

Insurers Can Tame Hurricane Exposures

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With much accompanying publicity but no real surprise, the National Oceanic and Atmospheric Administration (NOAA) recently announced that the 2006 Atlantic hurricane season is expected to be worse than average. From the 11 storm average of the past 40 years, NOAA anticipates 13-to-16 named storms this season. For personal and commercial lines insurers alike, this appreciable escalation of expected hurricane frequency likely has caused a reflexive reaction, heightening the focus on coastal counties in each of the hurricane-susceptible states on the Atlantic and Gulf coastlines.

Before accelerating the pace of nonrenewals in these coastal areas, however, carriers may find it worthwhile to review some of the facts about risks in each hurricane-sensitive state, and to develop state-specific strategies based upon each state's actual conditions. This article is intended to provide a broad brush view of some of the considerations within commercial lines; formulation of an actual strategy, of course, requires much more detailed analysis.

Where's the hurricane risk?

After the past few years' hurricanes, no one needs the following chart to convince them that Florida and Louisiana present the most intense risks for

commercial lines property exposures. Still few commercial lines types would come close to estimating the magnitude of Florida's risk. Moreover, even fewer would come close in estimating the relative risk present in other key states such as South Carolina or Texas.

It's important to note that Florida's extreme reading on this hurricane property risk scale is caused by the confluence of two distinct factors. The first, obviously, is the very high likelihood of a hurricane striking most any area within the state. That being said, some counties in Florida are almost twice as likely to sustain serious

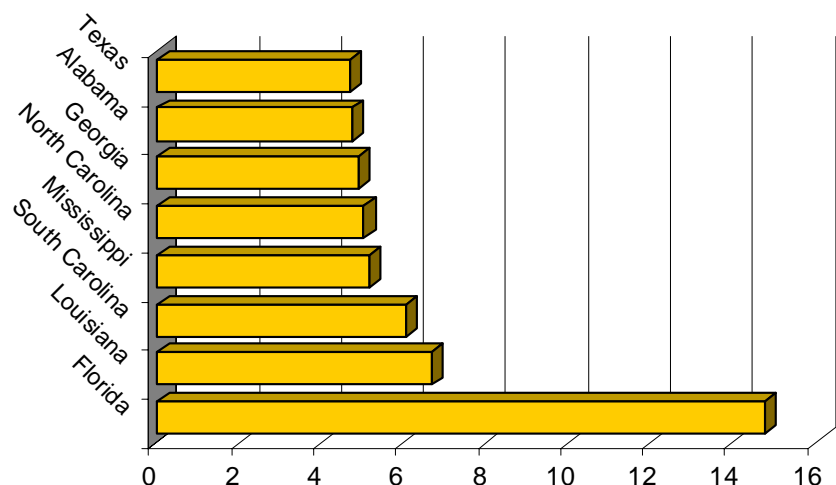
hurricane damage as other more northerly or inland counties. The second, less obvious factor, demonstrated in Chart 2, is that a large concentration of Florida's commercial lines property risks are located in the very counties having the highest hurricane likelihood.

How important is the coast?

The share of commercial line property exposures situated in coastal counties varies greatly among the Atlantic and Gulf Coast states. In Florida, more than 90% of the C/L property exposures are located in coastal counties. First strategic conclusion: coastal versus non-coastal distinctions are of relatively little importance in managing C/L hurricane exposures in Florida.

Chart 1

Relative Commercial Property
Hurricane Risk by State
Property-weighted Hurricane Risk Index



Texas and Louisiana also have quite sizable shares of their commercial lines property exposures located in coastal counties. However, these shares occur for somewhat different reasons than in Florida, and importantly, can lead to somewhat different strategic implications.

In Louisiana, the high 60% share of coastal county concentration reflects the fact that much of the state's industrial activity is located near the Mississippi River. Even well inland, the high potential for serious hurricane-induced storm surges has led the federal government to include most river-bordering counties in its coastal list. In essence, minimizing hurricane-susceptible property exposures in Louisiana requires avoiding much of the state's coastline commercial risks, and inland, paying close attention to elevation above flood stage of risks with proximity to the Mississippi river.

The situation in Texas is not quite so extreme. This state has a more moderate 35% share of property exposures situated in coastal counties. However, given that the state has extensive inland areas, this coastal share is quite high; largely reflecting the importance of the state's oil and gas-producing or supporting industries, much of which necessarily are located adjacent to the Gulf of Mexico. Strategic conclusion two: insurers eschewing oil and gas risks will find it much easier to manage their hurricane exposure in Texas.

The remaining states shown in Chart 1 all have relatively modest shares of their commercial property exposures concentrated in coastal areas – from 10% in Georgia to 18% in Mississippi. This suggests that simple avoidance of coastal risks is likely to be a much more sustainable strategy in these states than in the aforementioned three states.

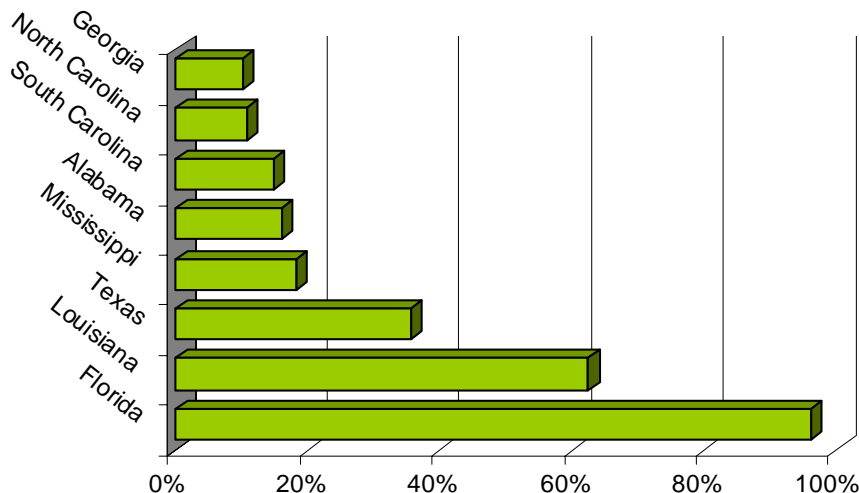
Are there key classes of business?

Even in these lower coastal involvement states, actual market characteristics can help to better define a state-specific strategy. As shown in Chart 3, the share of the real estate-related risks in coastal counties varies significantly. In particular, South Carolina is seen to have a very high share of its leased real estate property values in coastal counties – just about double the corresponding share for all other C/L classes. This suggests that a South Carolina hurricane strategy should focus on reducing real estate property risks and inversely, needs be less concerned with reducing the property risks associated with other classes of business in the state.

In contrast with South Carolina, Georgia is found to have a very modest share of its leased real estate located in coastal counties. As a result, an effective hurricane risk mitigation strategy for this state must focus on property risks stemming from classes of business other than real estate lessors and operators.

Chart 2

Coastal Counties' Share of Commercial Property Exposures
Percent of All C/L Property Exposures in Coastal Counties



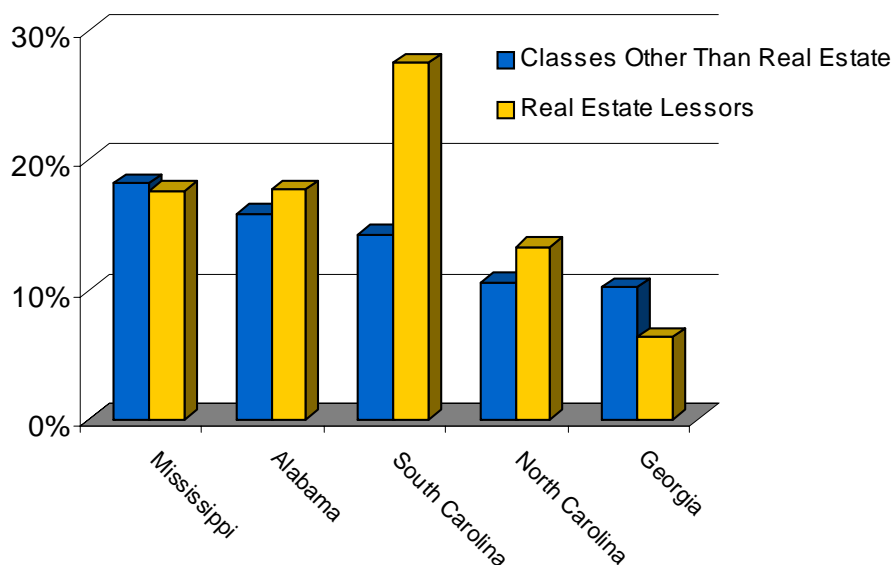
Can a coastal-focused strategy solve the problem?

Using the property-weighted hurricane risk index introduced here, it's possible to ask just how much more risky are coastal counties than their landlocked counterparts. In essence, each property risk's value is weighted by the relative likelihood of significant hurricane damage and the resulting aggregate is compared to the same calculation for a reference state such as Tennessee. For the states discussed in this article, the coastal vs. noncoastal results are shown in Chart 4.

Not surprisingly, noncoastal counties in Florida represent only a modestly lower level of C/L

Chart 3

Real Estate Presence in Coastal Counties Percent of Property Exposures in Coastal Counties



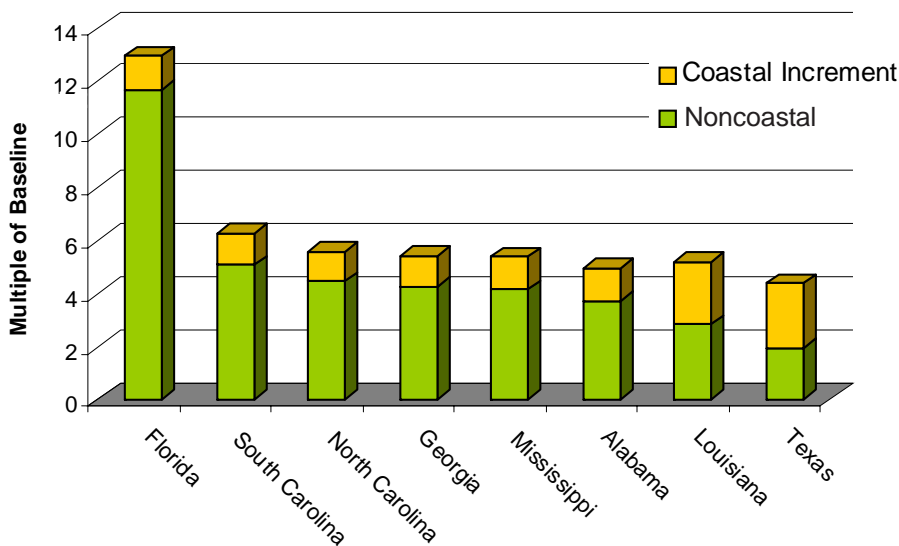
Noncoastal commercial lines risks in Georgia, North Carolina and South Carolina, however, are only moderately lower than in coastal counties. Nevertheless, shifting the emphasis of a book of business on these three states and away from exposures in Florida can result in a marked decrease in overall hurricane-related property risk.

What's a carrier to do?

By now well known in the industry, the probable maximum loss on a book of C/L business is a very important metric in managing hurricane risk. Unfortunately, this concept implies a largely reactive strategy: 1) Put business on the books, 2) measure the PML, 3) non-renew accounts to limit the PML. While the same strategy can be employed in all hurricane exposed states, its reactive nature takes no advantage of each state's unique distribution of commercial lines risks – and can carry the additional “cost” of substantial consumer and regulatory backlash

Chart 4

Comparison of Coastal and Noncoastal Risk by State Property-weighted Hurricane Risk Index



The concepts presented here provide carriers a glimpse of how more proactive state-specific strategies can be formulated to mitigate hurricane risk without the high cost of reactive strategies.

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property risk than do its many coastal counties. In contrast, non-coastal counties in Texas and Louisiana have substantially lower relative risk levels than do their coastal county cousins. This suggests that redistribution of a

given commercial lines book from coastal to noncoastal counties will have a significant impact on aggregate hurricane risk in these two states.



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