AFFORDABLE HOMEOWNERS INSURANCE COMMISSION
Monday, November 7, 2011
9:00 A.M.

Attendees

Judge Tim Russell (Chair)
Commissioner Julie Magee
Commissioner Jim Ridling
Senator Ben Brooks
Representative Joe Faust
Representative Joe McMillan
Representative David Sessions
Aubury Fuller
Don Price
Gary Ellis
Michelle Kurtz
Sid Belcher
Carl Schneider
Steve Simkins
Wayne Parker
Geoff Plott
Elizabeth Huntley
Jim Higdon
Joe Ruffer
Rux Bentley
Jerry Workman

Judge Tim Russell, Chairman of the Affordable Homeowners Insurance Commission (AHIC), called the meeting to order and issued opening remarks. After opening remarks, prayer, and the reciting of the Pledge of Allegiance, Judge Russell asked the Commission to identify issues that consumers face as learned during the series of consumer forums. Steve Simkins asked if the Commission should focus on "issues vs. problems". Simkins said issues could also be addressed and would not necessarily limit the Commission moving forward. Simkins' question prompted Judge Russell to ask how specific the Commission should be. The Commission agreed to try to be specific when addressing problems. The Commission also agreed that its duty as charged is to focus on homeowners insurance. Solutions for commercial issues will not be dismissed if they are identified but the focus will remain on homeowners insurance.

Issues

- Increased premiums and increased deductibles
- Availability of higher deductibles
- Rates are an issue particularly for those who live off of a low to moderate or fixed income.
- Transparency
- Consumers may need to better understand what a policy does or does not do
- Tying policies together
- Availability (general homeowners)
- Policy availability to renters (or landlord policies)
- Better notification to policy holders
- Fairness to consumers (arbitrary lines)
- Wind vs. hurricane deductible
- Having to have multiple policies to cover the same type of damage (coast)
- Home sales are impacted
- Lack of credits for mitigation (or lack of knowledge about available credits)
- Arbitrary zoning
- Role of the Commission

Judge Russell said that he believes Governor Bentley will not disband the Commission after initial recommendations are made and that the Commission will continue to serve under the Governor and the Commission may look more in-depth on other issues.

Commissioner Kurtz suggested that the Agenda Committee obtain the list of issues to see that each issue has been properly identified. It was also suggested the Commission needed to listen to the speakers and analyze the data to determine if the issues as presented are in fact problems. Clarifying, Judge Russell said these issues are not a complete, comprehensive list and that it can be modified as the discussions evolve.

The Department of Insurance's presentation
(Made by Charles Angell and Ragan Ingram)

The Department of Insurance (DOI) presented the Commission with a series of facts in a handout and briefly touched on a variety of issues.

General Breakdown of premiums collected from homeowners insurance per $100 (differs according to geographical location)

- 23% goes toward claims payments (coast)
- 58% goes toward claims payments (up-state)

The big difference in the percentage is because of cost of reinsurance. Forty percent of each payment on the coast goes to reinsurance. Up-state only 5 percent of the cost of premiums goes toward reinsurance.

Other factors are uniform throughout the state

- Claims adjustment expense
- Marketing expenses
- Overhead
- Tax and licensing fees

Data from 2009

- 96 percent of the earned premiums went to pay claims
- 15 percent claims adjustment
- 19 percent marketing
- 5 percent overhead
- 3 percent taxes and licensing
- **138 percent total** (collected $100 and paid out $138)

Investment gain, which was not included, was about 4 percent.

Return on Equity (ROE) for insurance companies was negative 24 percent

When the non-wind portion of homeowner's rate has to go up more than the state average, the companies look at the cost by territory and make adjustments accordingly. The wind component is where affordability problems become a concern for homeowners.

Three factors in a homeowner's policy

- Hurricane Rate
- Non-Hurricane Wind Rate
- The Cost of Reinsurance

Hurricane rates are not computed by claims data. This component is generated by hurricane models.

Looking at previous years' hurricanes doesn't provide accurate data because of infrequency, variation in size and the amount of damage done.

Roughly 100,000 different scenarios are used to determine a model, including actual statistics from hurricanes. That data includes frequency, landfall location, central pressure, radius, maximum wind, storm track, and storm surge.

Models are proprietary so the DOI does not know everything that goes into them. However, any time a new version of a model is created they're subject to a panel review by national industry experts set up by Florida Department of Insurance.

When the models are inaccurate it's called *Model Miss*.

Model Miss

- 84 percent to 188 percent of what the models actually predicted
- Actual storm damage was 28 percent higher than what the model indicated
- Models underestimate on average

Climate Change Theory has affected hurricane models and is expressed as Near Term vs. Long Term models.

Near Term

- Looks at warm sea surface temperatures
- Believed temperatures normally cycle around every 25 years
- Warm cycle = more hurricanes / cold cycle = fewer hurricanes
- Believed to be in a warm cycle (maybe in the middle?)

Long Term

- They don't acknowledge warming cycles
- These models simply look at all hurricanes dating back to 1900

Karen Clark questions the validity of warm water cycle view.

The DOI doesn't allow companies to use warm water cycle models.

Non-Hurricane Wind Rate

- DOI does not let companies use data from less than 20 years
- Most companies use 20 or 30 year historical claims data

For example, the tornado outbreak of April 27 is considered a 1 in 250 year event by the DOI. The DOI has said that insurance companies only get to use 8 percent of their losses in computing the non-hurricane wind load. The companies will be able to use that figure for the next 20 years.

Reinsurance

- Use the same models as the primary carriers
- May allow near term assumptions
- Reinsurers are not regulated by anyone

Per $1 Million for reinsurance

- $200,000 for expected loses
- $200 for overhead expenses
- $600 for risk load – cushion for volatility from year-to-year wind loses
- Expected loss to premiums is roughly 20 percent
- Global industry – affected by what's going on around the globe – earthquakes, floods, fires, etc.

Territorial Rates

Competition companies tend to want to be competitive up-state so they're going to suppress their rates there to become more competitive. This competition leads to variance in prices.

- Non-wind is fire, water, theft for a specific territory and premiums versus losses for a five-year period
- Reinsurance is heavily weighted toward the coast.
- The DOI tries to have a transitional phase for price increases.
- No consumer may experience more than a 35 percent increase during any renewal.
- Companies' NEIC data are premium/policy/state

Rates Indexed to Alabama (hurricane)

- Nationwide – 76%
- Florida – 144%
- Georgia – 70%
- Louisiana – 155%
- Mississippi – 120%
- Texas – 145%

The states of Mississippi and Alabama are the new tornado alley. Our states don't have as many, but tornadoes here stay on the ground longer. Alabama's rates are competitive compared to the rest of the country.

Things the DOI does to keep homeowners insurance from rising

- Required statistical justification for all rate changes
- Disallowed premium surcharges for claims caused by acts of God
- Disallowed more than one rate increase a year
- Capped individual consumer rate increases at 35 percent annually

Deductibles for hurricanes

Minimum hurricane deductible is 5 percent for Mobile, Baldwin is 2 percent and the rest of the state is half of 1 percent. 90 percent of Hurricane Ivan claims were less than a 20 percent deductible, so if insurance companies went to a 20 percent deductible, the insurance companies would only pay for 10 percent of the storm damage.

One suggestion is to go to a higher deductible and offer consumers low-interest loans to be able to pay for the damages. However, following the April tornadoes, the DOI learned that victims who did not have insurance wanted grants because they could not afford to pay back a loan.

Alabama Insurance Underwriting Association (AIUA)

- Provides a market for consumers in Baldwin and Mobile counties who could not obtain essential insurance from private companies
- Not a State Organization – Owned and managed by the insurance industry
- Provide a basic coverage at a naturally sound rate
- Last resort for property owners

CAP funds

- State or Regional fund created to provide reinsurance at a discounted rate to the AIUA and possibly other insurers or captives so that there could be a lower charge to the consumer.
- Florida has a CAP fund, but is woefully inadequate and will not be able to handle a large storm.
- Non-profit
- Needs initial capital from state, LLC, or bonds

Captives

- Single state authorized insurer
- Can't write across state lines
- Writes a policy on the parent or affiliates of the company

Association captives

- An Organization that insures risks of association members and their risks (neighborhood or townships)

Sponsor captives

- Sponsor (like an umbrella) will put up initial capital and cells will form and will only pay for losses in their cells.

Tax-free captives

- Places limitations on it, but it could be possible
- Would only be taxed on investments, not on underwriting

Purposes and advantages of a captive

- Insure at a price that is not available in the current market
- Choose to have the rates exclude profit load
- Gain control of how underwriting and claims are handled

- Offer flexibility of coverage and deductibles
- Share in any long-term earnings
- Premium tax is four-tenths of one percent, compared to 3.6 percent standard premium tax

Disadvantages of a captive

- Lack of spread of risk; not getting a geographical spread
- Not covered by the guarantee fund; if it goes insolvent the consumer must pay the remaining claims
- Possible lack of reinsurance
- Mortgage companies may not accept a captive

Mitigation

- Pure Premium – Portion that goes to pay for the losses (frequency of loss x severity of the loss)
- On the coast, 75 percent is to cover wind insurance alone
- To Lower Premiums deductible can be raised, can retrofit a home, or impose better building codes

Taxes on Insurance in Alabama

- 3.6 percent (one of the nation's highest) on many carriers
- Most Rural areas (dropped to 1 percent)
- 1 percent tax credit for companies that own offices in the state or property investments

Premium Taxes

- Generated $250M in 2011
- Primarily goes to the state's general fund

Surplus Lines

- Tax rate is 6 percent (one of the nation's highest)
- 180 million collected
- 2/3 is from Mobile and Baldwin counties

Legislative Presentation

Senator Brooks began the Legislative presentation by telling the story of how the problem has grown from a problem that everyone thought was just South of I-10 or Hwy 90. Since then it has grown to be a dominant issue in Mobile and Baldwin counties. The first insurance reform bill was passed in the 2006 session, which authorized the creation of captive insurance entity commercial context only.

Bills that have not passed

2008

- SB 5 – would have codified the insurance underwriting association (the wind pool)
- SB609 -- First draft of the Retrofit bill

2009

- SB7 – Would have allowed citizens to create a Catastrophe Savings Account
- SB191 – Would have prohibited a wind deductibles except in the context of a named tropical storm
- SB434 – Would have prohibited a cancellation of a homeowner's policy without justifiable cause
- SB530 – Would have made insurance fraud a criminal act (possible to pass this session)
- HB964 -- Would have allowed the DOI to create program of self-insurance in Mobile and Baldwin counties

2009 Special Session

- SB4 -- Would have prohibited a wind deductibles except in the context of a named tropical storm, "buy-back provision" added

2010

- SB3 -- Would have made insurance fraud a criminal act
- SB5 -- Would have prohibited a wind deductibles except in the context of a named tropical storm, with "buy-back provision"
- SB197 – Would have restructured AIUA "write out" to a "zone-by-zone" approach – divided the 4 coastal zones into two units for the purpose of calculating write-out credits
- SB198 -- Would have provided premiums tax incentives for carriers who provide private coverage and take homeowners out of the AIUA pool
- SB199 – Would have required disclosure by cost per thousand of each type of coverage
- SB200 – Would have required public disclosure of the actuarial rate filings
- SB573 – Would have required "Beach Pool" to be stricken from AIUA publications (later done by an administrative act)
- HB219 – Would have created a consumer's advocate office within the DOI
- HB248 – Would have required all homeowner's policies to provide coverage for all risks with level premium rates
- HB248, HB249, HB250 (Representative Joe Faust's bills) – would have legislated rates for homeowners insurance

2011

- SB1/SB400 -- Would have allowed citizens to create a Catastrophe Savings Account
- SB2/SB399 – "Clarity Bill" would require carriers to publish statistics on claims and premiums
- SB3/SB398 -- Would have provided premiums tax incentives for carriers who provide private coverage and take homeowners out of the AIUA pool
- SB7 – Would have required carriers to give written notice within the package of annually required mailed policies
- HB272 – Would have created the Homeowner's Bill of Rights

Bills that have passed

- Act 2006-509 – Authorized the creation of a captive insurance company in the context of commercial coverage

- Act 2008-391 -- Authorized the creation of a captive insurance company in the context of homeowner's coverage
- Act 2008-392 – Codified the AIUA
- Act 2009-500 – Required insurance premium discounts to those who retrofit their homes
- Act 2010-217 – "Seasoning Bill" reduced restrictions on surplus line companies in Alabama
- Act 2011-644 – Proved tax deductions and provided mandatory public disclosure of actuarial rate filing materials
- Act 2011-643 – "Strengthen Alabama Homes Act" established funds to provide potential grants to those who retrofit their homes.

At the end of his presentation Senator Brooks said there is not one specific thing that will solve all of the state's problems with insurance, but captives and wind pools have been two things that the Legislature has tried since he was elected in 2006. Further, Brooks said he has tried to take the less controversial bills to the Legislature, but some in the industry even opposed those measures.

During general discussion before closing, Geoff Plott made a motion to ask Renee Carter to help with the logistics of scheduling speakers. Kurtz says that the Agenda Committee should stay in charge of the logistics, but Carter's help would be welcomed.

With no further comments, Judge Russell adjourned the meeting at 4:30.