



Southwestern Insurance Information Service

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Insurance News

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Energy & Environment

Texas insurers suffer record losses, officials seek climate answers

Hurricanes clobbered Texas insurers last year, draining reserve accounts and igniting a full-blown debate in the Legislature about the state's ability to address rising risks related to climate change.

Two storms besieged the state's curved coastline, including one of the costliest in Texas history, Hurricane Ike. That sent damage claims soaring and resulted in \$6.6 billion in losses for state insurers, which had collected record-high premium revenue totaling \$5.17 billion last year, according to new data released by the Texas Department of Insurance.

The storm strike ended a five-year streak of profits for the industry, and it underscores the uncertainty that insurers and regulators face when setting rates during a time of rising seas, stronger winds and bigger storm surges.

The losses reflect "a very severe weather year for Texas," said Jerry Hagins of the state insurance department. Insurers compare their premium revenue with the claims they have paid. That painted a gloomy picture last year, when they paid about 27 percent more than they collected, according to the state data. The losses calculate even higher when factoring in other costs of doing business, like agent commissions and overhead. The state says that's a "better snapshot" of industry losses, which amount to 65 percent more than revenue.

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"It demonstrates to insurers -- and it should demonstrate to consumers -- that we live in one of the most weather-prone states in the country," said Jerry Johns, president of the Southwestern Insurance Information Service, noting that the state is beset by not only hurricanes but also frequent hail storms. "It is a 12-month cycle of weather-related events."

Inflated climate rates

Texas differs from most states in this way: It allows insurers to raise rates without preapproval from regulators. That has led to high premiums -- and accusations that the industry is justifying them with findings from controversial near-term catastrophe models. The models emphasize increased frequency and severity of hurricanes when predicting damage to homes and businesses.

Alex Winslow, executive director of the consumer group Texas Watch, said the models are "out of balance with the practical reality of the threat."

"The effect of climate change on weather patterns raises very real concerns," he said. "However, we believe that insurers are using the potential for climate change to increase rates more than is necessary."

Now state officials are wrangling over knotty questions related to rates and reducing the state's exploding exposure to storms. One proposal would empower regulators to approve rate increases before they are imposed. Currently, regulators can contest price hikes after the fact.

That change could highlight insurers' reasons behind raising rates, which might be based on the use of near-term models. Other states, like Florida, have prohibited companies from justifying price hikes based on those models, which calculate the probability of storms based on past chunks of years in which there were many. Traditional models consider a picture that is more diluted: the number of storms occurring over the last century or so. Near-term models can result in higher premiums. Many climate change experts say that can help preserve natural coastal barriers, protect human life, and reduce the burden on taxpayers helping to rebuild storm-damaged buildings.

"It might be that the other states have it wrong," Seth Chandler, an insurance law expert at the University of Houston, said of prohibitions against models assuming greater climate risks. "And those other states are going to find themselves in deep trouble when those near-term climate models turn out to be right."

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That's just one climate challenge facing Texas, he said. Rate setting will be a difficult undertaking.

No hurricane needed to drive programs into the red

These are not light questions for Texas. The state had \$895.1 billion in insured coastal property in 2007, putting it third in the nation behind Florida and New York. Much of that is covered by a state-run insurance pool that is backstopped by taxpayers. The account it uses to pay claims has a balance of zero following last year's Hurricanes Ike and Dolly, according to the Texas Windstorm Insurance Association, which manages the pool. But that's not unusual in the coastal United States. State-run insurance programs -- once considered "residual markets" of last resort -- ballooned after private insurers retreated from the shoreline following the ravaging hurricane season of 2005. Exposure in the United States doubled between 2005 and 2007 to \$684 billion. Given the financial collapse and deteriorating credit, these programs are now "more vulnerable," said Claire Wilkinson, a vice president with the Insurance Information Institute.

"It's important to recognize that many [programs] operate at deficits, or from slim positions of surplus, even in years with little or no catastrophe losses," she added.

One proposal in the Texas Legislature would dramatically reduce taxpayers' exposure by cutting the maximum coverage homeowners can obtain. State Rep. John Smithee, an Amarillo Republican and chairman of the House Insurance Committee, wants to slash coverage on new homes from \$1.7 million to \$250,000.

But there might be an easier way to mitigate the impact of climate change, said Johns of the Southwestern Insurance Information Service: enforcing current rules.

The public program requires homes that have been damaged in storms to be hardened under tougher building standards. But there's a loophole. Homeowners can skip the requirement by paying a small surcharge.

"Right now we're just encouraging people to build to the code," Johns said. "There are people that don't."

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