Multi-Year Homeowners Insurance Proposal Continues Struggle to Find Supporters

WASHINGTON, Apr 24, 2013 (A. M. Best via COMTEX) -- April 29 will mark the six-month anniversary of Hurricane Sandy’s landfall in New Jersey. The widespread impact of the storm, which caused an estimated $25 billion in insured losses, highlights the importance of homeowners insurance and could reawaken the idea of selling multi-year policies.

Howard Kunreuther, a public policy professor at the University of Pennsylvania’s Wharton School, in a 2012 study found consumers liked the idea of entering into a two- to five-year policy in which insurers were unable to raise premiums significantly or to “nonrenew” the policy after a catastrophe. The study found when insurers offer individuals one-year policies at an actuarially fair rate, approximately 62% of the subjects purchase insurance. When the same one-year contract is offered along with a two-year contract that has a loading cost of 5%, the demand for insurance increases to 73%. More than 60% preferred the two-year policy even though its expected cost was 5% higher than buying two annual policies.

“There is clearly an interest in the idea of multi-year insurance policies. This is something companies should be thinking about,” Kunreuther said.

Still, industry experts said insurers would have to be convinced that offering multi-year policies makes sense to their business models.

Rick Decker, A.M. Best assistant vice president for property/casualty, said the No. 1 concern for insurers is being able to price products adequately.

"From an insurer standpoint, pricing is critical," Decker said. "An annual policy allows a company to adjust premiums more frequently as costs go up or to factor in other changes in a risk." Being able to adjust prices is especially important in the wake of a catastrophe, Decker said.

The sluggish economy has also made especially important for insurers to price products appropriately, Decker said.

"Investments yields right now are low, which puts most of the heavy lifting on the adequacy of pricing in order to make an underwriting profit. Being able to have an annual look at the pricing of a product is really important during these economic conditions," Decker said.

Robert Detlefsen, vice president of public policy at the National Association of Mutual Insurance Companies, said insurers would need to know more about when policyholders could cancel their policies and under what circumstances under Kunreuther’s proposal.

"If you’re a policyholder who buys a, say, five-year policy, there is no real down side to taking on a long-term policy if you’re not locked in," Detlefsen said. "But for insurers, it would make it difficult to manage risks."
Kunreuther said multi-year policies could serve greater social good because longer term policies would decrease the number of possibilities for homeowners to allow their policies to lapse. "When people have to rethink their policy each year, many people choose not to renew because unless a major storm hits, they see insurance coverage as a bad investment," Kunreuther said. "But when a catastrophe does hit it is far more expensive to help people who do not have coverage." Real estate developers may be more tempted to build in a neighborhood where they know there are insurance policies in place, he said.

Multi-year flood insurance contracts would help shore up the National Flood Insurance Program's finances, he said. During congressional debates over the Biggert-Waters Flood Insurance Reform Act of 2012, which reauthorized the NFIP for an additional five years, Kunreuther testified multi-year policies would allow the NFIP to diversify risks over time as well as across individuals, thus reducing the variance in the losses.

Kunreuther, Mark V. Pauly and Stacey McMorrow made a more comprehensive case for multi-year NFIP policies in a book released earlier this year, titled, "Insurance and Behavioral Economics: Improving Decisions in the Most Misunderstood Industry." Because the NFIP is a nationwide program subject to federal oversight, Kunreuther said it would be easier to implement multi-year policies than in the private market. But the NFIP could also serve as a test case to show state regulators the multi-year system can work, Kunreuther said.

Kunreuther's proposal allows policyholders to cancel their homeowners' coverage for a filing fee.

Detlefsen said state regulators may be skeptical of Kunreuther's multi-year policy proposal. Homeowners' insurers would "have to justify a move to multi-year policies" in filings with regulators before they could implement such a change, Detlefsen said.

But perhaps the biggest reason insurers haven't tried to offer multi-year policies is that there is simply no reason to. Detlefsen said insurers have a system that works well in the annual-policy system. "Why would they try to complicate a system that already works? Insurers are always trying to find an edge over their competitors," Detlefsen said. "If insurers thought this would be attractive to consumers, the free market would have allowed companies to try this out. There hasn't been a move to make that change, and I assume there are good reasons why not."

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