THE WALL STREET JOURNAL.
SATURDAY, MAY 6, 2006

Who Needs A Flood Policy?

There's a Good Chance You Do; Feds Urge More Inlanders to Buy Insurance Before the Next Katrina

By M.P. McQueen

IF FLOOD INSURANCE sounds like something only beach dwellers need to worry about, think again.

Flooding ranks as the most common natural disaster in the U.S., occurring in all 50 states, and is surprisingly widespread. For instance, Pennsylvania, which has no oceanfront, had more flood-insurance claims in 2004 than any state except Florida, according to the Federal Emergency Management Agency. The reason? Heavy rains from Tropical Storms Ivan and Frances.

However, relatively few people insure themselves against the risk—even in danger spots. Despite last year's tragic hurricane season and high-profile coverage of the aftermath, 40% of private homes in high- risk areas in the South and West remain uninsured for floods, according to a March report by nonprofit research group Rand Corp.

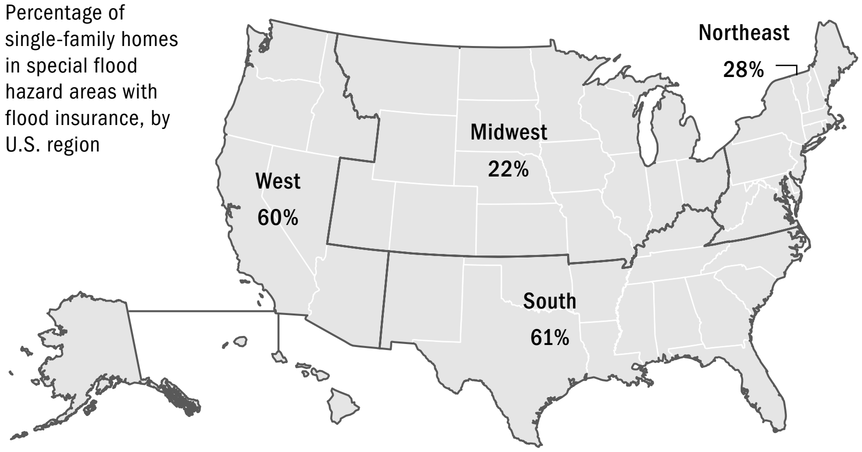
The statistics are more troubling for the Midwest and Northeast, where less than a third of privately owned houses in high-risk flood zones have coverage. The definition of a high-risk zone: An area with more than a one-in-four chance of flood damage over a standard 30-year mortgage.

Overall there are 11 million people who live in high-risk flood plains, and only a quarter of them have bought flood insurance, according to Insurance Information Institute, an industry research group. Nearly all home-insurance policies specifically exclude flood damage from coverage. As a result, damage from, say, a local flash flood after a rainstorm typically wouldn't be covered.

The Northeast is particularly at risk in coming years, FEMA says, given that it's "long overdue" for a major storm on the scale of the 1938 hurricane that clobbered New York and Massachusetts. All of this triggered FEMA this past week to launch an ambitious $19 million campaign to encourage more people to shell out for flood insurance.

Landscape

Percentage of single-family homes in special flood hazard areas with flood insurance, by U.S. region



Source: Rand Corp.

Basic coverage for homeowners, renters and small businesses is provided through the National Flood Insurance Program, or NFIP, which is part of the Department of Homeland Security. These policies, which are subsidized by taxpayer money, are relatively inexpensive and are sold by regular insurance agents.

However, the government-backed policies have their shortcomings. They cover a maximum $250,000 for a home's structure, and $100,000 for contents, making them inadequate for higher-priced properties and they have other restrictions. For instance, they don't cover most of the contents of a basement if a house is in a high-risk zone. Nor do they pay living expenses if a family is displaced.

Another major drawback: They don't provide replacement-cost coverage, but instead pay a depreciated value for damaged property or belongings. In buying it, coverage doesn't take effect for 30 days. Once a hurricane is forecast for your area, it's too late to make the purchase.

In high-risk flood zones, premiums on the NFIP coverage can run as high as about $2,000 for maximum coverage of a home's structure.

Recently, several private insurance companies have pushed into the market, including Fireman's Fund Insurance Co., a subsidiary of Allianz AG; American Insurance Group Inc.; and Chubb Group of Insurance Companies, with flood policies for high-end properties.

Supplemental flood policies that provide coverage beyond federal program limits are available in the private market in all states. One provider is AIG's Lexington Insurance Co., which provides flood coverage beyond NFIP caps up to $5 million.

There is a government-run Web site, floodsmart.gov, that lets users search by address to determine flood risk. However, the site's data are based on federal flood-hazard maps, which may be as much as 20 years old. More recent flood-risk data may be available from local flood-control boards or a municipal buildings department.

Experts say flood zones change shape over time, especially in built- up areas, so even if you're only near a flood zone, it's better to err on the side of caution. "You will get a cheap rate because, according to the map, you are outside the flood zone, but actually you may be inside it," says J. Robert Hunter, insurance director of the Consumer Federation of America.

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Few people heed that advice. Roughly half of all private homes in the country's highest-risk flood zones have flood insurance, according to the Rand study. Federal law requires homeowners in flood zones to have flood insurance if their mortgage is government-sponsored or guaranteed. But an estimated 25% of these homeowners don't comply, for reasons that aren't clear, according to the Rand study.

Lisa Magee and her husband, Chris, an Air Force captain, were glad that they complied. The couple bought a house in Ocean Springs, Miss., a year before Katrina hit in August, and were required by the mortgage lender to buy flood coverage because they lived near a bayou. "Flood insurance saved us," says Ms. Magee, whose neighborhood was hard hit by the hurricane. "Some neighbors didn't have adequate insurance, and some didn't have it at all. And they lost everything."

Outside of high-risk areas, a mere 1% of homes are covered for flooding, according to the Rand study, which was funded by FEMA. But this doesn't mean they are immune. About a quarter of flood claims are filed in low-risk areas, according to government figures. "Everyone is at risk," says Mary Jo Vrem, project manager of the NFIP marketing campaign.

Thomas Newgarden, chief underwriting officer for the AIG Private Client Group, which offers flood-insurance, says even wealthy clients refuse it. "Sometimes a client is paying upward of $20,000 in [homeowners' insurance] premiums, and you would be surprised how price-sensitive they may be to adding another $1,000 for [flood] coverage," he says.

So far, federal efforts to get more people to buy flood insurance have met with modest success. After years of negligible annual growth, the number of NFIP policies in force expanded 11% in the 22 months ended in April, with about 4.8 million policies currently in effect. But most of the sales growth is in areas that are already better covered than the rest of the country.

In the aftermath of Katrina, the insurance industry has defended itself in court against lawsuits over claims denials for hurricane- related water damage. In one suit, a federal judge in Mississippi last month upheld clauses in Allstate Corp. policies that excluded flood damage, ruling they were "valid and enforceable." One complication: Most homeowner policies cover damage from wind-driven rain, which can be hard for homeowners to distinguish from flood damage.

Of the new private-sector policies on the market, Fireman's Fund offers a special endorsement for flood coverage in its homeowner policies in 29 states, but only in low- to moderate-flood-risk areas. The policies offer broader coverage limits than the government insurance, living expenses, and full replacement cost of structure and contents. Flood insurance adds about $220 to $600 to the company's overall homeowner premium, which at Fireman's averages about $3,500.

Chubb Insurance Group of Cos. recently rolled out personal flood- insurance policies for customers who also buy their primary homeowner coverage from Chubb. The policies are available in three states—Arizona, Colorado and Illinois—with a limit of $15 million for property damage to home and contents.