Insurers Retreat From Coasts; Katrina Losses May Force More Costs on Taxpayers

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By Spencer S. Hsu

Alarmed at the sharply rising cost of hurricanes and other disasters, home insurers are pulling back from some U.S. coastal markets, warning of gathering financial storm clouds over how the United States pays for the damage of catastrophe.

The development is yet another legacy of Hurricane Katrina, whose mounting toll of destruction along the Gulf Coast has crystallized a growing industry debate about the combined effect of climate trends and population growth in coastal areas. Some believe the two are creating a risk of losses so large that insurers could be pushed to the breaking point, leaving the government and taxpayers holding the tab for the next disaster.

Since Aug. 29 -- when the hurricane made landfall along the Gulf Coast -- Allstate Corp., the industry's second-largest company, has ceased writing homeowners policies in Louisiana, Florida and coastal parts of Texas and New York state. The firm has stopped underwriting earthquake coverage in California and elsewhere. Other firms have pulled back from the Gulf Coast to Cape Cod, notifying Florida of plans to cancel 500,000 policies.

Meanwhile, homeowners are moving to state-backed insurer plans of last resort, which tend to be subsidized by taxpayers, and whose costs are also rising.

As companies raise premiums, shed customers and battle homeowner claims in hurricane-damaged states, an overhaul of the industry is being promoted by an unusual coalition. It includes Allstate and State Farm Fire and Casualty Co. as well as a bipartisan group of state regulators, academic experts and former homeland security officials.

They propose establishing a greater role for the federal government in backing up new state catastrophe funds or private insurance firms when losses exceed a certain level, toughening state and local building codes and increasing premiums to accurately price risks. Some also want to potentially pool the high costs of covering perils such as earthquakes, hurricanes, tornadoes and even floods into regional or national groups to ease consumer cost, and to use some money to help improve first responders and local preparedness.

"There is a potential market failure here, if not already an actual market failure at work," said Robert E. Litan, a senior fellow at the Brookings Institution who is working with state regulators in California, Florida, Illinois and New York on a plan to reshape catastrophe insurance. "If we have another hurricane season this year like we had last, I wouldn't be surprised if you see a stampede of insurers trying to get out."

Taxpayers are already feeling the impact. While Katrina caused an estimated $38 billion to $50 billion in private insured losses, it also helped put the federal flood insurance
program $23 billion in the red and prompted federal relief spending of more than $100 billion. That is set to include about $10 billion for Mississippi and Louisiana homeowners.

"The fundamental dispute is over the role of government, and whether the government should or should not play a significant role in effectively helping to diversify the catastrophic risks that this country faces," said Robert P. Hartwig, chief economist for the Insurance Information Institute, the research arm of the industry.

Companies are shedding homeowners policies and driving residents to taxpayer-funded state insurance plans. Florida's Citizens Property Insurance Corp., for example, has 815,000 policyholders and is adding 40,000 a month, said Kevin M. McCarty, state commissioner for the office of insurance regulation. Last week, Poe Financial Group collapsed, and many of its 316,000 policyholders probably will move to Citizens, which already faces a $1.7 billion deficit.

Louisiana Citizens Property Insurance Corp., the state's last-resort insurer, expects to reach 200,000 policies this year; it had none in 2004. Texas's insurer of last resort says it is down to $1.3 billion in reserves and wants to raise rates by at least 22 percent.

"Everybody's thinking about this issue, every insurance company certainly, and other businesses, bankers, lenders and government agencies," said Joseph J. Annotti, spokesman for Property Casualty Insurers Association of America, which represents 1,000 insurers, including some of the nation's largest insurers of homeowners. "It's a political problem, and it's an economic problem -- that's what makes it so difficult."

Analysts note that seven of the 12 costliest insured disasters in U.S. history occurred in the past two years. At $57.7 billion, private insured losses in 2005 were more than double those of 2004, according to the Insurance Services Office.

Hurricane forecasters predict five major storms of Category 3 or higher in the 2006 Atlantic season, with a chance of U.S. landfall at 81 percent, compared with a 100-year average of 52 percent. In March, catastrophe modeler Risk Management Solutions Inc. raised its estimate of insurance losses this year by nearly 50 percent above pre-2004 baselines for the East and Gulf coasts. RMS, whose estimates are used by insurers to calculate premiums, blamed "higher sea surface temperatures."

Whether global warming is at work or not, damage costs will increase because of rising property values and development. For instance, a direct hit on Miami by Hurricane Andrew that would have cost $60 billion in 1992 would cause $120 billion in damage today because the market value has doubled, the Insurance Services Office estimates.

"In this environment, we think catastrophes that cost $100 billion in insured losses are not hard to envision," ISO spokesman Christopher Guidette said.
In reaction, the National Association of Insurance Commissioners set up a task force this winter to study climate change, while the industry asked the Wharton School of the University of Pennsylvania to analyze the benefits of proposals, said Howard Kunreuther, head of the school's Risk Management and Decisions Processes Center.

Insurers are divided over whether such warnings are more Jeremiah or Chicken Little. As a whole, the industry is coming off some of its best years. It recorded a 12 percent increase in net income after taxes of $43 billion in 2005, despite the storms, according to the Insurance Services Office and Property Casualty Insurers.

What's more, up to half of the Katrina losses -- $38.1 billion -- were borne by overseas firms or reinsurers (insurers for the insurance companies), which say that growing capital markets are shouldering any growing burden.

"Our point is this industry has been very profitable and very resilient in the face of the most significant catastrophic losses -- both terrorist and natural disasters -- ever," said Frank Nutter, president of the Reinsurance Association of America, whose members would be supplanted by federal or state catastrophe funds or reinsurers. "We can't see why there's a case to be made for a government role."

"Let the private sector do its job without extraordinarily complex new government programs," said Eric Goldberg, spokesman for the American Insurance Association, which represents more than 400 property and casualty companies.

But Allstate has poured more than $1 million into a lobbying campaign it calls ProtectingAmerica.org, enlisting State Farm and retaining former Federal Emergency Management Agency director James Lee Witt and former Homeland Security deputy secretary James M. Loy.

Allstate suffered its first quarterly loss in a decade because of Katrina, $1.5 billion, and its reinsurance costs this year are expected to triple, to $600 million. "Our obligation is to earn a return for our shareholders, not to assume risks from people for a price that is not fair and adequate," said Thomas J. Wilson II, president and chief operating officer.

Supporters argue that the insurance industry has a "breaking point" -- $50 billion or $60 billion, McCarty said -- above which the government must step in to ensure solvency. What's more, they say, the cost of disasters is already affecting consumers by pricing premiums too high and discouraging participation in insurance programs against floods and earthquakes.

For example, 14 percent of Californians have earthquake insurance. About 20 percent of coastal Mississipians had federal flood insurance, Hartwig said. For consumers, changes could offer one-stop coverage for a range of disasters, avoiding gaps in coverage, pricey add-ons or disputes among insurers over which is responsible for losses, said Florida state Sen. Steven A. Geller (D), of the National Conference of Insurance Legislators.
For taxpayers, a coordinated system to accurately price and insure against the risk of disasters would create true market incentives for homeowners, developers and lenders to buy and build stronger and safer homes, cutting the need for politicians to provide aid after a disaster.

After Katrina, for example, the United States is providing rebuilding grants worth as much as $150,000.

"If I'm sitting on the San Andreas Fault and I have the choice of spending $7,000 or $10,000 on earthquake insurance, and I'm watching what's going on in Mississippi," Florida's McCarty said, "why wouldn't I wait for the inevitable to occur and then point my finger to the Gulf Coast and say, 'What happened in Mississippi should happen in California'?"