

Insurers Have A Point – Newsday 08/13/2006

By: Dennis G. Legg, CIC, CPCU

*Director of Marketing – Sammis Insurance Agencies &
Instructor at Hofstra University College of Continuing Education*

It's the start of the peak hurricane season, a year after the devastation of Katrina, and a major insurance company in this area is under attack for making it harder for Long Islanders and others in southern New York State to get homeowners insurance that would protect them in a major storm.

Allstate, New York State's largest supplier of homeowner's insurance has stopped selling new policies for homes on the Island and in six other downstate counties and the company refuses to renew many expiring policies.

Both Sens. Charles Schumer and Hillary Clinton have gone after the company, Schumer accuses Allstate of having an ulterior motive, which is to pressure the federal government into creating a catastrophe fund to bail out insurers swamped by claims in a major emergency. Clinton describes Allstate's move as "very troubling, especially in light of the recent floods that have ravaged New York State." She says, "Allstate owes it to its customers to explain their decision."

It is true; the company hasn't done a good enough job of that. We've been told that Allstate wants to protect itself from the huge concentration of claims that will result from major storms predicted for this region in coming years. But we haven't been helped enough to understand the extent to which, after Katrina, insurance companies have come to share American's new understanding of vulnerability to changing weather patterns.

Whether or not Allstate has a political agenda is irrelevant: It needs to protect itself or risk going out of business. At least 20 other insurance companies continue to sell homeowners policies on Long Island, but with a variety of different restrictions.

While meteorologists expect this year's hurricane season to be less severe than last year's. "We are not off the hook by any means," retired Navy Vice Adm. Conrad C. Lautenbacher, head of the National Oceanic and Atmospheric Administration (NOAA), said at a press conference last week.. For 2006, the Oceanic Administration predicts two to three major hurricanes will make landfall in the United States. Tropical Storm Risk, a London based risk analysis firm for the insurance industry, predicts 14 storms, 8 reaching hurricane strength.

For Long Islanders, it is important to realize the U.S. Army Corps of Engineers put New York as third most vulnerable American city behind New Orleans and Miami. AIR Worldwide, an insurance industry consulting firm, puts New York as number two.

A major hurricane could see 13 foot waves hitting New York Harbor and devastating winds that would leave lower Manhattan submerged as well as the east and west coasts of Staten Island and eastern Bronx. Much of southern Brooklyn and Queens and the south shore of Long Island as far north as the Southern State Parkway will also see flooding.

The transportation systems in these areas, including roads, tunnels and train and subway tunnels, would be crippled for extended periods of time.

A homeowner or business owner processes this information one-way: He or she wants to know he will be protected. But how does an insurance company view this?

Insurance companies operate on a few basic ideas, not intending to discount the complexity of insurance. An insurance company is not an altruistic endeavor, but a business that intends to make a reasonable profit for its owners while assisting individuals or businesses that have losses that they cannot financially entertain.

The policies they write must take into consideration such things as spread of risk, adequacy projected premiums for expected losses paid, concentration of potential losses in a given region and the possibility of catastrophes. On Long Island, the concentration of homes vulnerable to a single monster storm could easily put an insurance company out of business. A similar condition brought disaster to State Farm in Florida at the time of Hurricane Andrew; although claims were paid by corporate State Farm, a member company of the State Farm group operating in Florida went bankrupt.

Insurers are also at risk on Long Island because the newest catastrophe and meteorological models show that the companies are underfunded for the weather to come. The time between storms has shortened and their likely intensity increased significantly, perhaps due in part to global warming. The premiums available to fund catastrophic events are considerably less than what is required to keep the companies in business should a disastrous storm occur.

Companies are responding in different ways to the forecasts. On the extreme end, Allstate is exiting the market place, leaving at least 20 companies still selling homeowners insurance with various restrictions. Commonly, companies add a “distance to water” prohibition meaning they won’t insure a house that is too close to the shore. Others are simply charging larger premiums for houses on the coast. On the commercial side, St. Paul Travelers has responded with large premiums and high windstorm deductibles in the Long Island region (though not for Manhattan and the Bronx). The Hartford Financial Services Group and other companies use both windstorm and “hurricane” deductibles. A less frequently used tool requires the insured to pay a percentage of the claim after the deductible, which amounts to claim sharing.

Overall the message is: The industry is very concerned about hurricanes.

Consider all the possible losses in a giant storm. Flood insurance is sometimes offered as primary insurance, but more often is not in the homeowner’s policy, as payments for losses are passed through the insurance company from the federal government. But just about anything else that can happen is the insurance company’s responsibility to cover – windstorm, fire damage, explosion, collapse. There is also coverage for indirect losses, such as business interruption and loss of rental income.

So how well the insurance companies protect themselves against catastrophic storms is really a matter of survival for them. The option of increasing capacity by sharing a portion of premium with a reinsurance company that would share in paying out the claims is drying up. The number of reinsurance companies is now less than 20.

As with flooding, historically, the industry has identified types of losses that it deems uninsurable. Examples include unemployment, terrorism, and certain type of pollutants. In these cases, government has stepped in to provide relief to the public. Some types of programs do not lend themselves to government control, such as national health care. An alternative model, as with unemployment insurance, is risk sharing between government and private industry.

The answer to hurricane insurance lies in a partnership between government, the insurance industry and the people. The insurance companies can provide the delivery systems. The government can give the program the financial integrity needed for longevity. Home and business owners would need to accept the concept of cost sharing, which implies that folks that live or operate a business close to the water should pay more for their homeowner or business insurance, either in premiums or in paying a portion of the claims, or both..

The solution requires that neither the industry, the government nor homeowners bear a burden beyond their capacity. An model for this idea is the National Flood Insurance Program. Financial sharing means financial survival.