

CFA: Insurers Becoming Experts at Risk-Avoidance

Property Casualty 360

Insurers are shifting the cost of risk to consumers and taxpayers, side stepping their traditional role of risk-takers and becoming experts at risk-avoidance, according to a report from the Consumer Federation of America. The study titled, "The Insurance Industry's Incredible Disappearing Weather Catastrophe Risk," asserts that insurers are shifting the cost of risk away from the industry onto consumers and taxpayers, a point strongly disputed by industry experts. "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," says J. Robert Hunter, director of insurance for the CFA. The report says that some savings insurers have achieved, such as the use of reinsurance, securitization of risk, and other "wise risk diversification strategies" are legitimate. However, insurers are faulted for hollowing out coverage to homeowners "by increasing deductibles and capping the amount they will pay if the home is damaged and destroyed." The CFA also questions rate increases that have been granted "sometimes using questionable computer rate models." Insurers are also criticized in the report for the use of "anti-concurrent causation clauses" that allow insurers to avoid paying a claim for a loss due to wind if there was also flood damage at the same time. These practices have allowed insurers to increase their surplus, even in times when catastrophic loss events should have caused a drop in industry surplus, CFA says. For example, CFA explains that its studies show no noticeable drop in surplus following the four hurricanes that hit Florida in 2004 and Hurricane Katrina in 2005. To underscore the erosion in risk taking, the report says that in 1992, when Hurricane Andrew hit, insured losses accounted for 64 percent of the overall loss. By contrast, insured losses for Hurricane Katrina accounted for 50 percent of overall losses. To remedy this situation, CFA says state regulators need to carefully examine rate requests and review the reasons behind carriers exiting markets. The use of anti-concurrent language should also be banned. Regulators, and not insurers, should determine when a storm is classified as a hurricane in a state. States should also join together to form interstate compacts to share in hurricane risks to provide a pool of policies and to spread risk. At the federal level, CFA calls on the Federal Insurance Office to

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accumulate data similar to what is required of banks under the Home Mortgage Disclosure Act, allowing for detailed analyses of market stress. The federal government should also assist in the formation of the interstate compacts. CFA says insurers should take on risk for both flood and terrorism. The group calls the current system “a huge policy error.” Robert Hartwig, president of the Insurance Information Institute, disputes CFA’s assertions in a statement and notes that the industry paid a cumulative \$408 billion in catastrophe claims between 1990 and 2011. The payout from natural catastrophes grew seven-fold between 1960 and 2010, he says, and has accelerated even more over the last two decades. Hartwig went on to say that the spring tornado season in the United States in 2011, along with severe winter weather and Hurricane Irene, reduced policyholder surplus by more than 3 percent to \$539 billion as of Sept. 30, 2011. He also notes that the approval of hurricane deductibles have allowed for the writing of more private-sector coverage in coastal areas “than would otherwise be the case.” The Heartland Institute—a free-market think tank—declared the CFA’s report “dead wrong.” R.J. Lehmann, deputy director, center of finance, insurance and real estate for the institute, is critical of the CFA’s analysis of surplus because it measures the whole industry and not just homeowners. He further argues that insurers’ primary “responsibility to policyholders is to remain solvent” so it can pay claims. “Given the rampant irresponsible risk-taking we have seen by so many segments of the financial services industry in recent years, [property and casualty] insurers should be commended for taking a responsible approach to parsing and pricing risk appropriately,” he says.