CFA
Consumer Federation of America
1620 I Street, N.W., Suite 200 * Washington, DC 20006

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For More Information:
Bob Hunter, 703-528-0062
Jack Gillis, 202-737-0766

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. These states are Alabama, Arizona, Colorado, Georgia, Kansas, Kentucky, Maine, South Carolina, South Dakota, Tennessee, and Virginia.

"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.