Americans for Insurance Reform
Center for Economic Justice
Center for Insurance Research
Center for Justice and Democracy
Consumer Federation of America
Consumers Union
Empire Justice
Florida Consumer Action Network
Foundation for Taxpayer and Consumer Rights
Neighborhood Economic Development Advocacy Project
New Jersey Citizen Action
Texas Watch
United Policyholders

PROPERTY/CASUALTY INSURANCE IN 2008: OVERPRICED INSURANCE AND UNDERPAID CLAIMS RESULT IN UNJUSTIFIED PROFITS, PADDED RESERVES, AND EXCESSIVE CAPITALIZATION

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Americans for Insurance Reform is a coalition of over 100 public interest groups from around the country working to increase accountability and oversight of insurance industry practices.

The Center for Economic Justice (CEJ) is a 501(c)(3) advocacy and education center dedicated to representing the interests of low-income and minority consumers as a class on economic justice issues. CEJ's work focuses on administrative advocacy on insurance, utilities, and credit; the tools necessary for the poor to pull themselves out of poverty.

The Center for Insurance Research, based in Cambridge, Massachusetts, provides an independent voice for reform in debates about insurance, banks, financial services companies and related public policy issues around the nation. CIR focuses on national and state issues of insurance and financial services regulation in a range of areas including: mutual conversions, health care, illegal discrimination, insurance accessibility, cost reduction, quality assurance, disclosure, corporate and regulatory accountability.

Center for Justice & Democracy is a national consumer organization working to educate the public about the importance of the civil justice system.

Consumer Federation of America (CFA) is a non-profit association of 300 consumer groups, with a combined membership of more than 50 million people. CFA was founded in 1968 to advance the consumer's interest through advocacy and education.

Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education, and counsel about goods, services, health and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived form the sale of Consumer Reports, its other publications and services, and from noncommercial contributions, grants, and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports with approximately 5 million paid circulation, regularly carries articles on health, product safety, marketplace economics, and legislative, judicial, and regulatory actions which affect consumer welfare. Consumers Union's publications and services carry no outside advertising and receive no commercial support.

Empire Justice is a non-profit legal services organization with offices in Albany, Rochester, White Plains and Central Islip (Long Island). Empire Justice provides support and training to legal services offices statewide, undertakes policy research and analysis, and engages in legislative and administrative advocacy. Empire Justice also represents low-income individuals, as well as classes of New Yorkers, in a range of poverty law areas including insurance and consumer law. In May 2005 Empire Justice released a report entitled "The Homeowners Insurance Gap: How Race and Neighborhood Composition Explain Cost and Access Disparities in Rochester and Monroe County, NY."

The Florida Consumer Action Network is a grassroots organization which empowers citizens to influence public policy by organizing and educating in areas where consumer voices are underrepresented. It works to develop and mobilize activists from dozens of allied and affiliated organizations, including environmental, church, labor, civic, and senior citizen groups.

The Foundation for Taxpayer and Consumer Rights is a national leader on issues related to insurance, healthcare, energy and political reform. The nonprofit, nonpartisan organization is based in Santa Monica, California.

The Neighborhood Economic Development Advocacy Project (NEDAP) is a resource and advocacy center based in New York City. NEDAP's mission is to promote community economic justice and to eliminate discriminatory economic practices that harm communities and perpetuate inequality and poverty.

New Jersey Citizen Action works to protect and expand the rights of individuals and families and to ensure that government officials respond to the needs of people rather than the interests of those with money and power. Through organizing campaigns that promote economic, social, racial and political justice, NJCA encourages the active involvement of New Jersey residents in challenging the public and private institutions and agencies that impact our lives.

Texas Watch is a non-partisan, advocacy organization working to improve consumer and insurance protections for Texas families. Texas Watch provides a platform for Texas consumers on insurance, nursing home resident protection, patient protection and consumer law issues in legislative and regulatory activities.

United Policyholders ("UP") is a not-for-profit corporation founded in 1991 as an educational resource for the public on insurance issues and insurance consumer rights. UP monitors the insurance sector, works with public officials, has a nationwide network of volunteers and affiliate organizations, publishes written materials, files amicus briefs in cases involving coverage and claim disputes and is a general information clearinghouse on consumer issues related to commercial and personal lines insurance products. UP provides disaster aid to property owners across the U.S. via educational activities designed to illuminate and demystify the claim process.

I. EXECUTIVE SUMMARY

Property/Casualty insurance in America is overpriced. It has steadily become less of a good value for America's consumers over the last generation, as determined by two widely used measures:

- **Loss ratio, the portion of the premium dollar that is returned to consumers as benefits**. Some types of insurance show very good value, particularly government social insurance programs, while others show poor value. A low loss ratio indicates poor value for consumers even if insurers are not earning high profits, as they have been in recent years. This study documents that loss ratios for property/casualty insurance (such as auto and home insurance) have sharply declined over the last 28 years. Today consumers receive about 55 cents back in benefits for every premium dollar spent. This amount is more than 20 percent less than benefit ratios seen as recently as 20 years ago.

- **Profit, the return earned relative to the capital at risk**. It is an undisputable fact that insurers have earned unprecedented profits in each of the last four years. The property/casualty insurance industry, however, claims that it is underperforming because other industries earn a higher return on equity (Return on equity, or ROE, is the amount of profit earned relative to the capital invested). This report documents in detail that the use of this comparison is highly misleading and leads to a false conclusion. In fact, the insurance industry dramatically understates its return on capital in several ways. For instance, it includes excess capital earned by mutual insurers like State Farm when calculating ROE, which makes the actual return look lower than it really is. In reality, the ROE earned by publicly traded insurers is equal to or more than that earned by Fortune 500 companies, while their investment risk is lower than that of those corporations.

The bottom line is that insurers are charging consumers too much. Competition, such as it is, has not protected consumers from excess prices and unfair rating schemes, including the growing reliance on "black box" technologies used by insurers to set rates that are not transparent to the public or accountable to policymakers.

This report also documents that the financial statements released by property-casualty insurers significantly understate their profits. This is because insurers have padded the reserves they put aside to pay for future claims by $80 billion more than the amount they will need to pay those claims. If these "redundant" reserves are considered, property-casualty insurers have earned profits of $305.1 billion over the last five years, equal to more than $1,000 from every person in America.

Another major conclusion of the report is that the property/casualty insurance industry has inflated the surplus it holds, by as much as $100 billion beyond the level needed to back up the underwriting risk they face. This inefficient capitalization has allowed insurers to launch massive stock buyback programs, to purchase other businesses, and to increase compensation for its managers to among the highest levels in American business.[1]

The unjustified rates of recent years have led to excesses in both the surplus and reserves that property/casualty insurers hold. The Insurance Information Institute ("III") says that the industry has "excess capital" of up to $100 billion. This does not reflect the $53 billion in reserves that Insurance Services Office ("ISO") reports as "redundant." Thus the amount of unwarranted funds collected from consumers that the industry itself has reported is as much as $153 billion. CFA estimates that this amount is probably closer to $175 to $200 billion. However, using even an ultra-conservative estimate of $100 billion in excessive surplus and reserves, Americans have been overcharged by the equivalent of $870 per household in the last four years (There are 115 million households in the U.S.). It would take more than five Hurricane Katrina-sized losses to eliminate these unwarranted reserves and surplus. Even if such an unlikely series of losses occurred, the insurance industry would still be extremely secure financially and consumers would still be paying excessive rates.

At the same time that the insurance industry is enjoying unprecedented profits, excess surplus and redundant reserves, this report reviews how many consumers have had to purchase overpriced insurance, have been abandoned by insurers on the nation's coasts, and have confronted claims practices designed to systematically underpay the claims consumers dare to file.

The report concludes with proposals for public policy changes to reduce the excesses of the industry and better protect consumers.

II. THE INSURER-CULTIVATED MYTH OF LOW PROFITS AND HIGH RISK

For policymakers and Americans who do not pay close attention to insurance markets, it would be easy to assume that the property/casualty insurance industry is in financial peril because of the risk inherent in offering insurance in a world where weather events and terrorist attacks seem to be more frequent and more catastrophic. After all, in recent years, insurers have had to pay claims for the losses associated with the September 11th terrorist attacks and several of the most destructive hurricanes in U.S. history.

It is not surprising therefore, that when insurance companies petition Congress for federal assistance in covering terrorism or natural catastrophe losses, Senators and Representatives are often inclined to believe that such assistance may be necessary. When coastal states (including California, in the case of earthquakes) are asked to create risk pools so that insurers have a place to steer higher risk consumers, state regulators and legislators often assume that the industry is

[1] "Insurance CEOs Rake in Cash, But Not Stock," National Underwriter, January 2, 2008. The story cites a report by the Conference Board that found that, "For the insurance CEOs, the median cash compensation (sum of annualized salary, bonus, and non-equity incentive compensation) is highest among industries at $1.6 million." The story also reported that, "According to The Conference Board, the highest median total compensation was recorded for utilities CEOs ($3.9 million), followed by food and tobacco ($3.8 million), and insurance ($3.2 million), with construction a close fourth."

not in a financial position to cover such risk. When insurers sharply boost premiums on the coasts, increase deductibles, refuse to renew policies or otherwise cut back coverage, policymakers presumptively accept these steps as necessary to help the property/casualty insurance business meet the huge challenges it faces in a risky world filled with dangers that it cannot adequately measure. Many states have also been compliant when insurers ask them to reduce consumer protections in response to higher risks that insurers claim they face, such as a supposed rush by Americans to settle in coastal areas that are more dangerous. [2] (See below for evidence to the contrary.)

The "conventional wisdom" sown by insurers, then, is that insurance has become an inherently unstable business that generates profits insufficient to compensate for the extraordinarily high risk that they face.

III. THE REALITY: LOW RISK AND UNJUSTIFIABLY HIGH PROFITS

The financial reality of the property/casualty insurance industry could not be more different than the carefully cultivated perception fostered by insurers. Insurers are paying out lower claims, charging consumers higher premiums, reaping greater profits, and are more financially solid than at any other time in history. Moreover, insurers are poised to continue to reap hefty profits for years to come.

A. Excessive Profits, Declining Consumer Value, and Overpriced Insurance

Insurer profits can be measured in several ways. First is the pure loss ratio. This is the percentage of the premium dollar that is or will be paid out to policyholders and other claimants as benefits after an insured event occurs. (Some of these losses remain held in reserve by insurers for future pay out.[3]) Another method of evaluating profitability is the loss and loss adjustment expense (LAE) ratio, which adds the cost of adjusting claims to the pure loss ratio. A third measure is the combined ratio, which includes all additional expenses (called "underwriting expenses") such as commissions and overhead to the loss and LAE. This figure shows how profitable the insurance venture was compared to the premiums collected, but excludes investment income that insurers earn, which is very significant, particularly in some lines of insurance. Investment income is derived from the investment "float" that is earned between the time premiums are paid to the insurer and when the insurer pays out losses. In some lines of insurance, such as fire insurance, this period is relatively brief, so the investment income earned is relatively small. In other lines, such as medical malpractice, the float exists for long periods of time, so the investment income is large. Profit can also be expressed in dollar terms. The final, overall profit, is called "net income" and includes all investment income earned as well as all federal taxes incurred. It is the true bottom line figure for profit.

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[2] "…The risks keep rising because…people continue to flock to places that are exposed to catastrophe," Edward M. Liddy, Chief Executive Officer of Allstate Insurance, in "The New Deal – Insurers Learn to Pinpoint Risks – and Avoid Them," Los Angeles Times, November 28, 2006.

[3] "Incurred losses" include paid losses plus reserves for known claims and even for unknown claims, called "incurred but not reported" or IBNR reserves. Paid losses only include what was actually paid out. The profit figures discussed in this report are based upon incurred losses, including all reserves. We discuss reserves more completely below.

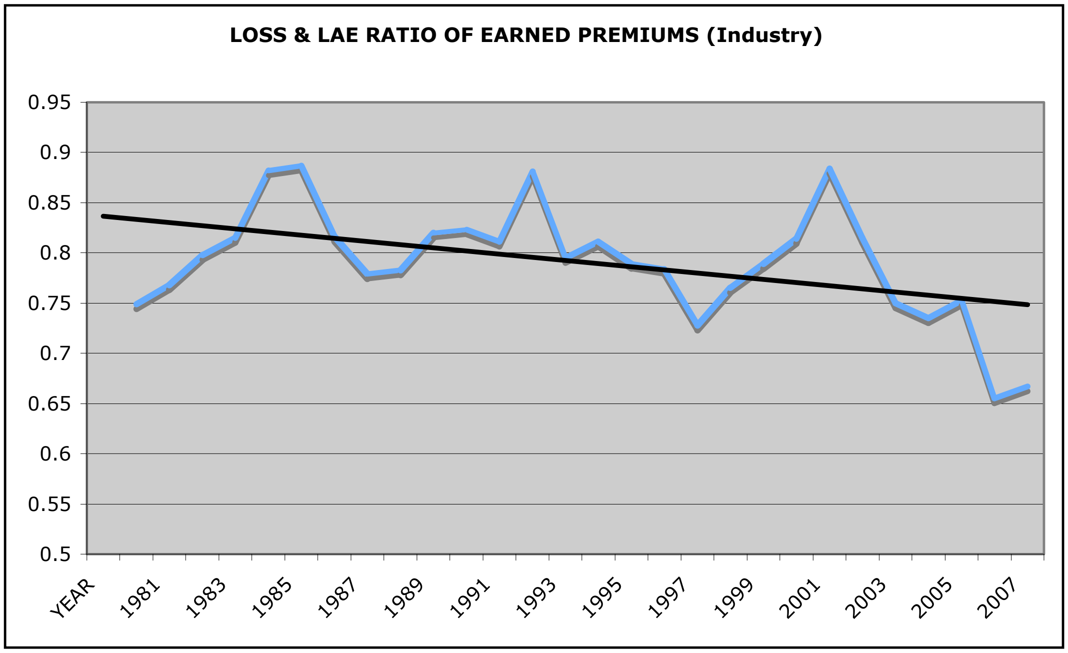
Addendum A details key profit, loss, and surplus data for the property/casualty insurance industry over the last 28 years. It reveals how remarkable recent profits are, despite hurricane and terrorist activity. Addendum B provides data for the top ten property/casualty insurer groups for the last 21 years, including the top stock company results for the first nine months of 2007. The following findings are apparent from reviewing this aggregate data:

- The Insurance Information Institute (III) estimates the combined ratio for 2007 at 93.8 percent.[4] If underwriting expenses (including policyholder dividends) hold at the 2006 level of 27.1 percent,[5] the loss and LAE ratio for 2007 will be 66.7 percent, just 1.2 percent higher than 2006, making 2007 the second lowest ratio recorded since at least 1980. III itself says that the 2007 combined ratio is "…one of the best underwriting performances in the past 80 years."[6] Astonishingly, if the 2006 LAE is observed in 2007, (12.1 percent),[7] the incurred losses would be 54.6 percent of premiums. This means that the property/casualty insurance industry is delivering only 54.6 cents in benefits for every premium dollar paid, a very inefficient delivery of benefits to Americans. The loss and LAE ratio for the last 28 years follows:

YEAR	**LOSS & LAE**
1980	74.9%
1981	76.8%
1982	79.8%
1983	81.5%
1984	88.2%
1985	88.7%
1986	81.6%
1987	77.9%
1988	78.3%
1989	82.0%
1990	82.3%
1991	81.1%
1992	88.1%
1993	79.5%
1994	81.1%
1995	78.9%
1996	78.4%
1997	72.8%
1998	76.5%
1999	78.9%
2000	81.4%
2001	88.4%
2002	81.5%

4 Earlybird Forecast 2008, Insurance Information Institute, December 17, 2007.
5 Aggregates and Averages, A. M. Best and Co., 2007 Edition.
6 Earlybird Forecast 2008, Insurance Information Institute, December 17, 2007.
7 Aggregates and Averages, A. M. Best and Co., 2007 Edition.

2003	75.0%
2004	73.5%
2005	75.3%
2006	65.5%
2007	66.7%

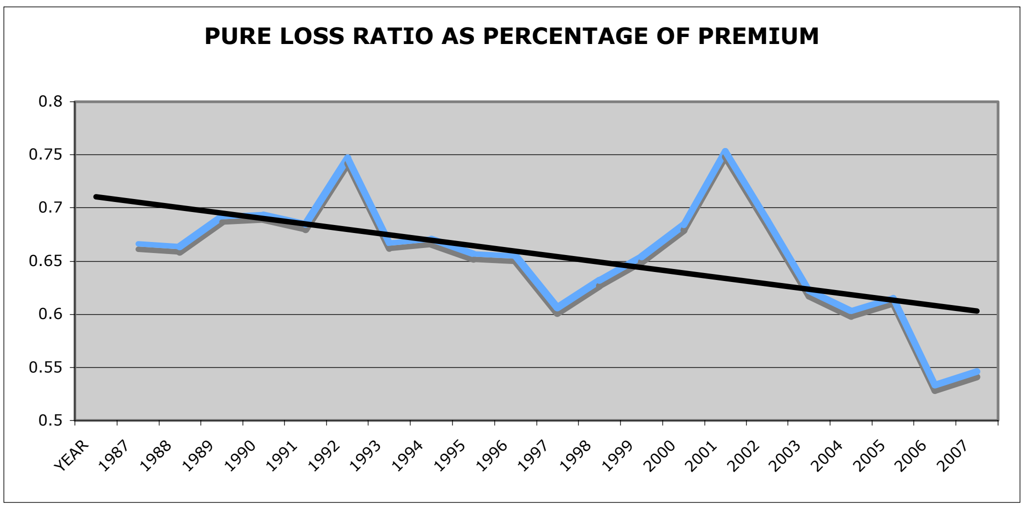


- Given that the loss adjustment expense portion of the above data is not paid to consumers, the part of the premium going to consumers is even less, as shown here for the last eleven years:

YEAR	PURE LOSS RATIO
1987	66.6%
1988	66.4%
1989	69.2%
1990	69.4%
1991	68.5%
1992	74.7%
1993	66.7%
1994	67.1%
1995	65.7%
1996	65.5%
1997	60.6%
1998	63.2%
1999	65.4%

2000	68.4%
2001	75.3%
2002	68.8%
2003	62.2%
2004	60.3%
2005	61.5%
2006	53.3%
2007	54.6%

Source: 2006 and earlier data from Best's Aggregates and Averages, 2007 and earlier Editions. 2007 data based upon an estimated 93.8% combined ratio (III Earlybird Forecast, 12/21/06) 26.3% expense and dividend ratio and 12.1% LAE based on 2006 results.



- The sharp drop in value of property-casualty insurance products to consumers is very clear in these charts. The line of best fit shows that the expected percentage of premium to be paid out of each premium dollar to consumers has declined from over 70 cents to 60 cents over the last twenty years.

- According to the III [8], "…healthy underwriting profits that could approach $25 billion in 2007, which would be the second largest underwriting profit on record…" and "…investment income, which could exceed $60 billion in 2007" yield an estimated pre-tax operating income of $85 billion; just a tad below the 2006 record high of $86.4 billion. The previous high prior to 2006 was $47.3 billion in 2005.

- We estimate net income for 2007 to be $65.0 billion, just shy of the all-time record set in 2006 at $67.6 billion. If insurers release into profit only a small part of the estimated $80 billion in redundant loss and loss adjustment expense reserves (see reserves discussion below), 2007 will be the fourth straight year to set a record profit.

[8] Earlybird Forecast 2008, Insurance Information Institute, December 17, 2007.

- The Insurance Services Office (ISO) actually shows a net income increase in the first nine-months of 2007 over 2006, from $46.1 billion to $49.4 billion.[9] It is very possible that 2007 will ultimately set yet another record for property/casualty insurance profitability.

- Five of the most profitable years in the industry's history occurred in the last six years, as demonstrated below:

YEAR	INDUSTRY NET INCOME
2006	$67.6
2007	$65.0
2005	$48.8
2004	$40.5
1997	$36.8
2003	$31.2
1998	$30.8
1996	$24.4
1999	$22.0
1995	$20.6
2000	$20.5
1988	$12.3
1994	$10.9
1993	$10.5
1987	$10.0
2002	$9.1
1991	$8.9
1990	$8.0
1989	$7.2
1992	-$2.7
2001	-$6.7

Source: Best's Aggregates and Averages, 1988 to 2007 Editions
Notes: Net Income is after tax and includes all investment income.
2007 estimated at $60 to $65 by III in the Earlybird Forecast (12/17/07).

- In the last five years, the property/casualty insurance industry had a total net income of $253.1 billion. This represents a profit of $844 from every American. If the reserve redundancy of $80 billion currently being projected is realized as profit, the amount of profit over the last five years will actually be over $1,000 for every person in America.[10]

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[9] "P/C Insurers Net Income and Surplus Rose Through Nine-Months 2007 as Underwriting Gains Dropped and Overall Profitability Slipped," Insurance Services Office, Insurance Information Institute and Property Casualty Insurance Association, December 19, 2007.

[10] $80 billion reduced by the corporate tax rate of 35 percent is $52 billion. Add this to the $253.1 billion in reported net earnings over the last five years and the total is $305.1 billion, or $1,007 for each of the 303,000,000 Americans as of December 31, 2007.

- Looking at the individual company data:

  (a) American International Group's loss ratio in 2007 for nine months is 53.8 percent, the second lowest since at least 1987. The 1987 to 2006 average ratio was 68.1 percent. The 2007 loss ratio is over 15 points below the insurer's long-term average. AIG is barely paying out half of the premiums it receives in benefits.

  (b) Allstate Insurance Group's loss ratio in 2007 for nine months is 51.6 percent, the second lowest since at least 1987. Despite this astonishingly low payout to its policyholders, Allstate has made very prominent efforts to convince Congress to provide a federal taxpayer subsidy for catastrophe coverage. The 1987 to 2006 average ratio was 65.8 percent. The 2007 loss ratio is more than 20 points below the long-term average. Paying out such a low percentage of premiums to Allstate policyholders is simply not justifiable. Allstate is barely paying out half of the premiums it receives in benefits.

  (c) Berkshire Hathaway Insurance Group's loss ratio in 2007 for nine months is 58.6 percent, tied for the second lowest since at least 1987. The 1987 to 2006 average ratio was 74.8 percent. The 2007 loss ratio is over 15 points below the long-term average, generating significant cash for Berkshire Hathaway to invest (see below for details).

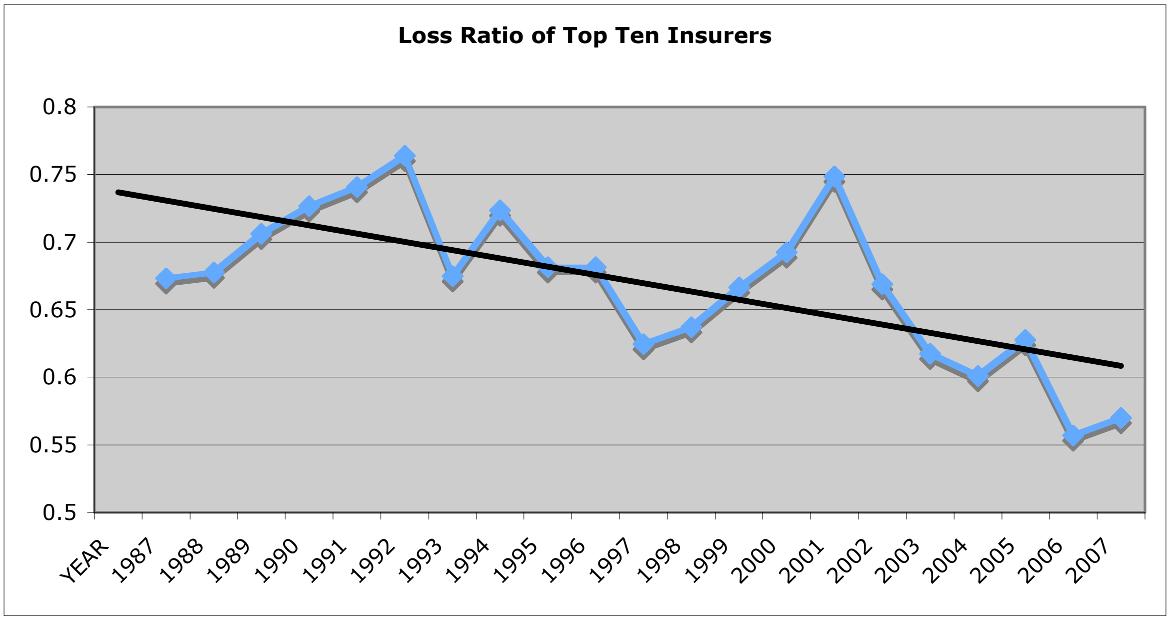
  (d) St. Paul/Traveler's Group's loss ratio in 2007 for nine months is 45.5 percent, the lowest since at least 1987, an unjustifiably low payout ratio. The 1987 to 2006 average ratio was 65.1 percent. The 2007 loss ratio is almost 20 points below the long-term average. St. Paul/Traveler's is paying out less than half of the premiums it receives in benefits.

  (e) Progressive Insurance Group's loss ratio in 2007 for nine months is 58.2 percent. The 1987 to 2006 average ratio was 55.7 percent, a meager pay-out ratio over such a long period of time, indicating that policies are significantly overpriced. The 2007 loss ratio is slightly higher than this extremely low long-term payout average.

  (f) Hartford Insurance Group's (Hartford) loss ratio in 2007 for nine months is 55.8 percent, the lowest since at least 1987. The 1987 to 2006 average ratio was 64.7 percent. The 2007 loss ratio is almost 10 points below the long-term average.

By any reasonable measure, net income or Return on Equity (ROE), 2007 profits continue a streak of excessive returns in recent years. And that does not include the profits hidden in reserves as the reserves become more redundant (discussed below in more depth). These excessive returns have caused significant deterioration in the value of property/casualty insurance for consumers. The astonishingly low loss ratios reported above mean that consumers are receiving record low payouts for their premium dollars for an ongoing period as insurers reap unprecedented profits. The average loss ratio for nine months of 2007 for the top six stock companies in the top ten-company list (mutuals do not supply quarterly info) is 53.9 percent.

Moreover, as is shown in the below graph, the trend in payouts is sharply down over the last twenty years, a period during which most state insurance regulators have allowed consumer protections to erode significantly.[11]



It is truly inappropriate for property/casualty insurers to be delivering only about half of their premium back to policyholders as benefits.[12]

Mutual companies, which do not issue quarterly reports and therefore are not included in the data for 2007, tend to report somewhat higher loss data. The overall loss ratio for the mutual companies is likely to be 4 to 5 percent higher than the stock companies, based on the long-term averages shown on the spreadsheet attached as Addendum B. Thus, the overall average payout should be about 57 percent, the figure used for 2007 in the above graph.

B. Inflated Reserves

There are several types of reserves that property/casualty insurers establish on their accounting books. There are loss reserves (including reserves for known claims and reserves for claims not yet known – called "Incurred but Not Reported" or "IBNR" reserves), reserves for claims expense (called "Loss Adjustment Expense" or "LAE," which also includes known and IBNR), and reserves for unearned premiums held by the insurer.

[11] CFA tested this drop in benefits related to premiums to see if it could be attributed to a drop in investment income. Within the time frame studied, there was a three percent drop in investment income. Since insurers typically reflect about half of investment income in prices, CFA believes that the drop in investment income accounts for only 1.5 points of the 15-point drop. That is, investment income explains only about one-tenth of the drop in benefit payouts to consumers per dollar expended in insurance premiums.

[12] Insurers contend that the loss adjustment expense is a benefit to consumers. Obviously, this is a "benefit" that does not go to the consumer to pay for car repairs and doctor bills, etc. But even the loss and LAE ratio itself is at a record low for many decades, at under 70 percent, as shown in the chart in Addendum A.

Loss and LAE reserves behave cyclically, in sync with the premium cycle. The premium cycle is a well-known phenomenon, with short periods (three years or so) of sharp price hikes, known as "hard markets," followed by longer periods (eight to twelve years) of mild price changes (known as "soft markets"). Reserves tend to become inadequate at the end of a soft market period and tend to become excessive after a hard market. We are in that post-hard market period today, so excessive reserves are anticipated and, as we see below, are observed, even by industry-affiliated observers. Excessive reserves are called "redundant" reserves in the insurance industry's lexicon.

When the profits roll in, as they have in record amounts since 2003, insurers tend to pad the reserves. This serves several purposes: a more secure insurance company, removal of income from profits and thus lower tax burdens (reserves are not taxed as income is) and the ability to point to inflated losses (which rise due to the reserve redundancies), all as justification for not lowering prices.

In a recent report, ISO estimates that loss and loss adjustment expense reserves at year-end 2006 were redundant (i.e., more than needed to pay the claims for which the reserves were set) by up to $40 billion. But ISO says the redundancy is 9 percent of year-end 2006 loss and LAE reserves of $552 billion,[13] so the year-end 2006 number is really $50 billion.[14] If year-end 2006 reserve redundancies were passed on in discounts for the time value of money, ISO predicts that these estimates would be $13.3 billion higher (i.e., a redundancy of up to $63.3 billion).

The ISO estimated 2006 redundancies by line of insurance were:

LINE		REDUNDANCY OF UP TO
Private Passenger Auto Liability		8%
Homeowners/Farmowners		15%
Commercial Auto Liability		14%
General Liability Occurrence		22%
Products Liability Occurrence		13%
General and Products Liability Claims Made		23%
Commercial Multi-Peril		7%
Workers Compensation		9%
Medical Malpractice Occurrence		30%
Medical Malpractice Claims Made		38%
Reinsurance		5%
TOTAL	(LINES STUDIED)	10%
TOTAL	(ALL LINES)	9%

13 Best's Aggregates and Averages, 2007 edition.
14 "Loss and Loss Adjustment Expense Reserves at Year-End 2006," ISO, December 2007.

The impact of this information can be quite important to policyholders. For example, if the medical malpractice reserves were lowered by, say only 25 percent, that would represent a value equivalent to 75 percent of premium charged. Redundant reserves are further evidence that premiums are excessive since the higher than realistic losses are pointed to as a rationale for not lowering prices for insurance, particularly in "long-tail" lines like medical malpractice that often pay out claims many years after initial premiums are paid.

The estimates of redundancy through 2006 by ISO probably understate the excessiveness of the reserves. They certainly do not include any additional padding that occurred in 2007. We believe that the redundancy in reserves did increase in 2007 and could be up to more than $80 billion by year-end 2007. If some of the redundancy is released from reserve into profits, as well could be done at year-end 2007, the net income for 2007 could easily be a new record profit year, the fourth straight.

C. Inefficient Surplus

The financial strength of the insurance industry is typically measured by the size of the policyholder surplus ("surplus") that it holds. Surplus is the balance sheet difference between the assets the insurers have and the liabilities insurers maintain. The key measure of solidity most analysts evaluate and consider a key measure of strength is the ratio of net premiums written ("net" means net of reinsurance) to surplus. "Premiums written" represents the value of premiums that policyholders pay to insurers. Premiums are a measure of the risk that insurers face, since actuaries calculate premiums as an estimate of the financial exposure, or risk, the insurer faces. Deducting the value of reinsurance from this premium amount reflects the fact that reinsurance diminishes an insurer's exposure to risk. If an insurer makes an error in properly setting premium amounts, the surplus is available to cover the error should the error be on the low side of the actual risk observed as time passes. The ratio of net premiums written to surplus shows the risk of the venture -- the higher the ratio, the greater the risk of experiencing a loss. For instance, if the insurer had $1,000 of premium and only $100 of surplus (a ratio of 10 to 1), a ten percent error in under-pricing the risk would bankrupt the insurer. If the insurer has $1,000 of surplus (a 1 to 1 ratio), the error in under-pricing would have to be equal to 100 percent of the premium to bankrupt the insurer. Regulators have historically frowned upon ratios greater than 3 to 1.

In determining whether the property/casualty insurance industry is adequately capitalized, one must first examine the losses incurred for major catastrophe or terrorism events. According to the Insurance Information Institute (III), the top ten insured loss disasters for property were:

EVENT[15]	PRE TAX DOLLAR	POST TAX LOSS
1. Hurricane Katrina, August 2005	$41.1 billion	$26.7 billion
2. Hurricane Andrew, August 1992	15.5	10.1
3. World Trade Center, Pentagon terrorist attacks, September 2001	18.8	12.2
4. Northridge, California earthquake, January 1994	12.5	8.1
5. Hurricane Wilma, October 2005	10.3	6.7
6. Hurricane Charley, August 2004	7.5	4.9
7. Hurricane Ivan, September 2004	7.1	4.6
8. Hurricane Hugo, September 1989	4.2	2.7
9. Hurricane Rita, September 2005	5.6	3.6
10. Hurricane Frances, September 2004	4.6	3.0

Source: Insurance Services Office (ISO); Insurance Information Institute. (Ranked on cost to insurers) We calculated the post-tax figures by applying the 35 percent corporate tax rate to the III pre-tax figures.

Considering that property/casualty insurers (including state funds) now have surplus in excess of $600 billion, catastrophes of this size are very easy for the industry to manage. The largest insured event in American history, Hurricane Katrina, resulted in $44.1 billion in losses before and $28.6 billion after taxes, adjusted by the Consumer Price Index level of inflation to 2007 dollars. This is only 4.2 percent of the current surplus.

Terrorism risk is an interesting case study. While insurers are rightly concerned about a huge event, such as a nuclear, chemical, or biological attack, the actual terrorism events that have occurred so far have been easily managed by private industry. According to FBI data, there were hundreds of terrorism events in America in the 20 years leading up to the September 11th attacks. In spite of this fact, insurers did not even bother to charge a separate price for terrorism coverage in their rating structures. September 11th changed this practice, but even that attack was a "small" insured event compared to the industry's mammoth capital and surplus, which has grown significantly since 2001. Yet, insurers convinced the federal government to provide free reinsurance in 2002 and continued the free backstop for seven years in late 2007. CFA estimates that this free reinsurance has represented about a four billion dollar taxpayer subsidy from 2002 to 2007.

Historically, the prime test of the financial solidity of the property/casualty insurance industry has been the ratio of net premiums written (NPW) to surplus, discussed above. Regulators became concerned about the financial soundness of an insurer if its ratio exceeded 3 to 1. The so-called "Kenney Rule," named after financial writer Roger Kenney, was that a safe insurer should not exceed about a 2 to 1 ratio. This guideline was introduced in the 1960s and served as the standard that insurers and regulators followed for many decades. More recently, some analysts have recommended lowering the acceptable ratio to about 1.5 to 1, in recognition of some more extreme risks that insurers now face, such as catastrophic hurricanes and terrorist

[15] The catastrophes were ranked by III based on size of loss in 2005 dollars, which we do not display here. What is displayed is the actual dollars in the year of the event. We calculate the post-tax figure by deducting the corporate tax rate of 35 percent.

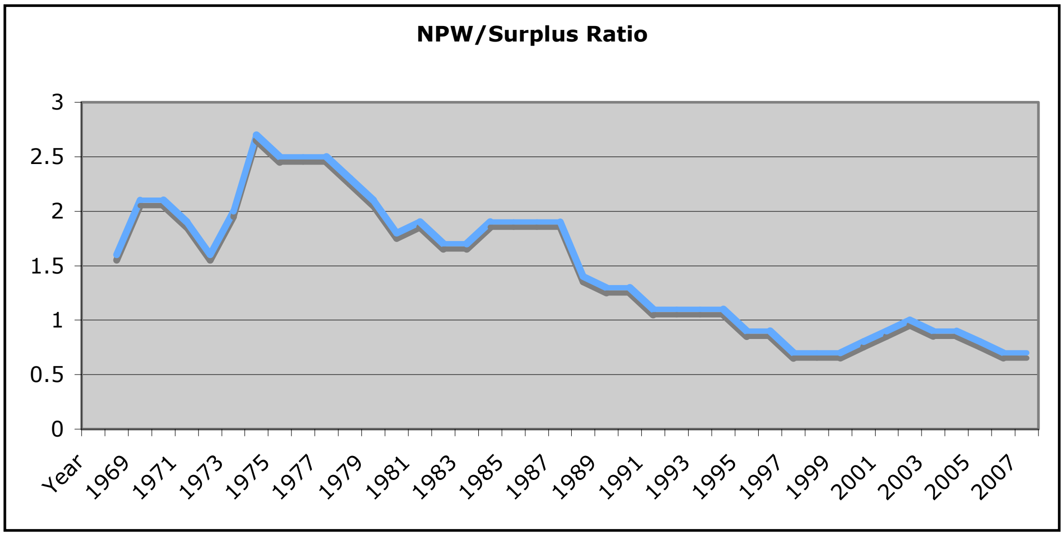
attacks. If surplus gets below even this conservative 1.5 to 1 ratio, the surplus may be described as inefficient (i.e., too high and thus excessive). When the ratio gets below 1 to 1, the surplus is clearly inefficient. Net premiums written to surplus ratios for almost thirty years are as follows:

YEAR	NPW/Surplus
1968	1.6
1969	2.1
1970	2.1
1971	1.9
1972	1.6
1973	2
1974	2.7
1975	2.5
1976	2.5
1977	2.5
1978	2.3
1979	2.1
1980	1.8
1981	1.9
1982	1.7
1983	1.7
1984	1.9
1985	1.9
1986	1.9
1987	1.9
1988	1.4
1989	1.3
1990	1.3
1991	1.1
1992	1.1
1993	1.1
1994	1.1
1995	0.9
1996	0.9
1997	0.7
1998	0.7
1999	0.7
2000	0.8
2001	0.9
2002	1
2003	0.9
2004	0.9

2005	0.8
2006	0.7
2007	0.7

Source: Best's Aggregates and Averages. 1998 to 2007
2007 Estimated at 0.3 premium growth, surplus up by estimated $65 Billion profit.

Property/casualty insurers have not exceeded the conservative 1.5 to 1 ratio of NPW to surplus in over twenty years. The sharp downward trend in this key leverage ratio is very clear, demonstrating that the industry is now significantly overcapitalized. Here is a graphic display of these data:



Even III admits that the industry is overcapitalized: "…there is excess capital in the industry today – estimated by some analysts to be as much as $100 billion…"[16] And this $100 billion estimate does not factor in the reserve redundancy. The excess capital approaches $175 to $200 billion were all the reserve redundancies eliminated.

The excess capital is evidenced not only by the low industry-wide premium-to-surplus-ratio, but also by the premium-to-surplus ratios of the most profitable insurers. For example, Allstate and Progressive not only have premium-to-surplus ratios much greater than the industry average, but are also buying back their own stock because they have too much capital to reasonably or profitably deploy. Allstate bought back $3 billion in its share repurchase plan in the first nine-months of 2007[17] that "compliment" the $12.8 billion program that was completed at the end of 2006.[18] The fact that Allstate still has a stock buyback program in place at the same time it is sharply reducing or eliminating coverage (because it claims it is financially threatened by the risk of future weather catastrophes) is astonishing.

16 Earlybird Forecast 2008, December 17, 2007.
17 "Allstate's Smart Policies," Barron's Online, December 10, 2007. Other major insurers are also buying back stock.
18 "Allstate Posts Solid Earnings," National Underwriter Magazine, October 19, 2006.

This excessive capitalization is a direct result of the excessive premiums being charged to consumers for so many years.

After the excessive returns earned over the last few years, Warren Buffett wrote to his Berkshire Hathaway shareholders that he was seeking large new investments. He put it this way: "We continue, however, to need "elephants" in order for us to use Berkshire's flood of incoming cash. Charlie and I must therefore ignore the pursuit of mice and focus our acquisition efforts on much bigger game… The larger the company, the greater will be our interest: We would like to make an acquisition in the $5-20 billion range."[19]

So, Mr. Buffett is out there, big game hunting using his insurance riches as his weapon:

> "At 77, Mr. Buffett, the country's most famous investor, is in the midst of his hottest streak in almost a decade. And he is capping his run with a flurry of deal-making. On Friday, Mr. Buffett stunned Wall Street by announcing that he would enter the troubled bond insurance business. He also spent about $440 million for a unit of ING Group, the Dutch financial giant. Three days earlier, on Christmas, he agreed to buy a $4.5 billion stake in the industrial conglomerate owned by the Pritzker family. And a few weeks before that, he waded into the junk bond market, buying $2.1 billion of debt issued by the TXU Corporation, the electric utility. As the fortunes of big Wall Street firms sink, Berkshire Hathaway, the holding company that Mr. Buffett runs out of Omaha, is on a tear. Its Class A shares have jumped 27 percent this year, their best showing since 1998, when they soared 52 percent. The Standard & Poor's 500-stock index, by comparison, has gained a mere 4.24 percent this year."[20]

IV. HOW CAN EXCESSIVE PROFITS AND CAPITAL BE RETURNED TO EQUITABLE LEVELS?

Property/casualty insurance is a public good, required to be bought by government (auto liability insurance) or by lenders (auto physical damage insurance and home insurance). Clearly, the property/casualty insurance industry has become overcapitalized, reserves have become excessive and prices paid by consumers remain much too high. Prices must reflect the actual costs borne by insurers, including a reasonable profit, and capital must be maintained at efficient, not excessive levels. If not, more and more people will be unable to afford insurance and will either go uninsured or will have to ignore other family needs to make ends meet.

A solution to the problem of obvious excesses in the current insurance system that is fair to policyholders is urgently required.

The Insurance Information Institute ("III") proposes one solution: "In an effort to manage this [excessive capital] impact, insurers are returning capital to shareholders in the form of increased dividends and share repurchases. Share repurchase activity in 2007 will shatter all

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[19] 2006 Annual Report, Chairman's Letter and Acquisition Criteria, February 28, 2007. Emphasis added.

[20] "A Deal Maker with a Hot Hand Opens His Wallet," New York Times, December 29, 2007.

previous records and could constitute a return of 4.5 to 5.0 percent of industry capital to owners…It is likely total share repurchases will exceed $20 billion by year's end." This is certainly not an equitable approach to solving this crisis for policyholders.

Another solution that should be rejected is to allow insurers to go on spending sprees buying up other businesses, as Warren Buffett is doing. Insurers have also been increasing the compensation for their officers and managers to levels that are higher than for other industries.[21]

These approaches reward investors at the expense of policyholders and are instructive about the mindset of the industry. Policyholders, who have suffered high prices and reduced claims payouts, need protection by state regulators to restore balance to the insurance system. Some insurers are beginning to drop rates a bit but these actions are insufficient to increase the value and quality of insurance products that are being offered.

Insurance regulators must take action to lower insurance prices below today's excessive levels. Every state has a law prohibiting excessive prices. But, despite our repeated warnings,[22] few commissioners (Florida and California stand out among the exceptions) are doing anything about it. This is an abysmal failure of state regulation requiring urgent attention in 2008.

Consider this startling fact: during the period from 2003 to date, consumers have paid insurers premiums sufficient to total $253.1 billion in profit for the property/casualty insurers, even ignoring excessive reserves. With the reserve redundancies counted as after-tax income, this profit amounts to $305.1 billion or over $1,000 from every person in America.[23] On a per household basis, the five year profit of property/casualty insurers represents $2,653.[24]

Consumers also must shop around for better deals, particularly for auto insurance. Homeowners insurance should also be shopped, particularly away from the nation's coasts where insurers continue to abuse some policyholders by unjustifiably dropping them into state plans and severely raising prices.

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[21] "For the insurance CEOs, the median cash compensation (sum of annualized salary, bonus, and non-equity incentive compensation) is highest among industries at $1.6 million," although, according to the Conference Board, insurer total compensation was third highest at $3.2 million behind CEOs of utilities and food/tobacco. Insurance CEOs Rake in Cash but not Stock, National Underwriter, January 2, 2008.

[22] "Property/Casualty Insurance in 2007: Overpriced Insurance, Underpaid Claims, Declining Losses and Unjustified Profits," Americans for Insurance Reform, Center for Insurance Research, Center for Economic Justice, Center for Justice and Democracy, CFA, Consumers Union, Foundation for Taxpayer and Consumer Rights and United Policyholders, January 8, 2007 and "How Regulators Can Return P/C Profits to Reasonable Levels," J. Robert Hunter, Regulator Magazine, March 2007. The article won the Shraeder-Nelson Award for best article in the magazine in 2007.

[23] 80 billion reduced by the corporate tax rate of 35 percent = $52 billion added to the $253.1 billion in reported net earnings = $305.1 billion or $1,007 for each of 303,000,000 Americans as of December 31, 2007.

[24] The number of households in 2005 in the United States was 113.1 million. We estimate that the number of households in 2007 is 115 million, based on trends in household growth.. Source: US Census Bureau as reported in the Statistical Abstract of the United States, 2008 edition.

V. EVALUATING INDUSTRY PROFITABILITY ACCURATELY

A. Industry Estimates of Return on Equity are Extremely Misleading

The Insurance Information Institute says that "…industry profitability as a whole – with an ROE in the 11 to 12 percent range – will still likely fall short of the Fortune 500 group for the twenty-first consecutive year…", complaining that insurers in 2006 will just about match the 11 to 12 percent return on equity of the Fortune 500 "for just the second time in many years."[25] ISO measured the return for the first nine months of 2007 at 13.1 percent of policyholders' surplus. But ISO stated, "…underwriting results weren't good enough for insurers to achieve the rate of return typically earned by firms in other industries."[26]

In 2007, the industry is on target for an approximately 13 - 15 percent return on policyholder surplus, not the 11 to 12 percent predicted by III. ISO reported nine-month net income of $49.4 billion (through September 30, 2007) plus unrealized capital gains of $6.2 billion for a total of $55.6 billion -- which translates to about $74 billion for a full year. Policyholder surplus for 2007 averaged $494 billion at the beginning of the year, representing a return on equity of 15 percent.[27] Our lower estimate of 2007 net income, $65 billion if reserve redundancies are not released, would be a 13.1 percent return on surplus.

This aggregate data actually understates industry-wide returns on equity for several reasons:

1. Industry aggregate data includes information from mutual companies like State Farm with massive capitalization. As a non-public mutual company, State Farm has no need to achieve a target return on equity, as it must only satisfy policyholders, not shareholders. Mutuals therefore build up much higher surpluses than stock companies, creating very inefficient surpluses that distort the industry-reported ROEs downward sharply. According to ISO, the 2006 return on average surplus was 12.8 percent industry wide, but it was 16.9 percent for stock insurers and 9.9 percent for mutual companies.[28] If this distribution holds for 2007, stock insurers would earn a return of well over 19 percent.

2. The Fortune 500 is a selected group of top companies -- not all companies -- doing business in America, regardless of size or quality. It is inappropriate and self-serving to compare an entire property-casualty insurance industry with a select group like the Fortune 500.

3. Publicly traded insurers have achieved returns on equity in 2006 and 2007 that are much greater than the "Fortune 500" average. For example, Allstate reported a return on equity of 23.2 percent for the year ending on September 30, 2007. Progressive reported a nine-

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25 Earlybird Forecast 2008, Insurance Information Institute, December 17, 2007.

26 Statement of Michael Murray, ISO Assistant Vice President in a News Release. "P/C Insurers Net Income and Surplus Rose Through Nine-Months 2007 as Underwriting Gains Dropped and Overall Profitability Slipped," December 19, 2007.

27 "P/C Insurers Net Income and Surplus Rose Through Nine-Months 2007 as Underwriting Gains Dropped and Overall Profitability Slipped," December 19, 2007.

28 "Industry Financial Results, First-Half 2007 Analysis," Insurance Services Office, October 5, 2007.

month return on equity of 20.8 percent on mean surplus.

4. The property/casualty insurance industry is tremendously overcapitalized. It is bringing in too much capital to warrant a higher return on equity, as discussed above. If there is $100 billion of excess surplus in the property/casualty insurance market, as III says and some observers believe, the 2006 return on mean surplus would increase from 14.4 percent to 17.8 percent if this amount were included.[29]

Surely, industry leaders and spokespeople should stop using the inaccurate comparison with the Fortune 500 in their public relations materials. Do they really expect people to believe that they are financially beleaguered when, at the same time that they are crying about the ROE results, they report record profits as well as excesses in capital and reserves?

B. Insurance is a Below-Average Investment Risk

Another reason why comparing insurance industry ROE to that of the Fortune 500 is not justified is because the insurance industry is a below-average investment risk, whereas the companies of the Fortune 500 represent an average risk. If one owns a property/casualty insurance company stock, one has, with few exceptions, bought into a low-risk business, lower in risk than the market in general. This is shown in Value Line statistics, which assess the riskiness of particular stocks. One key measure is the stock's Beta, which is the sensitivity of a stock's returns to the returns a particular market index, such as the Standard and Poor's 500 (S&P 500). A Beta between 0 and 1 represents a low-volatility investment, such as most utility stocks. A Beta equal to 1 matches the index, such as the returns yielded by an S&P index fund. A Beta greater than 1 is anything more volatile than average, such as most "small cap" funds.

Another measure of a shareholder's risk is the Financial Safety Index, with a range of 1 to 5, 1 being safest and 5 being least safe; 3 is an average risk.

A third measure is the Stock Price Stability assessment, reported in five percentile intervals with 5 signifying the lowest stability and 100 the highest stability; 50 is average stability.

Value Line posts results for 27 property/casualty insurers.[30] The simple averages for these carriers are: Beta = 0.95, Financial Safety = 2.4, and Stock Price Stability = 83.

By all three measures, property/casualty insurance stocks represent below-average risk, safer than buying an S&P 500 stock index fund. Therefore, long-term below-average returns for

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[29] 2006 data from Best's Aggregates and Averages, 2007 Edition. Net Income = $67.6 billion. Mean Surplus = ($437 billion at year-end 2005 plus $501 billion at year end 2006)/2 = $469 billion. Return on Surplus = $65.6/$469 billion =14.4 percent. Adjusted for excess Surplus = $65.6/($469 - $100) billion = 17.8 percent.

[30] Value Line, March 23, 2007. The stocks are ACE Ltd., Alleghany Corp., Allstate Corp., American Financial Group, W.R. Berkley Corp., Berkshire Hathaway, Inc., CNA Financial, Chubb Corp., Cincinnati Financial, Erie, Everest Re Group, HCC Insurance, Hanover Insurance Group, Markel Corp., Mercury General, Ohio Casualty Corp., Old Republic International Corp., PMI Group, Inc., Partner Re, Ltd., Progressive Corp., RLI Corp., Safeco Corp., St. Paul/Travelers Group, Selective Insurance, Transatlantic Holdings, 21st Century Insurance Group and XL Group, Ltd.

insurers should be expected given the low-risk nature of this investment. The fact that, calculated properly, returns for stock insurers are above that of the Fortune 500 is disturbing and is yet another example of excessive insurer profitability.

As stated above, these profits have been extraordinary in recent years. In 2004, insurers posted their largest dollar net (after tax) profit in history ($40.5 billion) despite the fact that four major hurricanes caused significant damage in Florida. Insurers achieved another record of $48.8 billion in 2005, despite the unprecedented losses caused by hurricanes Katrina, Rita, and Wilma. Profits in 2006 were the highest ever because of low hurricane activity, excessive rates, the use of programs to systematically keep payments to policyholders low and other factors discussed in this report.[31] Reported 2007 profits to date are just under the 2006 level, but if insurers release some of their redundant reserves this amount would be identified as 2007 profit, pushing the 2007 profits above the 2006 level.

Evidence that investment in insurance companies represents a below-average risk is also found in the market action of the property/casualty insurers stocks. Since June 17, 2002, the date S&P started to track insurance stocks, S&P 500 stocks increased by 60 percent through year-end 2006, while the S&P Insurance Index,[32] weighed down with life insurance stocks, increased only 45 percent. The simple average increase of the property/casualty insurance company stocks in the S&P Insurance Index was 48.0 percent over that period, lower than the S&P 500 mostly because of the impact of AIG, which declined sharply when it was punished for bid rigging and other illegal activities. However, if AIG is removed from the calculation, the rest of the insurance stocks increased by 56.8 percent in value, roughly the same as that the overall S&P 500. This demonstrates that the property/casualty insurance industry overall has done just fine with overall returns on equity that are less than that of the S&P 500. Individual insurers do much better than the S&P averages.[33]

VI. INSURERS HAVE REMOVED OR SHIFTED RISK THROUGH LEGITIMATE AND ILLEGITIMATE MEANS

This section will review how insurers have reduced much of the risk they face, allowing them to earn record profits even in years of severe hurricane activity.

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[31] Also see "Property/Casualty Insurance in 2007: Overpriced Insurance, Underpaid Claims, Declining Losses and Unjustified Profits," CFA and other groups, January 8, 2007 http://www.consumerfed.org/pdfs/2007Insurance_White_Paper.pdf

[32] The index is made up of AFLAC, Allstate, AIG, Chubb, Cincinnati, Conseco, Hartford, Jefferson Pilot, Lincoln National, Lowes, MBIA, MetaLife, MGIC Investment Corp, Progressive, Safeco, St. Paul/Travelers, Torchmark and UNUM.

[33] In its "2007 Notice of Annual Meeting/Proxy Statement/2006 Annual Report," Allstate states that Allstate's stock value rose by 115.66 percent through 2006, whereas the stock value of all property/casualty insurers rose by 60.58 percent (indexed to early 2002). During the same period, the Standard & Poor's 500 index increased by 35.43 percent. Further, A. M. Best reports, in its 2007 statistical study, that the total P/C industry had an ROE of 18.9 percent. Consider the top five writers, State Farm 16.4%, AIG 24.5%, Allstate 30.3%, Berkshire Hathaway 24.3% and Travelers 27.1%.

First, insurers have made intelligent use of reinsurance, securitization and other risk-spreading techniques. Securitization use increased sharply in 2006 and 2007.[34] One very innovative development that some insurers have pioneered to spread risk is to issue securities that couple the threat of a catastrophic event with the purchase of construction stocks that would likely increase in value if a catastrophic event occurs and the demand for construction increases. The use of this kind of creative approach to diversify risk is wise.

Second, after Hurricane Andrew, insurers changed ratemaking techniques by using computer models to project either 1,000 or 10,000 years of weather experience. While this caused huge price increases to consumers at the time, consumer leaders supported this change because insurers appeared to be genuinely surprised by the level of damage caused by Hurricane Andrew and promised that the models would bring long-term stability to prices. The model contained projections of periods of intense activity and very large hurricanes, as well as periods of little or no activity, and based rates on these estimates.

However, Risk Management Solutions (RMS) and the other modeling companies have recently stopped using this scientific method to project storms over a 1,000 or 10,000-year period and are now using 1 to 5-year projections. This has caused at least a 40 percent jump in loss projections on the Gulf Coast and a 25 percent jump in the Northeast. This move reneges on promises made by insurers in the mid-1990s and will lead to rates that are excessive. Florida acted in 2007 to ban the use of the short-term RMS model and Louisiana followed suit.

In fact, insurance rates on the coasts have soared for property, homes, and businesses in the last year. At hearings held in Florida in 2006, home and business owners provided information about rate increases of ten-fold or more that they have been forced to pay, particularly by Citizen's Insurance Company, the state insurer-of-last-resort that has become the largest insurer in Florida. A similar situation exists in Louisiana and other Gulf Coast states. Florida acted in 2007 to lower home insurance prices by making Citizens Insurance Company more competitive, selling more reinsurance at actuarially sound prices to insurers, and requiring that the private insurers pass along the savings to customers.

Third, insurers have sharply hollowed out the catastrophe coverage offered to consumers in recent years by placing a number of new requirements in policies:

- Deductibles of 2 to 5 percent have been imposed with little fanfare or notice. This reduction in coverage was accompanied in many cases by large rate increases.

- Insurers are placing caps on replacement costs. State Farm, for instance, caps payments for increased rebuilding costs at 25 percent. Other insurers allow no increased payments at all. A consumer who buys a $100,000 policy would receive only $100,000 to rebuild, even if the cost of repairs skyrockets after a storm due to increased demand for materials and labor. Costs can also increase when homeowners are required to make special

[34] Swiss Re states that the use of securities doubled in the five years ended 2006. "Securitization – New Opportunities for Insurers and Investors", December 2006. Early in 2007 "Allstate announced its intention to sell $4 billion in catastrophe bonds," and the authors bond market had gone from being "a tiny backwater to a $14 billion market." In Nature's Casino, New York Times Sunday Magazine, August 26, 2007.

repairs to comply with building codes that were enacted after a home was first constructed. For example, many municipalities require such code upgrades to comply with the National Flood Insurance Program if a home is more than 50 percent damaged by a flood. Given the surge in demand for home building and repair that occurs in the wake of a hurricane, and corresponding increases in prices, these changes significantly shift risk and costs to consumers even if the consumers had bought the precise amount of insurance appropriate for their homes absent this sort of demand surge in costs.

- "Anti-concurrent-causation" clauses are the most draconian policy reduction that insurers have attempted to impose in recent years. It removes all coverage for wind damage if another, non-covered event (usually a flood) also occurs, regardless of the timing of the events. Under this anti-consumer measure, if a hurricane of 125-miles-per-hour rips a house apart and hours later a storm surge floods the property, the consumer would receive no reimbursement for wind losses incurred.

Given the cutbacks in coverage that have occurred in coastal areas, there is a serious question as to whether this diminished coverage is worth the higher rates that many consumers must pay. However, demand for home insurance is essentially inelastic: most consumers have no option but to purchase such coverage as it is required by lenders.

As cited above, insurers have claimed that they are facing higher risks because of a sharp increase in the number of people and amount of construction in areas of the country vulnerable to earthquake and hurricane disasters. This claim was investigated in 2006 by investigative reporter Peter Gosselin of the Los Angeles Times, who wrote that:

> …Key statistics don't support the argument….Census figures…show that the population of coastal and earthquake counties grew at an annual average rate of 1.56 percent between 1980 and last year. But they show that the U.S population grew at a reasonably close pace of 1.24 percent.

Gosselin interviewed Judith T. Kildow, director of the government-funded National Ocean Economics Program at California State University at Monterey, who said, "You simply cannot make the case from the numbers that America's coastal counties have grown at a disproportionately faster rate than the country as a whole over the last 25 years."[35]

Fourth, insurers have also shifted risk, sometimes onto taxpayers who subsidize state-run insurers-of-last resort, by non-renewing tens of thousands of homeowner and business properties. Allstate, the leading exemplar after Hurricane Andrew, is emerging once again as the company that has been most aggressive in refusing to renew homeowner's policies in the wake of Hurricane Katrina. After Hurricane Andrew, Allstate threatened to non-renew 300,000 South Floridians, leading the State of Florida to place a moratorium on such precipitous actions. Today, Allstate is non-renewing thousands of homeowners even on Long Island, New York and Cape Cod, Massachusetts. It has also announced that it will offer no new homeowner's policies in many states, from Connecticut to Delaware and has refused to write new business in large

[35] "The New Deal – Insurers Learn to Pinpoint Risks – and Avoid Them," Peter Gosselin, Los Angeles Times, November 28, 2006.

portions of other states, such as Maryland and Virginia.[36] Other insurers have also cut back coverage on the nation's coasts.

Insurers have become quite adept at convincing government to use tax dollars to help them avoid risk. Consider the federal Terrorism Risk Insurance Act (TRIA), the California Earthquake Authority, Citizen's Insurance in Florida, and wind "pools" in a number of other states. As stated above, the state pools have become the largest writers of insurance in some states. Such an arrangement allows insurers to "cherry-pick" these states, keeping the safest risks for themselves and shifting the highest risks onto the taxpayers of the state, thereby socializing high-risk, potentially unprofitable policies and privatizing the low risk, profitable business.[37] This adverse result for policyholders and taxpayers is hardly surprising. It is akin to "solving" the health insurance crisis by requiring states to cover sick or terminally ill consumers, while the private sector writes coverage for young and healthy consumers. Allstate is also leading efforts at the federal level to create a taxpayer-backed program modeled on TRIA to reinsure the private market against the perils of wind and other weather damage.

Because of these insurer actions to shift risk to consumers and taxpayers, the national operating ratio for homeowner's insurance fell from 152 percent in 1992, the year of Hurricane Andrew, to 96 percent in 2005, the year of Hurricane Katrina and other major storms. This occurred despite the fact that insured losses for the 2005 storms were more than three times as great in insured losses for Hurricane Andrew.

VII. MANY INSURERS NOW USE PROGRAMS DESIGNED TO SYSTEMATICALLY UNDERPAY CONSUMER CLAIMS

Insurers have also reduced their payouts and maximized their profits by turning their claims operations into "profit centers" by using computer programs and other techniques designed to routinely underpay policyholder claims. For instance, many insurers are using programs such as "Colossus," sold by Computer Sciences Corporation (CSC.)[38] CSC sales literature touted Colossus as "the most powerful cost savings tool" and also suggested that the program will immediately reduce the size of bodily injury claims by up to 20 percent. As reported in a recent book, "…any insurer who buys a license to use Colossus is able to calibrate the amount of 'savings' it wants Colossus to generate…If Colossus does not generate sufficient 'savings' to meet the insurer's needs or goals, the insurer simply goes back and 'adjusts' the benchmark values until Colossus produces the desired results."[39] In a settlement of a class-

[36] "The 'Good Hands' Company or a Leader in Anti-Consumer Practices? Excessive Prices and Poor Claims Practices at the Allstate Corporation", J. Robert Hunter, July 2007. http://www.consumerfed.org/pdfs/Allstate_Report_07_18_07.pdf

[37] Florida changed this practice in 2007 when the state-run insurance program, Citizens Insurance Company, was allowed to compete with private insurers by selling complete homeowners insurance policies (not just wind coverage) throughout the entire state (not just on the coasts) at rates reflecting the risk (without having to set rates higher than all private insurers).

[38] Other programs are also available that promise similar savings to insurers, such as ISO's "Claims Outcome Advisor."

[39] "From Good Hands to Boxing Gloves – How Allstate Changed Casualty Insurance in America," Trial Guides, 2006, Berardinelli, Freeman and DeShaw, pages 131, 133, 135.

action lawsuit, Farmers Insurance Company has agreed to stop using Colossus on uninsured and underinsured motorist claims where a duty of good faith is required, and has agreed to pay class members cash benefits.[40] Other lawsuits have been filed against most of America's leading insurers for the use of these computerized claims settlement products.[41]

Programs like Colossus are designed to systematically underpay policyholders without adequately examining the validity of each individual claim. The use of these programs severs the promise of good faith that insurers owe to their policyholders. Any resulting increase in profits cannot be considered legitimate. Moreover, the introduction of these systems could explain part of the decline in benefits that policyholders have been receiving as a percentage of premiums paid in recent years.

VIII. CONCLUSION AND POLICY SOLUTIONS

The property/casualty industry has been remarkably successful in recent years in maximizing profit through rate increases, coverage reductions, inappropriate claims practices, and by shifting high risks onto taxpayers. As a result, consumers are, and have been, receiving substantially less value for their policyholder dollars (if they can afford the higher insurance premiums), while insurers are underpaying losses as a percentage of premiums. In fact, many insurers appear to have abdicated their corporate purpose as risk-takers and sentinels for safety.

The underlying factors that have led to the excesses documented in this report are hardly regulated at all by most states. The below recommendations include eight specific measures that states should take in 2008 to strengthen their weakened regulatory systems and gain control of excessive rates, inadequate coverage and claims abuses. CFA has also proposed a comprehensive set of principals and standards for states to use to increase the consumer protections that they offer (See Addendum C). We also suggest three important steps the federal government can take to assist the states in solving the current insurance crisis.

A. Policy Recommendations for the States

1. Require insurers to offer an all-risk homeowners insurance policy. Insurers should offer an all-perils homeowners insurance policy that would include flooding and earthquake coverage. This step is essential to ensuring that insurance policies actually provide protection from catastrophic events. It would also help consumers understand what exactly their policy covers and does not cover. An all-perils policy would also encourage insurers to return to the business of preventing losses -- and providing financial incentives to insured parties to do so -- instead of focusing primarily on financial management and increasing the financial exposure of consumers and taxpayers. Consumers could be allowed to "opt out" of purchasing an all-risk policy, but this step should require policyholders to send written permission to the insurer, after being fully informed the specific price reductions each opt-out choice would generate.

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[40] Bad Faith Class Actions, Whitten, Reggie, PowerPoint Presentation, November 9, 2006.
[41] Ibid.

2. Better regulate the use of socio-economic rating factors. Insurers have been able to maintain excessive pricing through the increased use of collective socio-economic pricing tools, such as information about consumers' credit scores, prior insurance limits, and occupational and educational attainment. This information is opaque to consumers and has not been thoroughly assessed by most regulators. For example, the use of credit scoring for insurance rating purposes is highly questionable because it is not a legitimate risk factor for automobile or homeowners insurance and appears to have a disparate effect on lower income and minority consumers.[42] Moreover, consumers do not understand the credit scoring process, allowing insurers to largely avoid competitive pressures to match rates to the costs they incur or to engage in risk reduction efforts. Active oversight of credit scoring modelers and catastrophe modelers by the states must begin in 2008. The use of credit scoring for insurance purposes should be prohibited, in our view. However, at the very least, states should undertake independent research on the disparate impact of credit score use on protected classes of Americans. Moreover, state regulators should require that pricing structures generally meet standards that promote risk reduction, are logically related to risk so consumers know how to reduce insurance prices by loss-reducing strategies, protect low income and minorities, and are fully open and transparent to the public. Modelers such as credit score providers should be regulated as advisory organizations.

3. Increase scrutiny of computer-based claims settlement procedures. The use of computer procedures has shielded insurers from scrutiny of questionable claims practices in the same way that credit-scoring and catastrophe modeling have impeded oversight of certain ratings practices. State insurance regulators have largely ignored the warning signs in the marketplace that have indicated improper claims settlement procedures. In 2008, they should begin to pierce the insurer-created mystery of how claims are settled today. States should study the use of computerized claims practices by undertaking market conduct exams of the users of such systems focused on how they work and if arbitrary and unjustified claims' settlements result. Services, such as computerized claims handling providers, should be regulated as advisory organizations.

4. Make state-backed reinsurance available. States should join together (in interstate compacts if necessary) to offer reinsurance to private insurers using the Florida model enacted in 2007. If all catastrophe-prone states joined together to underwrite reinsurance at actuarially sound rates, or even with a mark up of 50 percent over actuarially sound rates, they would likely end or significantly diminish the periodic crises that follow big hurricanes or earthquakes, when reinsurers dramatically and unjustifiably increase rates that are then passed onto homeowners.

5. Consider offering state-backed property and automobile insurance. Policymakers in coastal regions should consider whether the increasing rates, decreasing coverage and turmoil created by large numbers of periodic non-renewals have reached the point where private insurers should not be offering certain lines of coverage at all. In 2007, Florida allowed its primary insurer, Citizens Insurance Company, to offer complete homeowners coverage, not just wind coverage, at competitive prices. This competition forced private insurers to improve their pricing models and lower some rates. This move also gave consumers a choice of coverage

[42] "Insurance-Based Credit Scores: Impact on Minority and Low Income Populations in Missouri," State of Missouri Department of Insurance, January 2004. "Use of Credit Information by Insurers in Texas," Texas Department of Insurance, December 20, 2004.

throughout the entire state, not just in coastal areas, thus allowing the state to spread risk more broadly. Even Florida should consider taking this development a step further by offering automobile insurance, which would ensure that, over time, the state would make a small profit or at least break even on its insurance offerings. Since insurers have been shown to be tying the provision of automobile insurance to home insurance in many ways, such as giving a discount for the purchase of both products, and non-renewing in coastal areas if consumers do not carry both types of policies, states should consider offering both policies as well.

6. Better regulate the use of catastrophe modeling. States should follow the example of Florida and Louisiana in blocking catastrophe-modeling firms from using unscientific short-term projections as the basis for establishing insurance rates and require them to return to the practice of using the long-term forecasts that were first used in the mid-1990s. The National Association of Insurance Commissioners ("NAIC") is holding a hearing on the practices used by the modeling firm that has been at the forefront of this problem, Risk Management Solutions ("RMS"). Coastal states should consider uniting to develop a coastal weather modeling system of their own, perhaps starting with the model developed by Florida State University. This model should be used to test the accuracy of projections developed by private modelers and to evaluate insurer rate requests to determine if they are excessive, inadequate or unfairly discriminatory. NAIC hearings are also exploring this possibility. Catastrophe modeling firms should also be regulated as advisory organizations.

7. End unjustified geographic discrimination. If any insurer fails to market a line of insurance in one area of a state that it is selling in other parts of the state (or in other states), regulators should also consider convening hearings to determine if the insurer's license should be revoked for geographic discrimination, in not making insurance available to all or some of citizens of the state. Insurers should be required to fully document their actions in such cases by demonstrating, for example, why all residents of the state or a particular region do not qualify for insurance that is being sold elsewhere. Absent such a proceeding, it is very hard for regulators and the public to understand or accept as valid, for example, why an insurer would stop writing homeowner's insurance in an entire state where only some of the residents live along the coast.

8. Review homeowner's insurance policy forms for hidden provisions. Insurance regulators should carefully review policy forms and exclusions they have allowed to become part of homeowner's policies and take steps to require insurers to adjust pricing levels downward to reflect decreased risk that results from these added exclusions. In recent years more insurers have been restricting coverage for mold, "like kind and quality" construction, hurricane deductibles, law and ordinance coverage, extended replacement costs, and anti-concurrent causation, for example. Yet premiums continue to rise. Regulators should review these new provisions and determine if an average consumer really understands the potential coverage problems that they have. They should require clear disclosure of all such hidden coverage restrictions, knowing that consumers rarely read their policies and rarely read all the information that accompanies a renewal. The review should also assess whether pricing adjustments were made when such coverage cutbacks were added and, if not, require that the rate reductions are made immediately. Consumers also need information from regulators to help them comparison shop for insurance. It is more important now than ever that consumers be able to compare the features of policies so they know what is covered and what is not covered and can shop for quality as well as price.

B. Policy Recommendations for the Federal Government

1. Repeal the McCarran-Ferguson Act's antitrust exemption for insurance. It is clear that many of the excessive pricing and unjustified claims practices that are documented in this report are abetted by collusive and anticompetitive behavior allowed under the McCarran-Ferguson Act. These anticompetitive practices include the use of "advisory organizations" like Insurance Services Office (ISO) that develop and file with the states large portions of the rates for many insurers. Advisory organizations also adopt and file for insurers anti-consumer policy provisions such as the ACC clause. The Governor of Florida has accused insurers in that state of using collusion to maintain excessive home insurance prices. The use of computerized claims systems also offers a great opportunity for insurers to collude. Congress should impose the same antitrust law relative to insurance, with which virtually every other business in America must comply.

2. Authorize interstate cooperation on catastrophe insurance. Congress should authorize states to use interstate compacts if necessary to create multi-state risk pools to cover wind and other catastrophic coverage. Such legislation should allow states to permit the accumulation of tax-free reserves if the funds collected are kept for the purpose of paying claims after wind disasters strike. Congress could authorize some funding to help create these coastal pools. The federal government could also help fund the efforts by the states to develop a computer weather risk model.

3. Repair the troubled National Flood Insurance Program (NFIP) before vesting it with additional authority. Congress should not pass any legislation to subsidize wind insurance or to add wind coverage to the National Flood Insurance Program ("NFIP"). The NFIP has been shown to be in disarray. Out-of-date flood maps used by the NFIP have underestimated flood risk and resulted in unjustifiably low insurance rates. This has created hidden subsidies for unwise construction in the nation's highly flood-prone areas.[43] These subsidies have helped create a $20 billion shortfall in NFIP funding. Further, the use of private insurers to run the program has resulted in between one-third and two-thirds of flood premiums flowing to insurers, not to the payments of claims.[44] Worse, there is much evidence that a major conflict-of-interest that insurers have has led them in some cases to shift the cost of wind claims they should have paid to the NFIP. If the insurers who service the NFIP determine that damage to a structure has been caused by flooding, taxpayers pick up the tab. Insurers only have to pay for a loss if they determine that it was caused by wind damage.[45]

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[43] See, e.g., "Oversight of the National Flood Insurance Program," testimony of J. Robert Hunter before the Committee on Banking, Housing and Urban Affairs of the U.S. Senate, October 18, 2007. http://www.consumerfed.org/pdfs/Hunter's_Senate_Testimony_Flood_Insurance_10-2-07.pdf

[44] "FEMA's Management and Oversight of Payments for Insurance Company Services Should be Improved," General Accountability Office, September 2007.

[45] "Katrina Carriers Scammed Federal Flood Insurance Program, U.S. Rep Claims," National Underwriter, February 12, 2007. "Flood Program Must End Insurer Conflict of Interest," J. Robert Hunter, National Underwriter, August 6, 2007.

4. **Eliminate any federal policies that might undermine the development of the securitization of insurance risk**. Some experts have stated that federal policies may discourage the development of securities to cover catastrophic events.[46] The federal government should undertake a study of federal laws and rules to ensure that the sound securitization of risk is encouraged, not discouraged, by federal requirements, particularly tax policy. Aggressively pursing efforts to foster increased securitization of catastrophe risk is a far more favorable option for consumers and taxpayers than insurer efforts to receive more taxpayer subsidies.

IX. TIPS FOR CONSUMERS

1. If possible, avoid doing business with a company that has a history of anti-consumer behavior. When purchasing or renewing a homeowner's policy, consumers can contact their state insurance departments to get information on companies in their areas that have sharply raised rates and cut back coverage in recent years or have abandoned consumers in other areas at crucial times. Some states also provide information to help consumers compare policy value, such as loss ratios. Based on these factors, for example, CFA recommends that consumers avoid Allstate if possible.[47]

2. Carefully review policies at purchase or renewal to determine when and how claims payments will be triggered, including whether high out-of-pocket costs will be imposed. Consumers should look for higher deductibles for wind damage, anti-concurrent causation clauses, mold exclusions, limits on payments for replacing destroyed property, and other restrictions on coverage. Consumers should also determine whether the insurer would pay for any costs incurred if they are required to elevate their homes or make changes mandated by local building codes. Ask questions and get answers in writing before signing.

3. Consumers throughout the country, even on the coasts, should actively shop for better coverage and rates. Because insurance companies are overcapitalized and earning record profits, they are looking for new business in lower risk areas. Rate decreases and better coverage are possible in 2008, even in coastal areas.

4. Demand thorough oversight of insurer actions by state regulators. If consumers have an unresolved problem with rates or coverage, they should file an immediate complaint in writing with their state insurance agency and follow up for a response. Consumers should also contact insurance regulators to find out what they are doing to require that rates are fair and reasonable and to ensure that insurers are not unjustifiably withdrawing coverage. Regulators in every state should give consumers at least two options for registering complaints: 1) the option to file a formal complaint or request for assistance for the purpose of getting help; and 2) the option to register a complaint about a sales, pricing, or claim practice for the purpose of helping the regulator monitor the marketplace and watch for trends and problems. Many consumers will not

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[46] Then Financial Services Committee Chairman Oxley stated, "Problems with the nation's insurance, securities and tax laws have greatly hindered the growth of disaster insurance securitization." Congress Hears About Cat Bond Benefits, National Underwriter, October 11, 2002.
[47] "The 'Good Hands' Company or a Leader in Anti-Consumer Practices? Excessive Prices and Poor Claims Practices at the Allstate Corporation", J. Robert Hunter, July 2007.

file a complaint with their state regulator for fear of reprisal. This deprives regulators of important information and makes it hard for them to make public specific insurance company claims practice data that would in turn help consumers use the power of their purses to reward responsible insurers.

Addendum A: Profits, Losses, Surplus for All Property/Casualty Insurers

YEAR	LOSS & LAE	POLICY HOLDERS SURPLUS	PRETAX OPERATING INCOME	GROSS NATIONAL PRODUCT	PHS as a % of GNP	YEAR	SORTED BY LOSS & LAE RATIO
1980	74.9%		$7.7	$2,945		2006	65.5%
1981	76.8%		$7.0	$3,234		2007	66.7%
1982	79.8%	$75.7	$4.6	$3,349	2.26%	1997	72.8%
1983	81.5%	$81.8	$2.7	$3,730	2.19%	2004	73.5%
1984	88.2%	$78.9	-$4.0	$4,070	1.94%	1980	74.9%
1985	88.7%	$93.1	-$5.6	$4,349	2.14%	2003	75.0%
1986	81.6%	$116.1	$5.4	$4,558	2.55%	2005	75.3%
1987	77.9%	$128.5	$13.8	$4,907	2.62%	1998	76.5%
1988	78.3%	$145.7	$15.9	$5,278	2.76%	1981	76.8%
1989	82.0%	$166.4	$10.4	$5,616	2.96%	1987	77.9%
1990	82.3%	$172.5	$11.2	$5,899	2.92%	1988	78.3%
1991	81.1%	$197.2	$13.8	$6,128	3.22%	1996	78.4%
1992	88.1%	$200.5	-$2.5	$6,513	3.08%	1995	78.9%
1993	79.5%	$224.8	$14.6	$6,822	3.30%	1999	78.9%
1994	81.1%	$237.8	$11.6	$7,257	3.28%	1993	79.5%
1995	78.9%	$284.7	$19.5	$7,560	3.77%	1982	79.8%
1996	78.4%	$311.9	$20.8	$8,036	3.88%	1991	81.1%
1997	72.8%	$384.1	$35.5	$8,500	4.52%	1994	81.1%
1998	76.5%	$423.4	$23.4	$8,971	4.72%	2000	81.4%
1999	78.9%	$428.1	$15.3	$9,558	4.48%	1983	81.5%
2000	81.4%	$400.2	$10.5	$10,008	4.00%	2002	81.5%
2001	88.4%	$374.4	-$12.8	$10,301	3.63%	1986	81.6%
2002	81.5%	$376.0	$8.7	$10,641	3.53%	1989	82.0%
2003	75.0%	$450.1	$35.9	$11,297	3.98%	1990	82.3%
2004	73.5%	$509.1	$43.5	$11,999	4.24%	1992	88.1%
2005	75.3%	$551.0	$46.3	$12,743	4.32%	1984	88.2%
2006	65.5%	$621.8	$86.4	$13,452	4.62%	2001	88.4%
2007	66.7%	$687.0	$85.0	$14,063	4.89%	1985	88.7%

Dollar figures in billions. Pretax Operating Income excludes some investment income.
Source for 2006 and earlier data: *Best's Aggregates and Averages*, 2007 Edition and earlier editions.
2007 data based upon an estimated 93.8% combined ratio (Insurance Information Institute (III), Earlybird Forecast, December 17, 2007)
27.1% expense and dividend ratio based on 2006 results.
Surplus includes State Funds after 1997.
GNP Data from US Dept. of Commerce/BEA/2007 through July.

Addendum B: Profits, Losses, Surplus for Top 10 Property/Casualty Insurers

YEAR	INDUSTRY NET INCOME	Number 1 State Farm Loss Ratio	Number 2 AIG Loss Ratio	Number 3 Allstate Loss Ratio	Number 4 Berkshire Hathaway Loss Ratio	Number 5 St. Paul/ Traveler's Loss Ratio	Number 6 Nationwide Loss Ratio	Number 7 Liberty Mutual Loss Ratio
1987	$10.0	66.4%	71.6%	70.9%	64.9%	64.1%	72.7%	82.7%
1988	$12.3	70.6%	69.1%	71.0%	66.2%	62.8%	70.2%	83.1%
1989	$7.2	78.8%	67.7%	72.9%	69.2%	65.6%	72.7%	85.8%
1990	$8.0	77.4%	64.8%	75.2%	93.8%	64.6%	73.1%	84.3%
1991	$8.9	72.1%	68.9%	73.2%	112.6%	65.2%	69.6%	83.9%
1992	-$2.7	83.6%	71.0%	87.2%	91.9%	74.9%	73.6%	85.2%
1993	$10.5	70.4%	69.8%	68.3%	70.4%	63.6%	65.7%	82.2%
1994	$10.9	77.5%	69.9%	75.5%	91.5%	64.1%	66.3%	73.5%
1995	$20.6	70.8%	64.5%	66.8%	67.9%	61.4%	74.1%	72.9%
1996	$24.4	67.5%	66.6%	64.6%	66.7%	69.2%	71.2%	72.3%
1997	$36.8	60.4%	66.5%	58.2%	62.5%	60.7%	61.4%	72.6%
1998	$30.8	65.6%	68.0%	54.4%	62.0%	64.9%	64.8%	75.5%
1999	$22.0	67.8%	68.5%	59.6%	77.7%	60.2%	66.5%	73.4%
2000	$20.5	74.8%	65.3%	62.4%	78.0%	61.8%	73.5%	74.8%
2001	-$6.7	83.4%	71.9%	65.7%	98.9%	74.9%	68.4%	85.2%
2002	$9.1	74.7%	74.2%	62.8%	69.0%	80.4%	59.6%	68.1%
2003	$31.2	63.3%	64.3%	58.4%	56.4%	60.0%	58.2%	64.0%
2004	$40.5	60.2%	70.0%	57.0%	58.6%	65.1%	59.3%	63.9%
2005	$48.8	66.6%	72.2%	64.6%	77.5%	60.0%	58.0%	60.9%
2006	$67.6	57.3%	57.7%	47.6%	60.9%	57.6%	50.3%	59.6%
2007	$65.0	NA	53.8%	51.6%	58.6%	45.5%	NA	NA

Dollar figures are in billions.
Source: *Best's Aggregates and Averages*, 1988 to 2007 Editions
Net Income is after-tax and includes all investment income.
2007 net income estimated at $60 to $65 billion by III in the Earlybird Forecast (12/17/07).
ISO reports 9-month net income in Industry Financial Results (December 31, 2007) at $49.4 billion.
4/3 * $49.4 = $65.9 billion
Top ten 2007 P/C groups are displayed.
Loss Ratio is pure losses incurred to be paid to consumers, not LAE.
St. Paul and Travelers data in the years before 2004 were combined.
2004 data for AIG estimated based upon Loss and LAE ratio of 77.6%.
2007 data: From published reports on insurer web sites - Mutual Insurers do not report quarterly.
AIG 9-month Loss and LAE = 64.2% less 2006 LAE Ratio of 10.4%
Allstate 9-month Loss and LAE = 63.3% less 2006 LAE Ratio of 11.7%
St. Paul Travelers 9-month Loss and LAE = 57.3% less 2006 LAE Ratio of 11.8%
Berkshire Hathaway 9-month Loss and LAE = 68.2% (estimated) less 2006 LAE Ratio of 9.6%
Progressive 9-month Loss and LAE = 70.7% less 2006 LAE Ratio of 12.5%
Hartford 9-month Loss and LAE = 66.7% less 2006 LAE Ratio of 10.9%
2007 Data for ten companies conservatively assumed based upon the data from six stock companies

Addendum B (Cont'd): Profits, Losses, Surplus for Top 10 Property/Casualty Insurers

Number 8 Progressive Loss Ratio	Number 9 Farmers Loss Ratio	Number 10 Hartford Loss Ratio	YEAR	Simple Loss Ratio Top 10 L/R	10 Company 5 yr moving Average	10 Company 3 yr moving Average	Average L/R Top 6 Stock Cos	6 Stock Co 5 yr moving Average
48.8%	67.9%	63.2%	**1987**	67.3%			63.9%	
52.1%	68.9%	63.4%	**1988**	67.7%			64.1%	
53.6%	74.5%	65.5%	**1989**	70.6%		68.6%	65.8%	
48.9%	75.6%	68.9%	**1990**	72.7%		70.3%	69.4%	
50.4%	75.5%	69.2%	**1991**	74.1%	70.5%	72.5%	73.3%	67.3%
55.4%	73.6%	67.4%	**1992**	76.4%	72.3%	74.4%	74.6%	69.4%
52.9%	68.2%	63.3%	**1993**	67.5%	72.2%	72.6%	64.7%	69.5%
54.8%	85.7%	64.8%	**1994**	72.4%	72.6%	72.1%	70.1%	70.4%
61.8%	75.2%	65.9%	**1995**	68.1%	71.7%	69.3%	64.7%	69.5%
59.5%	65.6%	78.3%	**1996**	68.2%	70.5%	69.5%	67.5%	68.3%
57.7%	62.0%	62.3%	**1997**	62.4%	67.7%	66.2%	61.3%	65.7%
55.2%	64.9%	61.6%	**1998**	63.7%	67.0%	64.8%	61.0%	64.9%
62.3%	68.5%	61.8%	**1999**	66.6%	65.8%	64.3%	65.0%	63.9%
69.6%	72.4%	60.0%	**2000**	69.3%	66.0%	66.5%	66.2%	64.2%
59.3%	74.7%	66.1%	**2001**	74.9%	67.4%	70.2%	72.8%	65.3%
57.4%	62.4%	60.1%	**2002**	66.9%	68.3%	70.3%	67.3%	66.5%
54.1%	59.0%	79.9%	**2003**	61.8%	67.9%	67.8%	62.2%	66.7%
51.9%	56.8%	58.2%	**2004**	60.1%	66.6%	62.9%	60.1%	65.7%
54.9%	56.9%	56.0%	**2005**	62.8%	65.3%	61.5%	64.2%	65.3%
54.0%	54.9%	57.1%	**2006**	55.7%	61.4%	59.5%	55.8%	61.9%
58.2%	NA	55.8%	**2007**	57.0%	59.5%	58.5%	53.9%	59.3%

Addendum C: Consumer Principles and Standards for Insurance Regulation

1. Consumers should have access to timely and meaningful information of the costs, terms, risks and benefits of insurance policies.

- Meaningful disclosure prior to sale tailored for particular policies and written at the education level of average consumer sufficient to educate and enable consumers to assess particular policy and its value should be required for all insurance; should be standardized by line to facilitate comparison shopping; should include comparative prices, terms, conditions, limitations, exclusions, loss ratio expected, commissions/fees and information on seller (service and solvency); should address non-English speaking or ESL populations.
- Insurance departments should identify, based on inquiries and market conduct exams, populations that may need directed education efforts, e.g., seniors, low-income, low education.
- Disclosure should be made appropriate for medium in which product is sold, e.g., in person, by telephone, on-line.
- Loss ratios should be disclosed in such a way that consumers can compare them for similar policies in the market, e.g., a scale based on insurer filings developed by insurance regulators or independent third party.
- Non-term life insurance policies, e.g., those that build cash values, should include rate of return disclosure. This would provide consumers with a tool, analogous to the APR required in loan contracts, with which they could compare competing cash value policies. It would also help them in deciding whether to buy cash value policies.
- Free look period with meaningful state guidelines to assess appropriateness of policy and value based on standards the state creates from data for similar policies.
- Comparative data on insurers' complaint records, length of time to settle claims by size of claim, solvency information, and coverage ratings (e.g., policies should be ranked based on actuarial value so a consumer knows if comparing apples to apples) should be available to the public.
- Significant changes at renewal must be clearly presented as warnings to consumers, e.g., changes in deductibles for wind loss.
- Information on claims policy and filing process should be readily available to all consumers and included in policy information.
- Sellers should determine and consumers should be informed of whether insurance coverage replaces or supplements already existing coverage to protect against over-insuring, e.g., life and credit.
- Consumer Bill of Rights, tailored for each line, should accompany every policy.
- Consumer feedback to the insurance department should be sought after every transaction (e.g., after policy sale, renewal, termination, claim denial). Insurer should give consumer notice of feedback procedure at end of transaction, e.g., form on-line or toll-free telephone number.

2. **Insurance policies should be designed to promote competition, facilitate comparison-shopping and provide meaningful and needed protection against loss.**

- Disclosure requirements above apply here as well and should be included in design of policy and in the policy form approval process.
- Policies must be transparent and standardized so that true price competition can prevail. Components of the insurance policy must be clear to the consumer, e.g., the actual current and future cost, including commissions and penalties.
- Suitability or appropriateness rules should be in place and strictly enforced, particularly for investment/cash value policies. Companies must have clear standards for determining suitability and compliance mechanism. For example, sellers of variable life insurers are required to find that the sales that their representatives make are suitable for the buyers. Such a requirement should apply to all life insurance policies, particularly when replacement of a policy is at issue.
- "Junk" policies, including those that do not meet a minimum loss ratio, should be identified and prohibited. Low-value policies should be clearly identified and subject to a set of strictly enforced standards that ensure minimum value for consumers.
- Where policies are subject to reverse competition, special protections are needed against tie-ins, overpricing, e.g., action to limit credit insurance rates.

3. **All consumers should have access to adequate coverage and not be subject to unfair discrimination.**

- Where coverage is mandated by the state or required as part of another transaction/purchase by the private market, e.g., mortgage, regulatory intervention is appropriate to assure reasonable affordability and guarantee availability.
- Market reforms in the area of health insurance should include guaranteed issue and community rating and, where needed, a subsidy to assure health care is affordable for all.
- Information sufficient to allow public determination of unfair discrimination must be available. Zip code data, rating classifications and underwriting guidelines, for example, should be reported to regulatory authority for review and made public.
- Regulatory entities should conduct ongoing, aggressive market conduct reviews to assess whether unfair discrimination is present and to punish and remedy it if found, e.g., redlining reviews (analysis of market shares by census tracts or zip codes, analysis of questionable rating criteria such as credit rating), reviews of pricing methods, reviews of all forms of underwriting instructions, including oral instructions to producers.
- Insurance companies should be required to invest in communities and market and sell policies to prevent or remedy availability problems in communities.
- Clear anti-discrimination standards must be enforced so that underwriting and pricing are not unfairly discriminatory. Prohibited criteria should include race, national origin, gender, marital status, sexual preference, income, language, religion, credit history, domestic violence, and, as feasible, age and disabilities. Underwriting and rating classes should be demonstrably related to risk and backed by a public, credible statistical analysis that proves the risk-related result.

4. **All consumers should reap the benefits of technological changes in the marketplace that decrease prices and promote efficiency and convenience.**

- Rules should be in place to protect against redlining and other forms of unfair discrimination via certain technologies, e.g., if companies only offer better rates, etc. online.
- Regulators should take steps to certify that online sellers of insurance are genuine, licensed entities and tailor consumer protection, UTPA, etc. to the technology to ensure consumers are protected to the same degree regardless of how and where they purchase policies.
- Regulators should develop rules/principles for e-commerce (or use those developed for other financial firms if appropriate and applicable)
- In order to keep pace with changes and determine whether any specific regulatory action is needed, regulators should assess whether and to what extent technological changes are decreasing costs and what, if any, harm or benefits accrue to consumers.
- A regulatory entity, on its own or through delegation to independent third party, should become the portal through which consumers go to find acceptable sites on the web. The standards for linking to acceptable insurer sites via the entity and the records of the insurers should be public; the sites should be verified/reviewed frequently and the data from the reviews also made public.

5. **Consumers should have control over whether their personal information is shared with affiliates or third parties.**

- Personal financial information should not be disclosed for other than the purpose for which it is given unless the consumer provides prior written or other form of verifiable consent.
- Consumers should have access to the information held by the insurance company to make sure it is timely, accurate and complete. They should be periodically notified how they can obtain such information and how to correct errors.
- Consumers should not be denied policies or services because they refuse to share information (unless information needed to complete transaction).
- Consumers should have meaningful and timely notice of the company's privacy policy and their rights and how the company plans to use, collect and or disclose information about the consumer.
- Insurance companies should have clear set of standards for maintaining security of information and have methods to ensure compliance.
- Health information is particularly sensitive and, in addition to a strong opt-in, requires particularly tight control and use only by persons who need to see the information for the purpose for which the consumer has agreed to sharing of the data.
- Protections should not be denied to beneficiaries and claimants because a policy is purchased by a commercial entity rather than by an individual (e.g., a worker should get privacy protection under workers' compensation).

6. **Consumers should have access to a meaningful redress mechanism when they suffer losses from fraud, deceptive practices or other violations; wrongdoers should be held accountable directly to consumers.**

- Aggrieved consumers must have the ability to hold insurers directly accountable for losses suffered due to their actions. UTPAs should provide private cause of action.
- Alternative Dispute Resolution clauses should be permitted and enforceable in consumer insurance contracts only if the ADR process is: 1) contractually mandated with non-binding results, 2) at the option of the insured/beneficiary with binding results, or 3) at the option of the insured/beneficiary with non-binding results.
- Bad faith causes of action must be available to consumers.
- When regulators engage in settlements on behalf of consumers, there should be an external, consumer advisory committee or other mechanism to assess fairness of settlement and any redress mechanism developed should be independent, fair and neutral decision-maker.
- Private attorney general provisions should be included in insurance laws.
- There should be an independent agency that has as its mission to investigate and enforce deceptive and fraudulent practices by insurers, e.g., the reauthorization of FTC.

7. **Consumers should enjoy a regulatory structure that is accountable to the public, promotes competition, remedies market failures and abusive practices, preserves the financial soundness of the industry and protects policyholders' funds, and is responsive to the needs of consumers.**

- Insurance regulators must have clear mission statement that includes as a primary goal the protection of consumers:
- The mission statement must declare basic fundamentals by line of insurance (such as whether the state relies on rate regulation or competition for pricing). Whichever approach is used, the statement must explain how it is accomplished. For instance, if competition is used, the state must post the review of competition (e.g., market shares, concentration by zone, etc.) to show that the market for the line is workably competitive, apply anti-trust laws, allow groups to form for the sole purpose of buying insurance, allow rebates so agents will compete, assure that price information is available from an independent source, etc. If regulation is used, the process must be described, including access to proposed rates and other proposals for the public, intervention opportunities, etc.
- Consumer bills of rights should be crafted for each line of insurance and consumers should have easily accessible information about their rights.
- Insurance departments should support strong patient bill of rights.
- Focus on online monitoring and certification to protect against fraudulent companies.
- A department or division within regulatory body should be established for education and outreach to consumers, including providing:
- Interactive websites to collect from and disseminate information to consumers, including information about complaints, complaint ratios and consumer rights with regard to policies and claims.
- Access to information sources should be user friendly.
- Counseling services to assist consumers, e.g., with health insurance purchases, claims, etc. where needed should be established.

- Consumers should have access to a national, publicly available database on complaints against companies/sellers, i.e., the NAIC database.
- To promote efficiency, centralized electronic filing and use of centralized filing data for information on rates for organizations making rate information available to consumers, e.g., help develop the information brokering business.
- Regulatory system should be subject to sunshine laws that require all regulatory actions to take place in public unless clearly warranted and specified criteria apply. Any insurer claim of trade secret status of data supplied to regulatory entity must be subject to judicial review with burden of proof on insurer.
- Strong conflict of interest, code of ethics and anti-revolving door statutes are essential to protect the public.
- Election of insurance commissioners must be accompanied by a prohibition against industry financial support in such elections.
- Adequate and enforceable standards for training and education of sellers should be in place.
- The regulatory role should in no way, directly or indirectly, be delegated to the industry or its organizations.
- The guaranty fund system should be prefunded, national fund that protects policyholders against loss due to insolvency. It is recognized that a phase-in program is essential to implement this recommendation.
- Solvency regulation/investment rules should promote a safe and sound insurance system and protect policyholder funds, e.g., rapid response to insolvency to protect against loss of assets/value.
- Laws and regulations should be up to date with and applicable to e-commerce.
- Antitrust laws should apply to the industry.
- A priority for insurance regulators should be to coordinate with other financial regulators to ensure consumer protection laws are in place and adequately enforced regardless of corporate structure or ownership of insurance entity. Insurance regulators should err on side of providing consumer protection even if regulatory jurisdiction is at issue. This should be stated mission/goal of recent changes brought about by GLB law.
- Obtain information/complaints about insurance sellers from other agencies and include in databases.
- A national system of "Consumer Alerts" should be established by the regulators, e.g., companies directed to inform consumers of significant trends of abuse such as race-based rates or life insurance churning.
- Market conduct exams should have standards that ensure compliance with consumer protection laws and be responsive to consumer complaints; exam standards should include agent licensing, training and sales/replacement activity; companies should be held responsible for training agents and monitoring agents with ultimate review/authority with regulator. Market conduct standards should be part of an accreditation process.
- The regulatory structure must ensure accountability to the public it serves. For example, if consumers in state X have been harmed by an entity that is regulated by state Y, consumers would not be able to hold their regulators/legislators accountable to their needs and interests. To help ensure accountability, a national consumer advocate office with the ability to represent consumers before each insurance department is needed when national approaches to insurance regulation or "one-stop" approval processes are implemented.

- Insurance regulator should have standards in place to ensure mergers and acquisitions by insurance companies of other insurers or financial firms, or changes in status of insurance companies (e.g., demutualization, non-profit to for-profit), meet the needs of consumers and communities.
- Penalties for violations must be updated to ensure they serve as incentives against violating consumer protections and should be indexed to inflation.

8. Consumers should be adequately represented in the regulatory process.

- Consumers should have representation before regulatory entities that is independent, external to regulatory structure and should be empowered to represent consumers before any administrative or legislative bodies. To the extent that there is national treatment of companies or "one-stop" (OS) approval, there must be a national consumer advocate's office created to represent the consumers of all states before the national treatment state, the OS state or any other approving entity.
- Insurance departments should support public counsel or other external, independent consumer representation mechanisms before legislative, regulatory and NAIC bodies.
- Regulatory entities should have well-established structure for ongoing dialogue with and meaningful input from consumers in the state, e.g., consumer advisory committee. This is particularly true to ensure needs of certain populations in state and needs of changing technology are met.