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Kevin Beagan
Director
State Rating Bureau
Division of Insurance
One South Station
Boston, Massachusetts 02110

Dear Mr. Beagan:

We write to you to express our ongoing concern regarding homeowners insurance premiums in Massachusetts and, in particular, the use of unproven and in some cases discredited hurricane models to justify excessive voluntary market rates. After we sent a letter to the Commissioner of Insurance on this issue (copy attached for your convenience), we have continued to monitor the market. The situation remains troubling.

In Massachusetts, insurers continue to use untested and discredited hurricane models and include inflated reinsurance provisions in their voluntary market rates. Over the period 2004 through 2010, hurricane and reinsurance charges increased voluntary market homeowners insurance premiums by about \$2.2 billion statewide (or about 21% of Massachusetts voluntary market premiums).[1] The amount of overcharges during this period could be at least a half a billion dollars.

Insurance companies that include hurricane loss provisions in their rates typically use the RMS and/or AIR models[2] to estimate expected hurricane losses. The RMS and AIR models have significant shortcomings that unfairly raise rates for consumers. The RMS near term model used by insurers and reinsurers has been rejected for use by the Florida Commission on Hurricane Loss Methodology; a recent five-year review of the

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[1] This calculation is based on data compiled by the National Association of Insurance Commissioners (NAIC). It also includes an implied underwriting profit provision of 5%; while we believe a 5% underwriting profit is too high, we have included it for illustrative purposes as an upper bound to isolate the (lower bound) effect of hurricane and reinsurance charges. Overall, about \$2.8 billion of statewide premium during the 2004 through 2010 period, or about 26% of total premium, comprised hurricane and reinsurance charges and underwriting profit.

[2] These include different types of models, which rely on different aggregations of data, and weight data differently. For instance, the RMS long-term model is based on a 100+ year sample of historical data; the RMS near-term model is based on a smaller historical sample.

near term models, including the RMS model, determined that these model predictions are well above insurer loss experience.[3] A hurricane loss provision based on the long term RMS model was rejected by former Insurance Commissioner Nonnie Burns in the 2007 Fair Plan decision and appendix.[4] Also troubling is the fact that the AIR model has never been thoroughly reviewed by any regulatory agency here in Massachusetts or elsewhere to determine whether its estimates are accurate and suitable for use in the Commonwealth.

Excessive insurance rates have a significant impact both on individual consumers and on economic activity in Massachusetts. Using the methodology presented by the Division of Insurance in its report "The Impact of the 2008 Auto Insurance Reform on the Massachusetts Economy," every $1 billion in excess homeowners insurance charges during the 2004 through 2010 period reduced economic activity in Massachusetts by about $420 million annually, and cost Massachusetts about 2,800 jobs each year. In addition, excessive homeowners insurance costs may have contributed to the increase in foreclosures by raising the already high costs of homeownership.

Untested and unsupported model provisions should not be used to justify rates that are excessive. Because hurricane models have a significant impact on the premiums paid by all Massachusetts homeowners, all insurers should be required to demonstrate that the models they use produce accurate and reasonable estimates that are appropriate for use in Massachusetts. Without such a showing, the insurers have not shown and cannot show that their rates are not excessive, as required by Massachusetts law, G.L. c. 174A, §5 (a)(2).

Requiring insurers to justify their rates—and to lower rates that are excessive—is particularly important in Territory 37, comprising the Cape and Islands. In Territory 37, the high level of current homeowners insurance rates is largely the result of modeled hurricane losses. As we noted in our prior letter to the Commissioner, for those insurers that provide territorial data in their filings, modeled hurricane loss estimates are as much as 600% higher than the combination of ordinary losses and non-hurricane catastrophes in Territory 37.[5] Removing just a portion of modeled hurricane losses from the rates would result in large rate reductions in Territory 37.

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[3] Near Term Hurricane Models, Performance Update, January 2011, Karen Clark & Company. "We have now completed the first five-year near term hurricane model projected period, and actual insured loss experience has been well below the level of the model predictions. Four of the past five years have had minimal insured property loss from Atlantic tropical cyclones, well below both the long term average and the (much higher) near term projections. To date, the catastrophe models have not demonstrated any skill in projecting near term hurricane losses. The first decade of the 21st century was equal to the long term average with respect to hurricane landfall frequency and loss experience. This average decade was preceded by several decades of below average activity. This means the even the long term standard hurricane model activity rates are higher than what has been experienced since the models were first introduced in the 1980's." http://www.karenclarkandco.com.

[4] Decision and Order on the Massachusetts Property Insurance Underwriting Association 2007 Rate Filings, Docket No. R2007-02 (2008); Appendix to Decision and Order on the Massachusetts Property Insurance Underwriting Association 2007 Rate Filings, Docket No. R2007-02 (2008).

We request that the State Rating Bureau seek the initiation of administrative rate proceedings to review the voluntary market homeowners rate filings for the company rates currently on file at the Division, G.L. c. 174A, § 7. Such proceedings can lead to the disallowance of the excessive rates that are damaging Massachusetts homeowners and costing the Massachusetts economy thousands of jobs.

Yours truly,

Glenn Kaplan, Chief
Insurance and Financial Services Division

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[5] This comparison is based on actual losses in Territory 37, without adjusting for "credibility."