THE WALL STREET JOURNAL.
WSJ.com

INSURANCE | SEPTEMBER 14, 2009

Insurance Pool's Coverage to Coastal Carolina Ebbs

By LESLIE SCISM

Burgeoning state-created insurance pools that provide hurricane coverage in coastal areas have fueled a perception that rich homeowners are getting too good a deal. A new law in North Carolina asks both coastal and inland policyholders to give ground.

Under the law, which took effect late last month, coastal-area homeowners covered by the insurance pool can get $750,000 of coverage per dwelling, half of the $1.5 million previously available. About 3,000 homeowners who need more than $750,000 in coverage will go to private insurers to get the rest, at possibly much-higher prices.

Getty Images

A Wilmington, N.C., utility worker uses a chain saw to cut an oak tree felled by Tropical Storm Hanna in 2008.

In return, inland homeowners are now on the hook for some beach-area hurricane claims.

The state's overhaul is the latest -- and one of the stiffest -- by hurricane-prone states to rein in exposure for the state-created "insurers of last resort" and line up resources to pay for it. Swollen by coastal development, the nation's last-resort insurers have about 2.6 million policies in force, more than twice as many as in 2001, according to trade groups.

Lowering the coverage cap has been a hot topic in other states, too, with inland residents contending that, through state pools, they unfairly subsidize risks that coastal homeowners should bear. But few legislatures have moved as aggressively as North Carolina's, according to the trade groups. In Florida, over the objections of some lawmakers who would like a lower cap, the limit for wind-damage policies in the riskiest areas is $2 million.

In North Carolina, the lower coverage cap will hit only about 2% of the 166,000 residential policyholders in what is widely called its Beach Plan. But the provision was important in persuading inland lawmakers to support legislation that could cost constituents, but that ultimately is designed to keep private insurers in the state.

The new law obligates private insurers to pony up as much as $1 billion industrywide to help the plan pay claims from a megahurricane, with surcharges on property policies statewide to kick in after that.

Phil Berger, a state senator in Eden, 250 miles from the closest beach, voted for the law. But he insisted on the coverage limit.

"To require somebody who owns a house that sells for $150,000 to subsidize the insurance on somebody's house that is valued at $1 million just isn't right," he said.

North Carolina is dotted with small towns, many of them struggling with the decline of the textile and furniture industries. The state's unemployment rate of 11% is above the national average.

Like many coastal states, North Carolina experienced a development boom along its beaches over the past decade. Many owners of North Carolina coastal property are just now learning details of the law, as their policies come up for renewal. "They're basically outraged," said Len Gibbs, of insurance and real-estate firm Chalk & Gibbs Inc. in the coastal community of Morehead City.

Last week, Mr. Gibbs was working on homeowner and hurricane coverage for the Massachusetts owner of a roughly 4,000-square-foot house on Emerald Isle. Under the expiring $1.5 million Beach Plan policy, the owner paid about $12,500 annually. A new $1.4 million package from the Beach Plan and private coverage totals $15,790. The 26% increase comes even though coverage for the home's contents is reduced, thanks to another provision of the new law.

Real-estate and tourism executives against the lower cap argued that many big beach houses are rental properties vital to the state's tourism trade. Large beach houses "generate revenue for the owners and the property managers and the landscapers and handymen, the cleaners, all of that," said Rick Zechini, an executive with the North Carolina Association of Realtors.

The concept of last-resort plans is that they charge rates above those of the private sector, to encourage people to buy elsewhere. But many private insurers have scaled back sales in hurricane-prone areas as regulators rejected requests for big rate increases. That has pushed people into the last-resort plans, paying rates that the insurance industry generally maintains are inadequate.

Before the new law, North Carolina's plan required property insurers to help play claims in the event that the plan's coffers couldn't cover the costs of a huge storm. But there was no mechanism to allow insurers to pass the costs to customers. The unlimited liability drove one major insurer out in 2008, and officials feared others would follow.

Now, if the plan's coffers are emptied by a big storm, the plan would first call on the insurance industry to contribute as much as $1 billion. If that still isn't enough, policyholders from across the state would face surcharges on their property-coverage bills of as much as 10%. In return, Beach Plan homeowner policies will provide a maximum of $1.05 million in coverage: $750,000 for the dwelling and an additional $300,000 for contents -- down from $2.6 million, or $1.5 million for the dwelling and $1.1 million for contents.

Some owners of expensive houses say they understand the trade-offs. "I am pleased that we will have market stability," said J. Fletcher Willey Jr., who owns an insurance agency in Nags Head and lives on nearby Roanoke Island in a home that is affected by the cap.

Write to Leslie Scism at leslie.scism@wsj.com