Americans for Insurance Reform
Center for Insurance Research
Center for Economic Justice
Center for Justice and Democracy
Consumer Federation of America
Consumers Union
Foundation for Taxpayer and Consumer Rights
United Policyholders

Property/Casualty Insurance in 2007: Overpriced Insurance, Underpaid Claims, Declining Losses and Unjustified Profits

January 8, 2007

J. Robert Hunter
Director of Insurance
Consumer Federation of America
1620 I Street, NW; Suite 200
Washington, D.C. 20006
202-387-6121

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.*

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.*

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.*

THE PERCEPTION CULTIVATED BY INSURERS: PROPERTY CASUALTY INSURANCE IS A HIGH-RISK BUSINESS THAT IS FINANCIALLY THREATENED BY CATASTROPHIC WEATHER AND TERRORIST EVENTS

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 terrorism 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 agree that the industry is 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 often 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 asked by insurers to reduce consumer protections in response to higher risks that insurers claim to face, such as a supposed rush by Americans to settle in coastal areas that are more dangerous. [1]

The perception, then, is that insurance has become an inherently unstable business that generates profits insufficient to compensate for the extraordinarily high risk that insurers face.

THE REALITY: LOW RISK AND UNJUSTIFIABLY HIGH PROFITS

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

Measuring the Financial Strength of the Property/Casualty Insurance Industry

The financial strength of the insurance industry is typically measured by the size of the

[1] "…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.

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 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 premiums are made by actuaries 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. 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 riskiness 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 $10 of surplus (a ratio of 10 to 1), a ten percent error in pricing the risk would bankrupt the insurer. If the insurer has $1,000 of surplus (a 1 to 1 ratio), the error in 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.

Insurer profits are assessed using several methods. 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.[2]) Another method of evaluating profitability is the loss and loss adjustment expense (LAE) ratio, which adds the cost of adjusting claims to the 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 insurer’s earn, which is very significant in some lines of insurance. Investment income derives 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 federal taxes incurred.

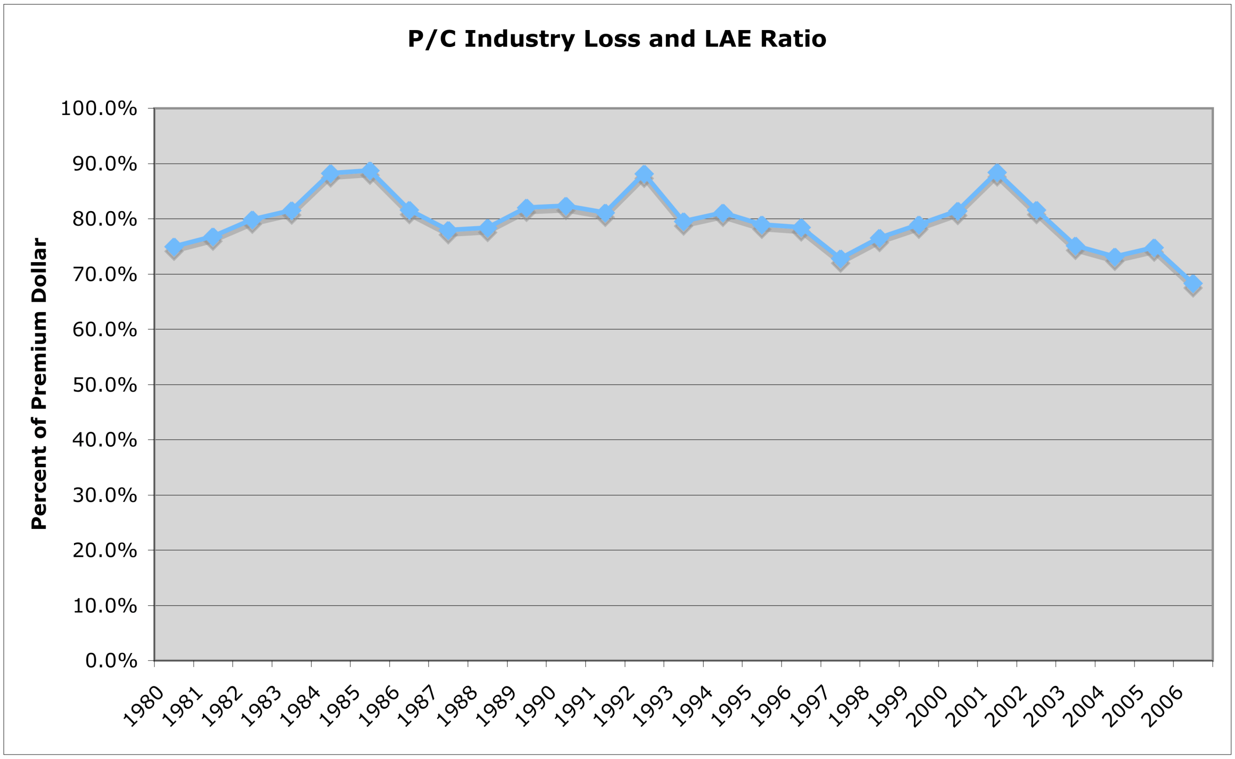
Addendum A details 25 years of key profit, loss and surplus data for the property/casualty insurance industry. It reveals how remarkable recent profits are, despite hurricane and terrorist activity. Addendum B cites 20 years of data for the top ten property/casualty insurer groups, including the top stock company results for the first nine months of 2006. The following findings are apparent from this aggregate data:

- A.M Best's estimate of the full year combined ratio in 2006 is 93.3 percent. The Insurance Information Institute (III) estimates this ratio at 94.3 percent.[3] The higher number will be used for the purposes of this analysis. If underwriting expenses

[2] “Incurred losses” include paid losses plus reserves for known claims and even for unknown claims, called “incurred bur 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.

[3] Earlybird Forecast 2007, Insurance Information Institute, December 21, 2006.

(including policyholder dividends) hold at the 2005 level of 26.0 percent, [4] the loss and LAE ratio for 2006 will be 68.3 percent, the lowest ratio recorded since at least 1980. III itself says that the combined ratio is likely to be the lowest recorded in 51 years.[5] Astonishingly, if the 2005 LAE is observed in 2006, (13.1 percent)[6], the incurred losses would be 55.2 percent of premiums. This means that the property/casualty insurance industry is delivering only 55 percent of the premiums to claimants for every premium dollar paid, a very inefficient delivery of benefits to Americans. The loss and LAE ratio for the last 27 years, with its lowest point in 2006, follows:



- Using the operating ratio and reported results for the first nine-month of 2006,[7] pre-tax operating income is an estimated at $82.8 billion; a record high by a wide margin. The previous high was $47.3 billion in 2005, so the new record will shatter the old by $35.5 billion or 75.1 percent.

- Looking at the individual company data:

  (a) American International Group's loss ratio in 2006 for nine months is 50.9 percent, the lowest since at least 1987. The 1987 to 2004 average ratio was 68.7 percent. The 2006 loss ratio is almost 20 points below the insurer's long-term average. AIG is barely paying out half of the premiums it receives in benefits.

[4] Aggregates and Averages, A. M. Best and Co., 2006 Edition.
[5] Earlybird Forecast 2007, Insurance Information Institute, December 21, 2006.
[6] Aggregates and Averages, A. M. Best and Co., 2006 Edition.
[7] 2006 – First Nine Month's Results, Insurance Information Institute, December 27, 2006.

(b) Allstate Insurance Group's loss ratio in 2006 for nine months is 43.5 percent, the lowest since at least 1987. This information is shocking given Allstate's moves to non-renew policies for tens of thousands of consumers in coastal states from Maine to Texas, especially in Florida, Mississippi and Louisiana. Allstate has also made very prominent efforts to convince Congress to provide a federal taxpayer subsidy for catastrophe coverage. The 1987 to 2004 average ratio was 66.8 percent. The 2006 loss ratio is more than 20 points below the long-term average. Paying out such a low percentage of premium (43.5 percent) to Allstate policyholders is simply not justifiable.

(c) St. Paul/Traveler's Group's loss ratio in 2006 for nine months is 46.8 percent, the lowest since at least 1987. The 1987 to 2004 average ratio was 65.4 percent. The 2006 loss ratio is almost 20 points below the long-term average.

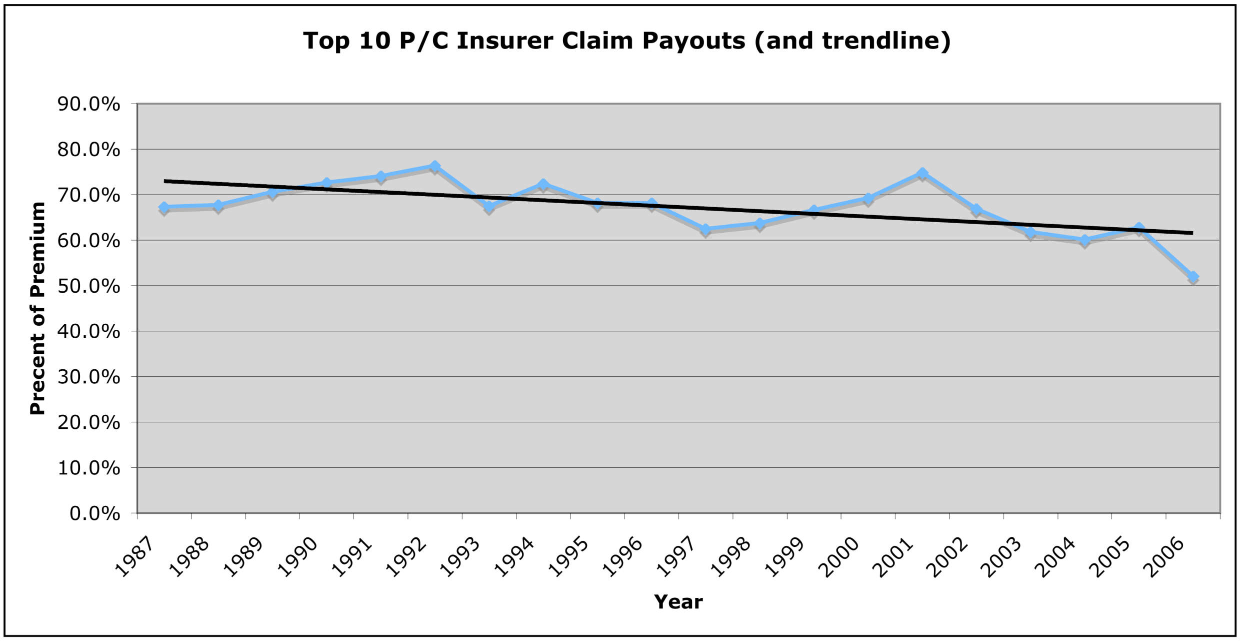
(d) Berkshire Hathaway Insurance Group's loss ratio in 2006 for nine months is 56.1 percent, the lowest since at least 1987. The 1987 to 2004 average ratio was 75.6 percent. The 2006 loss ratio is almost 20 points below the long-term average.

(e) Progressive Insurance Group's loss ratio in 2006 for nine months is 53.1 percent. Since 1987, Progressive had a loss ratio lower than this only once, in 2004 (at 51.9 percent.) The 1987 to 2004 average ratio was 55.8 percent, a meager pay out ratio over such a long period of time indicating that policies are significantly overpriced. The 2006 loss ratio is only 3 points below this extremely low long-term payout average.

(f) Hartford Insurance Group's (Hartford) loss ratio in 2006 for nine months is 53.2 percent, the lowest since at least 1987. The 1987 to 2004 average ratio was 65.0 percent. The 2006 loss ratio is more than 10 points below the long-term average.

By any measure, 2006 profits are excessive. The astonishingly low loss ratios reported above mean that consumers are receiving record low payouts for their premium dollars as insurers reap unprecedented profits. The average loss ratio for nine months of 2006 for the top six stock companies in the top ten-company list (mutuals do not supply quarterly info) is 50.6 percent. Moreover, as is obvious in the below graph, the trend in payouts is sharply down over the last twenty years, a period during most state insurance regulators have allowed consumer protections to erode significantly.[8]

[8] CFA tested this drop in benefits related to premiums to see if it could be attributed to a drop in investment income. Over 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 premium.



It is truly inappropriate for property/casualty insurers to be delivering only half of their premium back to policyholders as benefits.[9]

Mutual companies, which do not issue quarterly reports and therefore are not included in the data for 2006 tend to report somewhat higher loss data. The overall loss ratio for the mutual companies is likely to be about 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 53 percent, the figure used for 2006 in the above graph.

INSURANCE RISK DOES NOT JUSTIFY EXCESSIVE RETURNS

The common wisdom perpetuated by the insurance industry is that primary insurers need high profits to cover losses in a very risky sector of the economy. Insurers also claim that their shareholders should receive greater returns given the investment risk they assume. For example, the Insurance Information Institute says that, "considering the tremendous risk assumed by investors who back major insurance and reinsurance companies, the returns in most years are woefully inadequate," complaining that insurers in 2006 will just about match the 15 percent return on equity of the Fortune 500 "for just the second time in many years."[10] It is possible that reinsurance companies assume higher-than-average industry risk but this is certainly not true for the primary market. In fact, primary insurers have succeeded in eliminating or shifting most of their risk.

[9] Insurers contend that the loss adjustment expense is a benefit to consumers. Obviously, this is a "benefit" that does not go to the consumer or repair cars, 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.

[10] Earlybird Forecast 2007, Insurance Information Institute, December 21, 2006.

If one owns a property/casualty insurance company stock, one has, with few exceptions, bought into a low-risk business, lower in risk that the market in general. This is shown in ValueLine 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 Poors 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.

Consider Allstate. At the same time the company has taken draconian steps to sharply raise premiums and/or cutback coverage for many homeowners in coastal areas , it has presented shareholders with very low risk:[11] Beta = 0.90; Financial Safety = 1, and Stock Price Stability = 95.

ValueLine posts results for 26 property/casualty insurers.[12] The simple averages for these carriers are: Beta = 0.97; Financial Safety = 2.4, and Stock Price Stability = 83.

By all three measures, property/casualty insurance stocks are of below-average risk, safer than buying an S&P 500 index fund. Therefore, long-term below-average returns for insurers should be expected given the low-risk nature of this investment. The low returns demonstrate that the capital market is performing efficiently by awarding below-average returns to a below-average risk industry.

Another measure of how property/casualty insurers have insulated themselves from risk is the extraordinary profits they have earned 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. 2006 profits are the highest yet because of low hurricane activity, excessive rates, the use of programs to systematically keep payments to policyholders low and other reasons discussed in this White Paper.

In 2007, the industry is on target for an approximately 20 percent return on policyholder

[11] ValueLine, December 22, 2006 edition.

[12] The stocks are ACE Ltd., Alleghany Corp., Allstate Corp., American Financial Group, W.R. Berkley Corp., Berkshire Hathaway, Inc., CAN Financial, Chubb Corp., Cincinnati Financial, 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., PLI Corp., Safeco Corp., St. Paul/Travelers Group, Selective Insurance, Transatlantic Holdings, 21st Century Insurance Group and XL Group, Ltd.

surplus, not the 15 percent predicted by some in the industry. A.M. Best reported three quarters net income of $50.4 billion plus unrealized capital gains of $12.9 billion for a total of $63.3 billion -- which translates to about $84 billion for a full year. Policyholder surplus for 2006 was $423.1 billion at the beginning of the year, a return on equity of 20 percent.[13]

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. State Farm had 7.6 percent of industry net income, compared to 11.9 percent of industry surplus. In other words, State Farm has much more capital than a typical insurer, dragging down apparent industry-wide earnings because of its massive capital base. If data on State Farm's return on equity is removed, the industry-wide average increases by more than half a percent.

2. Publicly traded insurers have achieved returns on equity in 2005 and 2006 that are much greater than the "Fortune 500" average. For example, Allstate reported a return on equity of 23 percent for the year ending on September 30, 2006. Progressive reported a nine month return on equity of 24.3 percent on mean surplus.

3. The property/casualty insurance industry is tremendously overcapitalized. It is bringing in too much capital to warrant a higher return on equity. The excess capital is evidenced not only by the low industry-wide premium-to-surplus-ratio mentioned below, 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. In October of 2006, Allstate announced a new $3 billion share repurchase plan starting in 2007 that will "compliment" the $12.8 billion program that was completed at the end of 2006.[14] 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 says it is financially threatened by the risk of future weather catastrophes is stunning.

   Similarly, Progressive announced that it was buying back 1.1 million shares in April 2006. A representative of the investment firm Bear Sterns stated that the share repurchase was necessary because "both management and the board are working to address the company's significant excess capital position."[15] In August, Safeco announced a $1.4 billion repurchase for almost 20 percent of its outstanding shares.[16]

4. The industry method for calculating return on equity, as reported by A.M. Best,

[13] A.M. Best Special Report, October 2006.

[14] "Allstate Posts Solid Earnings," National Underwriter Magazine, October 19, 2006.

[15] "Progressive Announces Stock Split, Dividend," National Underwriter Magazine, April 24, 2006.

[16] "Safeco Increases Share Repurchase, Increases Dividend," National Underwriter Magazine, August 24, 2006.

underestimates the actual return. Insurer income is divided by the mean (i.e., average) amount of capital that insurers had available throughout the course of the year, rather than the amount of capital on hand at the beginning of the year. As the industry sharply increases its revenue throughout the year, more income flows into surplus. The use of this calculation method increases the amount of capital used to determine return on equity and appears to reduce the estimated return. If the return on equity were calculated using the amount of capital available at the beginning of a year, the return would be much higher.[17] Allstate's return on equity for the year that ended September 30, 2006 would be 25 percent rather that 23 percent if starting capital were used.

5. Proof that the investing 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 have increased by 43 percent through year-end 2006, while the S&P Insurance Index[18], weighted down with life insurance stocks, increased only 33 percent. During that time, however, the value of Allstate's stock rose by 65 percent and Progressive's by 62 percent. The simple average increase of the property/casualty insurance company stocks in the S&P Insurance Index was 48 percent over that period, slightly higher than the S&P 500 and more proof that the property/casualty insurance industry overall does just fine with returns on equity less than that of the S&P 500.

INSURERS HAVE REMOVED OR SHIFTED RISK THROUGH LEGITIMATE AND ILLEGITIMATE MEANS

First, insurers have made intelligent use of reinsurance, securitization and other risk spreading techniques. Securitization doubled in 2006. 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.

[17] For example, if one invested $100 in a one-year certificate of deposit with a 10 percent interest rate, one would earn $10 in interest and have $110 in principal at the end of the year. However, if one calculated return on equity in the manner that the industry does, the same $10 in interest would represent only 9.5 percent interest ($100+$110)/2) or $10/$105.

[18] The index is made up of AFLAC, Allstate, AIG, Hartford, Jefferson Pilot, Lincoln National, Lowes, MBIA, MetaLife, NFIC, Progressive, Safeco, St. Paul/Travelers, Torchmark and UNUM.

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 in Florida and 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.

In fact, insurance rates on the coasts have soared for property risks, homes and businesses in the last year. At hearings held in Florida last year, 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.[19] The number of homes insured by Citizen's grew from 407,387 in December 2005 to 854,892 in October 2006.[20] A similar situation exists in Louisiana and other Gulf Coast states.

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.

- Caps on replacement costs. State Farm, for instance, caps payments for increased rebuilding costs at 20 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 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.

- "Anti-concurrent-causation" clauses. This is the most draconian reduction of all 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 but 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 even higher price that many consumers must pay. However, most consumers have no option but to purchase such coverage as it is required by lenders or law or both. Demand for insurance is relatively inelastic.

[19] By law, the rates that Citizen's requires must be at least ten percent above those charged in the "voluntary" market.

[20] "An Overview of Florida's Insurance Market Trends," Florida Office of Insurance Regulation, 2006.

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 the Los Angeles Times investigated reporter Perter Gosselin, 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 interviewd 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."[21]

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 portions of other states, such as Maryland and Virginia. Other insurers have also cut back coverage on the nation's coasts (See Addendum C, for more information).

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. 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.

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

INSURERS HAVE EASILY HANDLED RISK AND ARE OVERCAPITALIZED

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, the top ten insured loss disasters for property were:

EVENT[22]	PRE-TAX DOLLAR LOSS	POST TAX
1. Hurricane Katrina, August 2005	$40.6 billion	$26.4 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 constant dollar cost to insurers)

Considering that property/casualty insurers now have surplus in excess of $600 billion, catastrophes of this size are very easy to manage.

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. 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 that CFA estimates has represented about a seven-billion taxpayer subsidy to date.

Historically, the prime test for the 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, analysts have recommended lowering the acceptable ratio to about 1.5 to 1, in recognition of some more

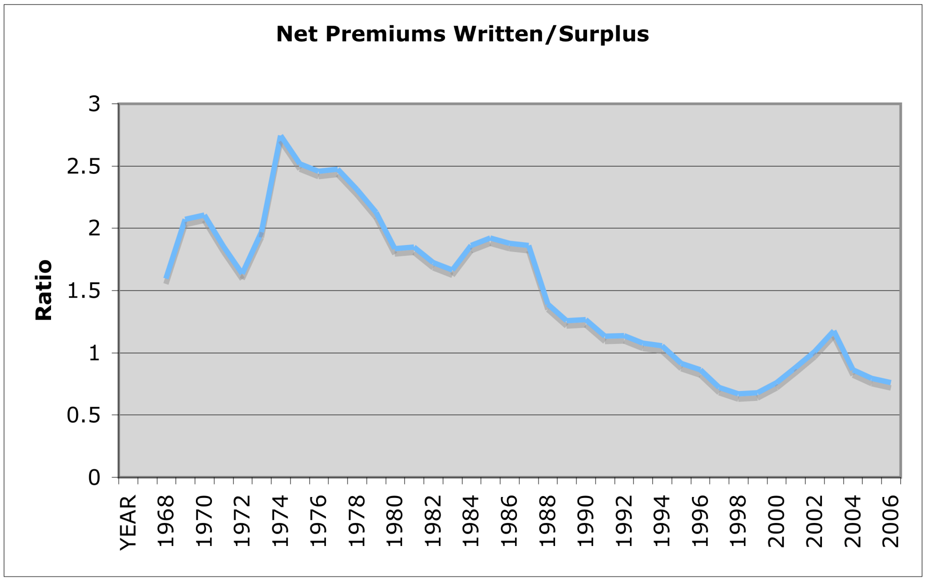
[22] The catastrophes were ranked by III based on size of loss in 2005 dollars, which we do not display here. What is displayed is the actual dollars in the year of the event. We calculate the post-tax figure by deducting the corporate tax rate of 35 percent.

extreme risks that insurers now face, such as catastrophic hurricanes and terrorist attacks. Net premium written to surplus ratios for almost thirty years are as follows:

YEAR	NPW/SURPLUS RATIO
1968	1.59
1969	2.07
1970	2.10
1971	1.85
1972	1.63
1973	1.97
1974	2.74
1975	2.52
1976	2.46
1977	2.47
1978	2.31
1979	2.13
1980	1.83
1981	1.85
1982	1.72
1983	1.66
1984	1.86
1985	1.92
1986	1.88
1987	1.86
1988	1.39
1989	1.25
1990	1.26
1991	1.13
1992	1.14
1993	1.08
1994	1.05
1995	0.91
1996	0.86
1997	0.72
1998	0.67
1999	0.68
2000	0.76
2001	0.88
2002	1.01
2003	1.17
2004	0.86
2005	0.79
2006	0.73

Source: Best's Aggregates and Averages, 1988/2006 Editions, Page 399. 2006 Estimated at 2.8 percent premium growth, Surplus up by estimated profit of $55B.

Property/casualty insurers have not exceeded the recommended 1.5 to 1 ratio of NPW to surplus in almost 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:



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.)[23] 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."[24] In a settlement of a class-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.[25] Other lawsuits have been filed against most of America's leading insurers for the use of these computerized claims settlement products.[26]

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

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

[25] Bad Faith Class Actions, Whitten, Reggie, PowerPoint Presentation, November 9, 2006.

[26] Ibid.

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 increase in profits that results cannot be considered to be 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.

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 the shifting of high risks onto taxpayers. As a result, insurers are underpaying losses as a percentage of premiums. In fact, insurers have significantly abdicated their corporate purpose as risk takers and sentinels for safety.

Proposed Policy Solution 1**.** States should strengthen weakened regulatory systems to gain control of excessive rates, inadequate coverage and claims abuses. CFA has proposed a comprehensive set of principals and standards for states to use to increase the consumer protections that they offer. (See Addendum D.)

In the near future, states should move to block RMS and other modelers from using short-term projections and require them to go back to the long-term projections they promised to use when these models were introduced in the mid-1990s. State regulators should also undertake research on the fairness of insurance rates similar to that done by California on home insurance and by the New York City Comptroller on auto insurance.

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.

If any insurer fails to market a line of insurance that it is selling elsewhere in all or part of a state, 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.

CFA will be releasing comprehensive reports later this year on the severe problems that consumers face under the largely deregulated state system of insurance regulation, as well as an analysis of how state oversight has failed in recent years and what can be done to fix it.

Proposed Policy Solution 2**.** To solve the mounting coastal insurance crisis, policymakers should consider whether increasing rates, decreasing coverage and the turmoil created by large number of periodic non-renewals have gotten to the point where private insurers should not be offering catastrophe coverage at all.

For example, CFA and Americans for Insurance Reform have proposed creating a state fund in Florida to cover all wind risk in the state.[27] Such a program could save Florida taxpayers at least $3 billion a year through the more efficient delivery of insurance, the ability to build reserves tax-free and non-profit status. CFA estimates that overhead costs and profits would decline from about 45 percent of premium to only about 10 percent, a 35-point advantage. Further, the ability to build tax-free reserves would save the state the 35 percent corporate tax charge on the amounts of money earned by insurers from the wind premiums that remain at year-end. Such a plan should be directed by private insurance carriers determined through a competitive bidding process. The risk of large losses during the transition to a self-funded state plan should be borne by insurers if necessary, by assessing all property-casualty insurers for all lines in Florida during the period of time in which adequate reserves are built up. If wind coverage by itself is too narrow a base upon which to make such a program work, states should consider using the entire homeowners' insurance line. An interstate compact would allow a number of states to develop this sort of arrangement to cover homeowners' wind risk along the entire coast.

Such an approach would allow private insurers to sharply lower their rates as wind coverage is removed from their policies. In fact, insurers would have virtually no excuses for unjustifiably increasing rates or reducing coverage in the future as the market would be considerably more stable.

Proposed Policy Solution 3. Congress should authorize states to use interstate compacts to create multi-state risk pools to cover wind risk. 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 also authorize some funding to help create these coastal pools. The federal government could also help fund the efforts by the states to development a computer weather risk model.

Proposed Policy Solution 4. Some experts have stated that federal policies may discourage the development of securities to cover catastrophic events. The federal government should undertake a study of federal laws and rules to ensure that 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 provide more taxpayer subsidies.

[27] Other organizations releasing this report have not taken a position on this proposal.

CONSUMER TIPS

1. If possible, don't do 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 in coverage in recent years.

2. Carefully review policies at purchase or renewal to determine whether high out-of-pocket costs will be imposed**.** Consumers should look for special deductibles for wind damage, anti-concurrent causation clauses, limits on replacement costs, and other restrictions on coverage. Consumers should also determine whether the insurer will 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 who live away from coastal areas should actively shop for better coverage and rates**.** Because insurance companies are overcapitalized, they are looking for new business in lower risk areas. Rate decreases and better coverage are possible.

4. Demand thorough oversight of insurer actions by state regulators**.** If consumers have a 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 that insurers are not unjustifiably withdrawing coverage.

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

							SORTED
			PRETAX	GROSS			BY
	LOSS &				PHS		LOSS &
	LAE	POLICYHOLDERS	OPERATING	NATIONAL	as a		LAE
					% of		
YEAR	RATIO	SURPLUS	INCOME	PRODUCT	GNP	YEAR	RATIO
1980	74.9%		$7.7	$2,945		2006	68.3%
1981	76.8%		$7.0	$3,234		1997	72.8%
1982	79.8%	$75.7	$4.6	$3,349	2.26%	2004	73.1%
1983	81.5%	$81.8	$2.7	$3,730	2.19%	2005	74.8%
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	75.1%
1986	81.6%	$116.1	$5.4	$4,558	2.55%	1998	76.5%
1987	77.9%	$128.5	$13.8	$4,907	2.62%	1981	76.8%
1988	78.3%	$145.7	$15.9	$5,278	2.76%	1987	77.9%
1989	82.0%	$166.4	$10.4	$5,616	2.96%	1988	78.3%
1990	82.3%	$172.5	$11.2	$5,899	2.92%	1996	78.4%
1991	81.1%	$197.2	$13.8	$6,128	3.22%	1995	78.9%
1992	88.1%	$200.5	-$2.5	$6,513	3.08%	1999	78.9%
1993	79.5%	$224.8	$14.6	$6,822	3.30%	1993	79.5%
1994	81.1%	$237.8	$11.6	$7,257	3.28%	1982	79.8%
1995	78.9%	$284.7	$19.5	$7,560	3.77%	1991	81.1%
1996	78.4%	$311.9	$20.8	$8,036	3.88%	1994	81.1%
1997	72.8%	$384.1	$35.5	$8,500	4.52%	2000	81.4%
1998	76.5%	$423.4	$23.4	$8,971	4.72%	1983	81.5%
1999	78.9%	$428.1	$15.3	$9,558	4.48%	1986	81.6%
2000	81.4%	$400.2	$10.5	$10,008	4.00%	2002	81.6%
2001	88.4%	$374.4	-$12.8	$10,301	3.63%	1989	82.0%
2002	81.6%	$376.0	$8.4	$10,641	3.53%	1990	82.3%
2003	75.1%	$353.8	$35.5	$11,297	3.13%	1992	88.1%
2004	73.1%	$508.7	$45.4	$11,999	4.24%	1984	88.2%
2005	74.8%	$551.0	$47.3	$12,743	4.32%	2001	88.4%
2006	68.3%	$606.7	$82.8	$13,339	4.55%	1985	88.7%

Dollar figures in billions. Pretax Operating Income excludes some investment income.
Source: 2005 and earlier data from Best's Aggregates and Averages, 2006 Edition and earlier editions.
2006 data based upon an estimated 94.3% combined ratio (III Earlybird Forcast, December 21,2006)
26.0% expense and dividend ratio based on 2005 results
Surplus includes State Funds after 1997. Other figures calculated as nine month data * 4/3 to annualize.
GNP Data from US Dept. of Commerce/Bureau of Economic Affairs /2006 through September.

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

		Number 1	Number 2	Number 3	Number 4	Number 5	Number 6	Number 7
		State			St			
	INDUSTRY	Farm	AIG	Allstate	Paul/Trav	Berk Hath	Nationwide	Progressive
	NET							
YEAR	INCOME	Loss Ratio	Loss Ratio	Loss Ratio	Loss Ratio	Loss Ratio	Loss Ratio	Loss Ratio
1987	$10.0	66.4%	71.6%	70.9%	64.1%	64.9%	72.7%	48.8%
1988	$12.3	70.6%	69.1%	71.0%	62.8%	66.2%	70.2%	52.1%
1989	$7.2	78.8%	67.7%	72.9%	65.6%	69.2%	72.7%	53.6%
1990	$8.0	77.4%	64.8%	75.2%	64.6%	93.8%	73.1%	48.9%
1991	$8.9	72.1%	68.9%	73.2%	65.2%	112.6%	69.6%	50.4%
1992	-$2.7	83.6%	71.0%	87.2%	74.9%	91.9%	73.6%	55.4%
1993	$10.5	70.4%	69.8%	68.3%	63.6%	70.4%	65.7%	52.9%
1994	$10.9	77.5%	69.9%	75.5%	64.1%	91.5%	66.3%	54.8%
1995	$20.6	70.8%	64.5%	66.8%	61.4%	67.9%	74.1%	61.8%
1996	$24.4	67.5%	66.6%	64.6%	69.2%	66.7%	71.2%	59.5%
1997	$36.8	60.4%	66.5%	58.2%	60.7%	62.5%	61.4%	57.7%
1998	$30.8	65.6%	68.0%	54.4%	64.9%	62.0%	64.8%	55.2%
1999	$22.0	67.8%	68.5%	59.6%	60.2%	77.7%	66.5%	62.3%
2000	$20.5	74.8%	65.3%	62.4%	61.8%	78.0%	73.5%	69.6%
2001	-$6.7	83.4%	71.9%	65.7%	74.9%	98.9%	68.4%	59.3%
2002	$9.1	74.7%	74.2%	62.8%	80.4%	69.0%	59.6%	57.4%
2003	$31.2	63.3%	64.3%	58.4%	60.0%	56.4%	58.2%	54.1%
2004	$40.5	60.2%	70.0%	57.0%	65.1%	58.6%	59.3%	51.9%
2005	$48.8	66.6%	72.2%	64.6%	60.0%	77.5%	58.0%	54.9%
2006	$59.9	NA	50.9%	43.5%	46.8%	56.1%	NA	53.1%
	87-05average	0.71152632	0.68673684	0.66773684	0.65447368	0.75563158	0.67310526	0.55821053

Source: Best's Aggregates and Averages, 1988 to 2006 Editions

Notes: Net Income is after tax and includes all investment income. 2006 estimated at 4/3* 9-months results from ISO.
Top ten 2006 P/C groups are displayed
Loss Ratio is pure losses incurred to be paid to consumers, not LAE
St. Paul and Travelers data is combined in the years before 2004.
Dollars in billions
2004 data for AIG estimated based upon Loss and LAE ratio of 77.6%.
2006 data: From published reports on insurer web sites - Mutual Insurers do not report quarterly
AIG 9 mos Loss and LAE = 64.1% less 2005 LAE Ratio of 13.2%
Allstate 9 mos Loss and LAE = 57.8% less 2005 LAE Ratio of 14.3%
St. Paul Travelers 9 mos Loss and LAE = 59.9% less 2005 LAE Ratio of 13.1%
Berkshire Hathaway 9 mos Loss and LAE = 56.8% (estimated) less 2005 LAE Ratio of 9.5%
Progressive 9 mos Loss and LAE = 66.3% less 2005 LAE Ratio of 13.2%
Hartford 9 mos Loss and LAE = 64.2% less 2005 LAE Ratio of 11.0%
2006 Data for 10 companies conservatively assumed based upon the data from 6 stock companies

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

		Number			10	10	Average	6 Stock	
Number 8	Number 9	10		Simple	Company	Company	L/R	Co	
Liberty				Loss	5 yr	3 yr		5 yr	
Mut	Farmers	Hartford		Ratio	moving	moving	Top 6	moving	
				Top			Stock		
Loss Ratio	Loss Ratio	Loss Ratio	YEAR	10 L/R	Average	Average	Cos	Average	YEAR
82.7%	67.9%	63.2%	1987	67.3%			63.9%		1987
83.1%	68.9%	63.4%	1988	67.7%			64.1%		1988
85.8%	74.5%	65.5%	1989	70.6%		68.6%	65.8%		1989
84.3%	75.6%	68.9%	1990	72.7%		70.3%	69.4%		1990
83.9%	75.5%	69.2%	1991	74.1%	70.5%	72.5%	73.3%	67.3%	1991
85.2%	73.6%	67.4%	1992	76.4%	72.3%	74.4%	74.6%	69.4%	1992
82.2%	68.2%	63.3%	1993	67.5%	72.2%	72.6%	64.7%	69.5%	1993
73.5%	85.7%	64.8%	1994	72.4%	72.6%	72.1%	70.1%	70.4%	1994
72.9%	75.2%	65.9%	1995	68.1%	71.7%	69.3%	64.7%	69.5%	1995
72.3%	65.6%	78.3%	1996	68.2%	70.5%	69.5%	67.5%	68.3%	1996
72.6%	62.0%	62.3%	1997	62.4%	67.7%	66.2%	61.3%	65.7%	1997
75.5%	64.9%	61.6%	1998	63.7%	67.0%	64.8%	61.0%	64.9%	1998
73.4%	68.5%	61.8%	1999	66.6%	65.8%	64.3%	65.0%	63.9%	1999
74.8%	72.4%	60.0%	2000	69.3%	66.0%	66.5%	66.2%	64.2%	2000
85.2%	74.7%	66.1%	2001	74.9%	67.4%	70.2%	72.8%	65.3%	2001
68.1%	62.4%	60.1%	2002	66.9%	68.3%	70.3%	67.3%	66.5%	2002
64.0%	59.0%	79.9%	2003	61.8%	67.9%	67.8%	62.2%	66.7%	2003
63.9%	56.8%	58.2%	2004	60.1%	66.6%	62.9%	60.1%	65.7%	2004
60.9%	56.9%	56.0%	2005	62.8%	65.3%	61.5%	64.2%	65.3%	2005
NA	NA	53.2%	2006	52.0%	60.7%	58.3%	50.6%	60.9%	2006
0.76015789	0.68857895	0.65047368							

Addendum C: Reprinted from the Los Angeles Times, November 28, 2006

Insurance company cutbacks have left more than 1 million coastal residents scrambling to land new insurers or learning to live with weakened policies. As insurers retreat, states and homeowners are left to bear the biggest risks.

Massachusetts

During the last two years, six insurers have stopped selling or renewing policies along the coast, especially on Cape Cod, leaving 45,000 homeowners to look for coverage elsewhere. Most have turned to the state-created insurer of last resort. The Massachusetts FAIR Plan, now the state's largest homeowners insurer, recently received permission to raise rates 12.4 percent.

Connecticut

Atty. Gen. Richard Blumenthal has subpoenaed nine insurance companies to explain why they are requiring thousands of policyholders whose houses are near any water —coast, river or lake —to install storm shutters within 45 days or have their coverage cut or canceled.

New York

Allstate has refused to renew 30,000 policies in New York City and Long Island, and suggested it may make further cuts. Other insurers, including Nationwide and MetLife, have raised to as much as 5 percent of a home's value the amount policyholders must pay before insurance kicks in, or say they will write no new policies in coastal areas.

South Carolina

Agents say most insurers have stopped selling hurricane coverage along the coast. Those that still do have raised their rates by as much as 100 percent. The state-created fallback insurer is expected to more than double its business from 21,000 policies last year to more than 50,000.

Florida

Allstate has offloaded 120,000 homeowners to a start-up insurer and has said it will drop more as policies come up for renewal. State-created Citizens Property, now the state's largest homeowners insurer with 1.2 million policies, was forced to use tax dollars and issue bonds to plug a $1.6- billion financial hole due to hurricane claims. The second-largest, Poe Financial Group, went bankrupt this summer, leaving 300,000 to find coverage elsewhere. The state also has separate funds to sell insurers below-market reinsurance and cover businesses. Controversy over insurance was a major issue in this fall's election campaign, causing fissures in the dominant GOP.

Louisiana

The state's largest residential insurer, State Farm, will no longer offer wind and hail coverage as part of homeowners policies in southern Louisiana. In areas where it still covers these dangers, it will require homeowners to pay up to 5 percent of losses themselves before insurance kicks in. In a move state regulators call illegal and are fighting, Allstate is seeking to transfer wind and hail coverage for 30,000 of its existing customers to the statecreated Citizens Insurance.

Texas

Allstate and five smaller insurers have canceled hurricane coverage for about 100,000 homeowners and have said they will write no new policies in coastal areas. Texas' largest insurer, State Farm, is seeking to raise its rates by more than 50 percent along the coast and 20 percent statewide.

California

The state has bucked the trend toward higher homeowners insurance rates with three major insurers, State Farm, Hartford and USAA, seeking rate reductions of 11 percent to 22 percent. Regulators have begun to question whether insurers are making excessive profits after finding that major companies spent only 41 cents of every premium dollar paying claims and related expenses. Alone among major firms, Allstate is seeking a 12.2 percent rate hike.

Washington

Allstate has dropped earthquake coverage for about 40,000 customers and will have its agents offer the quake insurance of another company when selling homeowners policies in the state. Nationally, the company has canceled quake coverage for more than 400,000.

Sources: Risk Management Solutions (map); interviews with state insurance regulators

NOTE: Since the Los Angeles Times *ran this recap of actions on the coasts, Allstate has announced it will stop writing new homeowner's insurance policies in many areas near the coast, including the entire state of Connecticut, the entire state of Delaware, and large portions of Maryland and Virginia. In California, several additional insurers have announced that they will be reducing rates. Regulators have begun to question whether insurers are making excessive profits after finding that major carriers have spent only 41 cents of every premium dollar paying claims and related expenses. Alone among major companies, Allstate is seeking a 12.2 percent rate hike, although the state insurance commissioner has suggested that the company may be required to lower rates and issue refunds for past overcharges instead. Regulators in California have more authority to question rates than in other states under Proposition 103, the voter-approved regulation system.*

Addendum D: 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, subsidies 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.