Consumer Federation of America

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Statement of

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Of the

Florida Senate

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Good afternoon, Mr. Chairmen and members of the Committee. My name is Bob Hunter. I am Director of Insurance of the Consumer Federation of America and formerly served as Texas Insurance Commissioner and as Federal Insurance Administrator under Presidents Ford and Carter. I have over 45 years of insurance experience, in the private sector, in the government and as a consumer advocate. I am an actuary, a Fellow in the Casualty Actuarial Society and a Member of the American Academy of Actuaries.

You asked for my testimony to address three points. First, you sought a brief summary of the Presumed Factor Report of March 1, 2007, which I assisted the Office of Insurance Regulation to prepare. Second, you wanted me to summarize a report I issued on January 10 of this year regarding the profitability of the property/casualty insurance industry. Finally, you asked for me to look at the presumed factor and true-up filings of five insurance companies and give you my initial reaction to those submissions. I am also providing a list of legislative actions I believe you should consider to address the insurance situation in Florida today.

THE PRESUMED FACTOR REPORT

After Hurricane Andrew, the insurers appeared to be genuinely surprised by the magnitude of the claims. They sought help for the state regulators to significantly alter how they wrote insurance along the coasts. Florida was at the epicenter of these changes.

Florida (and other coastal states) gave the insurers pretty much everything they sought. Much higher rates, using new computer models to calculate them, lower coverage (by

adding separate hurricane deductibles and other coverage limits) and a place to place high risks (Citizens in Florida). The legislatures and regulators were very compliant with the requests from the insurers, all they asked was a promise that, once the pain of these changes was over, the people would have stability in affordability and availability of insurance on the coasts going forward.

I know these promises were made because they were made to me when I was Texas Insurance Commissioner.

But the promises were broken as prices once again skyrocketed and coverage was cut back after the hurricanes of 2004 and 2005. As insurers sought even more rate increases, cutting back coverage on the coasts and dumping people into the high-risk pools, they demanded more and more help from the states and most states complied.

But it was different in Florida. For the first time a state has, rather than showering gifts on insurers and praying for some trickle down help to reach consumers, passed laws that directly help consumers. You Florida legislators deserve congratulations for that, not just from Floridians but also from consumers everywhere who have been gouged in the wake of the hurricanes.

You know what you did. But for those listening who do not, you did two very important things.

First, you made the high-risk pool competitive with the insurance companies by selling the full homeowner's policy at competitive rates in the entire state, not just on the coasts. This idea has proven successful in getting insurers to sharpen their pencils and compete more and has worked in several states in the workers compensation insurance market where state funds are significant, competitive providers of insurance.

Second, you replaced some hugely overpriced private reinsurance with actuarially priced reinsurance from the state through the Florida CAT Fund. Even the reinsurance executives admit they were too greedy so this substitution saves a lot of money. The law requires that the savings must be passed through to the consumers.

You look pretty good since no storm hit Florida this year, but you can't really judge the law based on only one year of experience. I would be standing here telling you that you did the right thing even if storms hit in 2007. The law could look bad in any year if a big storm hit but there is no question that, over the long-term, the law will break even or make a bit of money for the state while saving hundreds of billions for consumers. Even the insurance industry's own calculations show that.

Projected and Actual Savings

The Florida Office of Insurance Regulation (OIR) projected savings from the reinsurance replacement at 24%. I assisted in that calculation. We used a sample of 12 insurers to estimate the savings. By its nature this was done as a sample and some variation from

final results was expected. But, the calculations are sound and I would produce the same projected savings even today. The report was based on work by the country's best experts and was similar to the savings the industry itself calculated during the special session of the legislature.

But the actual savings so far have only averaged -14%. While a 14% savings is nothing to sniff at, the question that your Committee and others are looking into is why aren't the full 24 percent savings being realized – after all, Florida bore a lot of risk during the last hurricane season.

The OIR Presented this Information to you As of January 3rd

✓ **Range of Presumed Factor and True-Up Filings for Homeowners Multi-peril:**

Approved Filings
Average: - 21.9%*
Range: -0.9% to -43.1%
Represents 717,706 Policies or 17.6% of market share
*Does not include rate filings with zero percent change nor is the average weighted by market share. State Farm Florida, which filed a -7% presumed factor and -1.5% true up, is not included in the above information.

NOI/Disapproved Filings
Average Proposed: +12.8%**
Range: -21 to +50%
Represents 1,327,322 Policies or 32.5% of market share

Pending Filings
Average Proposed: -11.1%**
Range: -2 to -22.4
Represents 1,877,170 Policies or 45.9% of market share
**Does not include rate filings with zero percent change or rate filings denied due to various issues other than the proposed rate.

Why the Savings are Falling Short

In the Presumed Factor Report, we warned consumers, right up in the Executive Summary, that:

"The public must be alerted to the fact that these are average savings. There are many reasons why an individual policyholder might see a different amount of savings when a policy is renewed. One very significant reason is that the actual regional impacts are by Zip Code and not the broad regions listed above. Another is that the Office allows the insurance companies to make adjustments to the basis of the territorial distribution of the savings to follow the system used by the insurer in its last filing. One example of this is that some insurers capped the increases in some territories and therefore did not have all of the cost in the price and therefore must take a lower savings to reflect that. This approach is allowed so long as the overall savings in the entire state reflect the Presumed Factor and the overall savings agree with the calculations made in this report. An

additional reason that a policyholder may not see premium savings equivalent to these figures is that an insurer may have increased rates within the year prior to the policyholder's renewal, and they may not have felt the effects of the rate increase yet."

Some of the reasons for disparity between the 24% savings of the Report and what we see in the rate filings are for good reasons. For example, the calculation was based on insurers buying all $12 billion of the reinsurance but some insurers have consistently bought a small amount of reinsurance so their savings are, logically, less. Another insurer had not changed its rate for two years so it had not reflected the much higher reinsurance charges we used to estimate savings so it should not have to lower the rates by the full amount.

But most of the difference makes no sense. The reasons some companies do not pass through all the savings we expected are not legitimate. For instance, companies used savings to buy additional reinsurance they did not have before rather than passing through the savings as the legislation required. Some companies simply raised their profit margins to keep the money due consumers in their own pockets. Some insurers simply said that their reinsurance programs from the entire nation should be allocated unreasonably to Florida. Some said they could not get the reinsurers to pay them back for the lowered risk, in some cases even though the reinsurer was an affiliated company!

Possible Collusion to Make the Florida Law Look Bad

There appears to be what I have called the "Proposition 103 effect" at play in Florida. Proposition 103 was passed by the people of California in 1988. It required a 20% rollback of all property/casualty insurance rates unless the insurer could show, after hearing, that that would make their rates inadequate.

The insurers were very upset and engaged in suit, threats to stop writing new business or other threats. The intent was not only to hold onto the money they were getting from California's consumers but also to stop the spread of similar measures across the nation.

This happened, according to a report from the California Attorney General, after "numerous detailed communications among the insurers which signaled to each other their willingness to participate in a simultaneous withdrawal from the market, suggesting an unlawful group boycott had been agreed upon."

The Florida situation "smells" a lot like the Prop 103 time. Could the insurers want to make the Florida legislation look bad so other states don't follow suit in the same way the insurers feared the spread of Prop 103?

We will not know the answer to this question until government officials review the subpoenaed records, if you fight to get them as OIR is doing. Interestingly, the small insurers and Florida based insurers are passing the savings through pretty well…it is the national companies with the most to lose if the Florida approach spreads to other states that are balking.

As the public awaits the results of these important investigations, I can tell the people of Florida that the bill passed in January was absolutely the right move for the state. Floridians should be proud of this legislature, Gov. Crist and the people of OIR are standing bravely on your behalf to make sure every penny due to you is uncovered and passed on to you.

PROPERTY/CASUALTY INDUSTRY PROFITS

I have supplied to you a copy of a new report on insurance industry profits entitled, "Property/Casualty Insurance in 2008: Overpriced Insurance and Underpaid Claims Result in Unjustified Profits, Padded Reserves and Excessive Capitalization." This report was released on January 10, 2008, by many of the nation's leading consumer groups.

Over the last four years, the typical American family has paid at least $870 too much for property/casualty insurance. The proof is in the 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. Four years ago the III said the capital was "a matter of concern." This does not reflect the huge amounts of capital used by insurers in recent years to buy back their own stock (Allstate alone did more than $15 billion of that) and buy businesses or pay higher and higher salaries to management. Nor does the $100 billion in excess surplus take into account the $53 billion in reserves that the Insurance Services Office reports are "redundant." Four years ago reserves were about right. 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, even using 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. Consider this: It would take more than five Hurricane Katrina-sized losses to eliminate just these unwarranted reserves and surplus. Even if such an unlikely series of losses occurred, the insurance industry would still be extremely safe financially and consumers would still be paying rates that were excessive.

Twenty years ago, the property/casualty insurance industry paid out over 70 cents in benefits to policyholders for each premium dollar they paid in. Now they are paying out less than 60 cents. Policies like home and auto insurance have become a poor value for too many consumers. A low benefit payout is bad even if the insurers were earning reasonable profits. But the insurers have been earning excessive profits.

Profits and a strong insurance industry are good things. But excessive profiteering while people on the coasts of America are being denied insurance or asked to pay outlandish prices for insurance or having claims unfairly cut by computerized cheating – all while taxpayers are subsidizing the industry – is not a good thing.

In 2004, with four hurricanes here in Florida, the Property/Casualty insurers set a record profit at $40.5 billion in net income. In 2005, even with Hurricanes Katrina, Wilma, and

the other hurricanes, they set another record profit, at $48.8 billion. Profits in 2006 were astonishing and totaled $67.6 billion. In 2007, profits continued at the excessive 2006 level. We estimate that 2007 profits will be $65.0 billion, just short of the 2006 record but still remarkable. And this calculation of the 2007 profit does not factor in any release of those excessive reserves into profits. If that happens, as many experts expect, 2007 will set yet another profit record, the fourth in a row.

Whether 2007 just misses being a record or sets a new record is not clear yet, but one thing is clear: During the last five years, the profits of insurers have totaled over $250 billion.

And this excess does not count the over $50 billion in padded reserves. Insurers can avoid taxes and hide profits by stuffing cash into reserves rather than letting it flow to profit.

The insurance industry carefully cultivates the perception that they are an ultra high-risk business, requiring excessive returns, huge premiums and bloated capital to fight off the onslaught of catastrophes, such as hurricanes and terrorism risks. This is a myth.

Insurers are, in fact, a low risk to investors. Using standard measures of stock market performance, such as financial safety and stock price stability, the property/casualty insurance industry is below the average risk of all stocks in the market, safer than the risk of a diverse mutual fund.

In 2007, the stock property/casualty insurers will earn a Return On Equity of over 19%, well in excess of what is required by investors. The industry spokespeople will report lower returns than that but there are several reasons why the figures that insurers report are understated. For instance, the industry wide returns they report include mutual insurers in their averages, who tend to carry excess capital on their books.

Even if they corrected their calculations, the ROE would still be too low since the income the insurance industry earns today is earned on bloated surpluses. Reflecting removal of the $100 billion excess, the ROEs would rise by about 5%. This is a proper adjustment since it reflects efficient rather than bloated capital levels.

The industry is now at the lowest leverage ratios in history, indicating excess capital and inefficient economic behavior. Proof that the insurers are excessively capitalized is all around us. As I mentioned earlier, many insurers are engaged in massive stock buy back programs because of their excess capital situation, a move applauded by the financial community but not the policyholders who funded these excesses. Insurers are also buying other corporations and not little ones either. For example, Warren Buffett is using the excessive returns that he calls a "flood of incoming cash" to, as he puts it, hunt "elephants" for purchase. Further, insurance CEOs are helping reduce the excess capital by, according to the Conference Board, paying themselves the highest average cash compensation of any industry.

In the year of Hurricane Andrew, 1992, the operational loss of insurers was over 50% nationally for the homeowners line of insurance. In 2005, the year of Hurricanes Katrina and Wilma and others, the homeowners line actually made money.

How did the insurers become such a low risk industry, when the premiums we consumers pay include profit for alleged risk taking?

The answer is that they did legitimate and illegitimate things to lower their risk.

A legitimate risk lowering effort they used was making wise use of reinsurance and other risk spreading mechanisms, such as securitization.

But much of the risk reduction programs used by the insurers were, we think, illegitimate. For instance, they shifted risk massively to policyholders through sharp limits on coverage such as separate hurricane deductibles, the egregious anti-concurrent causation clause that will deny a wind claim if a non-covered event strikes the property (even hours after the wind damage happened), caps on replacement cost and on bringing a home up to code, exclusion of mold from policies, and other ways of restricting coverage. Also, new programs to turn claims departments into "profit centers" have resulted in inadequate reimbursement for claims. I am talking here about things like the use of “Colossus” and other such programs where the management at insurance companies can decide even before a claim occurs how much they want to save through their claims operation and implement the programs to cause inadequate payments – resulting in “lowball” offers on legitimate claims that on average produce the savings sought, often approaching 20 percent of the claims to which these programs are applied.

Another way insurers reduced risk in a questionable way was huge price hikes beyond what was needed. Hikes in prices started in late 2000 throughout the nation, as part of the economic cycle of the industry. At first, rate relief was necessary. But the insurers kept jacking up prices beyond reasonable levels, hikes that have resulted in the excessive profits, excessive capital, and bloated reserves we see today.

I should point out that we are, at last, seeing rate drops in some areas of the country, particularly away from the coast, and even some relief for business policyholders at the coasts. The drops so far have been too little and too late to avoid the excesses we see in profits, reserves and retained earnings today. Much more must be done to end the excessive rates that exist in many states today.

The third illegitimate way insurers reduced risk was to shift risk to taxpayers under programs such as the Terrorism Risk Insurance Act and state pools where the insurers can “cherry-pick” leaving the state with the high risks and the insurers with the safer, more profitable risks. Florida has, to its credit, understood that the state can’t operate that way and has passed laws to rectify that problem. But the insurers press on to shift risk to taxpayers. The socialization of risk, coupled with privatization of profit that has occurred over the last few years has been a remarkable – virtually unnoticed -- shift away from the corporate purpose of the nation’s insurance industry – to take risk.

The success of their effort to move risk onto policyholders and taxpayers has worked to produce record profits even in times of record catastrophes. The movement of this industry to low risk status is graphically revealed by the insurers steady decline in the portion of the premium dollar that is paid out to claimants in benefits.

If the insurance industry has made itself such a low risk business, why should Americans continue to pay such a high cost for their insurance? Why should we tolerate ever-increasing inefficiency in payouts of claims? Why should we accept the abandonment and price gouging of so many Americans along the coasts? Why should we agree to subsidize their business by providing taxpayer back-up for terrorism or catastrophe losses?

While this was not included in the profits report, I can tell you that Florida's 2006 homeowners insurance loss ratio was 31%, fourth lowest in the nation (Louisiana at a stunning 2% was lowest). The national loss ratio in the homeowners line was a far too low 48%. I expect similar results in both Florida and the nation in 2007. Over the five years ending in 2006, Florida's loss ratio was 105% vs. 62% nationally, not unexpected given all the hurricane activity. When 2007 results are in, the five-year result will be closer, perhaps 95% to 60% or so.

In personal auto, the 2006 result was a profitable loss ratio of 62% vs. a too low result of 58% nationally. Over five years Florida's loss ratio was 67% vs. 62% nationally. Auto insurance has been profitable in Florida.

Over the last 5 years, the property/casualty insurance incurred loss ratio in Florida was 72% vs. 62% nationally. If you add 2007 estimates, the difference falls to an estimated 8 points. Florida was roughly a break-even situation for the insurers during this time of crisis, not the horror show the insurers portray.

A REVIEW OF THE PRESUMED FACTOR AND TRUE-UP FILINGS OF FIVE INSURER GROUPS

You have asked that I take a look at the filings of five insurer groups, namely: 1) Allstate Floridian Indemnity and Allstate Floridian Ins. Co.; 2) the Hartford Group and Hartford Ins. Co. of the Midwest; 3) Florida Farm Bureau Gen. Ins. Co. and Florida Farm Bureau Casualty Ins. Co.; 4) Nationwide Ins. Corp. of Fla.; and 5) American Strategic Ins. Corp.

Here in brief is the current status on these insurers you are interested in:

INSURER	FINAL PRESUMED FACTOR	LATEST TRUE UP FILING	TRUE UP STATUS
Allstate Floridian Indem	-13.2%	27.4%	Withdrawn

Allstate Floridian Ins	-14.2%	43.4%	Withdrawn
Hartford Group (ex below)	-17.7%	22.0%	NOI
Hartford Ins of Midwest	-21.9%	31.6%	NOI
Florida Farm Bureau Gen	-24.4%	31.5%	NOI
Florida Farm Bureau Cas	-25.1%	29.6%	NOI
Nationwide Ins of Florida	-5.0%	-16.2%	Approved
American Strategic Ins	-11.4%	-9.1%	Approved

The Allstate problem is well known, including reinsurer use of near-term models and calculation of PML for reinsurance purchase using these prohibited models, but, since the true up filing has been withdrawn and Allstate has indicated a willingness to negotiate with the department, I will not discuss the rate filing further. However I must say this in regard to the Allstate situation: a regulator must make sure that his or her legitimate orders, subpoenas and such are complied with for the public to have any faith in regulation. You cannot let an insurer flout legitimate orders. I fully support the decision of OIR to suspend Allstate's license to write new insurance until the requested documents are supplied. I encourage Allstate to make a good faith effort to comply by submitting some of the key documents immediately. Once that is done, I would encourage OIR to let the suspension of Allstate's license be removed for a reasonable period of time while the rest of the documents required are delivered. If documents are not forthcoming, the suspension could be reinstated.

American Strategic is an example of an insurer doing what is right and its rates, fully reflecting the effects of HB-1A, are now approved and in place.

Nationwide had an unusual situation. Nationwide's filing for rates had been held up for a long time because the company demanded arbitration after receiving an NOI. Thus, the rates being charged at the time the Presumed Factor filings came due did not include more recent, higher reinsurance so the insurer had a lower rate on line and, thus, a lower indicated reduction from the legislative action that other companies did. But, between the Presumed Factor filing and the True up filing, the arbitrators granted a major price increase, over 50 percent, so, although the insurer did lower prices due to the legislation, many people saw big increases.

That leaves two groups of the five you requested that I address, both with Notices of Intent to disapprove their true up filings.

Hartford has received an NOI on its true up filings. Some of the issues in this filing noted by OIR are increased reinsurance costs and inability to renegotiate such costs as well as an astounding allocation by Hartford of 50 percent of its national reinsurance cost to Florida.

Florida Farm Bureau purchased more reinsurance this year above what they bought last year and higher than that offered through the CAT Fund, saying they could not renegotiate with the reinsurers and had to buy higher layers for the money they paid that the reinsurer refused to return (they bought reinsurance to cover a 250 year event vs. last year's100 year event cover). They also used new computer models for CAT projection that increased the risk beyond the 100-year level, models that are near term in nature and turned on demand surge in the model, which increases the cost to homeowners. The calculation of PML for reinsurance purchase was done using the prohibited short-term models, resulting in higher limits purchased.

OIR indicates that the usual issues they find with the true up filings that receive NOIs are:

- More reinsurance costs in the rate
- Rating Organizations tightening capital requirements pushed up reinsurance costs in rate, in some cases by reinsurers
- Risk load was included for the first time per 627.062(2)(b)11.
- Higher Profit and Contingency factors
- Use of unapproved, near-term models (some driven by reinsurers using these models)
- Claims that rates before 2007 were inadequate

LEGISLATION PROPOSALS

Here are some very specific Florida steps you should take to protect consumers from higher prices:

1. Permanently get rid of the arbitration option for insurers after the OIR decision is made.

2. Permanently end the Use and File method of rate adoption.

3. Regulate modeling companies and credit scoring companies as advisory organizations. Models should be made public, at least to the extent sufficient for consumers to understand how various factors are used and how they impact their premiums. The OIR should be directed to study all models and rate systems to determine if the systems cause a disparate impact on minorities and low-income Floridians.

4. Declare that certain class factors are required to be used and to have the largest impact on pricing. For example, in California, the mandatory auto insurance factors are (a) driving record, (b) miles driven, (c) years of experience and (d) everything else. The greatest impact on a premium paid by a driver must be driving record, then miles driven and so forth. All of the additional factors under (d) everything else must have less of an impact than (c) years of experience.

5. Declare by legislation that all insurer documents related in any way to rate and other filings are public information unless insurers prove to the regulator, subject to court review of such determination if a member of the public challenges it, that documents the insurers want to keep secret are indeed a trade secret.

6. Require that the regulator only allow in rates expenses that are used and useful for the provision of insurance.

7. Require regulation of insurance rates be on a total return basis, including investment income from all sources, including capital and surplus.

8. Require an in-depth investigation of computerized claims processing programs to make sure that systematic underpayment of claims does not occur. Models to be filed and the basic purpose and other information sufficient for consumers to understand how the model impacts a claim should be made public. Providers of claims models should be regulated as advisory organizations.

9. Consider adding actuarially priced, competitive auto insurance through citizens as a way to spread the risk more broadly and offer reasonable prices throughout Florida.

10. Require, as a condition of licensure, that insurer groups offer throughout the state the same insurance coverages they offer in other states.

11. Require that bad-faith verdicts, fines and penalties paid by insurers be identified and not be allowed to be passed through to consumers as part of future rates.

12. Require that expense levels being passed through in rates to consumers not be excessive for the type of insurer (e.g., agency company, direct writer) making the filing.

13. Insurer right to unfettered non-renewals should be limited to cause (things like more than three claims in five years, demonstrable change in risk or criminal behavior by the insured). The longer a person is insured, the tougher it should be for the insurer to dump the risk. In Louisiana, there is such a limit on homeowners insurance policies under which an insurer can't cancel a customer who has been with the company for three years unless he has committed fraud, has stopped paying his bills, let his house fall into disrepair, made excessive claims or unless the company gets special permission from state regulators to drop customers because it's in danger of becoming insolvent.

Note: in our recent profits report, which I understand has been made available to you, CFA suggested eight more general ideas for state legislators to consider to help consumers that you can review as part of your effort. Some of these have already been adopted in Florida.

I would be happy to respond to questions that you might have, Mr. Chairman and members of the Select Committee.