Insurers Put the Squeeze On Homeowner Policies

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May 29, 2002 -- Marion and Dorthea Sherrill of Monroe, Ga., were loyal insurance customers of USAA for 20 years. Mr. Sherrill pays quarterly life-insurance premiums to USAA and has used the company to insure 31 cars over the years. In February, however, USAA let the Sherrills know that they'd have to take their $1,077-a-year homeowners business elsewhere.

The reason: Three claims filed in the previous three years. A lightning strike and burst pipe, both in September 1999, and a car break-in last October, resulted in total claims of $4,200. A notice of "nonrenewal" from USAA dated Feb. 19 informed the Sherrills that three claims in three years were not "compatible with our underwriting standards."

"Are you supposed to just pay premiums and not file claims?" asks Mr. Sherrill, a 55-year-old stock broker, who suffered a series of rejections before finding a replacement policy at nearly twice the old price and quadruple the old deductible. "What USAA has done is label me as a major risk situation," he says. A USAA spokesman declined to discuss individual policyholders, including the Sherrills.

People across the country are learning that a run of misfortune that causes them to file several homeowners claims can have punishing financial consequences. It's the result of perhaps the most radical overhaul of homeowners insurance in decades. Hundreds of thousands of policyholders are being dumped or are paying sharply higher rates as insurance companies large and small rethink the way they price and sell policies.

In years past, insurers were willing to stomach losses on their homeowners policies in order to find customers for their larger and more profitable automobile and life-insurance lines. Besides, even if they lost money through careless underwriting -- taking in less cash in premiums than they paid out in claims and expenses -- they could usually make it up through their investments in the stock and bond markets.

But the waning bull market put an end to easy investment gains. And a slew of disasters last year -- ranging from massive storms in the Midwest and a costly outbreak of mold in Texas to the Sept. 11 terrorist attacks -- has suddenly rocked insurers with big underwriting losses. Now the companies are trying to wring profits from homeowners policies, and growing numbers of the nation's 58.6 million homeowners are paying the price.

In the first quarter alone, Allstate Corp. won regulatory approval for premium-rate increases in 23 states. The average jump: 19.8%. In Texas, Allstate and Farmers Insurance Group have more than doubled rates in certain areas because of mold claims, a growing problem in the state.

Dropping Clients

Insurers are also much quicker to ditch unwanted clients. State Farm Mutual Automobile Insurance Co., the nation's largest home insurer, last month instituted a practice under which customers in its middle-Atlantic region could lose the ability to renew expiring coverage if they have two claims in three years, according to an internal memo from its agents' association. State Farm suffered a $3.7 billion underwriting loss on its homeowners line last year, atop a $5.6 billion underwriting loss in its auto-insurance business.

A spokesman says the Bloomington, Ill., company hasn't undertaken a concerted strategy of nonrenewals. Instead, if a policyholder has two losses in three years, "we would consider them a candidate for reunderwriting." Meanwhile, State Farm has stopped offering policies for prospective customers who had a single claim at another insurance company in the past three years.

Of course, this isn't the first time homeowners insurers have declined to renew large numbers of policies. After Hurricane Andrew ravaged South Florida in 1992, many insurers dumped customers in that state in hopes of avoiding multibillion-dollar losses from future storms.

But this time around, improved technology -- including a massive shared database of claims -- has allowed insurers to focus on individual homeowners around the country they view as undesirable risks. This has angered consumers who complain they have no control over the weather.

"We have a lot of people coming to us with difficulty finding insurance these days, and they're mad," says Lee Jones, a spokesman for the Texas Department of Insurance.

Solid estimates of the number of customers who have been dropped in recent months are hard to obtain. John L. Ward, chief executive of Ward Financial Group, a Cincinnati consulting firm that counts more than 300 insurers as clients, says those insurers are declining to renew 6% of their policyholders, about double recent historical rates. Mr. Ward says his insurance-company clients make up about 20% of the market, or about 11.6 million of the 58 million homeowners policies in force. Applying the 6% figure, that means 696,900 policies weren't renewed by that group of insurers alone.

Some big insurers dispute Mr. Ward's figures, but they don't dispute they are seeking to boost profits. "Consumers don't believe how close the homeowners line is to complete chaos," says Jerry Carnahan, president of personal-insurance lines for Los Angeles-based Farmers. The industry points to figures compiled by ratings agency A.M. Best Co. showing that the industry has turned a profit on underwriting homes just once in the past two decades. That was in 1987, when claims and related expenses cost insurers 97 cents of every dollar collected in premiums.

After suffering a $15.5 billion loss from Hurricane Andrew, insurers dropped many customers as their policies expired, and they refused to take on new ones. Allstate alone canceled 90,000 policies, 8% of its Florida business pre-Andrew. Prudential Insurance Co. of America, now known as Prudential Financial, actually paid 23,000 policyholders a total of $15 million to take their business elsewhere.

To rebuild their capital, many insurers decided that homeowners insurance, which for years had been a good deal for consumers, should become less generous. By the late 1990s, insurers were shifting more of the risk and cost of insurance onto their customers.

State Farm, which covers about one in five homes in the U.S., led the way. Among its biggest changes was the elimination of guaranteed-replacement-cost coverage. Such coverage protected homeowners who were inadvertently underinsured by promising to pay the entire cost of replacing a house lost to fire, hurricane or some other disaster, even if the replacement cost far exceeded the insured amount listed in the policy. Instead, under a new policy form rolled out in 1997, State Farm began capping the amount it would pay, though it still generally exceeds the insured amount.

State Farm also inaugurated a program under which homeowners would be charged higher rates if they file frequent claims -- even if the claims were legitimate. State Farm said at the time that it wanted to hold down premiums for the overwhelming majority of policyholders who use preventative maintenance to ward off damage to their property.

Other insurers followed suit. Mr. Carnahan says Farmers has done studies of claims activity following storms and has determined that, while some homeowners will fix light damage to their homes rather than file a claim, others see storm damage as "a great way to fix the house" at an insurer's expense. He says Farmers typically wouldn't cancel someone with just two claims in four years.

In addition, in the mid-1990s the industry began using credit histories as a way to predict a customer's future claims behavior. Though insurers say a poor credit history is one of the best indicators of future claims activity, the practice has been decried by some regulators and many consumer groups.

Even if a policyholder hasn't stayed with an insurer long enough to develop a track record, the company can search a giant database of home and auto claims known as the Comprehensive Loss Underwriting Exchange, or CLUE. About 90% of the industry uses CLUE reports, which list the names of policyholders who have made claims, along with the frequency, type and size of the loss reports. Insurers themselves contribute the data, then tap into the information each time a new customer seeks coverage. The service is owned by ChoicePoint Inc. of Alpharetta, Ga. "Insurers have reached a new plateau of underwriting sophistication within the last two to three years," says Robert Hartwig, chief economist for the Insurance Information Institute, a trade group.

Also in the late 1990s, a new homeowners-insurance menace sprouted: mold. Experts say mold has become more common in houses because of the more airtight construction of new homes. Homeowners began filing more frequent mold claims in the late 1990s, as health concerns regarding certain types of mold surfaced. It became a high-profile and high-dollar problem in June 2001, when a Texas jury ordered Farmers to pay $32 million to an Austin homeowner who maintained that mold caused health problems for her husband and young son and forced the family from its home.

Avalanche of Claims

The Austin house has been left vacant, and other houses in Texas with similar problems have been torn down, because they couldn't be cleaned satisfactorily. The publicity surrounding the case brought an avalanche of mold claims in the state. Last year, Farmers registered more than 12,000 mold claims, up from 12 in 1999. Allstate says its monthly tally of such claims in Texas climbed to 1,000 in the first three months of this year, up from 40 a year ago.

Texas's homeowner policy forms -- tightly regulated by the state -- have for years been among the most generous in the country, and the most commonly used form included coverage for mold and the types of slow leaks that can lead to mold. Insurers tried to exclude all mold coverage from their policies. The Texas insurance regulators balked, though they ultimately reached a compromise that allowed insurers to scale back water-damage coverage, covering only sudden and accidental discharges of water.

Texas isn't the only state with mold problems. California currently hosts two high-profile mold-claim lawsuits, brought by Erin Brockovich, whose life was the subject of a movie starring Julia Roberts, and former Tonight Show sidekick Ed McMahon.

Now, when big storms hit anywhere in the country, insurers worry not just about the roofs that are damaged by branches falling, but the long-term ramifications of any water damage not properly dealt with. "The industry is deathly afraid of mold," says Farmers' Mr. Carnahan. "You've got this unknown bogey called mold and people are taking drastic actions."

State regulators and insurance agents say that insurers frequently are targeting potential mold problems with the current wave of nonrenewals. "Any time you have a water-related claim, whether mold manifests itself or not, you're on their radar screens," says James Armitage, an independent insurance agent in South Pasadena, Calif.

Last April, a storm pelted St. Louis and the surrounding area with softball-size hail that wrecked cars and shredded roofs, causing an estimated $1.2 billion in insured damage. That was followed by a rash of notices to consumers that their coverage wouldn't be renewed.

Susan and Lester Guyon of Florissant, Mo., were among them. The couple had been homeowners-insurance customers of Farmers for 35 years. But the $3,632 claim they filed to replace their roof -- coming on top of a previous claim related to another hail storm three years earlier -- was the end of the relationship. "Claim frequency should average one claim every 10 years," the company said in its notice. Ms. Guyon found replacement coverage at roughly the same price, but she's still steamed. "You stay with them for that long, then you file a claim and next thing you know you're being canceled," she says.

Most insurance experts believe the nonrenewal crisis won't be a long one, provided insurers receive approval from states for more rate increases that will make writing homeowners insurance worth their while. That, of course, means that homeowners likely will be paying still higher rates over the next few years. "For the next year or so, there will be bad decisions made by insurers" in which some good customers are rejected, says Robert Hunter, director of insurance for the Consumer Federation of America. But he thinks the cyclical nature of the industry will bring insurers back into markets they may have abandoned.

Until then, however, some consumers will continue to suffer. Dennis Paulsen, a 55-year-old trucking-company dockworker in Omaha, Neb., found out earlier this year that his insurer, Farmers Mutual Insurance of Nebraska, was dropping his policy as of April 27 because of too many claims. A string of bad luck and bad weather prompted him to file four claims since 1994, three between 1997 and late last year. The claims ranged from a stolen generator to hail damage to $621 worth of spoiled food in a freezer when weather knocked out power.

Now, Mr. Paulsen can't find insurance for his $70,000 home. "No insurers will take me on," he says, even though he has offered to accept higher deductibles if necessary. Recently a tornado warning was announced "and I just spent the night hoping nothing happened," he says.