Written By Caroline McDonald

Record weather events, ranging from flooding and hurricanes to high temperatures and wildfires, have put pressure on insurance companies. These events have led to increasing numbers of claims and costs, with several insurers exiting the property and insurance market in a growing number of states.

This has also given organizations pause to look at alternatives to their property coverage and to plan accordingly.

To secure ongoing coverage, as well as have more control over pricing, organizations are increasingly looking to self-insurance and captives.

WEATHER EVENTS LEAD TO INSURER WITHDRAWALS

Recently Farmers Insurance stopped offering new auto, home and umbrella policies in Florida, citing the growing costs of natural disasters and construction.

In California, AIG, Allstate, State Farm and Farmers have all ceased writing new policies due to weather events, inflation, and reconstruction costs.

AAA has also dropped some coverage in Florida, California, and Louisiana, citing weather risks.

According to McKinsey & Company's report, "Climate Change and P&C Insurance and Opportunity":

"The projected escalation of climate risk, such as the occurrence of more floods and wildfires, may lead to underinsurance—or to no insurance at all. The result, substantial market dislocation will include premium loss, higher rates of self-insurance, and an increased demand for disaster relief from the public sector."

Dale Porfilio, chief Insurance Officer with the Insurance Information Institute, and president of the Insurance Research Council notes that the nature of insurance is "the balance of availability and affordability. Based on the information they have, if insurers don't perceive they can achieve a reasonable return on a particular type of risk, they either need to increase the price, or to write less of it," he said. "With what's happening now with climate risk, there is a need to be taking prices up."

In the property market, "From the beginning of the pandemic to the end of 2022, replacement cost prices on losses went up a cumulative 55 percent for homeowners' writers," Porfilio said. This means higher costs to repair or replace damaged homes and business.

The Insurance Regulator State of Climate Risks Survey, conducted by the Deloitte Center for Financial Services, found that:

- A majority of U.S. state insurance regulators expect all types of insurance companies' climate change risks to increase over the medium to long term—including physical risks, liability risks, and transition risks.
- More than half of the regulators surveyed also indicated that climate change was likely to have a high impact or an extremely high impact on coverage availability and underwriting assumptions.

Hurricanes in Florida and wildfires in California have meant that insurers are having to file for rates as they are able, Porfilio said. Those that are not able to get the rate they need, "are scaling back the amount of business they can write—whether it's scaling back new business, opening the door for new business or deciding to leave the market—and different companies are making different choices."

The extra layer, he said, is that most companies writing property insurance also purchase reinsurance for their book of business. "In part because of Hurricane Ian coming through and the perception of increased climate risk, reinsurance pricing also went up," Porfilio said.

Higher reinsurance costs means that insurers ultimately have to pass that cost onto consumers, "and that is where it is affecting both personal lines and commercial," he said.

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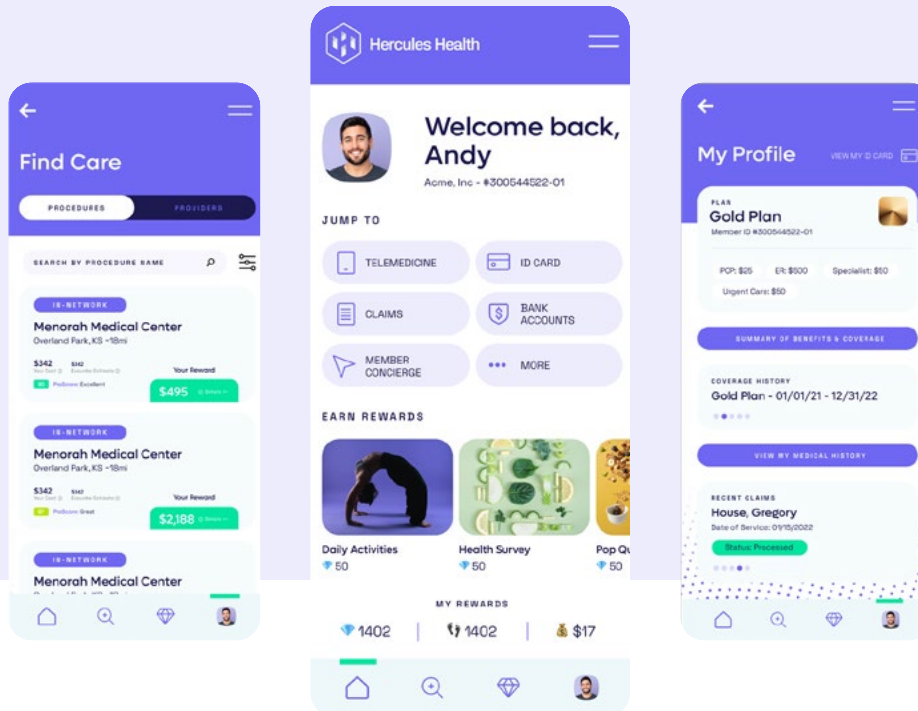

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IMPACT ON COMMERCIAL PROPERTY

While historically there has been greater regulation of personal products than commercial, "Looking at departments of insurance data every quarter, we are seeing commercial property insurance premiums going up more than personal property," Porfilio said. "This speaks to the fact that if an insurer feels it needs additional premium, they file for it and in general, commercial insurers are able to get higher rate increases than personal property insurers."

In the commercial property market, "I would say it is all business owners who are affected," he said. "If you own your own plant, you are the one who has to maintain insurance for that facility. You will have to maintain your own property insurance, and whoever the insurer is, odds are they have purchased reinsurance behind that."

He added, "If you are a renter of an office space or the place where you run your business, your landlord is probably passing that increase to you in the form of higher rent."

Robert P. Hartwig, clinical associate professor, finance department and director for the Center for Risk and Uncertainty Management at the Darla Moore School of Business, University of South Carolina noted, "Historically, the commercial property insurance markets have been less affected by the factors that are today leading personal property insurers to freeze, shrink or withdraw from markets such as Florida and California."

While commercial property insurance rates are not subject to the same degree of rate regulation as the homeowners market, commercial property insurers in Florida, California, and Louisiana, are still vulnerable to the pressures, "associated with the issues driving claim severity: higher inflation, supply chain issues, high labor costs, high catastrophe losses and high reinsurance costs," he said.

Commercial property insurance markets, "are hard and likely to remain that way for some period of time," Hartwig said. "Demand for commercial property cover remains strong."

This demand, in addition to the impetus from the drivers of claim costs, "does give insurers some leverage in terms of pricing," he said. "Even risks with good loss experience may be seeing double-digit increases and narrowed terms and conditions upon renewal."

For these reasons, Hartwig added, commercial property risks could potentially benefit from captive arrangements, "which could allow them to more directly benefit from their own commitment to loss control and risk management."

While there are potential advantages for commercial property risks using a captive arrangement, captives are "especially attractive for entities

with better-than-average loss performance," he said.

COVERAGE OPTIONS

If coverage is not available in the private market with standard carriers, "There are three relief valves," Porfilio said.

1. In some states "you have the Fair Plans—fair access to insurance. This is mostly for personal insurance, but they usually have a commercial insurance component as well. So, you could go to a state run organization like that, and they exist in most states."
2. Another option is the excess and surplus markets. "Those are outside of the standard regulators. Excess and surplus means they are operating outside of that and therefore have more latitude on pricing. They generally have more latitude on coverage restrictions, too. So, they may have stripped down some features to make it more affordable, but there is an entire excess and surplus market that operates, on top of the private market," he said.
3. The third is captives or self-insurance, which "I am hearing is happening more," he said.

Of these options, he said, "we know the state funds are growing, but we also see that excess and surplus and the captive markets are coming in to fill that void to the extent that they are able."

Organizations can set up a captive for their property insurance or exclusions. "I met with one of our members that covers personal lines for the high net-worth market," Porfilio explained. "The finding is that some companies don't want to write high-valued homes, so companies are placing the liability coverage with standard carriers and are doing combinations of self-insurance or a captive to cover the property risk."

DOMICILES WEIGH IN

Christine Brown, director of captive insurance with the Vermont Department of Financial Regulation noted, “We are definitively seeing growth due to increased rates, unaffordability and unavailability of certain types of coverage and lines of business.”

This has been happening, she said, “in the property space, with interest from large, well established real estate investors and property owners and managers.”

John Huth chairperson of the Montana Captive Insurance Association and an independent captive director, said, “It’s a fairly new phenomenon that companies are pulling out of these states, so I’m sure people are scrambling trying to figure out what to do.”

In the commercial market, he said, captives would be more likely for owners of office buildings and apartment complexes.

A captive, “could be an option for hotel chains with locations in different geographic regions. Or possibly hospitals,” Huth said. “Feasibility studies would have to be considered. You definitely would need a good premium base to even consider a captive.”

Group captives might be more viable for commercial captives with varied types of businesses and locations, he noted. “A group captive is something they could look at, but you would want to diversify your locations. Because if you have a natural disaster that takes out everybody, you’re not going to survive that,” Huth said.

Caroline McDonald is an award-winning journalist who has reported on a wide variety of insurance topics. Her beat has included in-depth coverage of risk management and captives. ■