States Shed Reinsurance and 'Run Naked' Through Storm Risks

by The-New-York-Times

Several states prone to natural disasters are measuring the odds on a mega-bet. Concerned observers say those calculations are based on "Lady Luck" and "rolling the dice."

Public insurance programs in some coastal states are flirting with the notion of saving millions of dollars every year by shrinking or canceling the coverage they buy from private reinsurers -- the deep-pocketed companies that insure insurers whose exposure to loss exceeds the budgets of some nations.

States are the insurers in this case. And they are either tired of paying piles of cash for reinsurance policies that are rarely needed, or too broke financially to maintain coverage that has saved state residents from paying billions in hurricane damage claims. In the parlance of the insurance business, without coverage or a hedge against their expensive risks, they are "running naked."

Here's the bet: Save hundreds of millions with no disaster, or pay perhaps billions with one.

"It's actively discussed every year," John Golembeski, president of Massachusetts' public insurance program, said of discontinuing the state's reinsurance policy. The price this year was $80 million. In return, the reinsurer promises to pay $900 million in claims if a storm sweeps ashore.

Golembeski makes sure those decisions, made by money-counting legislators, are accompanied by a weather warning: "We don't know when it's going to hit."

Texas wins big, then rolls the dice

Other states are more muscular in their movement away from reinsurance. Texas let its policy die at the end of May, less than a year after reinsurers paid $1.5 billion in claims related to Hurricane Ike. That's not a bad return on the state's investment. Texans paid $180 million for the policy.

Texas will buck this hurricane season with no reinsurance.

California is also looking to reduce its coverage. The state's public earthquake insurance program has paid $2.3 billion total for reinsurance since 1997 -- almost half of all its revenue. In return, it has collected $250,000 in claims. California wants to save its money and pay the claims on its own.

"Forty percent of all that California policyholders have paid in for their [earthquake] coverage, we've paid out the door by way of reinsurance premium," explained Glenn Pomeroy, president of the California Earthquake Authority. "It's time to reduce our heavy reliance on reinsurance."

It's a challenging time for state insurance programs. They are designed to be a safety valve, providing last-gasp coverage to residents who can't find -- or afford -- private catastrophe insurance. But the punishing hurricane seasons in 2004 and 2005 helped redefine these programs.

Premiums rise, and states hunt for alternatives

Private insurers gasped at the rising number of storms and destruction inflicted on the United States beginning in the mid-1990s. Scientists, meanwhile, began warning of stronger hurricanes spurred by rising temperatures related to greenhouse gases. Insurers reduced their exposure by vanishing from risky coastlines and raising rates. Policyholders crowded into the public programs, elevating the states' financial risk.

In turn, reinsurers responded to the rising risk of loss by charging states more. At the end of this June, premiums were up 15 percent from a year ago, according to the brokerage firm Guy Carpenter & Co. LLC.

That is vexing state insurance programs. And some of them hope the federal government will replace private reinsurers.

Four states -- California, Florida, Louisiana and Texas -- are pushing Congress to pass a bill that would make the federal government a co-signer for states that borrow money to pay damage claims after natural catastrophes.

That would mean the states could replace reinsurance with debt. The savings might be big. Millions normally paid for reinsurance could be stashed away into reserve accounts, used later to pay claims and service loans.

Debt payers 'aren't even born'

It could also backfire. One major storm could strap a state with debt for decades. Policyholders would have to pay it back through fees on all sorts of insurance policies, from auto coverage to inland property insurance.

"It's typical of governments today to not be willing to make the hard decisions that are necessary to face up to the true risks and the true costs of the policies that they've undertaken," said Robert Hartwig, president of the Insurance Information Institute, an industry group.

"Most of the people who will be paying that [debt] aren't homeowners, probably aren't Florida residents right now, and some aren't even born," he added, noting that those states would be "rolling the dice."

Critics warn that Texas, and perhaps other states, is following in the path of Florida. Residents there are paying fees, also called assessments, on every type of insurance policy except workers' compensation and medical malpractice from past hurricanes.

Florida hasn't had private reinsurance for years. Instead, it has a public program to reinsure its public insurance program. The Florida Hurricane Catastrophe Fund, the public reinsurance program, has failed to issue enough bonds needed to cover its exposure.

Washington's signature guaranteeing those loans would make it easier. It would also provide a more attractive interest rate. Florida's insurance commissioner, Kevin McCarty, has been pushing the legislation, introduced by Sen. Bill Nelson (D-Fla.), among members of Congress and other states.

"It's going to be a difficult lift," McCarty acknowledged. "We're competing with national health care, systemic risk and a number of other things that President Obama has on his agenda."

If the federal legislation passes, it could prompt more states to create their own reinsurance funds to save up-front money on the cost of private reinsurance.

"That would make it politically much easier for us to step up and do something like this at the state level," said Massachusetts state Sen. Robert O'Leary (D), a longtime supporter of a state fund.