



Consumer Federation of America

For Immediate Release:
Monday, January 8, 2007

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INSURERS INCREASE PROFITS TO RECORD LEVELS BY OVERPRICING POLICIES AND SHIFTING COSTS TO CONSUMERS AND TAXPAYERS

National consumer organizations joined the Consumer Federation of America today to release a new study concluding that the property/casualty insurance industry (which includes the nation's home and auto insurers) has dramatically increased profits and surplus in recent years, in part by systematically overcharging for insurance and shifting costs to consumers and taxpayers. The report provides extensive data demonstrating that property/casualty insurance companies are paying out lower claims in relationship to the premiums they charge consumers than at any time in decades. The combined ratio, the relationship of all paid claims and expenses to the premiums that insurers collect, appears to be the lowest on record in 50 years. This indicates the highest profit levels in recent history.

"Profits and a solid insurance industry are a good thing but unjustified profits and excessive capitalization harm consumers," said J. Robert Hunter, the Director of Insurance for the Consumer Federation of America (CFA) and author of the study. Hunter is an actuary, former state insurance commissioner and former federal insurance administrator.

"We saw record profits in 2004 and 2005 despite significant hurricane activity. Profits in 2006 rose to unprecedented heights, with pre-tax profits likely to increase by over \$30 billion for property/casualty insurers, a jump from the previous record of more than \$100 for every man woman and child in America. Meanwhile, the amount that insurers paid in claims and expenses as a percentage of the premium collected in 2006 plummeted to a 50-year low," he said.

"Unfortunately, a major reason why insurers have reported record high profits and low losses in recent years is that they have been methodically overcharging consumers, cutting back on coverage, underpaying claims, and getting taxpayers to pick up some of the tab for higher risks," said Hunter.

As this study is being released, many insurers are sharply increasing premiums for homeowner's and commercial insurance and reducing or eliminating coverage for tens of thousands of Americans in coastal areas of the country. Insurers are also urging Congress to continue taxpayer subsidies for terrorism losses and to create a federal catastrophe insurance program that could also involve taxpayer support.

Using a number of common measures of financial health, the study finds that balance sheets for property/casualty insurers are in better condition overall than at almost any time in recent history.

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Record High Profits/ Low Losses

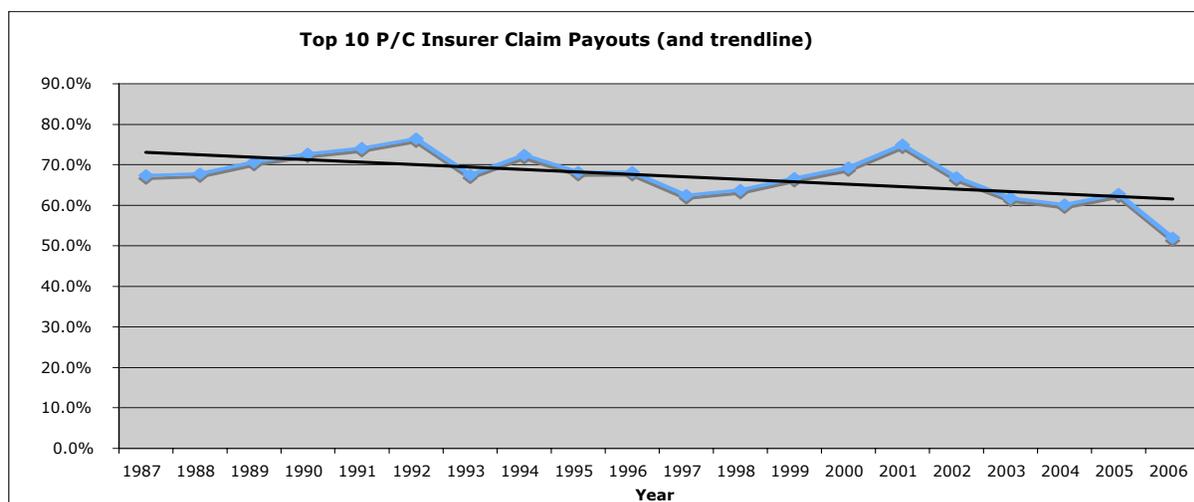
The study estimates that after-tax returns for 2006 are \$60 billion. Profits for the record years of 2004, 2005, and 2006 are estimated to be \$149.2 billion. The loss and loss adjustment expense (LAE) ratio for 2006 is estimated to be 68.3 percent, the lowest in 27 years studied. The years 2003 through 2006 represent four of the six lowest loss and LAE ratios in the last 27 years.

YEAR	INDUSTRY NET INCOME (post-tax)	LOSS & LAE RATIO	POLICYHOLDERS SURPLUS	PRETAX OPERATING INCOME
1997	\$36.8	72.8%	\$384.1	\$35.5
1998	\$30.8	76.5%	\$423.4	\$23.4
1999	\$22.0	78.9%	\$428.1	\$15.3
2000	\$20.5	81.4%	\$400.2	\$10.5
2001	-\$6.7	88.4%	\$374.4	-\$12.8
2002	\$9.1	81.6%	\$376.0	\$8.4
2003	\$31.2	75.1%	\$353.8	\$35.5
2004	\$40.5	73.1%	\$508.7	\$45.4
2005	\$48.8	74.8%	\$551.0	\$47.3
2006	\$59.9	68.3%	\$606.7	\$82.8

Source: A.M. Best Aggregates and Averages (2006 data estimated by CFA based on reported industry results for first nine months)

Claim Payouts Continue to Drop

For the top ten insurers, losses paid as benefits to consumers are an estimated 52 percent of premium in 2006. The amount of premium paid in benefits by the largest insurers has experienced a startling drop from 75 percent in the late 1980s to only 60 percent today when plotted on a straight-line trend over the period. This signals a great loss in insurer efficiency in delivering benefits to Americans. Allstate, for example, appears to be paying much less than half of the premium it collects in benefits to consumers.



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Insurance is a Low Risk Investment

Representatives of the insurance industry often claim that high premiums and profits are necessary to compensate for the high risks they must bear. In fact, insurance is a low-risk investment. Using standard measures of stock market performance that assess financial safety and stock price stability, the property/casualty insurance industry represents a below-average risk compared to all stocks in the market, safer than investing in a diversified mutual fund.

In 2006, the study estimates that stock insurers will earn a return on equity (ROE) of about 20 percent, well in excess of what is required by investors. The lower industry-wide ROE that insurers report underestimates the industry's actual ROE. The industry-wide ROE includes returns from mutual insurers, who tend to carry excess capital on their books. Insurers calculate their ROE using a method that understates returns, using mid-year capital rather than beginning-of-year capital. Moreover, since insurers are significantly overcapitalized by all historic measures, the income earned on swollen surpluses is lower than it would be if efficient capital levels were maintained.

Surplus is Unprecedented: Insurers are Overcapitalized

The study estimates that retained earnings, or surplus, for the entire industry is \$600 billion as of the end of 2006. An adequate surplus guarantees a solid and safe insurance industry but this amount is, by any measure, unprecedented. To assess the financial solidity of an insurance company, regulators examine the ratio of net premium written to surplus, which, at .73 to 1 (73 cents of premium written for every dollar of surplus) is less than half of the extremely safe 1.5 to 1 ratio that is recommended by many observers and far less than the famous "Kenny" rule of 2 to 1 as an efficient surplus level. The largest loss ever suffered by the insurance industry, Hurricane Katrina, represented an after-tax loss of \$26.3 billion, or 4.4 percent of current surplus. The \$12.2 billion in after-tax losses experienced by insurers after the September 11th terrorist attacks amounts to about 2 percent of surplus. Many insurers are engaged in massive stock buy-back programs because of this excess capital situation.

Insurers Have Lowered Risk and Maximized Profits through Legitimate and Illegitimate Means

In recent years, insurers have reduced their financial risk by making wise use of reinsurance and other risk spreading techniques, such as securitization. However, the study cites several tactics that insurers have also used to shift costs and risk onto consumers and taxpayers. Some of the questionable methods that insurers have used to shift risk include:

- **Sharp limits the on coverage and availability.** Insurers have imposed large hurricane deductibles, capped home replacement and rebuilding costs and placed unjustifiable restrictions on claims. For example, "anti-concurrent-causation" clauses now in wide use attempt to strip all coverage for hurricane damage if a non-covered event like a flood occurs, even if the flood hits hours after a home is destroyed by wind. More recently, some insurers have canceled policies, refused to renew policies, or refused to write new coverage in coastal areas and entire states from Texas to Maine.

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- **Harsh homeowner’s rate increases.** Insurers imposed sharp rate increases on many homeowners throughout the nation from 2000 to 2004. More recently, homeowners near coastal areas have faced rate increases of up to 100 percent on top of large previous increases. A major reason for these recent increases is that insurers are once again relying on short-term predictions of potential weather disasters, reneging on promises to use more scientific long-term computer predictions.
- **Programs designed to systematically underpay claims.** Many insurers are now using new computer-directed programs like “Colossus” and “Claims Outcome Advisor” that allow insurers to determine the amount of overall claims’ savings they want to achieve before claims are assessed for legitimacy.
- **Taxpayer subsidies.** Insurers and real estate interests were the major business proponents of the Terrorism Risk Insurance Act (TRIA), which Congress created in 2002. The study estimates that insurance companies have received a subsidy of about \$7 billion to date because insurance companies don’t have to pay premiums for the reinsurance provided by the federal government. Some insurers have urged Congress to create a similar program to cover natural disasters. Insurers have also received significant taxpayer support at the state level, through the creation of state directed “insurers-of-last-resort.” The existence of these companies allows insurers to “cherry pick,” by insuring lower risk households themselves and sending higher risk households to the state company. State wind pools have also been created that may expose taxpayers to liability.

“Insurers have been so successful in shifting their risk onto consumers and taxpayers that they have produced record profits during a period of increased storm destruction and terrorist attacks,” said Hunter. “This risk-shift is reflected by the fact that insurers are paying less and less of the premium dollars they receive in benefits to consumers.”

Recommendations for State and Federal Policymakers

1. **States should dramatically improve weakened regulatory systems to gain control of excessive rates.** In particular state lawmakers and regulators should carefully examine rate increases proposed by insurers and block them if necessary. Coastal states should consider uniting to develop a coastal weather modeling system that could be used to evaluate insurer rate increases.
2. **State agencies should undertake research on the fairness of insurance rates** similar to that done by California on home insurance and the New York City Comptroller on auto insurance.
3. **Coastal states should consider creating funds to cover all wind risk in the state, perhaps through a multi-state effort.** Such a program could be directed by private insurance carriers chosen through a competitive bidding process. CFA and Americans for Insurance Reform have called for the creation of such a fund in Florida and estimate that consumers could save at least \$3 billion a year through the more efficient delivery of insurance, the ability to build reserves tax-free and the non-profit status of the effort. (Other organizations releasing this report have not taken a position on this proposal.)
4. **Congress should authorize states to use interstate compacts to create multi-state wind pools.** Such legislation should allow states to permit the accumulation of tax-free reserves if the funds collected are kept for the purpose of paying claims after wind disasters strike.

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5. **Congress should clear the way for the greater use of insurance securities.** The federal government should undertake a study of federal laws and tax policies to ensure that securitization of risk is encouraged, not discouraged, by federal requirements. Aggressively fostering increased securitization of catastrophe risk is a far more favorable option for consumers and taxpayers than insurer efforts to require taxpayer subsidies.

Advice for Consumers

1. **If possible, don't do business with a company that has a history of anti-consumer behavior.** When purchasing or renewing a homeowner's policy, consumers can contact their state insurance departments to get information on companies in their areas that have sharply raised rates and cut back in coverage in recent years.
2. **Carefully review policies at purchase or renewal to determine whether high out-of-pocket costs will be imposed.** Consumers should look for special deductibles for wind damage, anti-concurrent causation clauses, limits on replacement costs, and other restrictions on coverage.
3. **Consumers who live away from coastal areas should actively shop for better coverage and rates.** Because insurance companies are overcapitalized, they are looking for new business in lower risk areas. Rate decreases and better coverage are possible.
4. **Demand thorough oversight of insurer actions by state regulators.** If consumers have a problem with rates or coverage, they should file an immediate complaint in writing with their state insurance agency and follow up for a response. Consumers should also contact insurance regulators to find out what they are doing to require that rates are fair and reasonable and that insurers are not unjustifiably withdrawing coverage.

The report was written by the Consumer Federation of America and released with other national consumer organizations, including Americans for Insurance Reform, the Center for Economic Justice, the Center for Insurance Research, the Center for Justice and Democracy, Consumers Union, the Foundation for Taxpayer and Consumer Rights, and United Policyholders. A copy of the report can be found at:
www.consumerfed.org/pdfs/2007Insurance_White_Paper.pdf.

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Consumer Federation of America (CFA) is a non-profit association of 300 consumer groups, with a combined membership of more than 50 million people. CFA was founded in 1968 to advance the consumer's interest through advocacy and education.