Drawing the Line on Hurricane Deductibles

Statutory standards and executive actions raise the question: How will hurricane deductibles be applied in the Northeast?

Property insurers in New York State were probably chagrined but not surprised in November 2012 when Gov. Andrew Cuomo pronounced that separate hurricane deductibles could not be applied to claims arising from Superstorm Sandy.

Insurers in Pennsylvania may have been more disappointed when Gov. Tom Corbett made essentially the same pronouncement.

In the opinion of insurance trade groups, neither executive had the authority to pronounce on the meaning and application of private contracts.

“We were concerned because [the New York ruling] was by regulatory decree, with no formal basis,” says Marc Craw, vice president of the New York Insurance Association (NYIA).

But Cuomo, a Democrat, was expected to be more consumerist in his orientation. Corbett, on the other hand, is a conservative Republican who consistently espouses free market principles.

Pun intended, however, both men were caught up in a storm that swamped whatever ideological inclinations they may have had.

Surrounded by states that had limited the application of hurricane deductibles by statute—Connecticut, New Jersey, and Maryland, in particular—Cuomo and Corbett faced the prospect of appearing to have failed to protect homeowners from thousands of dollars of additional cost (compared to neighboring states) at a time of distress.

Thus, for a storm which at one point was a hurricane, and which caused hurricane-scale damage over a vast area, separate hurricane deductibles were rarely applied, all because Sandy did not meet the technical definition of a hurricane when it made landfall in most states.

Standardize

Sandy seemed to confirm what started awkwardly a year earlier with Hurricane Irene: There is, in effect, a powerful move afoot to standardize the application of hurricane deductibles in northeastern states.

Like Sandy, Irene was downgraded from a hurricane to a tropical storm as it moved north. After it did so, insurance departments in New Jersey and Rhode Island notified insurers that the storm did not meet statutory requirements for the application of hurricane deductibles.

The New York Insurance Department (now merged into the Department of Financial Services [DFS]) followed suit by pronouncing that it would not allow hurricane deductibles to be applied to claims arising from Irene.

That left an awkward situation in Connecticut, where hurricane deductibles were permitted by statute, but the
statute did not restrict their application as did statutes in Rhode Island and New Jersey.

Connecticut Gov. Dannell Malloy publicly called on insurers not to apply hurricane deductibles, and engaged in negotiations with carriers to dissuade them from doing so. Some carriers claimed they would have waived the deductibles for business reasons, without needing to be pressured publicly.

In July 2012, Connecticut enacted a law establishing standards for hurricane deductibles similar to those in Maryland, New Jersey, and Rhode Island.

Farther south in Florida and the Gulf states, the use of hurricane deductibles is well established.

Defense

Insurance trade representatives argue that executive decisions to prohibit the application of hurricane deductibles undermine the sanctity of contacts and distort the market by forcing insurers to assume a level of losses for which they had not collected adequate premium.

Given the experience of Irene and Sandy, it’s not clear that insurers will get to use deductibles grounded in statute, either.

Craw says NYIA will be “playing defense” in the 2013 New York legislative session against proposals to establish standards for the application of windstorm and hurricane deductibles.

Separate windstorm deductibles that did not apply specifically to hurricanes could be applied in the wake of Sandy. As a result, the amount of recovery paid to households “varied quite a bit from company to company,” in Craw’s words.

That didn’t sit well with agents, who prefer to see most households treated in roughly the same fashion following a storm, while carriers prefer to retain flexibility in determining their level of exposure.

Proposals

A 2011 proposal from the New York Insurance Department, not implemented but still under consideration, would prohibit residential property insurers from implementing general windstorm deductibles for policies insuring residential property, but allow the application of separate percentage deductibles for losses arising from named hurricanes.

The deductible would be limited to 5% of the dwelling property limit, but a carrier would have to aggregate all covered losses caused by the event when determining whether the deductible had been reached. Also, separate hurricane deductibles could not be applied to loss of use coverage.

A bill authorizing the DFS to standardize the application of hurricane deductibles has been introduced in the New York legislature.

Turnabout

The logic underlying the use of separate hurricane deductibles is that insurers will forego some premium when selling a policy in return for having insureds accept a greater share of a hurricane loss when it occurs.

The experiences of Irene and Sandy suggest that the public may not accept having homeowners pay the cost at a time of great distress and dislocation.

If that’s the case, it will be “back to the drawing board” for insurers seeking to provide affordable homeowners coverage in coastal areas of northeastern states.

“After Irene and Sandy—storms which at one point were hurricanes, and which caused hurricane-scale damage over vast areas—separate hurricane deductibles were rarely applied.”