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Pattern of Greed 2007:

HOW INSURANCE COMPANIES PUT PROFITS OVER POLICYHOLDERS

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Introduction

It has been two years since Hurricane Katrina swept across the Gulf Coast, leaving historic levels of death and destruction in its wake. The storm caused an incredible $135 billion in damages, leaving thousands homeless, jobless and bereft of hope. Facing their darkest hour, many of the survivors found themselves victimized a second time by an insurance industry offering pennies on the dollar, refusing to honor many agreements, and claiming that the destruction had nothing to do with wind damage, which is covered under most policies, but was caused by floodwater, which is not. Mississippi Attorney General Jim Hood declared that some insurance companies even engaged in fraud, alleging that adjusters for some firms tried to trick Katrina victims out of millions of dollars in homeowner claims.

Katrina is not the first instance in which victims of natural disasters have been victimized a second time by the insurance industry. Over the years, insurance companies have used all manner of tactics to avoid paying for the natural disasters they insured against. From forging signatures on earthquake waivers after an earthquake, to claiming termites were responsible for tornado damage, no tactic is too low for an industry that consistently puts profits over its own policyholders to bloat its bottom line.

And what a bottom line it is. Insurance companies made more than $40 billion in 2005, the same year hurricanes Katrina, Wilma and Rita devastated the Gulf states. In 2006, the property-casualty industry boosted those profits nearly half as much again, to over $60 billion. With a callousness that is shocking, industry officials justified the record-breaking profits as a chance to “fix the roof while the sun is shining.” That irony was surely not lost on Katrina victims still living in FEMA trailers.

While the insurance industry enjoys skyrocketing profits and bulging bank accounts, the victims are still trying to get back on their feet. It’s no surprise. As this report shows, the insurance industry has made a practice of collecting billions of dollars from policyholders over the years and then stiffing them in their time of greatest need. It is a pattern of which Hurricane Katrina is just the most recent example—a pattern of greed.

Insurance Companies' Tactics Following Hurricane Katrina

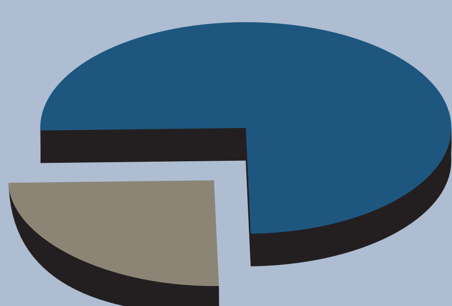
One of the deadliest natural disasters in U.S. history, Hurricane Katrina made landfall on August 29, 2005 near Buras, Louisiana. The storm killed nearly 1,600 people and caused $135 billion in damages.[1] Soon after Hurricane Katrina hit, and before anyone could possibly assess the damage, the insurance industry began their spin on the storm, calling it the "Great New Orleans Flood."[2] The distinction the industry hoped to make was an important one because, while wind damage from a storm is covered under homeowners policies, flooding is not.

INSURANCE INDUSTRY SPIN: "THE GREAT NEW ORLEANS FLOOD"

Immediately after Hurricane Katrina came ashore, and before anyone could possibly assess the damage, the insurance industry began pushing the message that the damage was caused by flooding, rather than wind. "The fact that a government-run levee fails and creates a flood does not create a liability for private insurers," said Robert Hartwig, chief economist with the Insurance Information Institute in New York. "I would say in dollar terms, at least among homes, the majority is related to floods."[3] William Bailey, a coordinator for the Hurricane Insurance Information Center, an industry clearinghouse for storm recovery information, added "Clearly most, if not all, of the damage to their homes is from the floods."[4]

The distinction was important because wind damage is covered under homeowner policies—flooding is not. Industry representatives took the message one step further when they tried to "spin" the storm as "The Great New Orleans Flood." The phrase first appeared in a press release issued by insurance industry group Risk Management Solutions (RMS), just three days after Katrina made landfall. RMS claimed that the flooding would account for at least 50% of the anticipated total economic losses, and that, "The 2005 Great New Orleans Flood has developed into the most damaging flood in U.S. history... The nearest historic analog to the 2005 Great New Orleans Flood is the 1953 flood in the Netherlands, also caused by a major wind-driven storm

Insurer Coverage of Katrina



RMS estimated that insurers would only have to pay $20-35 billion of the more than $100 billion in Katrina-related economic losses[6]

surge that overwhelmed poorly maintained defenses protecting land below sea-level."[5]

Following RMS' use of the term, other insurance entities began following suit. The Aspen Insurance Company disseminated a press release stating, "[a]lthough we believe the economic loss from the Great New Orleans Flood will exceed economic losses from Hurricane Katrina, our preliminary analysis suggests that the flood losses are substantially uninsured. We expect that Aspen's share of the industry's insured flood losses will be modest compared to Hurricane Katrina."[7]

The industry's attempt to spin the storm as a flood caught the attention of the Associated Press, which reported that, "Insurers are posturing to limit the amount of damages by saying massive flooding in storm-ravaged New Orleans is a separate event from the hurricane itself. This distinction could save insurers billions of dollars more from a catastrophe billed as the costliest natural disaster ever to face the industry. Some carriers have even adopted the phrase 'The Great New Orleans Flood' in an effort to make that distinction more tangible."[8]

Despite the concerted effort to have the damage reported as flooding, meteorologists would later testify that hurricane-force winds battered the coast for hours before water rushed onto land.

DENIAL OF CLAIMS

The next stage in the industry's post-catastrophe playbook was to reduce losses during the claims-handling process. Over the years insurers have been known to systematically deny claims or offer significantly less than true value for homes and replacement contents.[9] After Katrina, insurance industry spokespersons were quick to claim that insurers were acting fairly. According to Robert Hartwig of the Insurance Information Institute, insurers settled 95% of claims within one year of Katrina. State Farm claimed to have settled 99% of its cases.[10] However, Mississippi Attorney General Jim Hood accused the insurers of using misleading statistics. According to Hood, the insurers claimed that any house that had what they considered to be water damage did not constitute a claim in the first place.[11] In Louisiana the Department of Insurance reported that it was contacted by more than 9,000 consumers seeking help resolving disputes with their insurance companies.[12]

Nationwide Insurance Company denied the claims of more than 200 policyholders citing policy provisions that exclude coverage for water damage and for damage arising from

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"weather conditions" that may contribute. According to lawsuits against Nationwide, the company reeled in customers with the promise of "all-risk" coverage, including a "hurricane deductible." The company then refused to pay the policyholders for most, or in some cases all, Hurricane Katrina damage, and used a generic report from Haag Engineering to deny claims (the same engineering firm that came under scrutiny in the Oklahoma tornadoes—see below). Haag's report concluded "storm surge" caused all property damage.[13] In one case Nationwide representatives denied the claim of Biloxi, Mississippi resident Seng Thai, telling him flooding was responsible for the damage to his home—and not wind. "Oh, he already came this morning," Thai told CNN of his adjuster. "Above the water line inside, six feet high, above is covered, below is not covered which is everything below is damaged, the whole thing."[14] In April 2007, Nationwide agreed to settle 227 cases.

State Farm denied the claims of the Nguyen family of Mississippi who lost their home in Hurricane Katrina. State Farm's own engineers concluded that the damage was caused by wind and even cited eyewitnesses who saw another house picked up by the wind and thrown into the Nguyens' home. State Farm, however, hired another engineering firm to come to a different conclusion and then denied the claim, saying the damage was caused by flooding.[15]

> "I really question the ethics of someone who wants to fire us simply because our conclusions don't match theirs."

State Farm also denied the claims of Dean Barras in Louisiana. Barras' home was exposed to the elements for two weeks, but State Farm's response was "the chimney was not built properly."[16]

INSURANCE COMPANY FRAUD

The insurance industry didn't stop at using the "wind vs. water" argument to avoid paying claims. Some insurance companies crossed the line and engaged in outright fraud.

Bob Kochran, CEO of an engineering firm assessing Katrina damage for State Farm, said that he was asked to alter reports that the company did not agree with. In order to keep the State Farm contract, Kochran agreed to tell his engineers to "re-evaluate each of our assignments." One of the engineers, Randy Down, responded in an email, "I have a serious concern about the ethics of this whole matter. I really question the ethics of someone who wants to fire us simply because our conclusions don't match theirs." State Farm's attempt to unduly influence the engineers was exposed during litigation in Jackson, Mississippi.[17]

Mississippi engineer Ken Overstreet similarly claimed that his reports on Katrina damage were altered by the insurance company he worked for on at least four occasions. In a report on the house of Mississippians Hubert and Joyce Smith, Overstreet wrote, "The winds out of the east would have racked the entire

structure to the west and simply lifted the footings up." However, the report that the Smiths received said, "Due to the extent of the structural damage to the residence, the storm surge accounted for the damage." When Overstreet saw the final report, he informed the Smiths that the conclusions had been changed. The Smiths' insurance company settled with them in March of 2007.[18]

Mississippi Attorney General Jim Hood sued State Farm and other insurance companies in 2005, alleging that adjusters for the companies tried to trick Hurricane Katrina victims out of millions of dollars in homeowner claims. According to Hood, insurance company adjusters were cajoling policyholders into signing forms acknowledging flood damage, which was not covered by homeowners' insurance, saying they were necessary to immediately receive a check for living expenses.[19] Hood claimed the companies would then use the forms regarding flood damage against policyholders later. In January 2007, State Farm settled the case by agreeing to review the claims, and hand over all communi cations between adjusters and engineers.[20] In June, Hood filed a bad faith breach of contract suit against State Farm alleging the company was trying to back out of the obligations it had agreed to.[21]

PULLING UP STAKES

After doing everything they could to deny claims the insurance industry's next step was to cancel, or threaten to cancel, homeowner policies. In March 2007, just days after the expiration of an emergency rule preventing insurance companies from canceling customers hit by Katrina, Allstate dropped nearly 5,000 customers for allegedly not showing intent to repair their properties. An investigation by the Louisiana Insurance Department found that the cancellations were unjustified. "At best, it was a very ill-conceived and sloppy inspection program," said State Insurance Commissioner Jim Donelon. "At worst, they wanted off of those properties."[22]

The rush to pull out of markets with unfavorable risks was not isolated to Katrina. Over the last few years insurers have been canceling and non-renewing policies across the country:

- In Massachusetts, six insurers have stopped selling or renewing policies in the past two years, leaving 45,000 homeowners without coverage.
- In New York, Allstate refused to renew 30,000 policies.

Insurance company adjusters were cajoling policyholders into signing forms acknowledging flood damage, which was not covered by homeowners' insurance, saying they were necessary to immediately receive a check for living expenses.

"...a chance to fix the roof while the sun was shining."

- In Florida, Allstate handed off 120,000 homeowners to a start-up insurer.
- In Texas, Allstate and five other companies canceled a total of 100,000 homeowners policies.
- In Connecticut, the state attorney general subpoenaed insurance companies for threatening to cancel thousands of policies if homeowners did not install storm shutters within 45 days.
- In South Carolina, most insurers have stopped selling coverage along the coast.
- In Rhode Island, 10,000 coastal property owners lost their insurance and many more faced major rate increases.

In fact, across the country, over one million homeowners have found themselves looking for new insurance or dealing with weakened policies.[23]

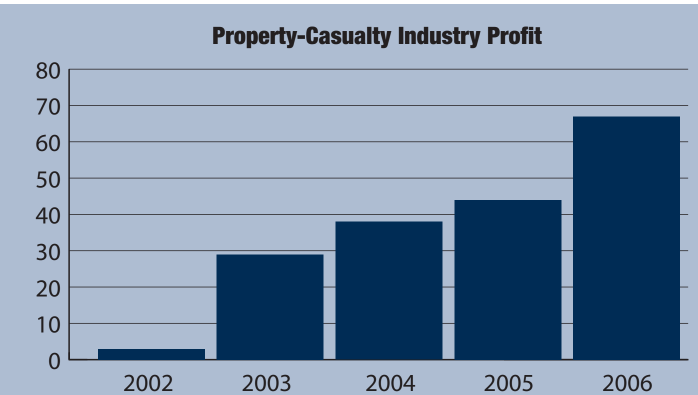
RECORD PROFITS

Hurricane Katrina caused twice the amount of losses as the previous most expensive catastrophe on record, 1992's Hurricane Andrew. Hurricanes Wilma and Rita, also in 2005, were, the third and seventh most expensive hurricanes in history respectively, and added a further $15 million in losses.[24] Yet remarkably, even after accounting for losses from the three storms, property-casualty insurers made a record profit of $44.2 billion in 2005, a 12 percent increase over the previous year and more than double the profit of five years earlier.[25] The industry also boosted its surplus by more than 7 percent to nearly $427 billion.[26] Nevertheless, Insurance Information Institute (III) President Robert Hartwig pleaded poverty, complaining that losses had taken their toll, and that "profitability in the industry is still low considering the extraordinary risk insurers assume."[27]

In 2006, the property-casualty industry's profits reached yet another record high, rising by an astonishing 44%, to $63.7 billion. In addition, the industry surplus rose another $60 billion to $487 billion. Hartwig abandoned the pleas of poverty this time around and instead justified the record-breaking wealth as "a chance to fix the roof while the sun was shining."[29] Policyholders still living in FEMA trailers would surely have found his choice of words ironic.

HAT IN HAND

Reaping over $100 billion in profits in the two years since Katrina did not stop the insurance industry from going hat in hand to politicians and asking for more. The industry made significant gains in the Louisiana legislature, garnering $100 million in grants. Consumers, meanwhile, received only the promise of a tax



According to the Insurance Information Institute insurers have made over $100 billion in profit since Hurricane Katrina.

Insurance Companies' Tactics Following Past Natural Disasters

credit for next year.[30] Consumer advocates were not impressed. "Florida learned the hard way that passing laws that please the insurers and try to encourage them to either lower prices or write more business doesn't work," said Bob Hunter of Americans for Insurance Reform. "The money does not trickle down to the people; it sticks in the insurers' bottom lines."[31]

The entire country came to the assistance of Hurricane Katrina victims in an unprecedented fashion, donating more than $3 billion in charitable contributions.[32] But the insurance industry, which has a legal responsibility to pay policyholders what they are due, has abandoned many of these victims. We shouldn't be surprised—as the following examples show, the insurance industry has a long history of putting its bottom line above the interests of victims of natural disasters.

THE NORTHRIDGE, CALIFORNIA EARTHQUAKE

On January 17, 1994, an earthquake with a magnitude of 6.7 struck the San Fernando Valley in California. It was the costliest earthquake in United States history. Fifty-seven

people were killed, 9,000 were seriously injured, and damage was estimated at $33.8 billion.[33]

Amy Zuniga, a former State Farm employee, testified that company officials repeatedly forged waiver documents to avoid paying earthquake-related claims, and then withheld key evidence to fend off lawsuits by policyholders.[34]

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Even when insurers did pay claims they underestimated values by as much as $250 million.[35] Insurers then refused to renew homeowners' earthquake policies, forcing the formation in 1996 of a state-run earthquake insurance company, the California Earthquake Authority.[36]

California State Insurance Commissioner Chuck Quackenbush allowed State Farm and other insurance companies accused of mishandling claims from the Northridge earthquake to donate $12 million to two non-profit foundations in lieu of over $3 billion in fines. The foundations had been created by Quackenbush. An insurance department whistleblower eventually revealed that much of the money had gone into projects that directly benefited Quackenbush, including the financing of TV ads on his behalf.[37]

HURRICANE ANDREW

On August 24, 1992, Hurricane Andrew made landfall in South Florida as a Category 4 hurricane. It caused 41 deaths and $37.6 billion in damages.[38]

The same day Hurricane Andrew hit South Florida, and before any damage could be assessed, AIG Executive Vice President J.W. Greenberg, son of AIG CEO Maurice R. "Hank" Greenberg, distributed an internal memo to senior managers throughout the country touting the storm as a chance to raise homeowner insurance rates. "We have opportunities from this and everyone must probe with brokers and clients," the memo stated. "Begin by calling your underwriters together and explaining the significance of the hurricane. This is an opportunity to get price increases now. We must be the first and it begins by establishing the psychology with our own people. Please get it moving today."[39]

American International Group (AIG) eventually recorded an after-tax profit of $344.6 million in the three months to end September, 1992. [40]

THE 1999 OKLAHOMA TORNADOS

In 1999, a series of powerful tornadoes killed 44 people in Oklahoma and caused $1.8 billion in damage.[41] Homeowners brought a class action against State Farm, alleging that the company had tried to understate damage to homes or claim that damage was caused by other factors such as faulty construction. In 2006 a jury ruled that State Farm had acted "recklessly" and "with malice" and had disregarded its duty to policyholders.[42] The firm that State Farm used to allegedly undervalue damage was Haag Engineering-the same firm accused of mishandling Katrina claims six years later.[43]

"We have opportunities from this and everyone must probe with brokers and clients. Begin by calling your underwriters together and explaining the significance of the hurricane. This is an opportunity to get price increases now."

In 1999, while State Farm Insurance was mishandling Oklahoma tornado claims, they earned a $1.03 billion profit after taxes.[44] Just as they did in the aftermath of Katrina, State Farm stopped writing new homeowner policies.[45]

HURRICANE IVAN

On September 16, 2004, Hurricane Ivan struck the United States near Gulf Shores, Alabama, as a Category 3 hurricane, and pounded the coast of Alabama, Florida, Mississippi and finally Louisiana. Ivan was the deadliest storm of 2004, causing 57 deaths and more than $14.7 billion in damages.[46]

State Farm Insurance Company denied the insurance claim of 83-year-old Joleeta Treadwell, whose home was damaged by a tornado caused by the remnants of Hurricane Ivan. State Farm representatives visited her home and claimed the damage was caused by flooding. Treadwell told *The Asheville Citizen-Times,* "I was surprised because I felt what had taken down my house was a tornado wind." State Farm then claimed the first stop for any appeal should be Treadwell's agent.[47]

In 2004, the same year in which State Farm denied Joleeta Treadwell's claim, the company posted profits of $5.3 billion—up from $2.8 billion in 2003.[48]

In 2005, the Florida Chief Executive Office Tom Gallagher ordered a criminal investigation into allegations that Paul Hulsebusch, the Chief Executive Officer of Florida's state-run Citizens Property Insurance Corp., accepted a $28,000 boutique brand motorcycle from a Texas firm in exchange for work it did in Florida handling insurance claims from Hurricane Ivan. According to *Florida Today,*[49] "It [Gallagher's investigation] found resolution of more than 120,034 claims fell to hundreds of freelance adjusters under contractors who answered only to other contractors. Outside companies without contracts paid themselves, hired family members and billed Citizens for pay never passed to their adjusters."[50] Hulsebusch eventually stepped down and Citizens paid nearly $1 million to settle the case.[51]

HURRICANE FRANCES

Hurricane Frances came ashore on the central east coast of Florida on September 5, 2004. The storm caused $8.9 billion in damages.[52]

Patrick and Carolyn Kelso's 1,100 square-foot Florida home suffered serious damage from Hurricane Frances, including foundation damage, stripped siding, and a ruined roof. Their insurance company refused to pay the claim for nearly two years, claiming the damage was the result of termite infestation. A jury ruled that the hurricane had left the house a total loss and ordered the company to pay $61,600.[53]

THE 2003 CALIFORNIA WILDFIRES

A series of wildfires devastated Southern California in 2003, destroying over 2,000 homes near San Diego alone, and killing 15 people. State insurance regulators received over 600 complaints about insurers' handling of claims. Yet the state authorities levied only small fines against some companies, and none at all against some of the worst offenders like insurance giant Allstate.[54]

Appendix

INDUSTRY QUOTES

"We have opportunities from this and everyone must probe with brokers and clients. Begin by calling your underwriters together and explaining the significance of the hurricane. This is an opportunity to get price increases now. We must be the first and it begins by establishing the psychology with our own people."

— AIG Executive Vice-President J.W. Greenberg, referring to Hurricane Andrew.[55]

"[Hurricane Katrina] is a significant event for our company. Our loss will leave us with enough capital to really thrive in the market opportunity that's going to follow. Following an event like Katrina, given how bullish we are about that market, this is one of those happy cases where if a rating agency were to insist that we raise capital to maintain our rating, it wouldn't trouble us much at all."

— Jeff Radke, CEO of PXRE, a Bermuda-based reinsurer, during a presentation at a post-hurricane industry conference.[56]

"[A] chance to fix the roof while the sun was shining."

— Insurance Information Institute President Robert Hartwig, referring to the property-casualty industry's record-breaking $63 billion profit in 2006.[57]

"Insurance is a business based on risk, and any risky business proposition must have a relatively high rate of return for investors from time to time, or the investors will take their capital elsewhere, and that business will cease to exist. Fortunately for all Americans, the property-casualty industry had a much better year financially in 2006 than in 2005 or 2004, when we saw record losses from natural disasters."

— American Insurance Association President Marc Racicot, conveniently forgetting state regulations mandate that rates be adequate but not excessive.[58]

"The 2005 Great New Orleans Flood has developed into the most damaging flood in U.S. history."

— Insurance group RMS press release trying to spin the damage from Hurricane Katrina as a flood.[59]

"Our obligation is to earn a return for our shareholders."

— Allstate President and CEO Thomas Wilson explaining Allstate's reasons for pulling out of coastal markets and simultaneously making clear his company's priorities.[60]

"[T]he goal is to withdraw [from the market] and let the pressure for reform build in the courts and in the state legislatures."

— John Byrne, then Chairman and CEO of GEICO, outlining the strategy of market withdrawals.[61]

"The bottom line is that insurance companies make money when they don't pay claims."

— Mary Beth Senkewicz, a former senior executive at the National Association of Insurance Commissioners (NAIC), explaining industry motives for denying claims.[62]

INDUSTRY FINANCES

Over the past eight years the insurance industry has seen its profits nearly double, while adding over $150 million to its surplus reserves. According to data provided by the Insurance Information Institute, industry profits increased from $22.2 billion in 1999 to nearly $64 billion in 2006. The data also indicates that the insurance industry has seen its surpluses grow by 45 percent-from $336.30 billion in 1999 to $487.1 billion in 2006.

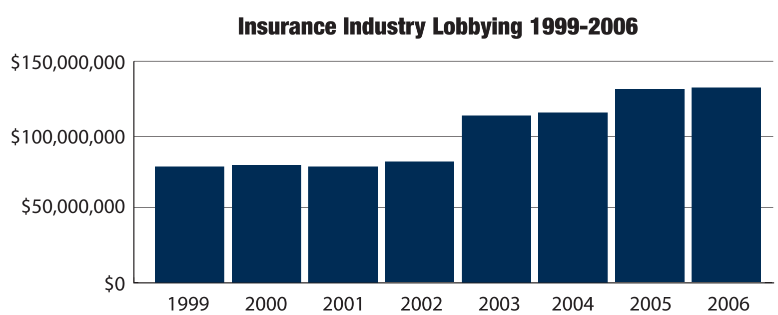
Insurance Industry Finances, 1999-2006 ($ Billions)

	1999	2000	2001	2002	2003	2004	2005	2006	Percent Change 1999-2006
Earned Premiums	282.9	296.8	312.4	348.2	388.1	412.6	417.7	435.8	54%
Incurred Losses	222.2	241.6	276.1	282.5	289.8	299.5	311.4	283.7	27.7%
Expenses	80.8	83.9	87	94.3	101.1	106.4	110.3	117.5	45.4%
Policyholder Dividends	3.3	3.9	2.3	1.9	1.9	1.6	1.9	3.4	3%
Investment Income	38.6	40.8	37.1	36.7	38.7	39.6	49.5	52.3	35.5%
Net After-tax Income	**22.2**	**20.2**	**-7.9**	**2.9**	**29.9**	**38.7**	**43**	**63.7**	**186.9%**
Surplus (End of Period)	**336.30**	**319.4**	**289.6**	**285.2**	**347**	**393.5**	**427.1**	**487.1**	**44.8%**

Source: The Insurance Information Institute, http://www.iii.org/media/industry

CAMPAIGN CONTRIBUTIONS AND LOBBYING EXPENSES

The insurance industry is one of the most powerful lobbying forces in Washington, DC. According to the Center for Responsive Politics, federal lobbying disclosure reports indicate that the industry has spent a total of $893,303,613 lobbying Members of Congress and federal agencies/departments between 1998 and 2006.63 In addition to these lobbying expenses, individuals and political action committees linked to industry have contributed hundreds of millions of dollars to federal candidates and party committees. In fact, the Center for Responsive Politics has ranked the top 80 industries that have contributed to federal campaigns, and the insurance industry was listed as the 7th biggest contributor since 1989.



Source: The Center for Responsive Politics, http://www.opensecrets.org/lobbyists/indusclient.asp?code=F09&year=2006

Insurance Industry Campaign Contributions (Federal Campaigns and Committees), 1989-2006

Election Cycle	Rank	Total Contributions	Contributions from Individuals	Contributions from PACs	Softy Money Contributions
2006	8	18,580,144	6,923,471	11,656,673	N/A
2004	9	36,153,618	19,757,899	16,395,719	N/A
2002	8	37,610,416	9,159,395	12,334,265	16,116,756
2000	7	41,554,668	13,188,742	12,413,562	15,952,364
1998	6	30,129,585	7,919,554	11,268,084	10,941,947
1996	6	32,888,052	10,515,555	11,737,683	10,634,814
1994	5	21,602,510	6,508,807	10,727,340	4,366,363
1992	6	21,652,031	7,280,280	10,653,255	3,718,496
1990	4	12,795,603	3,156,141	9,639,462	N/A
Total	7	252,966,627	84,409,844	106,826,043	61,730,740

Source: The Center for Responsive Politics, http://www.opensecrets.org/industries/indus.asp?Ind=F09

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