

Coastal Recovery Commission of Alabama Insurance Subcommittee of the Economic Committee

Discussion Note

November 11, 2010 -- Meeting in Orange Beach, AL

Date of issue
November 18, 2010

Author
Michael Joe

The chair, Walter Bell, opened the meeting by restating the purpose of the Coastal Recovery Commission. He highlighted the subcommittee's many discussions on the various issues regarding insurance availability and affordability in Alabama. He said if there were any issues not yet addressed they should to be raised, and also asked if anyone had questions about the timeline for the subcommittee and the CRC.

Asked whether the subcommittee would have any say in funding its recommended initiatives and if there was need to meet again, the chair indicated he did not think there was a need for the subcommittee to reconvene around the issue of funding because the subcommittee would not have that authority. The CRC's writer assigned to the subcommittee added that a process had not yet been decided in Washington, D.C., or Montgomery around the amount of funding and how it would be allotted.

The subcommittee reviewed the public meetings organized by the CRC in Orange Beach, Bayou La Batre, and North Mobile earlier in the week. The meetings had good attendance. Local officials made remarks, the CRC's chairman spoke, and questions were taken. Two of the meetings had claims tables with Feinberg representatives. Members who attended the meetings reported that citizens seemed most concerned with the economy, jobs, recovery from the oil spill, and clean up of the oil. They added it was clear that insurance is an important part of the economic recovery of the region. Insurance has been discussed by every section of the CRC, and people were noticeably attentive when the issue of insurance was briefly discussed. A common concern raised by citizens was high deductibles. It was noted the meetings showed that public education around the insurance issue would be important.

People are looking for answers to the high cost of insurance. It was noted that property insurance has been raised as an issue in every CRC committee, and citizens are frustrated because they are feeling that only the insurance industry is being listened to. It was further noted that citizens understand the need for better building codes and mitigating homes, but those ideas will take some time to implement. Consumers desire quick relief. It was agreed the idea of mitigation is supported, but there is a very strong interest in other ways to bring down costs.

The chair said we had discussed these issues in previous meetings and have now reached a point where it is time to make the actual recommendations. He noted that the rising cost of insurance is related to the higher valuations of property and homes over the years. He further added there is no one single answer to solve these issues -- not mitigation, not building codes, not subsidies, etc. The State of Alabama is facing large budget deficits for the foreseeable future. Subsidizing insurance through the state is not sustainable because, at some point, the money will run out and then insurance premiums will go right back up.

The chair continued, saying Individuals in Alabama's two coastal counties need to take responsibility for being more resilient and sustainable. For many years, citizens have paid a below-average premium on their homes. Then, after four or five hurricanes in a matter of a few years, the model makers changed their models due to the sense of urgency about the risks associated with living on the coast. Similar to the economy, there is a new normal when it comes to insurance in coastal areas from Texas to Maine.

A member continued that based on his experience, he thinks insurance companies are charging exorbitant rates. He paid \$900 for insurance on a three-bedroom home until the insurance company dropped his wind coverage. When he asked the company how much it would cost for only fire and liability insurance, he was told \$1,200.

The subcommittee moved to finalizing recommendations about building standards. The subcommittee had previously discussed how stronger building codes would help, and everyone agreed stronger buildings codes would be one of the subcommittee's strongest recommendations. A statewide, mandated building standard would be in the best interest of the state. At minimum, stronger codes should be adopted by the local jurisdictions in coastal counties.

In addition, enforcement of the building standards would be important. The chair asked whether it would be appropriate to ask that money from BP be used to pay for training and enforcement. Most members agreed it would be.

A real estate industry member said how a major concern of the industry is how the valuations of homes would be affected by raising the level of building standards. Currently the value of homes is based on a number of variables, but he warned that higher building standards could double the cost of construction for some homes.

A question arose about what the standards would be. The subcommittee has been discussing a recommendation that the minimum standard would be the 2006 International Residential Code (IRC). A member, who is a local building code official, reiterated the 2006 IRC is not sufficient for the two coastal counties because, for instance, it does not include what is needed to protect homes against higher wind speeds associated with major hurricanes. The code also does not sufficiently address what coastal communities need in order to protect homes against water and waves. What are needed are enhancements to the 2006 IRC; these code-plus additions that would help communities qualify for community discounts offered by some insurance companies.

Community discounts for reaching levels of Building Code Effectiveness Grading Standards (BCEGS) are not offered by many insurance carriers writing policies in the coastal region. It was suggested there be a recommendation to mandate that carriers offer the discounts in order to add motivation to communities to adopt and enforce a stronger code.

Under the BCEGS discount program, consumers who live in a jurisdiction with a strong, well-enforced code would receive the discount simply because they live there. Legislation to mandate BCEGS discounts would be similar to legislation enacted last year that mandated carriers offer discounts for mitigation measures.

A suggestion was made to make a separate recommendation to improve the effectiveness of the current mitigation discount mandate. The state could commission a reinsurance or hurricane modeling company to run a model for the two coastal counties that would better show what the discounts would be for different levels of mitigation, in different areas, and for different homes. The state department of insurance had wanted to commission such a model but it did not have sufficient funds. Instead, the department used data that had been collected by the Alabama Insurance Underwriting Association (AIUA), the state-run insurer of last resort. The AIUA offers discounts for BCEGS community ratings and also for mitigation levels (Bronze, Silver, Gold) established by the Institute for Business and Home Safety (IBHS), an association of insurers and reinsurers that researches and advocates for better construction, maintenance and preparation practices.

Regarding a mitigation study and model, it was noted that a better analysis of the existing housing stock in the two coastal counties might bring some immediate premium reduction since the modelers currently do not have good information. Reinsurers and insurers would likely discover houses in some areas are better built than previously thought, while houses in other areas are as poorly built as they suspected. Regarding the effect of stronger building codes on construction costs, which was noted earlier, it was added the cost of construction has not increased dramatically in areas where stronger standards have been established. In states that elevated codes to 2006 IRC, the cost of construction increased between 10 and 20 percent. In places where there was already a code in place and enhancements were adopted, the increase was about 3 to 5 percent. It was argued that it is a myth construction would significantly slow down because of the stronger standards.

As an aside the AIUA implemented BCEGS discounts in 2007. The summer after implementation, it refunded \$200,000 to policyholders.

A member motioned that the subcommittee adopt the list of recommendations that were identified at the previous meeting and a few additional recommendations. The additional recommendations are to 1) commission a new, comprehensive mitigation model to better identify discounts, 2) require carriers recognize BCEGS ratings and offer discounts, and 3) require higher standards to free board for flooding, set back requirement from the water, flood proofing requirements for homes, and land use that recognizes there are some places we should not build. The subcommittee agreed to offer these recommendations.

The subcommittee moved to recommendations for mitigation. The chair indicated providing for a strong inspection program is a vital piece of both strengthening building standards and increasing mitigation. Mitigation is key to getting consumers discounts through the IBHS standards. It was suggested the subcommittee consider mitigation through a two-step process. First, the homes must be inspected for details on what modifications need to be done to qualify for discounts. Second, homeowners need to hire contractors to supply the improvements; to get full credit for improvements, the homeowners must provide to insurers certification of improvements.

We need to find an incentive for homeowners to take mitigation measures. One idea would be to create an entity called a Coastal Mitigation Trust. Under this trust concept, the trust would be funded with public money (possibly BP penalty money to the state) to offer people in the two coastal counties either a grant or a loan to complete mitigation on their homes. To qualify for a grant, or a loan through a bank, homeowners must have a detailed inspection conducted on their home. For loans, once the inspection is complete, the homeowner would submit a loan request to the bank. The trust would guarantee the loans from the banks, which would make banks more likely to agree to a loan for people with lower credit ratings. The loans would likely be low-interest because of the guarantee. Banks would earn income on fees to administer the loan and a little from the interest. It was emphasized that the trust is a revolving fund. People who can pay back the loan will. Others who can't afford to pay it back would be given a grant.

To create more incentive, the interest on the loan could be state tax deductible. To make sure people get discounts, the insurance department would make sure rate filings show 20 to 30 percent discounts. When combined with building standard discounts, homeowners will start to see some immediate rate reduction. There's no limit in terms of how many homes the trust could help mitigate, because the trust would be revolving.

It was brought up that the average cost to mitigate a home in the My Safe Florida Home program, in order to receive between a 20 to 40 percent reduction in rates, was \$6,600. Consumers paid half the cost under the program because a grant provided half the funding. Furthermore, in the 1990s, the federal government underwrote a loan program called Project Impact administered by a number of banks. The loan was a simple interest, signature loan. To qualify, a consumer could not have had a bankruptcy but only needed the ability to repay the loan. Consumers could get as much as a \$20,000 loan to be repaid in 10 years. The program was not widely utilized because people were not aware of it. A lien could be placed on a signature loan if it were not repaid.

It was noted \$100 million could be utilized quickly doing 10 to 20 thousand homes annually. In addition to additional social benefits such as providing jobs and stimulating the economy, such a program would attract insurers to write policies and provide a pool of funds in the long run to continue mitigation. The program would also help to collect data on the housing stock.

It was also noted the default rate for similar loan programs can be very high. It was added that certified development companies which administer SBA loans could be used to help administer mitigation loans.

Asked whether the cost of inspection would be covered under the grant process for people with limited means, the response was it would, and that means a test to qualify for a grant could be used. Furthermore, there are already organizations that work in lower-income neighborhoods, such as community development action agencies, which could help spread the word in their respective communities.

Another suggestion was to create an advisory committee to learn from states that have already tried similar programs. It was further suggested that mitigation management models could be utilized for such a program. Smart Home Alabama, an educational nonprofit, has money to mitigate homes and it hopes to develop its own model.

Another member, who applauds the idea of a mitigation trust program, reiterated Alabama should study similar programs in other states to try to limit problems associated with them, such as scams, cash grabs, and poor workmanship by contractors. He added it has been good to see that some insurers are supporting mitigation by providing mitigation discounts in coastal areas.

Another member said mitigation and building code standard inspections should be done by qualified professionals who are trained and licensed. Ideally, the inspections should be completed by local government inspectors. The recommendations on mitigation were agreed to by the subcommittee.

The subcommittee moved to recommendations regarding transparency. It was noted a transparency bill which previously had been considered by a House committee in the state legislature had also been discussed by the subcommittee. Another suggestion was brought up that to improve transparency -- making insurers' rating filings with the state public information -- is not equivalent to the detailed data being requested in the transparency bill. At recent public meetings, storyboards used to publicize the work of the CRC included a possible recommendation to make rate filings public information, but the storyboards did not include the data call under the transparency bill. The member provided a copy of the language that was included in the transparency bill and language for how they would like it to be described in the final report.

Several members disagreed over whether, at the previous meeting, a recommendation for a detailed data call was in fact agreed to, or whether there was only agreement about wanting to recommend a transparency bill.

It was decided that even if the subcommittee agreed to certain details of the data call in the transparency bill, specifics about exactly what data to require would need to be determined later by the state legislature. A motion was made to recommend a transparency bill that would be worked out by the legislature.

Members in support of a data call as prescribed in the transparency bill warned they would not support a transparency bill recommendation if it did not include the data call detailed in their transparency bill.

Following further discussion that questioned whether such data under the transparency bill would be available, a member asked for clarification about the motion to adopt a transparency bill recommendation. The member who made the motion confirmed the motion was for a transparency bill with details to be worked out later by lawmakers. The subcommittee agreed to that legislative recommendation.

The chair requested that a subcommittee member who works for an association of insurers discuss with its members the claim that fire insurance is 300 to 400 percent more in South Alabama than in North Alabama. The member agreed. It was also noted that insurance companies tend to raise fire insurance rates in South Alabama as high as the state will allow them under an actuarially sound justification, but that they often choose to not raise rates as high in northern parts of the state to remain more competitive with other carriers.

The subcommittee moved to other possible legislative recommendations. One would require insurers to break out on multi-peril policies the premiums by fire, wind, hail, and hurricane, etc. It was suggested that because some carriers only submit to the DOI rate filings broken down by wind and non-wind, it might be easier to get this approved by the legislature. The idea is to help the DOI know the effect of a mitigation deduction provided for wind coverage and to help consumers understand how their rates are determined. The recommendation is for the DOI to determine if it could require through regulation that insurers separate the wind premium from non-wind premiums on declaration/disclosure pages and, if not, that the legislature should enact such a requirement. Another possible legislative recommendation would be to require licensing of contractors and subcontractors working in the coastal counties. This would help ensure minimum construction standards and that mitigation measures are done properly. The subcommittee agreed to these two recommendations.

Another possible legislative recommendation is for an insurance fraud law to protect consumers from unscrupulous agents and insurers and other consumers who take advantage of the system. It is estimated by the insurance industry that insurance fraud raises rates are between 15 and 20 percent nationwide. It was suggested that any insurance fraud bill not have a threshold to trigger an investigation; thresholds exist because it would be impossible for the state to investigate every fraud claim by consumers, regardless of the merits.

It was discussed that contractors can be prosecuted for fraud, but the DOI must work with county district attorneys to seek prosecution. The fraud that is not covered by the state contract fraud law is fraud by unscrupulous insurance agents, companies, and consumers. Because of how busy local DAs are, the insurance department has not been able to attract attention to insurance fraud. It was suggested that funding be set aside to help enforce insurance fraud. It was clarified that enforcement under an insurance fraud law would be done by DOI agents. It is hard to know how much fraud is occurring because it hasn't really been addressed. A member suggested that a fraud bill should have a reasonable statute of limitations. The subcommittee agreed to recommend an insurance fraud law.

Another recommendation was to create an Alabama Insurance Institute. The chair is planning to suggest to the governor he create by decree an insurance institute. The chair noted the institute would continue what the subcommittee has been doing. In concept, it would be an ongoing body to support the recommendations. It would be made up of various stakeholders -- consumers, agents, companies, professionals involved in the construction, sale, appraisal and financing of homes. The subcommittee agreed to recommend that the governor establish the institute.

Another possible legislative recommendation was for the DOI and Department of Revenue to conduct a study on the state's premium revenue structure. Because of the significantly higher premiums in coastal areas due to the cost of wind coverage and other factors, coastal areas are contributing more per homeowner than in other parts of the state. It was further noted that currently the premium tax on policies written by surplus line carriers is 6 percent, while policies written by admitted carriers is 3.6 percent. Some companies qualify for special credits that lower their tax.

Lowering premium taxes in coastal areas would provide some leverage for a company to write more business, but that the lower tax probably would not provide much of an incentive for companies to enter the coastal market because a lower tax -- which is passed through to consumers -- would not change the net income of insurance companies.

Premium tax could be used to bring some relief to coastal consumers, given the state is collecting more in premium taxes per homeowner than in other areas of the state. It was asked whether the point of the study would be to identify recommendations to bring more competition into coastal areas. The chair said the study would come first, but that recommendations related to the premium tax structure certainly could follow.

The recommendation was to conduct a premium tax study, with the idea that once the study is complete to perhaps come up with recommendations for how its structure could be used to incentivize competition and insurance availability in coastal Alabama. The committee agreed to the recommendation.

Another possible legislative recommendation was for the state to conduct a study on the concept of recoupment as a mechanism to increase competition and insurance availability. It was noted that a recoupment mechanism could be one that passes on the assessment statewide, or just for affected areas, or there could be an offset to recoupment that would make it palatable to companies throughout the state.

The recommendation was for the DOI and state lawmakers to do a study of recoupment of assessments paid by insurers participating in the state wind pool. The recommendation was agreed to.

Other legislative recommendations the subcommittee agreed to:

1) to encourage state lawmakers to develop and promote a tax-free catastrophe fund for individuals;

- 2) to encourage Alabama's lawmakers in Washington, D.C., to support and pursue a tax-deferred catastrophe reserve for insurance companies to lower their cost of capital;
- 3) to encourage Alabama's lawmakers in Washington, D.C., and Montgomery to find a resolution to wind and flood claim settlements and to increase transparency on all property coverage;
- 4) to research a catastrophe fund or captive to give short-term relief on homeowners' premiums;
- 5) to develop a comprehensive public education and communications strategy;

The subcommittee also decided that doing something to address repetitive loss properties should be added as a recommendation to the building standards recommendations.

Before closing the meeting, the chair said a list of recommendations agreed to by the subcommittee will be forwarded to members.