

The home insurance crisis could use a public assist



A house smolders in the aftermath of the Marshall fire in Rock Creek above the Interlocken golf course Dec. 31, 2021. The Marshall fire, fueled by high winds, destroyed more than 500 houses. ANDY CROSS — DENVER POST FILE

BY MARK GONGLOFF

BLOOMBERG OPINION

At a moment when America's home insurance crisis has become bad enough to turn conservatives into socialists, a possible solution may just involve — you guessed it — big government. And contra Ronald Reagan, in this case there's reason to think the government truly can help.

To address soaring insurance premiums and coverage gaps in an age of worsening climate- fueled disasters, the Brookings Institution has proposed creating a federal reinsurance company to cover U.S. home insurers. It would be, as proposal co-author Benjamin Keys of the Wharton School put it in a rollout event last week, a sort of "public option" for home insurance.

Ideally, "US Re" would lower costs, make it easier for homeowners to protect themselves against catastrophe and absorb insurance-market shocks, all without encouraging people to keep rebuilding in risky areas. That's a thin

tightrope to walk, and the proposal's political odds seem even thinner — for now. The longer we have to wait for better ideas, the more the idea of federal reinsurance will get attention. As well it should.

Reinsurance is basically insurance for insurance companies that helps them cover disaster losses.

One reason home insurance costs have far outpaced consumer price inflation in recent years, as the price-comparison site Insurify reported last week, is that private reinsurers have jacked up their rates to deal with bigger damages.

Insurance companies have hot-potatoed those costs down to the rest of us. In the most extreme cases, they've abandoned markets altogether, pushing homeowners into state-backed plans such as the California and Colorado FAIR Plans, which offer less coverage at high rates.

Rising disaster damage only partially explains the jump in reinsurance premiums. The rest of it, as the Brookings proposal explains, is down to capital costs and uncertainty. Reinsurers' costs of raising the capital they need to do business have been rising, with spikes after particularly bad disaster seasons. Reinsurers also want thicker financial padding in their premiums to account for the uncertainty of a world where the atmosphere is growing more chaotic because of global heating.

A U.S. government-run reinsurer, in contrast, would have the cheapest capital costs of any player on the planet, Brookings points out. It also would be the only reinsurer with a big enough fiscal stomach to digest the damage from multiple mega-disasters.

Lower reinsurance premiums might lure insurers back to California hillsides, Florida beaches and other climate-change battle zones. A market with more insurers would mean competition, which would mean lower premiums, bringing homeowners back to the fold and encouraging them to buy better coverage.

The gap between home values and actual insurance coverage, which could amount to \$2.7 trillion, by one estimate, would close. More and better home insurance also would relieve some of the financial burden on the Federal Emergency Management Agency and other taxpayer-funded disaster-relief agencies.

That's the perfect world. In reality, a lot can go wrong with this kind of plan if it's not executed well.

A relevant cautionary tale is the National Flood Insurance Program, which was created in 1968 after devastating floods chased private insurers from the market.

The idea was for the government to provide flood coverage while also discouraging people from building and rebuilding in flood-prone areas.

Everything that could go wrong with the NFIP has gone wrong.

Political pressures have kept premiums artificially low. Outdated floodplain maps have left everybody in the dark about true flood risks. Although mortgage lenders typically make sure homeowners keep house insurance, they often don't bother for flood policies, Harvard University economics professor Rebecca Diamond said at the Brookings event. Only 4% of Americans have flood insurance, although many thousands more need it.

The proposal's authors acknowledge these pitfalls and have tried to design US Re to avoid them. Because it would be a reinsurer and not a direct provider such as the NFIP, private companies still would write actual home policies. Those insurers still would have incentives and the risk data they need to set realistic premiums and send constructive signals to homeowners and politicians about risky behavior. There would be less threat of homeowners in relatively disaster-free locales subsidizing those who take bigger risks.

"We're not thinking of this as a government backstop of the market," Keys said. "It's an option. It would be a countercyclical shock absorber rather than taking over the market."

A slightly better, although still flawed, model can be found in that socialist haven of, uh, Florida.

The Florida Hurricane Catastrophe Fund is a state-backed reinsurer set up in 1993 after Hurricane Andrew caused huge insurer losses. Every private carrier in the state must participate in it for a fee, but they don't seem to mind; most take the priciest plans available. The FHCF arguably has helped keep Florida premiums from being more expensive. But it hasn't been nearly enough to keep them from leading the nation at \$8,292 a year, according to Insurify.

The problem with FHCF, as Brookings sees it, is Florida's limited access to capital. That means it can cover only middling disasters, leaving private insurers to cope with the biggest ones, your Andrews and your Ians.

Anyway, the idea's political moment may not be here yet. People have been kicking around plans for federal home insurance for decades and gotten nowhere.

As catastrophes mount and premiums rise, such sentiment probably will grow. Thinking about previously unthinkable solutions such as these today will help us avoid ill-advised, hasty decisions in a hotter, more chaotic future.

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