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Before the Next 'Big One' Hits

By Jay S. Fishman

It's time for all of us to face up to the economic reality of hurricane risks. With more than half of all Americans living within 50 miles of the coast, and the value of coastal properties from Texas to Maine nearing $7 trillion, financial vulnerability to violent storms has increased dramatically. These trends are sure to continue as baby boomers head into retirement with visions of sand between their toes.

Coastal-wide markets to spread the risk of coastal hurricanes.

Take all that very expensive and congested coastal property and add to it inconsistent building codes and enforcement; aggressive zoning and development policies; warnings that warming ocean temperatures will increase the likelihood of damaging storms; and inconsistent, unpredictable and politically charged local insurance regulations. It's no wonder that some insurers are heading for higher ground. The availability and affordability of coastal wind insurance has become a serious and growing economic problem and something has got to give.

Unfortunately, most legislative efforts and proposals to address these problems are based on shifting risk away from coastal property owners and on to the government—they're nothing more than broad-based transfers of risk to taxpayers.

Florida, which arguably faces the greatest challenges, has turned to the state-owned Florida Citizens Property Insurance Corporation to assume significant amounts of coastal wind risk. But that illustrates the central problem: If, for example, Hurricane Dean had hit Southern Florida, the obligations of Citizens would almost certainly have outstripped its resources. In that case, the likelihood is that some would call for a government, i.e., taxpayer, bailout.

A private, market-based insurance industry solution is far preferable—ideally before the next "big one" hits U.S. shores.

The basic tenet of insurance is to spread risk among as many people as possible *who are subject to the same kind of risk*. We should resist public policy measures that enact the sort of "windstorm socialism"—forcing inland property owners or all federal taxpayers to pay for hurricane risks to which they are not subject.

One way to avoid this outcome is to create a federally regulated "Coastal Hurricane Zone" along the Gulf and Atlantic Coasts—from Texas to Maine. The federal government would not have a financial role but rather would regulate and oversee most aspects of wind underwriting by private insurers, including pricing.

The system we have now, in which states regulate and oversee the insurance market, has historically led to regulatory inconsistency and unpredictability, for insurers and customers alike, in the aftermath of major storms. This lack of consistency has been a key factor in driving insurers out of coastal markets, decreasing supply and increasing cost. Properly designed and executed, a Coastal Hurricane Zone would provide a more stable set of rules that would allow insurers to make long-term commitments of capital to those areas for wind risks, increasing the availability of insurance at efficient prices over time. Consumers would be protected by standardized rights and responsibilities.

Because catastrophic storms are unpredictable, the proposed Coastal Hurricane Zone should include a mechanism to equitably adjust premiums after periods of significant weather-related profits and losses. If actual hurricane-related damage and loss over a multi-year period were less than anticipated, a portion of premiums would be returned; if actual losses were more than anticipated, the price of insurance would be increased. The goals here are to ensure customers receive rates that are fair and sound—and to avoid the sense that insurers are "winning" and customers are "losing."

Risk-based rates set in a more stable regulatory environment may be out of the reach of some coastal residents. One option would be temporary, transitional subsidies—maybe 10 to 15 years—in which those coastal residents who are unable to afford coverage would receive tax credits to help them pay, with the credits to be funded by tax surcharges for those coastal residents able to afford coverage. While this is clearly a wealth transfer, the social dislocation that would occur in the absence of such a transitional program would be unacceptable.

To reduce losses from inevitable hurricanes, federal, state and local governments have another critical role to play in promoting risk-mitigation programs. Federal incentives to state and local governments to adopt and enforce modern building codes would be one key component. Other loss-mitigation plans include prudent land use management, such as acknowledging the importance of coastal wetlands in minimizing a hurricane's impact upon landfall. Many observers have commented that these kinds of actions could substantially reduce the cost of major storms.

The right kind of public policy can do much good, and we hope state and federal government policy makers will carefully consider their potential role in creating a sustainable, uniform, market-based solution for the Gulf and Atlantic coasts.

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