

Risky Business: Exploring the Role of Reinsurance in U.S. Property Markets

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Tom Heintjes: Welcome to the Federal Reserve Bank of Atlanta's Perspectives on Real Estate podcast series. I'm Tom Heintjes with the Federal Reserve Bank of Atlanta. Today, we're talking with Bradley Kading, president and executive director of the Association of Bermuda Insurers and Reinsurers. Bradley served as a panelist at a conference hosted by the Atlanta Fed on December 1 called Exploring Impediments to a Real Estate Recovery: A Policy Discussion. This podcast will focus on some of his remarks on the role of reinsurers in the U.S. home market and the rising cost of property insurance.

Bradley, thank you for joining me today.

Bradley Kading: Thank you very much.

Heintjes: I'd like to start off by asking you, what role do reinsurers play in supporting U.S. home insurance markets?



Kading: The way to think about reinsurance and the role of reinsurance with regard to home insurance in the United States is to think of it as insurance for insurance companies. So, home insurers take on risk based on what agents produce for them, and at the end of the day the home insurance company will look at all the risk that they have accumulated and decide which kinds of risk or which amounts of risk in different regions they'll need support for. And reinsurance is a form of capital and so the insurer will sell some of that risk to the reinsurance company.

And, typically, you would look at, with regard to hurricane risk, if there is an excess accumulation of loss exposure that is accumulated, the home insurer will transfer some of that risk to the reinsurance company. So, let's say, if you have a portfolio of Southeast U.S. home insurance, you look at an aggregation of potential hurricane risk. You will sell a layer of that risk, let's say \$100 million, excess of \$100 million, to a reinsurance company.

Heintjes: I see. And what are some of the recent and long-term trends in the cost of property insurance, and why are the trends on that trajectory?

Kading: There are many different facets to that answer. Let's look at a couple of them. Historically, home insurance was sort of a loss leader. An insurance company would look at a consumer's insurance needs—auto insurance, life insurance, health insurance, property insurance, including home—and would try to use home insurance as one way to create a customer relationship. And if it was a loss leader, that may have meant that the cost of home insurance was not priced to cover the complete cost because the related consumer products in auto and life may have been viewed as where the true profit was over the long haul in the customer relationship.

Today, insurance companies have to look at home insurance as being priced to cover its actual cost, and that's because there's not much investment income to be earned in insurance markets today based on macroeconomic issues and because of a recognition that hurricane exposure, or earthquake exposure, or tornado losses are such that home insurance needs to be priced to recover its actual cost. So, we've got a repricing of home insurance risk going on as a result of that.

The second thing with regard to hurricane losses in the Southeast, particularly, there's an understanding that hurricanes are a reality, and hurricanes can occur frequently, and there could be repeat occurrences of hurricanes in multiple years—the Florida situation of 2004 certainly shows that, with four hurricanes crossing the peninsula in a single hurricane season. So, with that, the price of insurance has to reflect the true cost of the hurricane exposure, and that, again, causes a repricing of the risk.

The chief way in which a consumer can control the cost of insurance is to take steps to storm proof a house. So, it's fairly easy and fairly inexpensive to retrofit a house, to put roof straps on a house, for example, to put storm shutters on a house. Little things like that can actually go a long way to reducing actual insurance costs, claims costs after a hurricane.

In addition, new building codes since 2001 in the Southeast are really very good. Good science is being done every day in insurance research facilities on how to test additions to those building codes that would reduce future claims costs, as well as to examine building materials to create better building materials that will resist both water penetration and wind damage.

Heintjes: Great information for people in the Southeast especially. Bradley, my last question to you is: What are some of the potential policies and solutions that could be implemented to redirect this trajectory, or help overcome this impediment?

Kading: The chief advice we would have for policymakers is to focus on storm proofing, to focus on hazard mitigation, to focus on the way consumers can control their own costs by taking action to protect the property. And, by taking action to protect the property, they are also protecting their family from injuries that would have occurred during hurricanes. So looking at building codes in place, Florida has a strong building code. Other states in the Southeast do not have strong building codes. Some communities, historically, have resisted a standardized building code, and that needs to be addressed by policymakers. Certainly, encouraging consumers to educate themselves on hazard mitigation techniques, working with builders to make sure that builders understand the best technology. And the Insurance Institute for Business and Home Safety in South Carolina is testing building design and materials, issues today to help with builders and getting better knowledge of what really works to prevent storm damage. So, our advice to policymakers would be to focus whatever resources are available in terms of public funds on hazard mitigation. Avoid insurance subsidies, so avoid governmental programs that try to subsidize the cost of insurance. Instead, focus on a long-term payoff that will be received from hazard mitigation efforts. For every \$1 somebody invests in hazard mitigation, there will be a \$4 payoff according to federal research on hazard mitigation programs.

Heintjes: *Well, that's very interesting. Bradley, thank you for joining us today.*

Kading: Thanks, Tom. It's been a great opportunity.

Heintjes: *This concludes our podcast with Bradley Kading, president and executive director of the Association of Bermuda Insurers and Reinsurers. For more podcasts on this topic and others, visit the Atlanta Fed's website at frbatlanta.org. If you have comments or questions, please e-mail podcast@frbatlanta.org.*

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