deny policyholders coverage when they need it the most, such as anti-concurrent causation clauses.
- Coastal states form an interstate compact to spread risk and lower costs by developing common insurance pools and provide consumers and insurers with consistent requirements. A common approach would also better position states – especially small ones – to resist coercive efforts by insurers to weaken regulatory protections for consumers.

Federal Solutions

The study offered a number of recommendations for federal taxpayer savings in the National Flood Insurance Program (NFIP), and regarding potential taxpayer losses in the event of a terrorist attack:

- Congress should limit the exposure of taxpayers to terrorism risk to only extreme events, such as nuclear, chemical or biological attacks that result in more than $100 billion in losses.
- Congress should amend pending legislation to extend the NFIP to require a study on how the private sector could start covering flood losses, perhaps by requiring insurers that currently service NFIP policies to pick up a small, but increasingly larger, percentage of flood risk. The Federal Emergency Management Agency (FEMA) should also reduce the excessive servicing fees that it pays, which create a windfall for insurance companies at taxpayer expense.

"The fact that insurers do not take financial risk for either flood or terrorism insurance is a huge policy error. Taxpayers are required to pick up huge risks that private insurers are more than capable of identifying and backing," said Hunter. "The lack of financial involvement by insurers in the flood program tempts them to illegitimately shift hurricane related costs that they should pay to the taxpayer-funded flood program. Taxpayers deserve to have at least some of the financial risk for flood and terrorism losses removed from their shoulders, particularly because so many Americans are under economic stress and lawmakers are searching for ways to cut federal spending."

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The Consumer Federation of America is an association of nearly 280 nonprofit consumer organizations that was established in 1968 to advance the consumer interest through research, advocacy, and education.

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RESPONSE OF THE INSURANCE INFORMATION INSTITUTE TO CONSUMER FEDERATION CATASTROPHE INSURANCE STUDY IGNORES HUGE COST-SHIFT BY INSURERS TO TAXPAYERS AND CONSUMERS

In a February 17, 2012 news release, the Insurance Information Institute (III) ignored the main findings of CFA's recent study, which presents data demonstrating that insurers have significantly and methodically decreased their financial responsibility for weather catastrophes like hurricanes, tornados and floods in recent years, shifting much of the risk and costs for these events to consumers and taxpayers.[1]

III: Natural catastrophes represent a larger share of claims' payouts, a trend that has accelerated over the past two decades. Hurricanes and tropical storms account for 44 percent of all claims' payouts caused by natural catastrophes from the early 1990s through today, while tornadoes have generated 30 percent of the payouts.

CFA: This response highlights CFA's main finding that the property/ casualty industry's surplus has grown much larger, in spite of a significant increase in the frequency and severity of catastrophic weather events. Over the last two decades, surplus grew from $159 billion in 1991 to $580 billion in 2010. During that time, the key measure used to assess industry financial solidity -- the premium-to-surplus ratio -- fell from 1.40 to 0.73. (Most experts estimate that the ratio of premiums to surplus that is safe is 1.5.) This means that, despite the increase in catastrophe damages, industry financial risk declined by half. This has led many industry observers to ask if the property/casualty insurers are excessively capitalized. Even III itself has said that industry surplus was excessive by $81.9 billion, as of 2010. III put it this way, "Record policyholder surplus (capital) has resulted significant excess capital in the p/c insurance sector as of year-end 2010."[2]

III: Large weather catastrophes in 2011 reduced the property/ casualty insurance industry's cumulative policyholders' surplus—the amount of money remaining after insurer liabilities are subtracted from assets— to $538.6 billion, as of September 30, 2011. This is 3.3 percent lower than the $556.9 billion policyholder surplus at year-end 2010.

CFA: This "loss" in surplus of $18 billion was not due to losses in insurance operations, which showed a net income of $8 billion, but to the $16.9 billion in dividends that insurers paid to stockholders, and capital losses of $13.1 billion. However, even a drop

[1] "Insurance Industry's Financial Strength has Proven to be an Asset, as Demonstrated by the Events of 2011," Insurance Information Institute, February 17, 2012.
[2] Slide 73 of III presentation, "Overview and Outlook for the P/C Insurance Industry", August 10, 2011.

in surplus of $18 billion would still leave an excess of about $60 billion, according to III's own estimates. ($81.9 Billion less $18 billion is an excess of about $60 billion). CFA calculates that the industry's excessive surplus is greater than $60 billion, but there is no debate that excess capital exists today.

III: Property/ casualty insurers are in the risk management business and have, with the approval of state lawmakers and regulators, instituted hurricane deductibles in recent years to allow them to write policies in the most hurricane-prone parts of the U.S. This has made private-sector coverage more available and affordable in coastal areas than would otherwise be the case.

CFA: Some states have responded to insurer threats to withdraw coverage from coastal areas by allowing unjustified rate increases, significantly higher deductibles and more severe coverage limits, which have shifted huge costs to home and business owners. For example, in some states, insurers are permitted to include unjust "anti-concurrent causation" clauses in homeowners' policies, which allow insurers to refuse to pay for wind damages if some water damage occurs at about the same time. CFA urges states to roll back these anti-consumer changes.

III: "The industry's business model was put to the test, and passed with flying colors."

CFA: Industry profits may be "flying," but they are coming at the expense of consumers, who are forced to pay more for much less coverage. States must act to control these excessive and unjustified charges by insurers.