New York Insurance Superintendent: Insurance Companies Should Create Hurricane Reserve Funds

by NAMIC

Insurance companies providing homeowners, business, and other property insurance in New York State would be required to create a catastrophe reserve fund to help pay claims caused by hurricanes and other natural disasters under a new regulation proposed Oct. 4 by the State Insurance Department, Superintendent Eric Dinallo announced.

â€œMost people probably think that the extra money they pay on their homeowners insurance for hurricane protection goes into a â€˜very rainy day fundâ€™ to pay claims when hurricanes hit,â€• Dinallo said. â€œIn fact, because of current insurance accounting and tax rules, if there is no hurricane, the extra money goes to insurance companiesâ€™ profits. That leaves the companies with no reserves to pay huge claims from big hurricanes and consumers angry over ballooning profits and rising premiums.

â€œThere are many proposals to have government take over or subsidize hurricane insurance, as it does with flood insurance,â€• Dinallo said. â€œI believe it is better to find a private sector solution. Thatâ€™s why we are proposing a new state regulation requiring insurance companies to set aside the portion of the premium they now collect for catastrophe protection. This reserve fund will help pay the claims if and when hurricanes and other disasters do hit. Catastrophe reserves will provide increased transparency that will be good for the industry and consumers. Consumers will see where the money they pay for hurricane protection goes. They will see if it is not enough and there is a need for higher premiums. And they will see if the reserve is large and untouched and can then question the need for higher premiums.â€•

Insurance companies set aside reserves to cover claims for incidents that occur in a given year. For example, for auto insurance, a company can set aside what it will pay only for accidents that occur that year. That works with auto accidents because there is predictable historical data on the number of claims every year and the cost of those claims. It makes sense to have the people who drive in a given year share the cost of accidents in that year.

Insurance, then, spreads risk over a large group. No one knows who will have an auto accident or house fire this year, but people are willing to pay a relatively small amount to ensure that whoever does have that loss is protected.

The problem for big catastrophes such as hurricanes is that there is a very small number of very costly events that are spread out over many years. So sharing risk in one year does not work. Effectively spreading the risk of hurricane losses requires not only sharing among many people but also across several years.

Under current accounting and tax rules, insurance companies are discouraged from setting up a reserve to fund losses from events that have not yet occurred, such as those from future hurricanes. Companies can deduct from this yearâ€™s revenues money reserved for claims resulting from events that occur this year. That reduces this yearâ€™s taxes. Statutory accounting considers those reserves an operating expense. But if a company does not know when the event will occur, then money placed in reserve is not considered an expense in the current year by statutory accounting and is subject to federal and state taxes.

â€œIâ€™m in favor of tax-deferred reserves for hurricanes, but the industry will only achieve that change if it acts first and gains credibility,â€• Dinallo said. â€œMeanwhile, we need to start building protection against the potentially huge costs of hurricanes now.â€•

The new reserve would cover losses related to natural catastrophes such as hurricanes, wind, hail, earthquake, winter storms (snow, ice, freezing), or tsunami. The regulation would require companies to reserve the amount they now charge policyholders for catastrophe protection, less any taxes paid and the cost of reinsurance.

â€œI believe a hurricane reserve fund is an important part of the solution. But I am happy to start a discussion with insurance companies, consumers, and legislators about possible improvements to this proposed regulation and to develop other ideas. A decision to do nothing would be a bad decision. The current system doesnâ€™t work for companies or consumers,â€• Dinallo said.

The Insurance Department is conducting outreach by circulating a working draft of the proposed regulation to the insurance industry and consumers. It will then go through the formal proposal process, which includes publication in the New York State Register and a formal 45-day comment period for written comments.

Source: New York State Insurance Department news release