

Coastal Recovery Commission of Alabama Insurance Subcommittee of the Economic Committee

Discussion Note

October 4, 2010 Meeting in Fairhope, AL

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Author
Michael Joe

The subcommittee chair, Walter Bell, opened the meeting by stating that the subcommittee's mission is to propose recommendations that will look at the issues surrounding insurance and how those issues affect the economic development in South Alabama. The chair noted that the recommendations will need support from the incoming Governor of Alabama.

The subcommittee reviewed the commission's two-part statement of purpose, an approach each subcommittee will take toward making their recommendations:

- Identify the impact of the BP oil spill on INSURANCE. Outline the negative vulnerabilities that have become known.
- Propose bold but attainable goals that would be a road map toward making our community more resilient in the area of INSURANCE to both man-made and natural disasters.

The chair said that the BP oil spill was a unique event and that the subcommittee will primarily focus on the effect of previous and future natural disasters.

The subcommittee reviewed the work of the 2005 Hurricane Issues Task Force report, which was released following Hurricane Ivan, but prior to Hurricane Katrina. The report looked at ways to relieve stresses on the insurance marketplace. The three areas of emphasis the task force identified were 1) claims coordination, 2) alternative markets, and 3) restrictions and exclusions of coverage.

- Regarding claims coordination, the report said that one year removed from Ivan there were still many claims not yet settled. At the time, the market had not experienced much disruption. The beach pool had not yet exploded. The only market disruption was the initial exclusion of wind insurance from about 2,300 policies by a single insurer.
- A task force recommendation was to launch a non-binding mediation program, which was used to help wrap up Ivan claims and many Katrina claims. It had a 90 percent success rate.

- The task force discussed enhancement of the single-adjuster program to handle claims, as well as consumer education. Since Katrina, many companies have decided to take steps to reduce exposure in the region.
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- Regarding alternative markets, the task force discussed how an effective insurance law could benefit condominium associations or like-minded businesses to handle property insurance. The legislature passed a captive insurance law for commercial property in 2006; a captive law was passed in 2008 for a potential homeowner coastal captive. But the state has not yet licensed a captive for either purpose.
- The task force voted to expand the board of the Alabama Insurance Underwriting Association to include consumer representatives from each county.
- There was discussion of establishing a long-term disaster fund involving either catastrophe bonds or some other mechanism to serve as a backstop, but the task force did not make a recommendation to establish such a mechanism, acknowledging the political and financial difficulties.
- The task force also discussed wrap-around policies -- which would essentially split policies between wind coverage and other basic coverage for fire and theft and other liabilities. Although there was no recommendation, a large segment of the market has ended up in this posture as the wind pool has grown in the last five years.
- In 2008 the legislature codified the wind pool. Lawmakers also allowed the board to retain a surplus, but the pool currently does not have much in surplus that it is able to retain because much is spent on reinsurance. A fourth zone was created to encompass the city of Mobile. The pool has grown from below 3,000 policies prior to Ivan to more than 15,000; the premium volume has grown more than that.
- Regarding restrictions and exclusions, the task force was concerned with providing consumers with adequate notice as insurers began to exclude coverage. Regulations were issued requiring 90 days notice to the commission and 60 days to the consumer. The regulations have since been amended to 150 days and 120 days.
- The task force also discussed creating a market assistance plan involving a list of companies providing insurance in Baldwin and Mobile counties. The plan became obsolete almost immediately as companies ceased writing insurance or instituted strict underwriting guidelines following Katrina.
- A few things have happened since the task force reported: 1) a surplus lines waiver law passed last legislative session, and a mitigation discounts law passed two sessions ago.
- The state continues to have discussion with insurance companies interested in entering Alabama. One company, which does not have a significant presence in the state, is interested in picking up policies in the beach pool zone; companies that have a small

market share, but still face the state assessment, are seeking relief from the assessment by picking up beach pool zone policies.

A subcommittee member discussed the possibility of using BP money to fund a homeowners insurance captive. The captive insurance law that passed in 2008 has a \$1 million minimum capitalization. The member also noted insurance discounts of up to 35 percent for consumers who take steps to mitigate damage to their homes. The problem is that the average homeowner does not have \$7,500 to \$15,000 to pay for the retrofits. Other states have established a pool of grant money to allow citizens to apply for grants for retrofits, which is another option for which BP money could be used. The member also noted that another idea is to permit companies to sell high deductible policies, but to establish a pool, or trust fund, in which citizens have the option to buy against the risk of a high-deductible policy.

The subcommittee chair noted that no matter what type of captive insurance program that might be established, the insurer will be subject to reinsurance.

A member noted that while the insurance market for commercial properties stabilized about 18 months after Katrina, the market for homeowners continues to be a major issue. "We've got to have people who can afford to live and work down here to make the economic engine go," the member said.

Another member said that the obvious challenge is that the market continues to constrict as insurance carriers reduce their portfolios. Some of the market has been picked up by surplus lines, but the vast majority has gone to the Alabama Insurance Underwriting Association. The member has been wondering how to remove insurance companies from some of the loss, which could reduce premiums for consumers.

The chair emphasized a particular planning approach in looking at types of comprehensive mitigation programs. The chair noted that insurance companies are in business to take a risk, but they are not in the business to go out of business. When considering affordability and availability, he said, companies will pull out of the market if they cannot get a risk-based premium, which is what has been happening. However, he said, we cannot allow citizens to have insurance premiums that approach their mortgage payment. He emphasized the need to retain a private marketplace for insurance and to provide citizens affordable insurance.

The chair further noted that tornadoes are becoming another peril we have to deal with and he said that tornado damage should be addressed by the subcommittee. He said there are a number of cost-effective measures that can mitigate the effects of the wind and the storm surge. He said "ecological maintenance" is important -- stronger new construction; a statewide building code; at minimum stronger codes for coastal counties and neighboring counties to the north along I-65. Retrofitting is quite expensive, he added. He said people have previously talked about providing grants for retrofitting but that the state has not been able to do it. He said finding some funding for a mitigation grant program would be a good start.

The chair added that ideas for a state pool -- such as the AIUA -- should not be considered a panacea. In the long-run, the state should look to reduce the number of people participating in any state pool to pre-Katrina levels.

A member raised a number of issues for the subcommittee to consider. He said companies entering the market are focusing on providing coverage for homes that are better built. He said inspectors are finding that between 20 and 30 percent of new homes do not meet building codes. One major carrier recently reduced its automatic insurance discounts because the company discovered that the vast majority of inspected homes did not meet building standards. During a recent meeting among building inspectors from Mobile and Baldwin counties, they discussed how the national press was reporting about low construction standards in Alabama and Mississippi.

He recommends not only a statewide building code, but a code-plus building code for Baldwin and Mobile counties for both new and existing homes. Another issue, he said, is that contractors are hiring unlicensed subcontractors who build roofs that do not need to meet criteria. Regarding the issue of mitigation grants, he noted that an organization in Pensacola called Rebuild Northwest Florida has mitigated more than 6700 homes in Pensacola with state and federal money. The money is also available in Alabama but the state has not had an organization put it together. Regarding public education, he stated the subcommittee should emphasize that coastal Alabama is a hazardous area, prone to hurricanes, and that there could be an event worse than hurricanes Ivan and Katrina. Regarding the wind pool, he said the subcommittee should look at what other states are doing. He said assessments are a big issue for a few key carriers, and the subcommittee should also look at how the wind pool is affected by adverse selection, in which the pool collects a high number of properties with high risk exposure. Regarding insurance fraud, he noted that it is becoming an issue along the coast; consumers don't know what they are buying and he recommended standardization from the state. Regarding the premium tax, he said there is unfairness in the current tax program. Regarding uninsured and under-insured homes, consumers are going without insurance or buying coverage without wind coverage. He added that consumers do not know the difference between admitted and non-admitted insurance carriers, and that there is also the issue of whether the state's guaranteed pool has sufficient resources to handle the loss of a major insurance carrier after a storm.

The chair noted that the member raised many important points and emphasized the need for natural resource protection – sustainability of the coastal dune and barriers system.

Another member noted that the subcommittee should keep in mind there are a growing number of homeowners who are “functionally uninsured,” a category that includes people who have insurance but do not have wind insurance, or have wind insurance as part of a policy but do not have the money to pay the deductible.

A member said he has witnessed a good bit of insurance fraud and recommended that when an insurance agency sells a new policy, the agency should be required to give the new policy holder an insurance education sheet. Another member said that a bill offered in the legislature would have required insurance carriers to give policy holders an information sheet explaining that policy holders may be entitled to a discount if they retrofit their homes -- but he said the bill died. Another member said it was difficult to get people to read their policies. The chair said that perhaps some money could be set aside to do public education and outreach and that, with the public funding, perhaps agencies could be convinced to help fund an education campaign. The chair added that regardless of what is done, we must be able to measure the effectiveness of what is done.

A member said that it is important for the subcommittee to remember that citizens in Baldwin and Mobile counties pay twice as much in tax than the average citizen in Alabama pays. He said it was also important to remember that the premium tax structure in Alabama is more heavily borne by citizens in Baldwin and Mobile counties because there is more catastrophic exposure. He asked that the subcommittee recommend that some money be given to establish a captive insurance system. He said he was convinced that making available \$20 million or \$40 million to establish a government-formed, not-for-profit captive would work.

A member said that while coastal counties are contributing a growing share of the state's insurance premium tax collection, premium tax collections as a whole are decreasing because people are either dropping health insurance or not buying life insurance.

The chair noted that years ago nursing homes couldn't find insurance and that a successful captive was created. He also noted that there are examples of failures in the captive area. He asked that members prepare a presentation on captive insurance proposals for the next meeting.

A member noted that a previous proposal for a captive was for a commercial captive, not a residential captive. He explained that in Alabama it is illegal under the constitution for governments to use public money for private gain.

A member asked whether it would be possible to form a regional captive involving two or more states. He said there are states that, like Alabama, are expecting to receive money from BP. Another member said there has been discussion about possibly partnering with states not adjacent to each other, to truly spread risk should a named storm impact several adjacent states.

A member discussed ways a captive could possibly negotiate better coverage rates from reinsurers. He noted that it might help to connect a captive to improved building codes, or form an alliance with other captives in states that are not contiguous to Alabama.

A member noted that captives that have been successful have a limited number of entities involved and that there is some control over safety and due diligence. The other reason for their success is that they are able to spread risk. He said reinsurers are reinsuring for coastal areas around the world, which spreads the risk. But the challenge, he said, will be having some control over many people -- in both commercial and residential properties -- so that they meet building codes and other mitigation requirements.

The chair noted that adverse selection would occur in a captive. He said people south of I-10 and along the beach would join the captive, which would result in a lot of exposure. The chair said that insurance premiums may not be that much less, and perhaps will be more, particularly at the beginning. The chair added that the captive would have to be subsidized for a long enough period, perhaps 5 or 10 years without a major storm.

The discussion turned to the merits of mitigation. Several members voiced support for providing mitigation grants for retrofitting and fortifying homes, saying that money invested to retrofit existing homes or fortify a new home will pay benefits over time through lower premiums. A member asked whether grant programs in other states do not require people below a certain income level to provide a dollar match to receive a grant. In response to the question, a member said that the

money provided by the state of Florida has a means tested, but federal money for Florida's mitigation program can never involve a means test.

A member said that Rebuild Northwest Florida in Pensacola has developed into an organization that has proven to be the best mitigation program that FEMA has funded. Initially the organization was created to help people who did not have insurance or did not have money to put a roof on their damaged homes. Now, he said, people with homes worth \$1 million can access the program. The program pays 75 percent of the cost of mitigation. A cost-benefit analysis must be run to show that the money spent by FEMA reduces the cost of potential future damage. Regarding the cost of mitigation homes, the member noted that in jurisdictions that have already adopted the international building codes of 2003, 2006, or 2009, the cost is an additional \$3,000 to \$5,000 to mitigate a new home. In jurisdictions that have not adopted those international building codes, it would cost an additional \$10,000 to \$15,000 to mitigate a new home. To mitigate existing homes, he said, there are some inexpensive things that can be done.

A member asked about the risk of falling trees. In response, a member said there has been some research and study regarding tree risk in a storm.

A member noted that inspections of homes make a difference. He said homeowners learn that their premiums could be lower; homebuilders notice that people are inspecting their work; and insurers that offer discounts want verification that homes they insure are fortified.

The chair asked members to also arrange a presentation about mitigation for the next meeting. He said the subcommittee would try to include representatives from the homebuilders association and a realtor group. He said increasing competition in the market is key, and he said he would like to work on outlining a public education plan. The chair added that he likes the idea of recommending that an organization, or commission, be created to continue the work of the insurance subcommittee.