

March 16, 2012

Hon. Judge Russell and Members of the
Affordable Homeowners Insurance Commission
4112 Gordon Persons Building
50 North Ripley Street
Montgomery, AL 36132

Dear Judge Russell and AHIC Commission Members;

Thank you again for the opportunity to address the Commission in February. I appreciate the Commission's attention to my presentation and patience with the audio technical difficulties. The information I offered for your deliberations is drawn on my 28 years of experience in public policy matters related to insurance rates, sales, claims, regulation, legislation and litigation. I would be more than happy to visit with the Commission again and/or answer any questions in writing.

Here is a recap of the main points from my February presentation:

- 1) I commend the Alabama Department of Insurance for disapproving rates that are based on computerized catastrophe models that use short term (fewer than 20 year time periods) and for working to enhance its capacity and authority to review and modify rate filings.
- 2) I hope this Commission will recommend that Alabama either create its own public cat insurance risk model or participate with neighboring coastal states in creating one.
- 3) I commend Senator Brooks and the entire Commission for recognizing that the management and business practices of AIUA need to be restructured. Like many such pools (which I refer to as "quasi-public insurance entities") throughout the United States, it was not originally designed to handle a large volume of policies. It needs restructuring. The risks and rewards of selling homeowners insurance policies must be assigned equitably between the entities that participate in AIUA and the AIUA itself. Reductions in the compensation paid to servicing carriers that have limited or no responsibility for paying losses, and the ability to secure alternatives to or reduced cost reinsurance are the two steps most likely to strengthen the Association.
- 4) Some of the factors impacting homeowners' insurance rates in Alabama, such as reinsurance costs, are beyond the control and jurisdiction of a single state. However, there are many steps that will improve the situation, some of which are already in the works in Alabama:

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- Increasing the transparency of homeowner's insurance rate filings and the effectiveness of the rate review process.
 - Rejecting rates that rely heavily on short term models or exclusively on one model.
 - Enforcing mandated insurance discounts for mitigation.
 - Helping homeowners know what mitigation steps will make their homes more resistant to damage and qualify them for insurance discounts.
 - Helping homeowners finance mitigation. We strongly support allowing homeowners to create tax-free Catastrophe Savings Accounts to cover losses below their deductibles. We strongly **oppose** granting tax breaks to cover homeowners' insurance premiums (as proposed by the Property Casualty Insurers Association). This approach would give a direct taxpayer subsidy to insurance companies, many of whom are paying their CEOs multi-million dollar bonuses each year.
- 5) While it is small comfort that Alabama is not alone, numerous other states are experiencing similar homeowners' insurance crises. Coordination between AIUA and other "FAIR"/quasi-public/pooling/association entities and the creation of one or more new sources of catastrophe level claims paying capacity for these entities makes sense. ¹
- 6) At previous NAIC meetings and at a 2011 Windstorm Network conference in Houston, Texas, United Policyholders proposed that the top executives of Louisiana and Florida Citizens, AIUA, TWIA and the MWUA stay in close contact and help each other make efficiency and productivity improvements to their operations. UP supports various federal solutions that would give these entities alternatives to reinsurance capital.

My points to the Commission also included the following:

- 7) The fact that people with mortgages are legally obligated to buy and maintain homeowners insurance, like it or not, means that insurers have a "captive market" which reduces free market competition.
- 8) In the first decade of the 21st century insurers went full steam ahead using new catastrophe risk modeling tools to set their homeowners insurance rates in the Gulf Coast states. These tools are advertised as accurately predicting the frequency and severity of future weather and other events. But because future events are truly unpredictable, and because computerized catastrophe risk modeling is a relatively new field, these tools have limited accuracy. Some of them, particularly those which are based on short term data (less than 20 year time periods) have already been proven wrong. (E.G. Risk Management Solutions version 11 that reversed predictions about coastal versus inland damage that were in an earlier version).

¹ At the most recent meeting of the National Association of Insurance Commissioners (NAIC), Texas Commissioner Eleanor Kitzman proposed the creation of an interstate compact for coastal property insurance to aid in the flow of capital.

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- 9) It cannot be a complete coincidence that the boom in catastrophe risk modeling technology has coincided with dramatic rate increases in coastal areas.

Conclusion

For many, many years prior to the last decade – private insurers were happy to insure coastal homes. Obviously the situation has changed dramatically. The fact that international reinsurers have tremendous control over insurance pricing in Alabama, yet there is little regulation of their rates is perhaps the biggest challenge for this Commission. But while this Commission cannot turn back the clock or invent its own jurisdiction, it can evaluate the information that's been presented, make reasoned recommendations, and unwind *some* decisions by insurers that can fairly be classified as overreacting. There is much this Commission *can* do.

Historically, when one or more leading insurers in a region react to a perceived increase in risk by implementing extreme rate increases and/or non-renewing large blocks of customers, it has scared competitors away as opposed to drawing them in pick up those customers. The decision to deal with this scenario by creating entities like AIUA and the Citizens companies has already been made. The most productive approach now, in our view, is to make these entities as efficient and well run as possible so as to minimize subsidies and taxpayer support and best serve the segment of property owners who truly have no options in the private marketplace.


An effective state-based system of rate regulation will **help, not harm** the private insurance market by maintaining fair competition and stability and by preventing panic-based actions by insurers. Alabama needs:

- Public filings
- Actuarial review/Adequate resources at AL DOI
- A process for allowing intervener participation/compensation to supplement AL DOI's resources
- Automatic hearings on rate increase requests over 10%
- Limit use of catastrophe modeling (no near/short term)

We hope whatever issues from this Commission will include recognition that insurance works when diverse risks are pooled. There is one Alabama - coast and inland. Divisiveness and misunderstandings about coastal economics (e.g. "all coastal homeowners are wealthy") should be confronted head on.

In closing, I again thank Michelle Kurtz, Dan Hanson and the Hurricane Homeowners Insurance Initiative, as well as Reese Hodges, Iris Bailey and Renee Carter for assistance with my participation logistics.

Sincerely,



Amy Bach, Executive Director