Sandy's Crash Course on Hurricane Deductibles

Fox Business

An insurance industry that has taken its lumps from hurricanes has come to treat them differently. Today, homeowners insurance often comes with special and potentially steeper deductibles that kick in when claims are related to the punishing storms.

Superstorm Sandy recently raised awareness about hurricane insurance deductibles and probably had more than a few homeowners along the East Coast checking their policies, even though — through an odd twist — the higher out-of-pocket costs may not apply this time.

The deductibles were born out of Hurricane Andrew, which crashed into South Florida in 1992 and left insurers holding the bag for more than $15 billion in losses. At the time, it was the costliest hurricane in U.S. history, although Hurricane Katrina now tops that list, according to the Insurance Information Institute, a New York-based trade group.

How Hurricane Deductibles Work

Andrew's legacy means homeowners in 18 coastal states and the District of Columbia may find themselves subject to hurricane deductibles, a second deductible on some home insurance policies that applies only to damage caused by hurricanes and typically runs between 2% and 5% of a home's value.

So say a home is insured for $300,000. A standard homeowners deductible on that house might be a straight $500, meaning the first $500 of the claim is paid out of the policyholder's own pocket. However, a 5% hurricane deductible on that same home would leave the owner on the hook for $15,000 in damages before the insurance takes over, as long as the damage was the direct result of a hurricane as defined by the policy.

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In some states with hurricane deductibles, homeowners may be able to get a traditional dollar-amount deductible by agreeing to pay a higher premium, though in high-risk shore areas, the percentage deductibles may be unavoidable.

No Hurricane Deductibles for Sandy?

In the curious case of Sandy, the fact that the National Weather Service officially downgraded it from a hurricane to a “post-tropical cyclone” just hours before it made landfall near Atlantic City, N.J., could save hard-hit homeowners plenty by failing to trigger the hurricane insurance deductibles.

Sandy’s storm surge and high winds flooded New York City and coastal communities, leaving millions without power and causing an estimated $10 billion to $20 billion in damage. Still, what could become one of the 10 costliest U.S. “hurricanes” on record lacked the sustained wind speeds of 75 miles per hour necessary to even qualify as a hurricane when it hit the East Coast.

Noting Sandy’s diminished status, elected officials in the region declared that homeowners would not be subject to hurricane deductibles.

Eight states New York, New Jersey, Connecticut, Maryland, Delaware, Pennsylvania, Rhode Island and Maine) and the District of Columbia issued no-hurricane-deductibles-for-Sandy decrees. At least one major home insurer, Allstate, has publicly agreed to waive its tropical cyclone and hurricane deductibles in those jurisdictions.

Expert: States Act Within Their Power

Some onlookers may have mistaken the hurricane deductible reprieve as a capricious attempt by elected officials to provide storm relief by meddling with the terms of binding home insurance contracts. But Peter Kochenburger, executive director of the Insurance Law Center at the University of Connecticut, says news reports left out one important detail: Those contracts are already subject to state oversight.

“Insurance contracts have to comply with state laws,” he explains. “This is not political interference; it’s the Department of Insurance doing what it’s supposed to do: regulate insurance.”

But David Bresnahan, client manager for The Horton Group, an Illinois-based insurance brokerage, says

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some insurers may not comply with the order. And some homeowners are finding themselves subject instead to a similar percentage-based “windstorm deductible,” which applies regardless of any hurricane declaration.

“At the end of the day, the carriers are going to make a decision that might be based on underwriting standards, and it might be based on the public relations impact,” Bresnahan says, “But the key for them is, whatever they decide now, they’re going to be setting a precedent. Historically speaking, carriers don’t like to set precedents that make their coverage a lot more liberal because they’re not always sure what’s going to happen down the line.”

Consumer Group is Hopeful

Amy Bach, executive director of United Policyholders, a San Francisco-based insurance consumer group, says insurers would be wise to follow Allstate’s lead and waive hurricane insurance deductibles for Sandy. “Insurance companies should be glad to have this opportunity to get some favorable publicity and just abide by the governors’ declaration,” Bach insists.

In her view, that’s a small price to pay in a storm where many of the claims may be excluded from homeowners policies, either because they involve flooding, which falls under the National Flood Insurance Program, or because they arose from a combination of insured and uninsured perils.

“The real story to me is, these governors know that ??? they’re going to have a lot of very, very upset homeowners who won’t have insurance money coming in to pay for the recovery,” Bach says. “Taking the view that this event was not a hurricane is a very helpful approach.”

She urges homeowners with Sandy-related damage to contact their governor or state insurance commissioner in writing if their home insurer declines to waive their hurricane insurance deductible.

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