INSURANCE TERMS and ANALYSIS OF SB454

PREPARED 4/11/12 FOR DAN, MICHELLE, & MEMBERS A. C. Leggett

You asked for the terms: Earned Premiums, Premiums Paid, Premiums In Force in your 4/10/12 email to me. I checked the following glossaries: www.irmi.com (Insurance Risk Management Glossary), www.ambest.com (A.M. Bests) These two sites were helpful.

Dan, I know you were interested to know about PREMIUMS IN FORCE..see page 2 item #3

The following were incomplete, sketchy glossaries: www.2.iii.org (Insurance Information Institute), www.naic.org (National Association of Insurance Commissioners, www.nationwide.com Nationwide Ins. Resource Center

NOTE: My general sense after doing this research and analyzing the SB454 (SB210) is that someone intentionally or unintentionally is playing loose with terms, and that the bill should use insurance accounting terms that should be easy to find in a glossary or a codicil or else describe the terms in detail within the bill itself.

To answer the terms above:

1. EARNED PREMIUMS are that portion of the policies premium that applies to the expired portion of the policy. Although insurance premiums are paid in advance, Insurers typically earn the premium at an even rate throughout the policy term. The "UNEARNED" portion sits in another account waiting until "time" has elapsed to write representative portion of the Unearned Account into the Earned Premiums Account. This is a simple accounting situation not unique to the Insurance Industry. I can explain in further detail if needed. In order to know the TOTAL PREMIUMS PAID AND DUE TO BE PAID you must add the Earned Premiums to the Unearned Premiums and that will reflect the total of the policy term premiums.

The last copy of the Clarity Bill came to me 4/10/12 and that is the one I will be referring to as SB454 pg 2,, line 11 refers to DIRECT EARNED PREMIUMS. These 3 words were not found in any of the glossaries, but I might can shed some light on what the pitfalls could be with those words. At the IRI.com site DIRECT WRITTEN PREMIUMS are the total of an insurer's written premiums without any allowance for RE-INSURANCE. Same Site says DIRECT PREMIUMS are the GROSS premium income for coverage under the policies. We want PREMIUMS PAID to track the policies and we do not want some account that has been written down by the amount of the Re-insurance purchased because the deduction of re-insurance from the Premiums would make it look like they did not collect as much premiums as they actually did.

POLICIES WRITTEN and then someone decided they wanted it to be POLICIES IN FORCE pg 2, line 26. I can Explain the difference between Written and In Force. A policy is written by an agent but is not IN FORCE until consideration (money) has changed hands. Whoever is helping Pittman is pulling these terms out of a hat, and perhaps it is just sloppiness or it is designed to write a weak bill.

2. PREMIUMS PAID Holy Moly this is a good one. Just what it says PAID, i.e., money in the bank. BUT, if you are comparing Premiums Paid to Claims in the year 2012 then you are going to want the Premiums Paid to be on the Policies In Force to which the CLAIMS relate, right? Therefore, Premium Dollars paid in year 2012 will have some Dollars that relate to the Prior Year Premiums (2011) but were not received until 2012. No problem, it is a timing issue and I am sure the Ins Companies know how to calculate it by deducting those 2011 prems from 2012 (because they don't want Premiums 2012 to be any higher that it needs to be.) But can't let them forget to ADD back to 2012 those prems that were received in 2013.

MY PREMISE with all this is: Early on we said that what we wanted to establish is not whether they are making money or not, BUT whether certain zip codes were paying greater prems and less claims then the rest of the state.

3. PREMIUMS IN FORCE Now, Pittman is mentioning PREMIUMS IN FORCE which is the sum of the face amount of policies, plus the amount of dividends for LIFE insurance policies outstanding at given time. (Source: Insurance Institute Information Glossary)

Do you just love this fox chase they (who?) have created with all these slippery terms. We do not want any adjustments made to PREMIUMS EARNED & UNEARNED and the dollars need to be EXACTLY the dollars the Policy says are due. I have no problem with the DIRECT being added since I did find in the Glossary the term Direct Premiums being the GROSS premiums in income under the policy". One thing to keep in mind is that there could be a new Codicil acted upon by the NAIC that might not be in the glossaries yet. Someone we trust could confirm that.

4. On to CLAIMS and we are not talking about DIRECT INCURRED LOSSES pg 2, line 11, pg3, line 20, Losses contain other items (expenses)other than CLAIMS paid to homeowners. Direct Incurred Losses belongs on the Financial Statements and it is not what we said we wanted in the Clarity Bill. Keep it simple..just CLAIMS. www.irmi.com defines INCURRED LOSSES as the total amount of paid claims AND loss reserves associated with a period of time.

Note, it did not say associated with the policies written or in force. Incurred Losses would always be a bigger figure than CLAIMS. They are trying to write this bill so the Premiums will be smaller and the Claims will be bigger.

To further explain Incurred Losses: In order to accurately reflect Losses on the Financial Statement, one would add to the cost of claims expenses to defend (legal), cost of adjusting the claims, salaries, etc. until finally you have a figure that does not reflect what the Homeowners received for their loss.

So, do we agree, take out the "incurred losses" Also, during some discussion didn't someone with the DOI say we needed to use the Incurred Loss Ratio, and Dr. Hunter said we did not need that? If that crops up again..we don't want that because that ratio is a measure of the company's ability to meet their obligations, and I think I read the Insurance Commissioners want that ratio to be less than 3:1 and does not tell us what they are paying out per zip code to homeowners claims See definition Incurred Loss Ratio at www.irmi.com

FURTHER ANALYSIS OF SB454: I. Synopsis, pg 1, line 9-11 should read .."aggregate information for homeowners insurance policies pertaining to the number written and in force, the Direct Written Premiums, Amount of Claims Approved, and Amount o Claims Pending representing the total of every insurance company…"

Where ever the words "direct earned premiums" appear replace with Direct Written Premiums, where ever the words "direct incurred losses" appear replace with the words Amount of Claims Approved and Amount of Claims Pending

II. Strike out (c) pg 5 in red The DOI is part of the problem. The commissioner should have only whatever power he now has, and not additional power. If this bill really passes in some form, and any of the parties have a problem complying let the Attorney General deal with it.

III. The Clarity Bill is just going to give us data for the "admitted" insurance companies. Why can't we get the non-admitted included? They pay a tax to do business in Alabama which is higher than the admitted companies pay. Dan, straighten me out on this.

TIDBITS: I found out the insurance companies keep a register of the Policy Year Experience defined as: The premium and losses associated with a given annual policy period. The policy year experience for an individual insurance policy includes each premium and loss transaction that relates to that particular policy. An aggregate policy year experience for an entire book of business is calculated by including the individual experience of all policies that became effective during that year. For example 2007 policy year data would include the experience

of all policies effective between Jan 1, 2007 and Dec 31, 2007, regardless of the date on which losses or other events associated with those policies occur. This approach provides a clear match between losses and premiums. THIS IS NOT WHAT WE WANT FOR THE CLARITY BILL, but it is good to know what is needed to ask for if we were analyzing profitability, and this register does include what we want, but we don't want all the expenses they are applying to the premiums. Although we can't use these numbers in the register, we need to have the same "matching" process with CLAIMS & PREMIUMS. Don Price can explain this better than I can, because of his insurance financial experience. I have just done some of the grunt work. What about advice from our experts in Mass & Calif?

I hope this helps with feeling comfortable about the terms and what should be reflected on the bill.

If ya'll have any questions I'll try to get an answer…I hope I helped and didn't thoroughly confuse everybody. But it does not look like the SB454 is ready!

See y'all sometime A. C.