

Tough Love

EVERYBODY TALKS ABOUT THE WEATHER, but nobody ever does anything about it. Except actuaries. They decide what people have to pay to insure against the effects of disastrous weather and determine how much insurance companies need to set aside to pay the resulting claims—without putting the companies out of business.

When the topic switches to insurance companies, it's usually to complain about how high the rates are, how unfair insurers are, and how much money they make at the expense of just about everybody.

This issue of *Contingencies* is about risk management and actuaries. (See stories on pages 24 and 34.) It was being put together just as Hurricane Katrina was taking apart New Orleans and the Gulf Coasts of Mississippi and Alabama. This article was being written as Hurricane Rita smacked down on Texas. And the season still isn't over yet.

Fortunately, the issue of how well federal and local governments managed the risk of two impending Category 5 storms isn't up to the actuaries. What is up to the actuaries is how well their companies managed that risk.

According to Chris Guidette at the Insurance Services Office in New Jersey, the industry as a whole seems to have managed it pretty well, with more than enough reserves to weather both storms. (How individual companies will fare, only time will tell.)

The real crunch will come when insurers have to separate wind and rain losses from flood losses.

"Flood losses aren't covered by commercial or personal property insurance sold on the voluntary market," says Guidette. "You have to buy separate flood coverage, which is underwritten by the federal government with commercial companies acting as fronting agents. Adjusters, policyholders, and carriers will have to decide whether water losses are covered under catastrophic coverage contained in the property policy or not. The flood-catastrophe question could become a hotly contested issue."

One Mississippi congressman has introduced legislation that would make flood coverage retroactive for homeowners affected by "Katrina." Even consumer advocate J. Robert Hunter doesn't think that's such a good idea. But according to a Sept. 21 editorial in the *Washington Post*, the federal flood insurance program does virtually the same thing anyway. Why buy flood insurance when you already know the government will bail you out? Not only that, but it'll pay you to rebuild in exactly the same flood-prone place.

"We've created trillions of dollars of 'insurance guzzlers' on beaches and earthquake faults through state rate suppression, residual markets, cat funds, and the federal flood program," says Rade Musulin, vice president and actuary with the Florida Farm Bureau Insurance Co. "People living in those property Hummers expect that they have a right to rebuild and continue getting their \$1.299 premium insurance.

"The problem is that rate suppression and residual markets can only hide this elephant for so long, and eventually we have to pay billions and billions to finance that right to rebuild. Eventually, the cost of the disasters will result in fewer schools being built, inflation, or other ills.

"We're going to have to take many painful steps to address this problem, including charging a lot more for insurance and depopulating high-risk areas. We have to tell people that if they get paid off one time and if their damage is more than 50 percent, they get a cash settlement and they cannot rebuild."

Actuaries aren't politicians. Long before the storm hits, they're the ones who have to make the tough choices, the unpopular choices. And, as long as the insurance companies are still there to hand out the checks, the right choices. ●



EDITOR

Contingencies

Volume 17 / Number 6

PUBLISHED BY THE AMERICAN ACADEMY OF ACTUARIES

PRESIDENT
Robert E. Wilcox

EXECUTIVE DIRECTOR
Kevin Cronin

DIRECTOR OF COMMUNICATIONS
Noel Card

EDITOR AND ASSISTANT DIRECTOR FOR PUBLICATIONS
Steven Sullivan

PUBLICATIONS AND MARKETING PRODUCTION MANAGER
Joe Vallina

ADVERTISING
Mohanna & Associates

DEPARTMENT EDITORS
Thomas L. Bakos
Sam Gutterman
Yan Fridman
Richard T. Zatorski

PUBLICATION DESIGN & PRODUCTION
BonoTom Studio, Inc.

EDITORIAL ADVISORY BOARD
Julia T. Phillips, Chair
Dwight K. Bartlett III
Robert L. Brown
Frederick W. Kilbourne
Barbara J. Lautzenheiser
Bruce D. Schobel
Susan E. Witcraft

INTERNET ADDRESS
www.contingencies.org

Contingencies (ISSN 1048-9851) is published bimonthly by the American Academy of Actuaries, 1100 Seventeenth Street, NW, Seventh Floor, Washington, DC 20036. For subscription information and customer service, contact the *Contingencies* Subscription Department at the address above or (202) 223-8196. Advertising offices: Mohanna & Associates, Inc., (972) 596-8777, dawnette@mohanna.com. Periodicals postage paid at Washington, DC, and at additional mailing offices. BPA circulation audited. (Basic annual subscription rate is included in dues. Nonmember rate is \$24.)

Copyright 2005. All rights reserved. This magazine may not be reproduced in whole or in part without written permission of the publisher. Opinions expressed in signed articles are those of the authors and do not necessarily reflect official policy of the American Academy of Actuaries.

Postmaster: Please send change-of-address notices for *Contingencies* to PMG Data, P.O. Box 7225, Bensenville, IL 60106-7225.

