Insurance Claims Payment Processes in the Gulf Coast after the 2005 Hurricanes

Written Testimony of

Robert P. Hartwig, Ph.D., CPCU

President & Chief Economist

Insurance Information Institute

New York, NY

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Tel: (212) 346-5520
Email: bobh@iii.org
www.iii.org

Good afternoon Mr. Chairman and members of the Committee. Thank you for the opportunity to discuss the important and vital role played by the insurance industry in the response, rebuilding and recovery effort following Hurricane Katrina.

My name is Robert Hartwig and I am President and Chief Economist for the Insurance Information Institute, an insurance trade association based in New York City whose primary mission is to improve the public's understanding of insurance: what it does and how it works. Our members consist of insurers and reinsurers that operate on a global scale and account for more than 60% of the premiums written in the United States.

Hurricane Katrina was the largest, most expensive disaster in the history of insurance. Claims payments to restore homes, businesses and vehicle losses totaled $40.6 billion on some 1.74 million claims filed by policyholders across six states. For all of 2005, insured losses from all hurricanes reached $57.1 billion arising from 3.3 million claims **[Figure 1]**. It is a remarkable fact that seven of the ten most expensive hurricanes ever to strike the United States occurred in the 14 month interval from August 2004 through October 2005 **[Figure 2]**.

These staggering numbers illustrate the magnitude of the threat posed by hurricanes to people who live in coastal regions, the financial resilience of the insurance industry and the economy of the United States.

The enormous challenge posed to the nation by natural catastrophes calls on all of us to address it with reason, not rancor; facts, not fiction and as partners, not partisans.

My testimony today will address four major issues:

- The insurer response to Hurricane Katrina and the key role of insurance in helping homeowners, businesses and communities recover from disasters;
- The lessons learned from that extraordinary and tragic event;
- The enhancements that have been made to insurer catastrophe response capability based on those lessons; and

- The current regulatory, legislative, and litigation-related obstacles that are raising costs and reducing choices for consumers.

Insurance Industry Response to Hurricane Katrina

As we know, the devastation wrought by these catastrophic hurricanes was unprecedented. So too was the industry's response. Some 15,000 adjusters were called in from across the country. These men and women worked tirelessly day and night for months throughout the 1,400 mile arc from the Florida Keys to East Texas, often in difficult and dangerous conditions.

For many property owners, insurance adjusters and the checks they cut on the spot were the first tangible signs of relief they had seen. Millions of American families and businesses devastated by the storms of 2004 and 2005 are back on their feet today because of the more than $80 billion paid to them by their insurance companies.

Insurers are justifiably proud of their performance in both 2004 and 2005. As of the first anniversary of Katrina in August 2006, more than 95 percent of the 1.1 million homeowner's claims in both Mississippi and Louisiana had been settled, with fewer than 2 percent of such claims in dispute **[Figure 3]**. Approximately half of this small proportion of overall claims sought redress through no-cost mediation programs established by insurance departments in both Louisiana and Mississippi. Both programs report that approximately 80 percent of cases heard are resolved successfully. Across the Gulf, only a tiny fraction—well under one percent—of homeowners claims have been litigated.

Claims adjustment is a highly systematic process. Indeed, a recent Louisiana Department of Insurance examination of a leading insurer found that its claims adjustment process was neither "arbitrary" nor "capricious" and that in the small number of cases when delays did occur they were due to "severe problems, impediments, roadblocks and hindrances" caused by the storms.

Adjusters work diligently to accurately assess the extent and cause of loss associated with each claim. If some damage is the result of an excluded cause of loss, such as flooding, the adjuster will apportion the loss accordingly, with the insurer paying the share of the losses covered under the terms of the policy purchased by the property owner. If the property owner also has a flood insurance policy issued through the National Flood Insurance Program (NFIP), then the share of losses that are attributable to flood damage (including storm surge), will be paid through the NFIP, subject to policy limits. The NFIP conducts routine audits of flood claims (including claims practices) and has the authority to audit and challenge any claim at any time.[1] The partnership between the NFIP and private insurers has worked smoothly for many years, providing families and businesses with the funds they need to recover more quickly, efficiently and with greater consistency than if the claims were adjusted separately.

Consumers also are protected in every state by "unfair claims practices" statutes that grant state insurance regulators the authority to investigate and penalize insurance companies that refuse to pay valid claims. There are also consumer protection laws in every state, and these apply to insurance transactions as well. Finally, state courts provide a judicial remedy for contract violations and for torts committed by insurers.

Insurance companies strive to settle claims without any disputes with their customers. And the record is clear that in the overwhelming number of cases, that is exactly what happens. They are settled by adjusters with policyholders at the scene without the involvement of attorneys or engineers in a courtroom.

Lessons Learned from Katrina

As I noted, Hurricane Katrina was a storm without precedent in scale or scope, occurring amid a hurricane season that itself was without precedent. By definition, unprecedented events offer lessons to all those affected. Katrina was no different—with hard lessons learned by coastal residents, government at all levels and insurers alike.

[1] Per 44 CFR 62.23(j)(2), Write-Your-Own (WYO) companies (insurers that offer NFIP flood coverage on behalf of the NFIP) are subject to operational reviews (including claims practices) at least every 3 years. In addition, FEMA also engages in routine claim reinspections on an ongoing basis, conducting a larger number of claim reinspections in the wake of large loss events. WYOs understand that any claim can be reviewed by FEMA at any time.

But the lessons of Katrina and the unparalleled destruction of the 2004 and 2005 hurricane seasons also include a very stark reminder—that living along the hurricane-exposed coastline of the United States is an increasingly risky proposition. Meteorologists predict that the number and intensity of hurricanes will remain at elevated levels for the next 15 to 20 years, even before accounting for any possible effects associated with global climate change.

From an insurance perspective the reality of a long-term crescendo of risk is a paramount concern. Key risk-related lessons revealed in the aftermath of Katrina include the following:

- Many, if not most, coastal structures in the United States today are insufficiently well constructed to withstand the forces of a major hurricane, either in terms of wind or flooding;
- Flood insurance penetration rates are woefully inadequate. In parts of coastal Mississippi, for example, fewer than 20 percent of dwellings were insured against flood. By contrast, upwards of 60 to 80 percent of homes in some Louisiana parishes had flood coverage; **[See Figures 4, 5 and 6]**
- The risk and related cost associated with offering insurance in hurricane-prone areas will continue to escalate as coastal populations continue to soar in many hurricane exposed areas and more and more vulnerable areas are opened to development. The state of Florida's population, for example, has increased by 80 percent since 1980 while the dollar value of insured coastal property now exceeds $2 trillion and is growing by some 10 percent per year. In North Carolina, the population of highly vulnerable Dare County, for example, has grown by more than 400 percent since 1960 and Brunswick County has grown by more than 300 percent. The value of hurricane exposed property along the state's 300 miles of coastline now stands in excess of $100 billion **[Figure 7]**.

There are other lessons, of course, related to the logistics of responding to large-scale events like Hurricane Katrina and I will address those shortly. But one of the most important of all lessons driven home by Hurricane Katrina and the $80 billion in combined losses from the storms of 2004 and 2005 is also one of the least discussed. That lesson is that only an insurance industry that is financially strong, sound and secure can deliver the financial relief necessary to help communities recover from major catastrophic events.

Insurance is by far the fastest, most efficient means of recovery for communities affected by disasters large and small. Unfortunately, the operating environment that allows insurers to pay sudden and extreme losses like Hurricane Katrina is now under siege in several states. Punitive, burdensome legislation and regulation accompanied by a surge in litigation is already driving-up costs and reducing choices for consumers. Worse still, these measures do nothing to reduce the actual risk faced by people living in harm's way. Put simply, neither laws nor lawsuits can diminish the real, formidable risk associated with catastrophic hurricanes or any other type of disaster. This is critical point I will return to later in my testimony.

Enhancements to Catastrophe Response Post-Katrina

Hurricane Katrina and the other storms of 2004 and 2005 provided insurers with valuable insights into loss reduction, mitigation and catastrophe response. The insurance industry's decades-long support of tougher building codes and mitigation technologies, for example, bore fruit throughout the Gulf Coast, with homes built to industry-supported standards faring far better than structures built to less stringent standards. Insurers will continue to invest millions of dollars annually through organizations such as the Institute for Business and Home Safety in order to fund additional research that will save lives and reduce property damage from future disasters.

The enormity of destruction associated with Hurricane Katrina produced response challenges to every agency and organization involved. The destruction of infrastructure hampered travel and communications throughout the affected areas, not only for residents, but for insurance agents and adjusters as well. There was often little or no gas for adjuster vehicles, no lodging and no food. In some cases, adjusters were not allowed into the most devastated areas for an extended period of time by government authorities because of ongoing search and rescue operations or because the adjusters' health and safety could not be assured. In other instances the policyholders themselves could not be located despite every effort to do so. All of these factors slowed normal response times. Traditionally, insurers target the most badly damaged areas first, but in the case of Katrina the level of destruction denied them that opportunity.

Recognizing that speed of payments was critical, insurers issued advance payments to tens of thousands of policyholders even before having the opportunity to physically inspect the property, guided in some cases by aerial and satellite photography. In the end, despite a gauntlet of obstacles, the hundreds of thousands of claims filed were adjusted fairly and expeditiously and billions were paid to homeowners and businesses throughout the devastated region. These payments were usually the first to reach home and business owners, helping to stabilize local economies and enabling the rebuilding and recovery process.

Since Katrina, insurers have complemented their existing investments in catastrophe response with a variety of new and enhanced capabilities. Increased use of GPS-linked technologies, for example, help insurers identify insured properties even when the property has been reduced to rubble and the property owner cannot be located. Insurers are also reducing and in some cases eliminating completely paper files, so that customer service functions can be performed anywhere in the country. Some insurers have purchased additional catastrophe response vehicles. Many also now conduct pre-event surveys of business policyholders to make sure they're prepared before a storm hits. The Insurance Information Institute has even produced free, home inventory software available for download at www.iii.org, that allows homeowners to create an electronic archive of their possessions and then email that file to a location that is out of harm's way **[Figure 8]**.

Looking ahead, insurers must operate under the assumption that Hurricane Katrina and indeed the entire 2004/2005 hurricane seasons were not aberrations. If history is any guide, a disaster that will dwarf hurricane Katrina may be just a few months to a few years away. A repeat of the Great Miami Hurricane of 1926, for example, would today produce insured losses in the $80 billion to $100 billion range. The 2007 hurricane season begins just three months from tomorrow and forecasters expect activity in the North Atlantic Basin to be 40 percent above average with elevated landfall probabilities for Category 3, 4 and 5 hurricanes along the entire East and Gulf Coasts **[Figures 9 and 10]**.

Insurers remain dedicated to providing the best claims service possible to their customers. To meet this objective, insurers after each major disaster engage in a post-disaster review process to identify successes and streamlining opportunities. One problem reported by many insurers in the wake of Katrina involved enormous amounts of bureaucratic red tape that slowed down the adjusting and rebuilding process. These delays also create opportunities for desperate people to be scammed by unscrupulous contractors and other fraud artists. Red tape exists at numerous levels, including the following:

- **Access to Disaster Zones:** At the local level, each community makes its own decisions as to when adjusters can enter affected areas, leading to an appreciable slowdown in insurer response. Insurers urge FEMA to implement procedures in conjunction with state and local officials so that properly credentialed adjusters can move quickly throughout disaster areas.
- **Adjuster Licensing:** At the state level, delays in the licensing of adjusters who are brought in from out of state are a major concern. Insurers urge state departments of insurance to establish fast-track licensing or registration procedures to accommodate these adjusters.
- **Contractor, Engineer, Architect and Building Inspector Licensing:** Hurricane Katrina demonstrated that in-state construction companies cannot handle the rebuilding or even temporary repairs needed for homes and businesses following a catastrophic hurricane. Out-of-state contractors as well as engineers, architects and building inspectors are needed. Insurers urge state agencies to establish

expedited licensing procedures for out-of-state contractors, engineers, architects and building inspectors that are properly licensed and insured in their home states.

Regulatory, Legislative and Litigation-Related Obstacles to Insurer Operations

A state's regulatory, legislative, and tort environment establish the parameters under which insurers operate and compete. The requirements for competitive insurance markets are modest, centering primarily on the ability to (i) price policies that reflect the actual risk or cost; (ii) a judicial system that upholds contract language in policies which have been approved by state insurance regulators, and (iii) a regulatory and legislative environment that is supportive of both requirements.

In most states and for most types of insurance, insurance markets are highly competitive, with dozens of insurers competing for the business of auto, home and commercial policyholders. Indeed the cost of auto, home and business insurance is actually *declining* today. Recently, however, regulatory and legislative actions and proposals in a number of states and proposed legislation at the federal level threaten to stifle competition thereby increasing costs for insurers and reducing choices for consumers.

Florida's recent legislative changes illustrate this point. Leading insurance rating agency A.M. Best just this past Friday (February 23) issued the following ominous statement about recent legislative changes in the state: *"A.M. Best views the recent legislative changes as weakening the business profile of companies with significant concentration of Florida business*."

In other words, insurers with significant exposure to hurricane risk in the state could see their financial strength ratings downgraded, potentially impairing their ability to operate nationwide. The only way for the insurers to maintain their ratings is to increase rates or non-renew current policyholders. Infusing additional capital could also preserve the insurer's rating, but such an infusion would be tantamount to throwing good money after bad.

That's because the recent actions in Florida also cancelled even previously approved rate changes even though the state's homeowners insurers are already more than $10 billion in the red since 1992.

Mississippi is another example, with its homeowners insurance market in a freefall, especially in the state's southern tier of counties. Operating in coastal Mississippi is an extremely risky proposition. The state has been the target of some of the most destructive storms in history, including mega-storms like Hurricanes Camille and Katrina.

Claims from Katrina in Mississippi alone totaled $13.6 billion. Homeowners insurance losses in the state wiped out approximately 17 years worth of premiums and every dime of profits those insurers had ever earned in the history of the state. In Louisiana, the $10.9 billion dollars in insured homeowners losses were equivalent to 25 years worth of premiums.

Expectations of an increase in the number and intensity of storms for the next 15 to 20 years compound the risk. These factors mean that property insurance in coastal Mississippi is relatively expensive—but it has nevertheless generally been regarded as a *priceable* risk. It is the actions of men, more than nature, which have crippled the market for insurance in Mississippi.

As I have pointed out, the number of lawsuits suits is very small relative to the total number of claims filed. However, they have an inordinate impact on the health of the marketplace. The litigation in Mississippi, initiated just 17 days after Katrina by the Mississippi Attorney General's Office, followed by civil actions from trial lawyers and compounded by court decisions that have retroactively rewritten the terms of regulator-approved insurance contracts, constitute an *unpriceable* risk. Litigation has pushed uncertainty past the tipping point, leaving insurers with no alternative but to reduce their presence in the state. Litigation in Louisiana is threatening to impair insurers' ability to operate in that state as well.

Remarkably, litigiousness in Mississippi may have accomplished what Katrina did not—delivery of a potentially lethal blow of uncertainty to the viability of a private homeowners insurance market in the state. Today, the only choice for an increasing number of Mississippi homeowners is the state-run insurer of last resort, which itself went broke in 2005, forcing it to make an initial rate hike request of nearly 400 percent.

Summary

The record $41 billion insurers paid by more than 100 insurers and their reinsurers to more than 1.7 million Hurricane Katrina victims and the $80 billion paid to 5.5 million policyholders over the course of the 2004/2005 hurricane seasons are vivid and tangible demonstrations of the vital and important role played by insurers in helping families, businesses and entire communities recover the devastation wrought by major disasters.

The unprecedented nature of Katrina obligated all institutions to review preparation and response to large scale disasters. Insurers, like other affected industries and every level of government, have refined and enhanced their disaster response capabilities based not only on the lessons of Katrina, but also by aggressively integrating new technologies designed to streamline the disaster response process. Insurers are also partnering with local, state and federal agencies to cut the bureaucratic red tape that unnecessarily increases response times and leaves disaster victims vulnerable to fraud.

Unfortunately, today, the modest pre-conditions that give rise to competitive insurance markets are being eroded away in a number of states, forcing the price of insurance up and reducing choices for consumers. States such as Florida have abandoned the fundamental concept of risk-based pricing while in Mississippi the tort system has been used to require insurers to pay potentially hundreds of millions of dollars in flood losses—a type of loss for which they have never received a penny in premium.

Courts' reluctance to enforce regulator approved contracts and the associated swarm of lawsuits has increased uncertainty to intolerable levels, effectively destroying insurers' ability to price risk accurately and leaving with few alternatives other than to reduce their exposure to the state.

To conclude, the insurance industry is committed to working in partnership with public policymakers, consumers and business in developing fact-based solutions to the formidable challenge posed by Hurricane Katrina and the other disasters and continuing our tradition of helping families, businesses and communities wherever and whenever disaster strikes.

Thank you for the opportunity to address the Committee today. I would be happy to address any questions you might have.

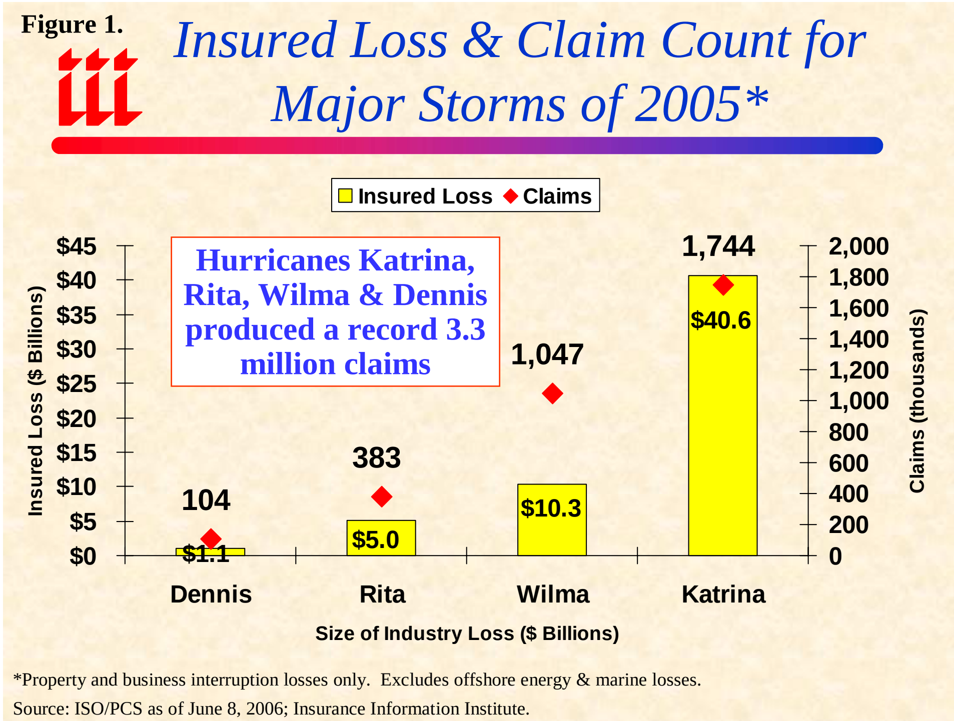


Figure 1.
Insured Loss & Claim Count for Major Storms of 2005*
Insured Loss
Claims
Hurricanes Katrina, Rita, Wilma & Dennis produced a record 3.3 million claims
$45
$40
$35
$30
$25
$20
$15
$10
$5
$0
Insured Loss ($ Billions)
2,000
1,800
1,600
1,400
1,200
1,000
800
600
400
200
0
Claims (thousands)
104
$1.1
383
$5.0
1,047
$10.3
1,744
$40.6
Dennis
Rita
Wilma
Katrina
Size of Industry Loss ($ Billions)
*Property and business interruption losses only. Excludes offshore energy & marine losses.
Source: ISO/PCS as of June 8, 2006; Insurance Information Institute.

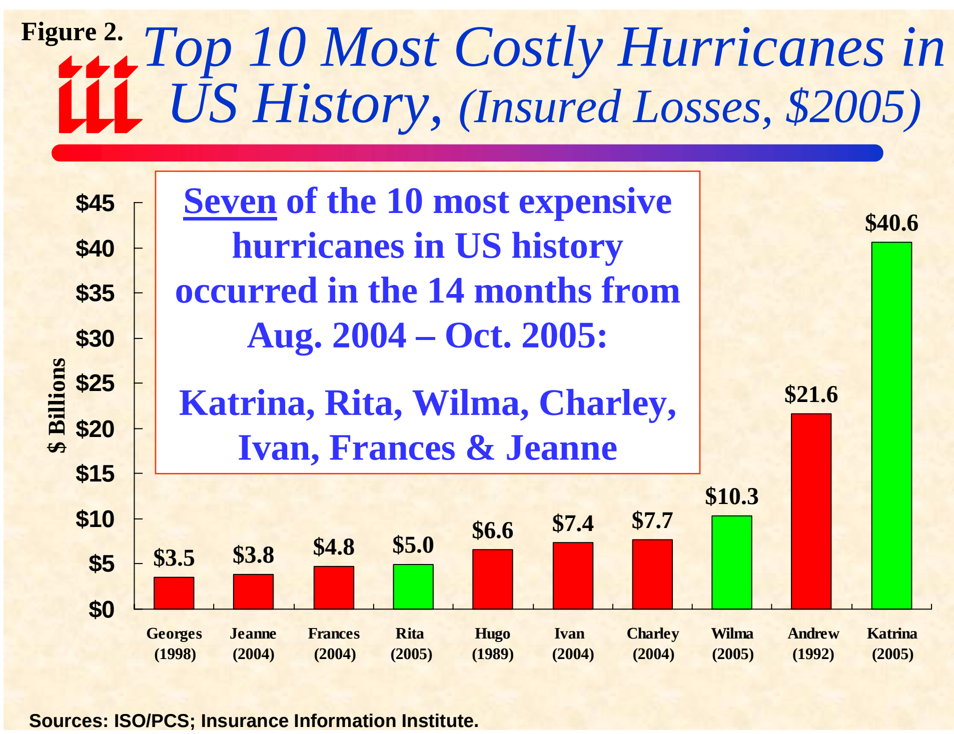
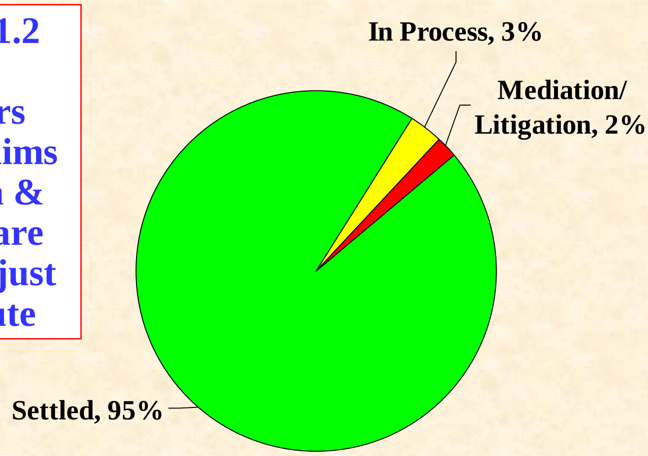


Figure 2.
Top 10 Most Costly Hurricanes in US History, (Insured Losses, $2005)
Seven of the 10 most expensive hurricanes in US history occurred in the 14 months from Aug. 2004 – Oct. 2005:
Katrina, Rita, Wilma, Charley, Ivan, Frances & Jeanne
$ Billions
$45
$40
$35
$30
$25
$20
$15
$10
$5
$0
$3.5
$3.8
$4.8
$5.0
$6.6
$7.4
$7.7
$10.3
$21.6
$40.6
Georges (1998)
Jeanne (2004)
Frances (2004)
Rita (2005)
Hugo (1989)
Ivan (2004)
Charley (2004)
Wilma (2005)
Andrew (1992)
Katrina (2005)
Sources: ISO/PCS; Insurance Information Institute.

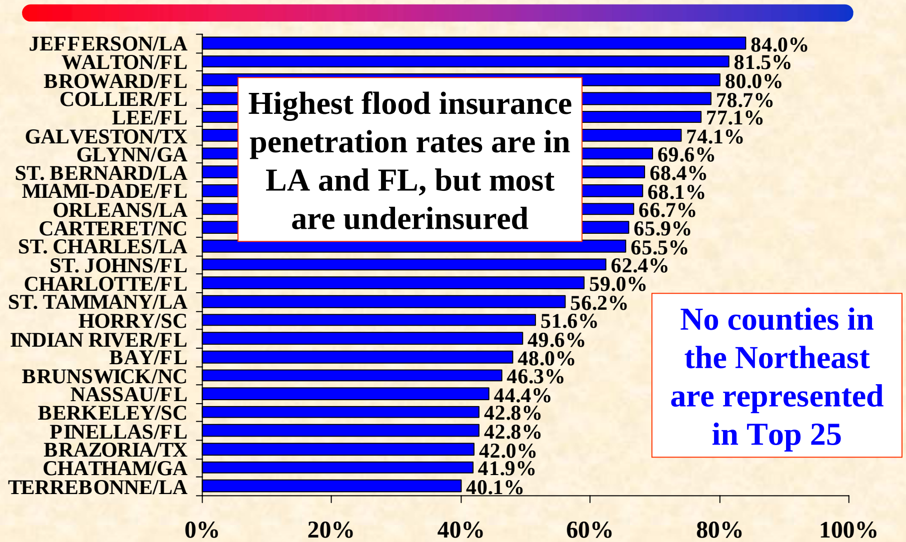
Figure 3. *Hurricane Katrina Claim Status on Storm's 1st Anniversary**

95% of the 1.2 million homeowners insurance claims in Louisiana & Mississippi are settled, with just 2% m dispute



*Hurricane Katrina made its north Gulf coast landfall August 29, 2005.
Source: Insurance Information Institute survey, August 2006.

Figure 4. *Flood Insurance Penetration Rates: Top 25 Counties/Parishes in US**



*As of 12/31/05.
Source: New Orleans Times-Picayune, 3/19/06, from NFIP and US Census Bureau data.

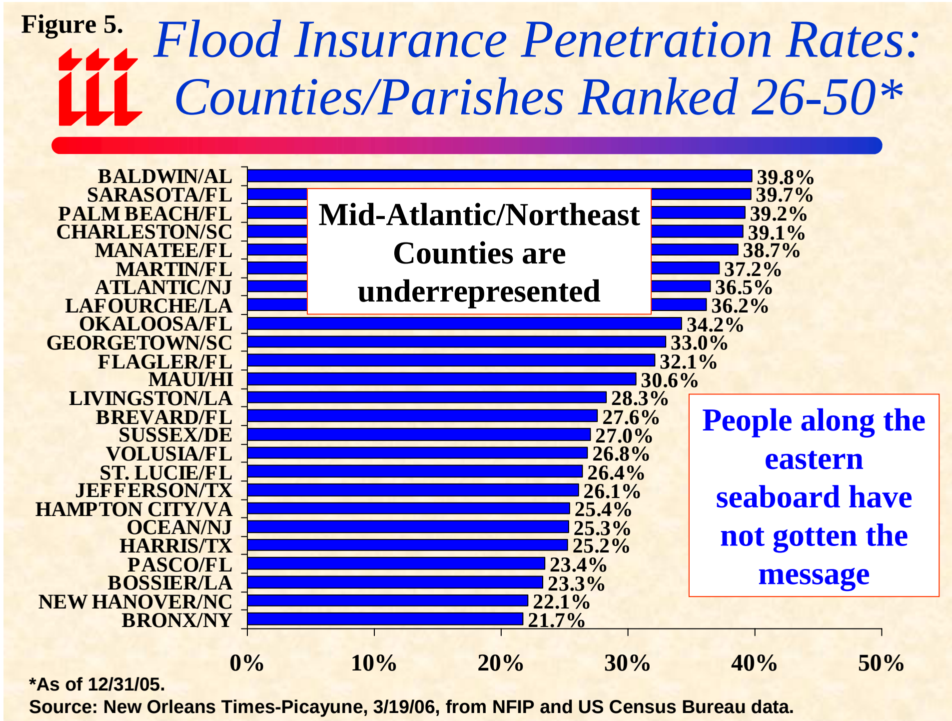


Figure 5.
Flood Insurance Penetration Rates: Counties/Parishes Ranked 26-50*
BALDWIN/AL 39.8%
SARASOTA/FL 39.7%
PALM BEACH/FL 39.2%
CHARLESTON/SC 39.1%
MANATEE/FL 38.7%
MARTIN/FL 37.2%
ATLANTIC/NJ 36.5%
LAFOURCHE/LA 36.2%
OKALOOSA/FL 34.2%
GEORGETOWN/SC 33.0%
FLAGLER/FL 32.1%
MAUI/HI 30.6%
LIVINGSTON/LA 28.3%
BREVARD/FL 27.6%
SUSSEX/DE 27.0%
VOLUSIA/FL 26.8%
ST. LUCIE/FL 26.4%
JEFFERSON/TX 26.1%
HAMPTON CITY/VA 25.4%
OCEAN/NJ 25.3%
HARRIS/TX 25.2%
PASCO/FL 23.4%
BOSSIER/LA 23.3%
NEW HANOVER/NC 22.1%
BRONX/NY 21.7%
Mid-Atlantic/Northeast Counties are underrepresented
People along the eastern seaboard have not gotten the message
0% 10% 20% 30% 40% 50%
*As of 12/31/05.
Source: New Orleans Times-Picayune, 3/19/06, from NFIP and US Census Bureau data.

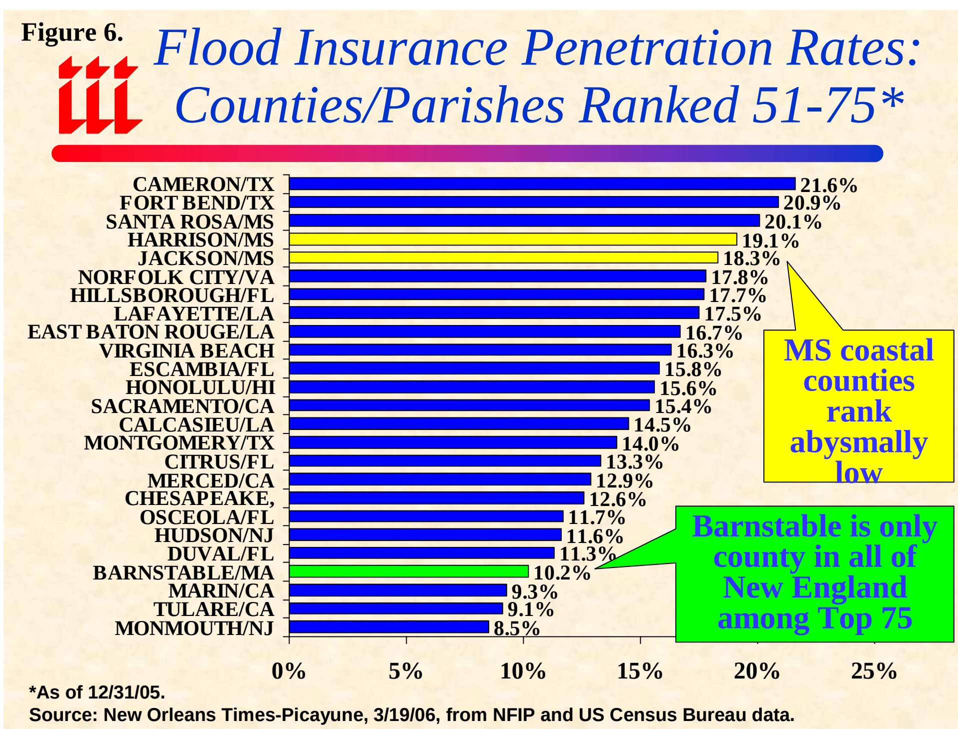


Figure 6.
Flood Insurance Penetration Rates: Counties/Parishes Ranked 51-75*
CAMERON/TX 21.6%
FORT BEND/TX 20.9%
SANTA ROSA/MS 20.1%
HARRISON/MS 19.1%
JACKSON/MS 18.3%
NORFOLK CITY/VA 17.8%
HILLSBOROUGH/FL 17.7%
LAFAYETTE/LA 17.5%
EAST BATON ROUGE/LA 16.7%
VIRGINIA BEACH 16.3%
ESCAMBIA/FL 15.8%
HONOLULU/HI 15.6%
SACRAMENTO/CA 15.4%
CALCASIEU/LA 14.5%
MONTGOMERY/TX 14.0%
CITRUS/FL 13.3%
MERCED/CA 12.9%
CHESAPEAKE, 12.6%
OSCEOLA/FL 11.7%
HUDSON/NJ 11.6%
DUVAL/FL 11.3%
BARNSTABLE/MA 10.2%
MARIN/CA 9.3%
TULARE/CA 9.1%
MONMOUTH/NJ 8.5%
MS coastal counties rank abysmally low
Barnstable is only county in all of New England among Top 75
0% 5% 10% 15% 20% 25%
*As of 12/31/05.
Source: New Orleans Times-Picayune, 3/19/06, from NFIP and US Census Bureau data.

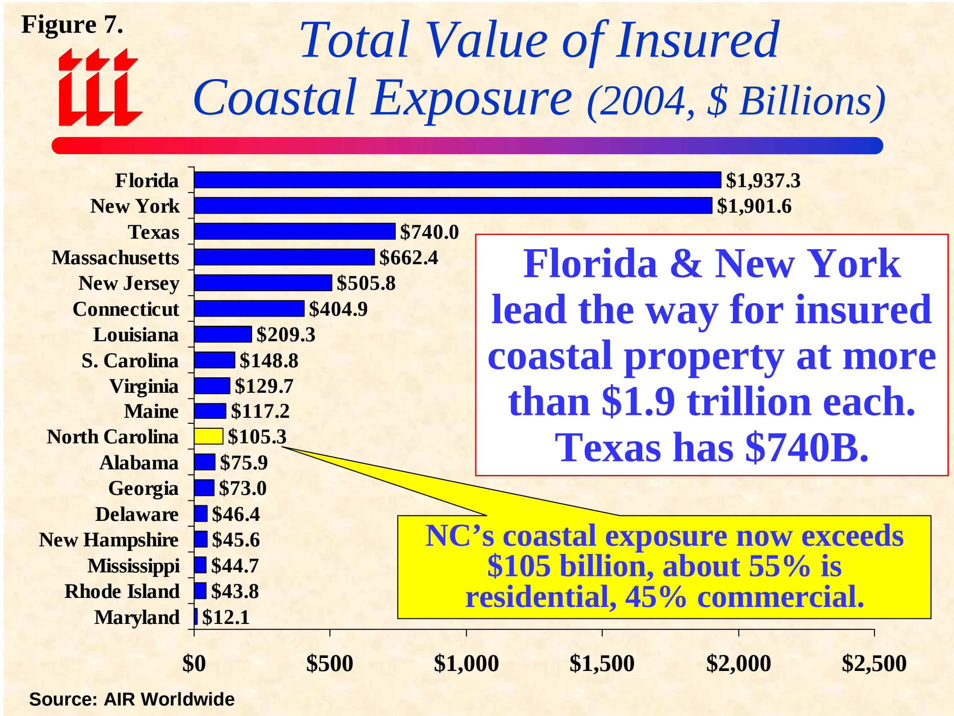


Figure 7.

Figure 8.

Figure 9.

Outlook for 2007 Hurricane Season: **40% Worse Than Average**

	Average*	2005	2007F
Named Storms	9.6	28	14
Named Storm Days	49.1	115.5	70
Hurricanes	5.9	14	7
Hurricane Days	24.5	47.5	35
Intense Hurricanes	2.3	7	3
Intense Hurricane Days	5	7	8
Net Tropical Cyclone Activity	100%	275%	**140%**

*Average over the period 1950-2000.
Source: Dr. William Gray, Colorado State University, December 8, 2006.

Figure 10.

Probability of Major Hurricane Landfall (CAT 3, 4, 5) in 2007

	Average*	2007F
Entire US Coast	52%	64%
US East Coast Including Florida Peninsula	31%	40%
Gulf Coast from FL Panhandle to Brownsville, TX	30%	40%
ALSO…Above-Average Major Hurricane Landfall Risk in Caribbean for 2007		

*Average over past century.
Source: Dr. William Gray, Colorado State University, December 8, 2006.