Natural Disasters and the Homeowners Insurance Market

June 12, 2024

Insurance consumers in parts of the United States have been experiencing higher prices and gaps in coverage, with households often struggling to find and afford homeowners insurance that sufficiently protects against hazards such as wind and wildfire. This may leave some households unable to find insurance outside of state-created insurers of last resort offering coverage that may be more expensive or less complete than private coverage.

Recent media reports include accounts of insurers increasing premiums or withdrawing from homeowners insurance markets in many states. Without such insurance, lenders are unlikely to issue mortgages, leaving many people unable to purchase homes. Current homeowners may be left facing greater financial risk without insurance and may find difficulties in selling their homes. Higher insurance rates may serve as an important signal regarding future risk but may shift the risk of losses to individuals, the government, or other financial institutions.

Although most policies addressing insurance markets are enacted at the state level, the scale of recent withdrawals from the market has increased congressional interest in federal intervention.

Why Are Insurers Withdrawing from Some Insurance Markets?

Rising prices and reduced availability of homeowners insurance involves the interplay between two large-scale factors: (1) increasing losses from natural disasters and (2) the recent macroeconomic environment marked by rising inflation and interest rates.

Insured losses from natural disasters have increased over past decades, with nearly every major peril recording an individual insured loss event over $10 billion. Although large events such as major hurricanes cause outsized losses, secondary perils—lower cost but higher frequency events, such as thunderstorms—caused higher combined losses in 2022 and 2023—the fourth consecutive year where global insured losses topped $100 billion. Losses reached this threshold, although no single event caused more than $10 billion in insured losses. The prediction of an above-average Atlantic hurricane season in 2024 is leading to concerns about additional increases in homeowners insurance premiums. Increasing losses from natural disasters can be attributed to a combination of factors: rapid expansion of population

Congressional Research Service
https://crsreports.congress.gov
IN12375

into areas susceptible to natural disasters, increasing replacement costs, higher reinsurance costs, inadequate building codes, and climatological and environmental changes.

The U.S. homeowners insurance industry has experienced net underwriting losses in all but one year since 2017, and over the past decade insurers have paid out more in claims than they received in premiums. If risks increase or become more volatile, regardless of the cause, insurers often respond by reducing their net exposure to these risks, typically by increasing premiums or reducing the insurance offered. Premium increases allow insurers to increase the capital available to pay future losses and encourage consumers to purchase less insurance, reducing future claims. Insurers may reduce insurance offered on an individual basis by cancelling or not renewing insurance policies seen as the highest risk or, on a broader geographic basis, by ceasing to offer insurance (either entirely or specific product lines) in certain areas. These responses are primarily intended to protect the interests of the individual insurer and may end up creating difficulties for individual consumers or the broader economy. This industry reaction is not new—the National Flood Insurance Program (NFIP) was created in 1968 following widespread insurer withdrawals from offering coverage for flooding.

Where Are Insurers Withdrawing from the Market?

Changes in the availability of wildfire insurance in California and wind insurance in Florida have received the most attention, but recent reports also include accounts of insurance companies increasing premiums significantly or withdrawing from the wildfire or wind markets in other states. Examples include Colorado, Texas, Hawaii, Washington, Louisiana, Iowa, and Illinois. In 2023, insurers lost money on homeowners coverage in 18 states.

What Are the Respective Roles of the Federal Government and the States?

Homeowners insurance in the United States is primarily regulated by individual states, and states are typically the first actors in addressing insurance market issues. Each state government has a department charged with regulating insurance companies and the sales of insurance products. The National Association of Insurance Commissioners, comprised of each state's insurance regulator, fosters uniformity in insurance regulation. States have used their regulatory role to address immediate market disruptions though polices such as moratoria on cancellations and to encourage risk mitigation through rate discounts for homeowners who build houses that are more fire resistant or who reduce flammable materials around their houses or elevate flood-prone structures. In some cases, states have created the aforementioned insurers of last resort to address gaps in the market. The state-based insurance regulatory system falls under the auspices of the 1945 federal McCarran-Ferguson Act.

Because insurance plays an important role in the overall economy, larger-scale market instability can lead to federal government intervention. For example, after the 9/11 terrorist attacks, insurers quickly moved to exclude terrorism losses, with terrorism insurance coverage becoming extremely expensive or unavailable. Congress responded with the Terrorism Risk Insurance Act (TRIA), which required insurers to offer terrorism coverage, and created a federal reinsurance program to share in terrorism losses.

Congress has preempted aspects of state regulation in addressing insurance market disruptions. This occurred in TRIA and in the Liability Risk Retention Act. Other programs, such as the NFIP and federal crop insurance, supply insurance more directly.

Another federal policy option would be to encourage more hazard mitigation actions that may lead to lower damages and claims. Effective mitigation actions, at both the individual level and the community level, could make policies less expensive for households implementing them and potentially stabilize insurance markets. Federal grants and loans already fund mitigation actions to allow homeowners and businesses to undertake property-level mitigation, possibly targeted at properties with repeated losses or for communities to adopt and enforce hazard-resistant building codes. Federal funding could encourage community mitigation actions for perils such as wind or wildfire, possibly modeled on the NFIP Community Rating System. Federal funding could also provide incentives for insurance companies to offer discounts for approved mitigation actions.

Author Information

Diane P. Horn
Specialist in Flood Insurance and Emergency Management

Baird Webel
Specialist in Financial Economics

Disclaimer