

After Tornado, Victims Fear Insurers Will Spin Them

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As the nation's insurance adjusters descend on Mississippi and Alabama to assess the damage of last weekend's deadly tornado, one question that worries its victims is whether insurers will try to avoid covering claims related to the disaster.

The tornado, which has already resulted in at least 12 deaths and destroyed nearly 1,000 homes, was given a rating of EF-4, the second highest tornado rating based on damage. Until insurers fully investigate the damage caused, it's not clear how they can avoid paying for it. But if previous disasters are any guide, insurers are adept at finding clever escape clauses.

Five years ago after Hurricane Katrina ravaged the southern coast of the U.S., many insurers denied homeowners' claims because the losses were caused by flooding rather than by wind and rain. (Wind and rain damage were covered, but flooding was not.) As a happy coincidence, many insurers posted record profits that year, thanks to snazzy little deals they made with European-based reinsurers, under which they were covered or reimbursed for their Katrina-related losses.

Similarly, the Eyjafjallajökull volcano in Iceland reportedly caused an estimated \$1.7 billion in collective damages for airlines, but it's not clear how much of that will be covered by insurers. Turns out, most airlines' policies specify that the carriers must cover the cost of canceled flights, while insurers are responsible for damaged equipment.

Moody's, a credit ratings agency, said the financial impact of the volcano on the insurance would likely be muted for a variety of reasons. Agricultural losses probably won't be covered because the concentration of ash in the air is too low. Business interruption claims that result from undelivered packages will likely be denied because the damage must be material to trigger coverage. And airlines and airports probably won't be reimbursed for volcano-related losses since there wasn't any physical damage to their properties.

Increasing the Number of Exclusions

Another way insurers have learned to avoid payment, according to Amy Bach, executive director of

consumer advocacy group United Policyholders, is that they've dramatically increased the number of exclusions in any given homeowners policy. "Homeowners policies used to look like blankets — now they're more like Swiss cheese," Bach says.

Damages that might have been regularly covered even 10 years ago have probably tossed out in the wake of Hurricane Katrina. To make matters worse, the policies are often so confusing that homeowners may not understand their coverage. "Forget about normal people — not even judges can make heads or tails of some of the language in these policies," Bach says.

As for deductibles, Bach says insurers have been known to low-ball the cost of repairs and tell homeowners that the damages aren't high enough to meet deductibles. A homeowner with a \$10,000 deductible, for example, might be told by an insurer's contractor that the cost of replacing a repair is only \$5,000, well below the homeowners deductible. Therefore, the insurer avoids responsibility for covering the repair.

Moving to Percentile Deductibles

Insurers have also increasingly switched policy holders to percentile deductibles as opposed to fixed dollar rates. Someone who might have had to pay a \$500 deductible in the past, might now have to pay a 5% deductible. On a \$25,000 repair, that would mean the homeowner pays significantly more out of their own pocket than they might have with a fixed-dollar deductible.

"It used to be a lot safer to trust insurance companies," says Bach.

But if it's nerve-racking and frustrating for homeowners, it can be challenging for insurers, too. All it takes is one beefy natural disaster to wipe out a decade's worth of premiums, says Insurance Information Institute spokesman Michael Barry.

Private Insurers Wary of Disaster-Prone States

"If you look at states like Alabama, they've had problems getting private sector insurers to write down there since Hurricane Ivan [in 2004]. In disaster-prone states private insurers are reluctant to write there unless regulators let them share more of the risk with the policyholder," says Barry.

Although policyholders in high-risk locations may pay more for coverage and repairs, Barry says the alternative is not having coverage at all. Besides, he doesn't think last weekend's tornado will be nearly as problematic for homeowners or insurers as Hurricane Katrina.

"In many respects policyholders in Mississippi will be covered because this was a wind event," he says. "With Katrina, the issue was that a lot of policyholders weren't covered for flooding damage."