GAO Highlights

Highlights of GAO-14-179, a report to congressional requesters

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HOMEOWNERS INSURANCE

Multiple Challenges Make Expanding Private Coverage Difficult

Why GAO Did This Study

Homeowners insurance protects against a range of perils, but policies do not insure against all risks. Owners whose homes are damaged by natural and other disasters not covered by their insurance can be exposed to serious financial losses. Federal and state initiatives provide some assistance for catastrophes, which can involve significant taxpayer expense. With coastal populations growing and the possibility of more frequent and severe weather, more homeowners could experience heavy losses not covered by homeowners insurance, putting increasing financial pressure on government programs and thus on taxpayers.

GAO was asked to study the possibility of private insurers providing more comprehensive insurance. This report addresses (1) what perils homeowners policies typically cover and exclude, (2) how exclusions impact homeowners and taxpayers and the potential benefits of more comprehensive coverage, and (3) what additional perils insurers might be willing to cover and what challenges are associated with expanding policies. GAO reviewed homeowners insurance policies and conducted interviews with the National Association of Insurance Commissioners, other industry organizations, consumer advocates, and risk experts, among others.

GAO requested comments on a draft of this report from the Federal Insurance Office and the National Association of Insurance Commissioners. Both provided technical comments which we incorporated into the report as appropriate.

View GAO-14-179. For more information, contact Alicia Puente Cackley at (202) 512-8678 or Cackleya@gao.gov.

What GAO Found

Homeowners insurance policies typically protect homes, garages and other structures, and personal belongings from damage caused by perils such as fire, hail, lightning, explosion, and theft, among others. The insurance industry considers these perils insurable because they are accidental, predictable, and do not involve catastrophic losses. These policies also typically exclude losses from a number of perils, including disasters caused by floods, earthquakes, and war. Industry officials said that such events are difficult to predict and involve extensive losses that are a challenge for private insurers to cover. Insurers also exclude losses from defective products, which industry participants said could be addressed by manufacturer warranties and commercial general liability insurance. Intentional losses; damage from wear, tear, or neglect; and losses caused simultaneously by covered and uncovered perils, such as wind (covered) and flood (uncovered) during a hurricane are also generally excluded.

Policy exclusions can impact homeowners, communities, and state and federal governments. When excluded losses occur, they can create significant costs for homeowners to repair homes and replace possessions. Wide-scale catastrophes can also cause shortages of building materials and contractors that delay reconstruction and substantially increase the costs of repairing homes. When damage to properties caused by excluded losses is not repaired, affected communities may experience blight and face reduced tax revenue. When federal and state governments have stepped in to cover what private insurers exclude, taxpayers may face a significant expense. In addition to federal disaster assistance, the National Flood Insurance Program (NFIP) paid more than $7 billion in claims after Superstorm Sandy. In Florida, insurers and policyholders can be assessed extra charges to help pay for state efforts to cover wind damage where it is not covered by insurers. Industry participants suggested that expanded private coverage could provide additional protection for homeowners and reduce reliance on government programs, but the resulting policy premiums would likely be prohibitively expensive for many homeowners.

Multiple factors make expanding private coverage challenging and several conditions would need to be addressed for insurers to offer more comprehensive insurance. A main challenge is that expanded coverage would have higher costs, potentially limiting consumer demand. Even if insurers charged higher rates that were based on risk, the severity and unpredictability of catastrophic losses could still jeopardize insurers' solvency. Some industry participants said that insurers and others are discussing possibilities for expanding private homeowners coverage, with a focus on risk-based premiums, mitigation efforts, effective building codes, and sound land use policies. The challenging mix of financial risk, political and regulatory issues, policy cost, and consumer demand has thus far prevented private sector insurers in the U.S. from offering flood insurance to homeowners, let alone more comprehensive or all-perils policies. Because of this mix of factors, some in the insurance industry have suggested that a continuing financial role by federal and possibly state governments may be required, and that ensuring a response to the impact of disasters and other perils will require the cooperation and resources of government, homeowners, and insurers, as well as balance in the assumption of risk and cost by each of these parties.