

# **SPECIAL COMMISSION TO REVIEW THE CURRENT STATE OF THE HOMEOWNERS INSURANCE MARKET IN THE COMMONWEALTH**

## **Dissent**

While we concur with many of the recommendations of the Commission, we believe that while the Commonwealth explores the adoption of a catastrophe fund, and begins to build the equity such a fund will need to replace private reinsurance in our homeowner marketplace, it is imperative that we take immediate steps to protect consumers beyond those endorsed by the majority of the Commission. These additional steps are outlined below.

**Capping System for FAIR Plan Rates-** The FAIR Plan provides homeowners insurance for consumers who cannot obtain insurance from private companies in the Massachusetts marketplace. As consumers often have no other choice but to purchase insurance from the FAIR Plan, the legislature imposed certain rate caps on FAIR Plan premiums, to assure that consumers are not faced with immediate year to year rate shock. These caps are necessary protections for vulnerable citizens; they should be clarified and enforced.

The FAIR Plan has urged the Commissioner of Insurance to ignore the existing rate caps entirely, citing 2004 legislation that added catastrophe risk and reinsurance costs as considerations for the Commissioner's approval or disapproval of FAIR Plan rates. Last year, ex-Commissioner Bowler agreed with the FAIR Plan and allowed the FAIR Plan to raise its rates by 25% for dozens of coastal communities. While the Attorney General is currently litigating this issue on behalf of consumers, and has asked the Supreme Judicial Court to order application of the caps, further legislative clarification that the caps are mandatory is important for consumers.

This year, the FAIR Plan has asked for another 25% rate increase for coastal communities, and its proposed rate request indicates that it is very likely that they will ask for an additional 25% next year, for at least some towns and cities. Legislative action to ensure the application of a cap is imperative if we are to keep homeowner insurance affordable for those who cannot obtain it in the voluntary marketplace. Until we can stabilize the home insurance market, the FAIR Plan safety net must have a working cap.

*Therefore, we recommend that the Legislature clarify that the current cap system is mandatory and must be used by the FAIR Plan in making its rate requests.*

**Catastrophe Modeling-** Many insurance companies rely on undisclosed catastrophe models to justify substantial rate increases in coastal territories. The Commission's Report does not go far enough to ensure that these models receive the review necessary to determine their accuracy or reliability. Thus, we recommend the creation of a public hurricane model in order to (1) allow the Attorney General to properly challenge homeowner rate increases before the Division of Insurance, and

(2) make available to private market insurers a fairer and more transparent model for purposes of computing hurricane risk in Massachusetts.

In the FAIR Plan rate proposal currently before the Commissioner of Insurance, the FAIR Plan bases much of its 25% rate increase request on hurricane models predictions that purport to estimate the risk of a hurricane hitting the Massachusetts coast. However, key data and underlying calculations of the model have never been shared with Commissioner of Insurance, who must approve the rate request, or the Attorney General, who intervenes in FAIR Plan rate proceedings on behalf of the consumer. In the current rate case, the FAIR Plan was ordered to produce the workings and data used in the models, but it refused to do so. The Attorney General has filed a motion for sanctions against the FAIR Plan on this issue, and that motion is currently pending before the Commissioner of Insurance.

Numerous questions have been raised regarding the validity of the use of hurricane models in New England. While many key details of the workings of the models remain secret, it is clear from the limited data available that (1) the two major models adopted by the FAIR Plan vary widely in their predictions, (2) one of the nation's leading hurricane experts has testified that the frequency and intensity distribution of New England hurricanes in one of the models is inconsistent with historical data, and (3) the models have not been calibrated to Massachusetts conditions. In addition, consumer advocates have raised concerns that the private modelers may be in a 'race to the top,' in which the modeler that can produce the highest predictions will be the one most likely to win insurance company business. Such incentives cast further doubt on the validity of models whose inner workings are kept secret from the public and from decision makers.

If insurers are going to rely on models in their rate filings, then there needs to be additional procedural protections put in place. First, the FAIR Plan must not be allowed to use a model in support of its rate filing unless that models' underlying formulas and calculations are fully disclosed to the Attorney General at least six months in advance of any rate filing. While public disclosure would be preferable, further disclosure of the model could be limited if the Commissioner were to find that such a ruling was in the public interest.<sup>1</sup>

Second, the Attorney General needs to be able to provide an alternative to the private models in the FAIR Plan rate cases. Such an alternative would allow the Commissioner to consider different possibilities for an approvable rate, and it would help put into perspective the FAIR Plan's own proposal. In order to ensure that the Attorney General can both fully inspect the industry's model and make an alternative choice available for review, we propose that the Attorney General receive funding to work with experts and create a public model for calculation of hurricane risk.<sup>2</sup> This model, unlike the industry models, would be completely transparent and would be open for public

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<sup>1</sup> We believe that similar requirements should also be considered for insurer rate requests in the private market.

<sup>2</sup> This public model can be developed at the University of Massachusetts.

inspection. It would also be available for use by both the FAIR Plan and private insurers should they choose to adopt it themselves.

The Commission recommends creation of an independent public entity that will further study private models and report its findings to the legislature. This will not actually change anything regarding the rates consumers will pay in the near future. Should the legislature choose to act on such a report, consumers may at that future time see some benefit from this new entity's work. But that is not a sufficient solution to the current problem. To the extent that this public entity is envisioned to have the power to approve models, we do not believe this will be an effective remedy to the Hurricane Model problem. In fact, it may make the problem worse, depending the content and funding (or lack of funding) of the entity. An entity that may be dominated by those in the insurance or modeling industry, or insufficiently funded to permit service by independent qualified members without industry ties may be unable to properly explore the functioning of the models.

Moreover, if the Commonwealth were to adopt an entity such as a Hurricane Model Review Board, creation and funding for a public model is essential. Only if there is a viable public model, built in an open fashion from its inception, will there be a fair and proper comparison for how an industry-proposed model will function. Without such a comparison, it is unclear how the Board would determine whether a model functioned well enough to be loaded into homeowner insurance rates.

Finally, if the Board incompletely reviews, or fails to identify errors or shortcomings in a model, any "approval" of that model by the Board may make flawed models less subject to scrutiny in proceedings such as the FAIR Plan rate case. If Massachusetts creates a Modeling Board and the Board approves a model, consumers may find themselves with higher rates and little recourse.

*For these reasons, we recommend the legislature create a public model for use by the Attorney General in rate hearings before the Division of Insurance. We also recommend that the FAIR Plan (and, potentially, any insurer relying on a model) should fully disclose each model relied upon for rate purposes to the Commissioner of Insurance and the Attorney General at least 6 months prior to the proposed effective date of any rate filing.*

**Other Issues-** In addition to the matters noted above and some of the matters identified by the Commission as worthy of further study, we believe the following additional recommendations will help to address the affordability of homeowners insurance in Massachusetts:

Credits for Mitigation: Credits or premium discounts for those who undertake storm mitigation work on their homes should be required. By improving the stability of their houses, such homeowners are lessening the likelihood of significant storm damage.

Protections Against Appraisal Inflation: We also believe some action is necessary to stop the anti-consumer practice of appraisal inflation. Numerous homeowners testified to the Commission regarding a disturbing phenomenon- - their insurance companies suddenly applied very significant adjustments to the homeowner's purported property value, often at odds with town assessment values or other indicators of replacement costs. These actions may reflect efforts to effectively raise rates further than the companies are authorized to do so by the Commissioner of Insurance, or they may simply reflect the desire of the insurer to hedge better against the risk of loss. Either way, significant changes are disruptive to consumers, especially when the assessments are made at the time of a renewal (when a consumer has little time to shop for additional insurance) or after renewal (when the consumer has already been enticed by a proffered rate, only to then have a much higher premium applied to the consumer's home). The problem is even worse for FAIR Plan customers, who have nowhere else to go for insurance.

To prevent this problem, we recommend that consumers whose appraisal has changed more than 5% in a given year be entitled to obtain an independent appraisal and submit the issue for review to a Board of Appeal. If the Board agrees with the consumer's appraisal, the insurer will be required to write the policy at that appraised value, and pay the costs of the consumer's appraisal.

Reasonable Deductibles: In order to ensure that consumers are offered the choice of fuller coverage or relatively lower premiums, insurance companies with a mandatory deductible over 1% of the Home value should be required to offer insurance with a 1% deductible as an alternative.

Improved Information: We also recommend that the Commissioner of Insurance list the combined ratio of each insurance company that sells homeowners insurance in Massachusetts in her Homeowners Report. Although she currently includes the companies' loss ratios, the combined ratio is a more reliable indicator of a company's health. This information is necessary to gauge the success of insurers in Massachusetts; insurers' profitability should not be kept secret.

Insurer Insolvency: We also believe that further study should be directed at the issue of insurer solvency. A critical potential problem in homeowner insurance is whether and how insurance companies will weather a significant hurricane. If insurers enter the Massachusetts market via undercapitalized shells, or need not set aside an appropriate amount of surplus to protect against FAIR Plan assessments and other claims, this can have catastrophic effects on our homeowners marketplace. Even with a catastrophe fund, this is an important matter to consider. We would recommend that a further study group be convened to look specifically at this issue and to recommend statutory guidelines reflecting the need for stringent insurer solvency requirements.

Review of Voluntary Market Insurance Rate Proposals: Finally, we recognize that not only FAIR Plan customers are faced with unprecedented rate increases. Some private insurers have also greatly increased their rates. In the current market conditions,

consumers often have few or no places to turn (aside from the FAIR Plan), when faced with these additional costs. Currently, rate filings are often neither affirmatively approved, nor disapproved, and simply come into effect. In order to ensure that insurers have support for their proposed increases, we recommend that, as in auto insurance, workers compensation insurance, and Medicare Supplement insurance, there either be a mandatory rate adjudication under certain circumstances and/or that the Attorney General be authorized to trigger a rate hearing for private market homeowner insurer filings. Such a trigger could apply in all instances, or only when the average rate increase exceeds a set percentage. Either way, such a consumer protection would be invaluable for homeowners in the Commonwealth.