

AFFORDABLE HOMEOWNERS INSURANCE COMMISSION

April 11, 2012

2:00 P.M. – 5:00 P.M.

Attendees:

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| Judge Tim Russell (Chair) | Gary Ellis |
| Representative Joe Faust | Geoff Plott |
| Representative David Sessions | Michelle Kurtz |
| Representative Steve McMillan | Carl Schneider |
| Commissioner Julie Magee | Don Price |
| Jerry Workman | Tom Malone |
| John Caylor | Wayne Parker |
| Rux Bentley | Joe Ruffer |
| Ben Woodruff | Joe Demos |

Opening Remarks:

Chairman Russell began the meeting by stating that the Commission has made good progress, but that time is moving quickly, especially with the legislative session. In describing the meeting's agenda for the day, Chairman Russell said Dr. Robert Hunter will have an hour long presentation to begin the meeting, after which the Commission will look at creating four sub-committees from the Commission. These four sub-committees will have the responsibility of writing a report which will tie in to the report which Auburn is doing for the Commission. Each sub-committee will be assigned to one of the main general categories and will submit a written report at or near June 1, 2012. Chairman Russell said this does not mean the Commission would stop; rather it means the Commission will have a report, in addition to the Auburn report, to give the Governor and legislators. The Commission's work would continue on beyond these reports. Chairman Russell added Dr. Veal has a concept of a regional conference which he would like the Commission to discuss.

Commission member Michelle Kurtz asked about the nature of the reports and the Auburn report. Chairman Russell explained the Governor would like to have a written report on where we are and the progress which the Commission has made. Chairman Russell added there is a good deal of expertise on the Commission in areas of concern and the sub-committees can use the expertise to sharpen the focus of these areas.

Dr. Robert Hunter's Presentation:

Dr. Hunter is the former Director of the Texas Department of Insurance. He presented his thoughts and research via telephone conference and through handouts which were provided to the Commission members. He has worked as a consultant with various states regarding "low frequency/high severity event" such as earthquakes, hurricanes and tornados. Dr. Hunter explained he has been studying these events since the 1970s.

He began his presentation by discussing his research of the economic cycle of the property and casualty insurance industry. Dr. Hunter said that by his tracking, prior to 1992, the insurance industry was able to "weather catastrophes pretty well". However Hurricane Andrew had a major impact in the insurance industry and their profitability. Following the devastating losses

caused by Andrew, the insurance industry had to “radically change” how they do business. The insurance companies said they need to use models which provide thousands of years of data. The insurance companies also said they need to restrict coverage, for example by charging hurricane deductibles and putting caps on replacement costs. Finally, the insurance companies said they need to “dump” the higher risks by putting them into a state or federal government pool.

Dr. Hunter explained there was consensus among the state’s governments and consumer advocates that changes needed to be made and he endorsed the changes. Dr. Hunter said insurance executives told him once these changes are in place, the insurer’s ability to write coverage, restrict coverage and prices would not change. Based on these assurances, Dr. Hunter, while Director of the Texas Department of Insurance, told his citizens that while these changes will hurt in the short run, it would bring stability to an otherwise unstable insurance industry. Dr. Hunter said he told the Texas coastal citizens “the pain would be inflicted once”, and then there would be stability. Then, in 2004 and 2005, then Katrina, the insurance companies “did it again” and “renege on all their promises”. Dr. Hunter felt he was duped by the insurance companies. He said they (insurance companies) were either price gouging or they mismanaged their previous changes.

Dr. Hunter further explained that the insurer’s ratio of risk per every dollar of surplus is at a historic low. He said it is a very safe industry. He said most experts agree that the risk ratio should be 1.5 to 1, but now it is in the order of .8 to 1.

Dr. Hunter addressed the way insurers eliminate the risk of hurricanes by using reinsurance and risk aversion strategies. He said insurers put the risk back on to the consumer by use of deductibles, caps on replacement costs and the anti-concurrent causation clause. Dr. Hunter said if all of the disasters including the 911 event occurred in this year alone, the insurance companies would still have a very safe leverage ratio.

Dr. Hunter explained in the past thirty years, there have only been three years in which the insurance companies made an underwriting profit. The insurance companies’ large surpluses have come primarily from investment income. He concludes an underwriting profit is not essential to an insurance company’s financial health. He stated the largest impact to insurance companies’ financial health has not come from any natural disaster, but instead came from the financial crisis.

Dr. Hunter’s presentation continued with his explanation of use of models and how they can often be inaccurate and that companies which produce models compete with each other and may produce models which are more favorable than others to insurers. He believes insurance companies should make their actuarial data public. He stated the lack of competition between insurance companies may explain the diversity of rates. Dr. Hunter provided information on why regulation is necessary for homeowner’s insurance. He contends most people lack a fundamental knowledge or understanding of what they are buying. Most people are not lawyers and they do not understand their policies. He cited after Katrina, most people didn’t understand the anti-concurrent causation clause and didn’t realize their claims would not be paid under this clause.

Dr. Hunter recommended exploring a multi-state compact. The states can work together to develop a regulatory model and create a multi-state reinsurance mechanism. He also recommends banning the anti-concurrent causation clause and suggests collection of data. Dr. Hunter believes carriers should use several models, instead of just one and that modelers need to be regulated as an advisory organization. He suggests the federal government can offer opportunities to provide assistance to Alabama in development of regulatory models and data collection. Dr. Hunter also said mitigation is very critical in helping resolve the problems. He concluded his presentation and offered to take questions.

Chairman Russell thanked Dr. Hunter for his extensive research and described the diversity of the Commission to him. Chairman Russell said there were legislators, consumers, HHI representatives, realtors, attorneys, professors and industry representatives on the Commission.

Dr. Hunter was asked about his thoughts regarding the multi-state compact and the impact on risk comparing Alabama's limited coastline as compared with Texas and Florida's coastline. Dr. Hunter acknowledged every state has a different risk. He suggested the models would be worked out that addresses the exposure. Dr. Hunter said the federal government could help prepare a multi-state model.

Chairman Russell asked for Dr. Hunter's thoughts regarding a Hurricane Facility and Authority which would deal with deductibles on insurance/financing arrangement which would be funded by money from the BP fine money. The deductibles would be large enough so that the companies could give a substantial premium credit. Dr. Hunter said the higher the deductible, the lower the premium and a facility as described by the Chairman would encourage policyholders to take a higher deductible.

Commission member Carl Schneider asked Dr. Hunter if the surplus numbers he referred to include all carriers, or was it solely P & C carriers and if it includes all carriers, how can he make the relationship between the surplus for all companies versus companies that only take on the risk of property. Dr. Hunter replied it is based on all companies. He added only a small handful of companies don't write property. Mr. Schneider asked Dr. Hunter about leverage ratio and in particular some of the startup companies which have gone into Florida and are running a five or six to one ratio.

Additionally, Mr. Schneider asked Dr. Hunter to further clarify his comments regarding how P&C insurers eliminate risks.

Commission member Michelle Kurtz asked how one state could initiate a multi-state type of entity. Dr. Hunter said there was a meeting in Atlanta several years ago which was initiated by Florida's Department of Insurance. He suggested contact between the states's Departments of Insurance. There was discussion on the viability of the Federal Flood Program.

The role of the federal government was discussed and clarified as having an advisory role in the capacity of data collection and not regulating what the states are doing.

Representative Joe Faust discussed the feasibility of using the BP money and the bond money from Raymond James to start Alabama's own reinsurance pool. Presently a lot of reinsurance money is going overseas. Dr. Hunter is of the opinion the state could make money if a reinsurance pool is carefully constructed.

There was additional discussion on the collection of data from insurance companies regarding cause of loss information.

Dr. Hunter's presentation and question/answer session was concluded. Chairman Russell thanked Dr. Hunter for his work and sharing his expertise and knowledge.

Representative Joe Faust addressed the Commission and stated there is agreement on the fact there is an insurance crisis in Baldwin and Mobile Counties. But the crisis is not limited to these areas and he foresees the crisis spreading across the state. In that context, he sees a need to have a meeting with all involved parties, particularly the insurance executives. Representative Faust said it's no secret there are billions of dollars in the form of reinsurance being pumped out of this country. An earthquake in Italy or tsunami in Japan affects reinsurance which causes our rates to go up. We need a mechanism set up to keep the money at home.

Dr. Veal of Auburn distributed a report compiled by his staff. The report compiled and collapsed issues which were previously reported. Dr. Veal organized the information in a better situation which allows for better conversation and direction. The report summarizes all of the ideas in a concise report. Dr. Veal asked the Commission to take a few moments to read the report and make corrections or comments. There were questions asking to clarify some issues and their general categories. The Commission discussed its interest in the multi-state compact and additional discussion of how best to benefit from the BP money. For example the deductible funded program could be a beginning point on a regional basis, with each state's contribution relative to its exposure.

Dr. Veal confirmed the latest report produced is a cumulative report of all issues previously agreed upon. He added this is the time to make corrections to the report. It was suggested to change "local building standards" to "Building Construction Data".

A question was raised about the process for adding issues which weren't previously discussed. An example is exploration of the multi-state compact. After group discussion, it was decided the sub-committees would flesh out and explore these and other ideas which are appropriate to their sub-committee's topic.

There was discussion on how to form the sub-committees and how to allocate resources and knowledge/experience of the Commission members to best address the identified issues. After further discussion, it was decided four sub-committees would be established. There will be a sub-committee assigned to Education issues, a sub-committee assigned to Regulatory issues, a sub-committee assigned to Statutory/Legislative issues and a sub-committee assigned to Mitigation issues. Each sub-committee will have seven Commission members and a representative from Auburn. Each Commission member will send their top three preferences regarding on which sub-committee they would like to serve. Chairman Russell will appoint a

chairperson of each sub-committee. Each sub-committee would meet at their convenience and will issue a written report within a six week deadline (on or near June 1).

There was further discussion regarding the makeup of the sub-committees and whether or not a non-commission member would be able to serve on a sub-committee. It was decided that the sub-committees would only be comprised of Commission members and their appointed faculty advisors. Chairman Russell stated each sub-committee can use assets of whatever resources they want, but the sub-committee's members are restricted to the members of the Governor's appointed Commission.

After further discussion, the meeting adjourned.