SCIENTIFIC AMERICAN.COM

August 01, 2007

Insurers Claim Global Warming Makes Some Regions Too Hot to Handle

As the nation braces for an active hurricane season, private insurers jump ship, leaving federal and state governments liable for ever increasing payouts

By Victoria Schlesinger and Meredith Knight

In the wake of skyrocketing insurance claims due to natural disasters—hurricanes, wildfires, droughts, blizzards and the like—insurers have been imposing steep rate hikes and, in some cases, fleeing high-risk areas, leaving consumers out in the cold. It's gotten so out of hand, consumer advocates say, that insurers now are even crying climate change as a factor in raising premiums or dumping clients.

As the crisis mounts, hard hit states such as Florida and Louisiana are increasingly stepping up as insurance companies check out, providing coverage for residents dropped by their insurers. And signs are things will get worse before they get better: The National Oceanic and Atmospheric Administration (NOAA) is predicting that this year's hurricane season—which officially began June 1—will be "very active," with three to five major hurricanes in the Atlantic.

Weather-related insurance losses rose to $50 billion in 2005 from less than $10 billion a decade earlier, according to a study by Ceres, a Boston-based nonprofit group that lobbies corporations to be environmentally responsible. The bulk of these losses can be attributed to sprawl in regions prone to catastrophe—the total area of coastal development in Florida has increased over 30 percent since 1990.

A Warmer Earth, and Fewer Insured

Private insurers also point fingers at a changing climate, citing a report issued by the Intergovernmental Panel on Climate Change (IPCC) earlier this year that concluded global warming is to blame for a doubling over the past five years of natural disasters—and that the situation will worsen if nothing is done to stop it. (The often-touted link between climate change and increased hurricane strength, however, has yet to be firmly established.)

"If circumstances change due to global warming that alter the level of risk, insurance companies need to be free to reflect that risk," says David Snyder, vice president and assistant general counsel for the American Insurance Association (AIA). "The reality is that in some places the risk is so severe that [these locations] are uninsurable."

Over the past year alone, insurance companies have dramatically raised homeowners' annual premiums in parts of Texas, Louisiana, the Carolinas, Massachusetts and New York State. In the Florida Keys, for instance, windstorm insurance rates for a 1,900-square-foot home in Monroe County soared from $3,000 in 2004 to nearly $16,000 in 2007. In South Carolina private companies have stopped insuring homes valued at less than $500,000. In Rhode Island some agencies have refused to cover any coastal properties. Allstate, one of the largest residential property insurers on the east coast, elected not to renew 30,000 policies covering coastal properties in New York City, Long Island, Westchester County and Connecticut, and is considering reducing coastal area coverage in Massachusetts and along the Gulf.

Predictable Risk or Idle Speculation?

Consumers are up in arms about these trends. "I think [insurance companies] are speculating on the fear of global warming and using it as an opportunity to raise rates," says Bill Newton, executive director of the Florida Consumer Action Network.

In the past, when private industry backed away from ventures it deemed too risky, the state and federal government often picked up the slack. The best examples are flood and crop insurance, which are now largely federally funded.

"There's a continuum between public and private risk sharing, formally and informally. They play off one another and it's like a tug of rope almost," says Evan Mills, an environmental and energy systems scientist at Lawrence Berkeley National Laboratory in California.

The Federal Government began the National Flood Insurance Program (NFIP) in 1968 to counter the chronically high premiums for water damage and to cover consumers who either could not afford or were turned down for flood coverage by private companies. Since its inception, NFIP, which has typically run at a loss, has become the country's primary provider of flood insurance. For instance, in 2005 and 2006 NFIP requested and was granted a $24 billion in loans from the U.S. treasury to reimburse Gulf Coast customers for losses caused by Hurricane Katrina. Mills says that it is unlikely NFIP will ever be able to pay back the loan, given that it pulls in an average of only about $2 billion a year in premiums from consumers.

Florida, Texas, Louisiana and Massachusetts have followed the example of the federal government and started their own insurance operations. Florida's state-funded Citizens Property Insurance has underwritten more than 1.3 million policies since its start in 2002. Some states have also taken steps to minimize the losses of private insurers.

In January, for instance, Florida Gov. Charlie Crist signed into law regulations that cap insurance company losses at roughly $23 billion annually. Under the measure, the state will cover all claims in excess of the limit.

The state "made the very calculated decision to act as a reinsurance carrier," says state Rep. Janet Long (D), a member of the Committee on Insurance and cosponsor of the legislation. "As long as we go along for a few years and we don't have any major catastrophic losses, this positions the state financially very well."

Who's to Blame

To avoid price gouging, consumer advocate Newton and scientist Mills urge insurance companies to be transparent about the models they use for setting premiums—specifically how they factor in catastrophes believed to have been brought on by climate change. "We're looking at the global warming surcharge and asking them to back it up," Newton says. There are currently no state or federal laws requiring that companies provide this information.

Industry representative Snyder dismisses the notion of a "global warming surcharge." "What insurers are doing," he says, "is pricing as accurately as they can for the risk, which seems to be increasing significantly, from whatever cause, leading to more intense and greater numbers of serious storms."

Mills stresses that there is a lot more going into premium increases than just new models that factor in climate change, including population increases along the coast, deterioration of infrastructure such as levies, and destruction of naturally protective wetlands. "Even if climate change wasn't happening," he says, "we'd be expecting insurance losses to be going up."

Mills predicts that more states will get into the insurance game as their denizens are deemed "uninsurable" by private industry. "It certainly comes back to the taxpayer in the end," he notes.

Snyder says the long-term solution is to try to limit property damage by improving land use and enforcing building codes already on the books. In this respect, insurance companies have a role as advocates for preventive measures that decrease consumers', and, therefore, insurers' liability. (One of the ways insurers have accomplished this in the past, for instance, was to push for greater motor vehicle safety.) By this logic, a government spurred to action by citizens and private industry can enforce smart development rather than becoming an insurer.

According to Mills, the bottom line is that in the aftermath of hurricanes Katrina and Rita, private insurers have been dropping coverage and hiking rates, leaving states and consumers holding the bag.

Rep. Long echoed that sentiment. "We're working very hard to try and level out, to try and give people some breathing room," she says, "but I can tell you that over the long haul it's going to continue to be a major issue, finding affordable coverage for Floridians, because we live in a volatile part of the world."

The same could be said for every other U.S. citizen who is lucky, or unlucky, enough to live on or near the water.