

**Shortcoming of the HB713 Transparency Bill:**

*The following comments are those of Charles Angell as a member of the CRCAL Insurance Subcommittee and do not necessarily reflect the position of the AL Department of Insurance or the Insurance Commissioner.*

The main goal of the HB 713 Transparency Bill is to provide historical insurance industry data by zip code that will help demonstrate whether the Homeowners premiums being charged in Mobile & Baldwin Counties are justified.

Unfortunately, the Transparency Bill will only be able to require admitted insurance companies to submit the requested data, but not the non-admitted (or surplus lines) companies which make up a large portion of the coastal insurance marketplace. Also, the wind loss data that the bill would be requiring from insurance companies is not actually utilized by those companies in establishing the wind portion of their Homeowners insurance rates. Therefore, users of the data may not be able to reconcile or rationalize premiums being charged in one zip code versus another zip code based on this data. On the surface this may not seem proper to a consumer, but the ratemaking methodology used by the insurance companies is appropriate and fair. The following facts should help a consumer understand the reason for this.

- (1) (a) The wind portion of the Homeowners premium is intended to cover the average wind loss expected in the coming year. Near the coast, 70% to 80% of the premium charged is due to the wind exposure. That is, the wind portion of the premium is 250% to 400% of the non-wind premium. If the wind coverage is excluded from a full-coverage policy, the premium should be reduced by approximately three-fourths.

(b) Most of the wind exposure on the coast comes from hurricanes, which are very unpredictable as to the frequency with which they will occur and the amount of damage they will do. Past claims experience from hurricanes has proven to not be a good predictor of the average loss that could be expected in the coming year because:

- (1) Next year's storm could be significantly larger or smaller than the storms of the last decade or two or three;

- (2) The property values that exist today in any coastal municipality are most likely significantly greater than they were in the past several decades due to population growth and change in home sizes, meaning that the losses next year would be greater than the past losses, even if the identical hurricane were to strike again;

- (3) Building codes and construction materials/techniques have changed over the years and inflation has increased the cost of building materials and labor, making past losses not representative of future losses.

- (2) Because of the issues above, independent scientists (not working for any insurance companies) have developed computer models to better predict the frequency, path and damage level of future hypothetical hurricanes. These models begin with industry-wide loss data from historical

hurricanes going back a hundred years, relate those losses to many atmospheric, geographical and other scientific data and demographic data about the properties, then apply that information to the property exposures that exist today in a zip code or county. The computer models create approximately 10,000 hypothetical hurricanes of different sizes and intensities, “run” those storms over the zip code or county, and estimate the damage that would be done. Each hypothetical hurricane has assigned to it a probability of occurring (e.g. once every 10 years, once every 150 years, etc.), and then a weighted average of each hurricane’s probability and damage is calculated to estimate how much damage, on average, would occur in that zip code or county over the next 100 year or 200 year period.

These complex hurricane models continue to evolve every year. When a new hurricane occurs, the model scientists compare the actual hurricane losses to what the model would have predicted for that specific storm, and then they fine-tune the model to better match the actual storm results. In recent past the models have typically under-estimated the damage that hurricanes have actually caused.

- (3) When an insurance company establishes the wind portion of the premium they wish to charge in a zip code or county, the wind premium is based on the estimates predicted by the hurricane model, and is not based on the actual losses the company has paid over the past decades.
- (4) Insurance companies purchase reinsurance from other companies to protect themselves from extremely large hurricanes that could render them insolvent, and they pay a portion of their collected Homeowners premium to these reinsurers for this protection. Reinsurers set the rates that they charge to the insurance companies based on these hurricane computer models, but the reinsurers’ rates are not regulated, by law, by insurance departments in any state. Since insurance companies must buy this reinsurance to protect their solvency and to meet regulatory scrutiny, they are at the mercy of the reinsurance marketplace and must pay the rates they are charged. Therefore, the rates that the insurance companies charge the consumer must be sufficient to cover the reinsurance premium plus the other claims that are not paid by the reinsurer (smaller storms, fire, theft, liability, etc.). As a result, the insurance companies must use the hurricane computer models themselves, like the reinsurers do, in order to estimate the cost of their reinsurance.
- (5) Since hurricanes are infrequent, insurance companies may go several years without hurricane losses, thus yielding larger profit dollars in those years, which are saved up for a future year when the hurricane will hit. Once the hurricane does hit, it is conceivable that the insurance company could pay out \$200 in claims for every \$100 in premiums they collected that year, requiring them to draw on the savings from the prior years. In 2009, a year in which no hurricanes occurred, the Homeowners insurance industry in Alabama paid out \$124 in claims and overhead expense for every \$100 of premiums collected. Over the past 12-year period collectively, they paid out approximately \$108 in claims and overhead expenses for every \$100 of premiums collected. Companies must feel confident that over the long run they can make a

profit on Homeowners insurance in Alabama, or they will choose not to offer insurance in our state.

Bottom-line, the wind loss data that the Transparency Bill would be requiring is not related to the premiums that are charged by the insurance companies for the wind exposure. If the data shows very little wind losses paid out on the coast for several years, the insurance companies will be appropriately saving those profits for the future years when the hurricanes hit. As the past 12-year period has shown for Alabama, the insurance companies have not been charging enough for the wind exposure, though in 5 or 6 of those 12 years the data would show that they earned a profit. Looking at the actual claims data over the years will not provide a clear picture of how many premium dollars the insurance company needs to be collecting to save up for the bad years. Therefore, it has been suggested that consumers would be better served to review the output from the hurricane computer models utilized by the companies in creating the rates that they charge the consumer, rather than requiring the data specified in this bill. The model output for each insurance company is available on a territory and statewide basis in the rate filings that the company provides to the Department of Insurance. If current law were changed, the Department would be permitted to make the data in the company's rate filings public information and available on the Department's website. (Note, however, that non-admitted companies are exempt from having to submit rate filings to the Department, so model results for those companies will not be available.) However, the hurricane models (not owned by the insurance companies) are extremely complex, sophisticated, scientific programs that are considered trade secrets by the model developers, so the models themselves would not be made public....only the model output would be made public.