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Hurricane Risk and the Regulation of Property Insurance Markets

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Working Paper #2009-11-01

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July 27, 2009

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Note: The author expresses his appreciation for the support and assistance provided by the Wharton Extreme Events Project. The author also wishes to acknowledge the assistance of Natalai Hughes in performing research that was used in this paper. Of course, the opinions expressed in this paper are solely those of the author and do not necessarily represent the opinions of any other person or organization.

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Abstract

This paper analyzes the regulation of property insurance markets in selected Southeastern coastal states subject significant risk from tropical storms and hurricanes. The severe storm seasons of 2004-2005 and subsequent actions by insurers raised a number of issues and prompted a range of government reactions in various states. The 2006 and 2007 seasons were relatively quiet but hurricanes returned with a vengeance in 2008 and reaffirmed the region's image as a locus of storm activity. This paper examines and compares regulatory policies in Alabama, Florida, Louisiana, Mississippi, South Carolina and Texas. All of these states are dealing with similar issues at one level but their specific circumstances and policies also vary. The evidence suggests that Alabama, Louisiana, Mississippi and South Carolina have taken a less restrictive approach to regulation than Florida and Texas. Of the six states, Florida and Louisiana face the greatest problems because of the large size of their coastal areas in relation to their statewide markets. Hence, their different approaches to regulation are of interest in terms of there motivations and effects.

I. Introduction

The severe storm seasons of 2004-2005 and subsequent actions by insurers (e.g., rate increases, reductions in coastal exposures, etc.) have raised a number of issues and prompted a range of government reactions in various states. The occurrence of two consecutive multi-event years rattled insurers and reinsurers and prompted them to significantly raise their assessment of hurricane risk in Gulf and Atlantic coast states. The 2006 and 2007 seasons were relatively quiet and the lack of hurricanes provided a welcome but short-term respite (see Klein, 2009a). Losses from the 2008 Gulf Coast hurricanes were significant (estimated to be approximately $11 billion) and reaffirmed insurers' concerns about the high risk of hurricanes in the region.[1]

The loss shocks and recalibration of hurricane risk after 2005 was followed by a number of market adjustments. These adjustments included substantial rate hikes, retrenchment from high-risk coastal areas, and increases in wind/hurricane deductibles, among other actions. The evidence suggests that Florida experienced the greatest market changes followed by Louisiana and Texas (Klein, 2009a).

These market developments have placed insurance regulators (and legislators) in a difficult position. They face considerable pressure to keep insurance "affordable" and "available." If they impose excessive constraints and mandates on insurers, this can induce insurers to further reduce the supply of insurance and exacerbate availability

[1] Estimates of the losses caused by Hurricanes Gustav and Ike vary depending on their source and the way they are calculated. The $11 billion figure refers to insured losses incurred by US insurance companies. Munich Re has issued estimates of $15 billion for Hurricane Ike and $5 billion for Hurricane Gustav. These estimates include losses insured by the National Flood Insurance Program (NFIP).

problems. Hence, regulators must balance efforts to restrain insurers' actions with the need to preserve private insurance markets and restore them to a sustainable equilibrium.

The regulation of insurance companies and insurance markets plays a prominent role in the management of catastrophe risk. Each state exercises considerable authority over insurers' entry and exit, financial condition, rates, products, underwriting, claims settlement and other activities (Klein, 1995 and 2005). Regulatory constraints and mandates in these areas can have significant implications for how property insurance markets function and on property owners' incentives to control their risk exposure. Ultimately, regulators cannot dictate market outcomes but their policies can either support more efficient insurance markets or create problems and distortions.

This paper analyzes and compares the regulation of property insurance markets in six Southeastern states – Alabama, Florida, Louisiana, Mississippi, South Carolina and Texas. All of these states are dealing with similar issues at one level but their specific circumstances and policies also vary. Hence, insights can be drawn from this comparison regarding what motivates different regulatory policies and how they affect market outcomes.

This analysis indicates that, since 2005, the regulation of property insurance in the hurricane-prone Southeastern states has undergone significant changes, but the changes differ among the individual states. It is interesting to note that in their efforts to balance consumer and industry interests after similar catastrophe experiences, Louisiana and Florida have moved in opposite directions in their regulatory approaches. Louisiana has taken a less restrictive approach to regulation to facilitate a more competitive market while Florida is imposing greater regulatory constraints on insurers' rating and underwriting activities and is implementing measures that have suppressed the supply of insurance in the voluntary market. It appears that Louisiana also has taken a less restrictive approach to regulation than Texas. Regulation has tended to be more benign (on the whole) in Alabama, Mississippi, and South Carolina, but these states are facing less market pressure and their coastal areas represent smaller portions of their statewide markets. Florida is experiencing the negative consequences of its regulatory policies (causing the Legislature to rethink some of these policies) while Louisiana's policies may be preventing more severe market disruptions. Regulation in the other states affects market conditions in coastal areas but its statewide impact is less significant.

Arguably, even under the most accommodating regulatory policies, the timing and extent of market restoration will be affected by other factors and are uncertain.[2] There may be a limit to the amount and types of property exposures that private insurers will underwrite in high-risk coastal areas. National insurers may continue to constrain the amount of high-risk exposures they are willing to assume. New insurers are coming into the market but these companies tend to be relatively small with limited geographic diversification. These companies can supplement their internal capacity by buying reinsurance but there are limits to how much reinsurance they can purchase. Hence, their ability to fill the gap left by other insurers is also constrained although, barring significant hurricane losses, their capacity should continue to grow over time (to the extent they retain earnings to increase their surplus). It should note that further development in coastal areas will increase the demand for insurance and add to the pressure on these markets.

[2] This paper is one of a series that address different aspects of catastrophe risk in the Southeast.

The next section of this paper reviews the government framework that overlays property insurance markets which includes but is not limited to insurance regulation per se. Subsequent sections examine the regulation of rates, policy forms, underwriting, marketing/distribution, and claim adjustment. Other topics discussed include the financial regulation of insurance companies and hazard mitigation efforts and their implications for catastrophe risk and insurance markets. The final section offers a summary and conclusion and discusses further research.

II. Overview of the Institutional Framework for Government Intervention

A number of government institutions and policies affect property insurance markets and the management of catastrophe risk. The regulation of insurers and insurance markets is a principal area of attention and the primary focus of this report but it is important to identify other elements of the governmental framework. These different elements interact and policies in one area can affect the objectives for other areas. Ideally, the full range of government institutions and policies should be coordinated to achieve the best possible outcomes in terms of the performance of insurance markets and efficient catastrophe risk management.[3]

A. Legislative, Regulatory and Judicial Roles and Authorities

An extensive institutional structure has been developed to perform insurance regulatory functions in the US. This institutional structure is primarily based within the

[3] See Klein (1995) and Klein (2005) for a detailed review of US insurance regulation.

insurance departments of each state and their respective laws and regulations, policies, procedures, and resources. In addition, the National Association of Insurance Commissioners (NAIC) serves as a vehicle for individual state regulators to coordinate their activities and share resources to achieve mutual objectives. Further, state legislatures and state and federal courts play important roles in the overall regulatory structure. The federal government also has selectively intervened in certain aspects of insurance regulation.[4] This section reviews the roles and authorities of the branches and levels of government that together determine how insurers and markets are regulated.

Each of the 50 states, the District of Columbia and the five US territories has a chief government official who is responsible for regulating insurance companies and markets. This official has the authority and responsibility to ensure that insurance companies do not incur excessive financial risk nor treat policyholders unfairly. More specifically, insurance commissioners oversee insurers' admission and licensing; solvency and investments; reinsurance activity; transactions among affiliates; products; prices; underwriting; claims handling; and other market practices. Regulators also oversee producer licensing and their market practices along with certain other areas related to insurance company and market functions. However, it should be understood that insurance commissioners' authority is limited in some respects and that various other public and private institutions are part of the insurance regulatory system. Regulators

[4] The McCarran-Ferguson Act (enacted in 1945) still serves as the principal federal statute that establishes the framework for state and federal roles in regulating insurance. The Act delegates most of the regulatory authority to the states but also retains the authority of the federal government to supersede state regulation where it specifically chooses to do so. Over the years, the federal government has imposed laws and policies in certain areas and could do so in the future. Legislation to create an optional federal regulatory charter for insurers has been introduced but has not been enacted. Other legislation has been introduced to establish a federal insurance and/or reinsurance program for natural catastrophes and other proposals have been introduced or discussed.

operate within a broader governmental framework that influences and constrains their actions.

Commissioners can exert considerable influence with respect to insurers' conduct through the admission and licensing process. Insurers who fail to comply with regulatory requirements are subject to losing their authorization to sell insurance through the suspension or revocation of their license or certificate of authority. Commissioners may exact fines for regulatory violations that serve as a further financial inducement for compliance. Commissioners also may intervene and seize companies that are deemed to be in hazardous financial condition. Other rules and regulatory actions can constrain or impose mandates on insurers' rates, products and market practices.

These measures give regulators considerable leverage in compelling insurers to comply with insurance laws and regulations. Regulators may try to use this leverage in compelling insurers to offer catastrophe coverage under more favorable terms to property owners. In addition, insurance commissioners can exercise public and political influence in their visible role as consumer protectors and insurance experts. The governor and legislature typically look to the insurance commissioner for guidance on key policy issues and legislation but they can choose to enact laws counter to regulators' preferences that regulators are required to enforce.

Private insurers also have options. Ultimately, they can fully withdraw from a state if forced to take this action. Also, an insurer exiting the homeowners insurance market in a state may elect to exit other lines because total withdrawal may be necessary from a business perspective. However, in considering withdrawal from a state, insurers will balance various considerations, such as exit costs, their overall profitability in writing multiple lines of insurance, and their expectations regarding how and when regulatory policies and market conditions may change for better or worse.[5] In private insurance markets where consumers can choose among multiple insurers, it is difficult for regulators to enforce significant cross-subsidies (from low to high-risk insureds) over a sustained period. Further, insurers can respond to regulatory policies affecting one area, e.g., rates, by making changes in other areas, e.g., underwriting, quality of service, etc.

Hence, insurance commissioners are neither autonomous nor omnipotent and face a number of constraints in exercising their authority. Most important, regulators must act within the framework of insurance laws enacted by the legislature. Regulations promulgated by the commissioner can be subject to review and approval by the legislature. Regulatory actions are also subject to review and enforcement by the courts. Further, legislatures can enact laws and the courts can issue rulings that supersede the regulatory policies of insurance commissioners.[6] Hence, while regulators can exert considerable power and influence over insurers, producers and insurance markets, they are subject to various checks or overrides that can ultimately determine what regulatory policies will be and how those policies will affect market outcomes.

B. Overview of Insurance Regulatory Responsibilities

For the purpose of this paper, insurance regulatory responsibilities are divided into two primary categories: 1) financial regulation; and 2) market regulation. These areas are discussed in greater detail below. In theory, financial regulation seeks to protect policyholders by limiting the risk that insurers will be unable to meet their financial

[5] Klein (2009a) documents insurer withdrawals from Florida and the other target states.
[6] One example of this is the Florida legislature's enactment of a moratorium on policy terminations following Hurricane Andrew. Louisiana and Mississippi imposed similar moratoriums after Hurricane Katrina.

obligations because of financial distress or insolvency. Market regulation, in its idealized form, attempts to ensure fair and reasonable insurance prices, products and trade practices. Insurance producers (i.e., agents and brokers) also are subject to regulation. Financial and market regulation are inextricably related and must be coordinated to achieve their specific objectives. Regulation of rates and market practices affects insurers' financial performance and financial regulation constrains the prices and products insurers can reasonably offer. The balancing of market and financial regulatory objectives is especially relevant to catastrophe risk – less stringent solvency requirements can increase the supply of insurance but insurers "on the margin" can be exposed to greater default risk.

All US insurers are licensed in at least one state and are subject to financial and market regulation in their state of domicile as well as all other states in which they are licensed to sell insurance. In markets that are not adequately served by licensed insurers, some US and non-US insurers write certain specialty and high-risk coverages on a non-admitted or surplus lines basis. The transactions of non-admitted insurers are exempt from price and product regulation. This is intended to provide non-admitted insurers greater flexibility in providing insurance coverage which is difficult to obtain from licensed insurers. It is also presumed that buyers in surplus lines markets are more sophisticated and, therefore, better able to protect their own interests. States can control the entry of surplus lines carriers by imposing minimum solvency and trust requirements and supervising surplus lines brokers. Surplus lines regulation is pertinent to catastrophe risk issues as some coastal states are looking to non-admitted insurers to supplement the supply of property insurance from licensed carriers.

With the exception of financial oversight by their domiciliary jurisdiction, reinsurers are not generally subject to direct financial and market regulation. Reinsurers are, however, regulated indirectly through the states' regulation of the primary insurers that are ceding risk to reinsurers. Regulators control whether a ceding insurer can claim credit for reinsurance on its balance sheet, which historically has been conditioned on whether the reinsurer is regulated in the US or alternatively posts collateral to back up its liabilities if it is a foreign reinsurer.[7] Stiffer rules on when insurers can obtain credit for reinsurance can affect their capacity to handle catastrophe risk and supply insurance.

Market regulation encompasses a number of different aspects of insurers' activities, including but not limited to:

- Rates (including the use of catastrophe model results);
- Policy forms/terms (e.g., deductibles, excluded perils, etc.);
- Underwriting practices (ability to decline or restrict coverage);
- Marketing and distribution; and
- Claims adjustment.

Each of these areas are discussed in detail below beginning with a general description of the regulatory function followed by an evaluation of specific policies in the selected states.

[7] The NAIC recently adopted a revised framework determining collateral requirements for reinsurers. This new framework may ultimately help to expand the supply and reduce the cost of reinsurance from foreign reinsurers, although it is unclear as to how and when this framework will be adopted. New York has issued a proposed rule that would ease collateral requirements for foreign reinsurers and Florida regulators have been authorized to do so.

III. Rate Regulation

Rate regulatory systems and policies differ considerably among the states. Some attempt to impose binding constraints on rates while others rely on the market to determine rates. Hence, the degree of regulatory stringency – how much regulators seek to limit overall rate levels or compress rate structures – varies greatly among states (Klein, 1986). In turn, rate regulatory policy and actions can have significant effects on insurance markets. Severe constraints on overall rate levels or compression of geographical rate structures can compel insurers to tighten the supply of insurance which decreases the availability of coverage. Also, these policies can reduce insureds' incentives to optimally manage their risk from natural disasters. Ultimately, it is not feasible to force market outcomes that are greatly at odds with economic reality, e.g., low rates and widely available coverage in the face of very high risk, without the government replacing private insurers as the principal source of insurance coverage.

A. Types of Rate Regulatory Systems

One aspect of rate regulation is the type of rate regulatory system that state law imposes on particular lines of insurance. There are various types of systems which can be divided into two basic categories: 1) "non-competitive rating" (NCR) systems; and 2) "competitive rating" (CR) systems (NAIC, 2008). In non-competitive rating systems, regulators have more explicit authority over rates, but may choose not to constrain rates below market levels. In competitive rating systems, in theory, regulators essentially rely on the market to set prices and do not attempt to constrain rates but, in practice, they may seek to do so.

Table III.1 shows the type of rating system in each state for homeowners insurance. Six types of rating systems are reflected in the table. Under a prior approval system, insurers must file and receive approval of their rates from regulators before they can be put into effect. Under a flex rating system, rate changes that fall within certain bounds (e.g., a 10 percent change) are typically subject to a file-and-use or a use-and-file requirement (defined below); rate changes that exceed the bounds are subject to prior approval. Under a "modified prior approval" system, insurers are required to obtain prior approval only for rate changes due to changes in expense or profit loads or that affect rate differentials between risk classifications. Prior approval systems are generally placed into the NCR category. Flex rating systems fall into a gray area and their categorization can be a matter of choice that could depend on the tightness of their bounds and how they are implemented.

The other three systems are generally placed into the CR category. Under file-and-use systems, insurers are required to file their rates before they put them into effect but are not required to obtain approval of their rates before they are implemented. Under a use-and-file system, insurers can put rates into effect and then file them with regulators at the same time or within a certain designated time frame. Under both systems, regulators can retroactively disapprove rates that have become effective which necessarily requires an insurer to refund all or a portion of rate increases they have implemented. Generally, under a file-and-use system, a regulator can notify an insurer that its rates will be disapproved before they become effective which can preclude the need for refunds. Many states that have file-and-use or use-and-file systems have statutes that require regulators to issue a finding that the market is not competitive in order to disapprove insurers' rates but, as discussed below, regulators can administer these systems to constrain insurers' rates in a manner that effectively replicates a prior approval approach.[8] Finally, one state – Wyoming – does not require insurers to file their rates with regulators.

Table III.1
State Rate Regulatory Systems for Homeowners Insurance

State	System	State	System
Alabama	**Prior Approval**	Montana	File & Use
Alaska	Flex Rating	Nebraska	File & Use
Arizona	Use & File	Nevada	Prior Approval
Arkansas	File & Use	New Hampshire	File & Use
California	Prior Approval	New Jersey	Prior Approval
Colorado	File & Use	New Mexico	Prior Approval
Connecticut	File & Use	New York	File & Use
Delaware	File & Use	North Carolina	Prior Approval
District of Columbia	File & Use	North Dakota	Prior Approval
Florida	**File & Use**	Ohio	File & Use
Georgia	File & Use	Oklahoma	Use & File
Hawaii	Prior Approval	Oregon	File & Use
Idaho	Use & File	Pennsylvania	Prior Approval
Illinois	Use & File	Rhode Island	Flex Rating
Indiana	File & Use	**South Carolina**	**Flex Rating**
Iowa	Use & File	South Dakota	File & Use
Kansas	File & Use	Tennessee	Prior Approval
Kentucky	Flex Rating	**Texas**	**File & Use**
Louisiana	**MPA**	Utah	Use & File
Maine	File & Use	Vermont	Use & File
Maryland	File & Use	Virginia	File & Use
Massachusetts	File & Use	Washington	Prior Approval
Michigan	File & Use	West Virginia	Prior Approval
Minnesota	File & Use	Wisconsin	Use & File
Mississippi	**MPA**	Wyoming	No File
Missouri	Use & File	Source: NAIC, PCIAA, III	

MPA = Modified Prior Approval.

[8] This may be articulated as a two-step process. The commissioner first determines that a market is not competitive and then establishes prior approval authority in that market.

While the types of rating systems are typically placed into one of the two basic categories, one cannot infer how a state actually regulates rates by simply looking at its rating law. Some NCR states may seek to constrain rates below levels that the market would otherwise set and other NCR states may effectively let the market set rates by approving the rates that insurers file. Further, some so-called CR states may employ devices and policies that effectively attempt to constrain rates below what the market would set.

B. Standards and Practices

Essentially all states have similar language in their laws that establish the fundamental standards for insurance rates. These standards are articulated in the associated NAIC model law language excerpted below:

> Rates shall not be inadequate or unfairly discriminatory in a competitive market. Rates shall not be excessive, inadequate, or unfairly discriminatory in a noncompetitive market. Risks may be classified using any criteria except that no risk shall be classified on the basis of race, color, creed, or national origin.

Beyond these basic standards, states may differ somewhat in terms of how they interpret these standards and may have additional statutory language, regulations and other rules that further outline rate requirements. For example, the Louisiana commissioner may consider the following factors in determining whether rates are excessive, inadequate, or unfairly discriminatory:

1. Basic Rate Factors: Due consideration shall be given to past and prospective loss and expense experience within and outside the state, catastrophe hazards and contingencies, events, or trends within and outside the state, dividends or savings to policyholders, members, or subscribers, and all other relevant factors and judgments.

2. Classification: Risks may be grouped by classification for the establishment of rates and minimum premiums. Classification rates may be modified for individual risks in accordance with rating plans or schedules which establish standards for measuring probable variations in hazards or expenses, or both.

3. Expenses: The expense provisions shall reflect the operating methods of the insurer, the past expense experience of the insurer and anticipated future expenses.

4. Contingencies and Profits: The rates must contain a provision for contingencies and a provision for a reasonable underwriting profit and shall reflect investment income directly attributable to unearned premium and loss reserves.

5. Other Relevant Factors: Any other factors available at the time of the rate filing.

The states also promulgate rules governing the processes for rate filings. Certain aspects of these processes tend to be fairly similar among states, but other aspects can differ to some degree. Electronic rate and form filing processes have been implemented in many states with the expectation that these systems will greatly reduce the time in which insurance department staffs, particularly those in prior approval states, will need to review a filing. States vary in terms of whether electronic rate and form filings are mandatory and also in terms of the lines of business for which they are able to accept electronic filings. Most states utilize the NAIC SERFF system for rate and form filings. Florida, however, has its own electronic filing system.

The use of catastrophe model results has also become an issue in the review of property insurance rates since many key details of the workings of the models are considered proprietary and thus not available to the public. In hurricane-prone states, the "catastrophe load" in rates can be substantial and is often based on catastrophe modeling. Consumer advocates have raised concerns that the private modelers may be engaged in a "race to the top," in which the modeler that can produce the highest predictions will secure the most insurer clients. Insurers dispute this allegation and the issue remains contentious. Companies do vary in the models they utilize, which affects their rate indications as well as other aspects of their catastrophe risk management.

Another concern with catastrophe models is that most catastrophe modelers have begun using five-year horizon frequency assumptions (i.e., near-or medium-term event periods depending on the respective catastrophe model) in loss projection calculations and some insurers are using these projections in the development of rates filed in coastal states. Ratings agencies such as A.M. Best, Fitch Ratings and Standard and Poors have increased capital requirements used in the rating process based on near-term model projections (Guy Carpenter, 2006). States, however, differ on the ways in which they have allowed near-term model loss projections to be used in insurer rate filings. Louisiana currently does not allow the use of short or medium-term projections. It also requires insurers and catastrophe modelers to file responses to interrogatories on the catastrophe model used when a rate filing is based on catastrophe model results. The interrogatories must be filed each time a new version of a model is employed. Several other states including Florida, Alabama and South Carolina have published bulletins or developed rules that prohibit or limit the use of near-term model projections in property insurance rates.

Florida also has established a modeling commission which reviews and approves catastrophe models that may be used by insurers in regulatory filings. Insurers can choose to use an approved model in its rate filings or a model that has not been approved. If an insurer uses a non-approved model, it faces a heavier burden of proof in supporting its rate indications to regulators. The Florida commission also has developed a public model to use as a benchmark for assessing other models. Obviously, the commission has not eliminated the controversy over cat modeling, but it would seem to point the way toward a public review and assessment process that should assist regulators. A near-term model has not yet been submitted to the Florida commission for its review and approval.

The NAIC has recently commissioned the development of a catastrophe model. Presumably, the motivation behind this initiative is to provide a public model that can used by various states. How the states will employ this model in their review of insurers' rates and other decisions remains to be seen, but this could result in further challenges to the models used by insurers.

C. Rate Regulatory Stringency

Hence, as noted above, the degree of rate regulatory stringency can vary among states and cannot be determined solely by their rating laws. Stringency is defined as the degree to which regulators attempt to suppress insurers' prices below competitive levels or the prices insurers would charge in the absence of regulatory constraints – the greater the relative difference between the rates that insurers seek to charge and what regulators allow, the more stringent regulation is.[9] For example, a state that allowed insurers to charge only 50 percent of the rate levels or increases they would otherwise implement would be considered more stringent than a state that allowed insurers to charge 90 percent of what the insurers would chose to charge.

[9] Researchers have sought to measure regulatory stringency and its effects in different ways. This research suggests that greater stringency may have some effect on the net price of insurance, at least in the short term, or other effects which tend to have negative effects on consumers (see, for example, Klein, 1986 and Klein, Phillips and Shiu, 2002).

The terms "rate suppression" and "rate compression" are used in this paper with somewhat different meanings. Suppression refers to regulators' attempts to constrain overall rate levels for all classes of insureds. Compression refers to the attempt to constrain rate differentials between different risk classes, e.g., high-risk and low-risk territories for home insurance. Rate compression often results in rate suppression as regulators will typically lower the allowed rating factors for the highest-risk classes while requiring no changes in the underlying base rate or rating factors for the low-risk classes.[10] This ultimately lowers the overall rate level that an insurer can implement.[11]

A number of factors affect regulatory stringency, including but not limited to[12]:

- The degree to which rate regulation is vulnerable to political manipulation. NCR systems tend to be more vulnerable to manipulation although CR systems are not immune from political interference.

- The underlying risk of loss – higher risks and costs tend to put more pressure on legislators/regulators to constrain rates in response to political pressures. Also, regulators are more likely to disapprove large rate increases (higher than 5-10 percent) than small rate increases.

- "Philosophies" concerning regulation and the need to constrain insurers – some states exhibit prevailing philosophies that call for stricter regulation while others may be more willing to allow market forces to determine prices.

- Economic Leverage – the negative consequences of exit from a large market state are greater for an insurer than they are for exit from a small market state. Hence, regulators in large states may seek to extract greater concessions from insurers than regulators in small states.

[10] In theory, insurers might seek to charge higher rates to low-risk insureds to partially or completely offset the effect of constraints on rates for high-risk insureds, but insurers rarely if ever employ this strategy because it would exacerbate adverse selection. In practice, it would be difficult if not impossible for insurers to charge rates for low-risk insureds that would exceed the costs of covering these insureds.

[11] Technically, the change in an insurer's overall rate level is calculated as the exposure-weighted average of the changes in the rates for each rate classification.

[12] Klein (2008) discusses the political economy of regulation in the context of catastrophe risk and factors that can affect regulatory behavior.

- Regulator Selection – there is some evidence that elected regulators are more likely to engage in rate suppression and compression but studies suggest that this has only a small effect.

- Legislation – legislatures enact the laws and often approve regulatory rules and hence can substantially influence regulatory policies.

It is difficult to develop objective empirical measures of regulatory stringency and obtain the data needed to calculate such measures. The author has employed various proxies for regulatory stringency as have others with some success, but the quest continues.[13] This paper presents a more anecdotal discussion of rate regulatory policies. It may be possible to add more objective measures of regulatory stringency in further research. In subsequent work, we also will undertake a broader econometric study of the effects of regulation using a larger set of states.

D. Regulatory Policies in Southeastern States

1. Florida

After Hurricane Andrew, Florida regulators resisted large rate increases in one swipe and only allowed insurers to gradually raise rates over the decade.[14] Initially, this policy worsened supply/availability problems because insurers were concerned about substantial rate inadequacy (Grace, Klein and Kleindorfer, 2004). Over time, as insurers were allowed to further increase rates, these concerns eased although it appears that insurers believed that there was still some compression of rates in the highest-risk areas.

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[13] For example, one proxy that the author has used is the difference between the rate levels that insurers have filed versus the rate levels that regulators have approved (Klein, 1986). Another proxy has been survey-based insurer ratings of the regulatory environment in various states. Both measures are imperfect but some studies have revealed fairly robust results when different stringency measures are tested (see, for example, Klein, Phillips and Shiu, 2002).

[14] This might be labeled as the “sticker-shock” effect. In normal markets, rate increases less than 5 percent tend not to encounter significant resistance. In markets hit by a major hurricane, consumer and regulatory tolerance may even be somewhat greater. However, there is a limit to this tolerance even in markets that have been subject to significant hurricane losses.

By the beginning of 2004, most insurers probably viewed their rates as being close to adequate except in the highest-risk areas and there was not substantial pressure to further increase rates. This began to change after the fourth major hurricane hit the US in 2004.

By 2005, many insurers began to file their first wave of significant rate increases in Florida. The magnitude of the rate increases varied among areas within the state based on insurers' estimates of the inadequacy of their existing rate structures. High-risk coastal areas received much larger percentage increases than low-risk areas. It appears that the initial wave of rate increases were largely approved or allowed to go into effect by regulators as shown in Table III.2. However, as some insurers began to file a second wave of rate increases in the latter part of 2006, they began to encounter greater regulatory resistance. Since 2006, the Florida Office of Insurance Regulation (FLOIR) has generally disapproved filed rate increases by all major insurers.

A combination of growing consumer displeasure over previous rate increases as well as the lack of damaging hurricanes in 2006-2007 likely influenced regulators' resistance to further rate hikes. Florida's escape from singificant losses in 2008 contributed to more of the same in terms of regulatory policies. The further tightening of regulatory policies was foretold in Florida's 2006 elections and was manifested in its 2007 legislative session. In early 2007, Florida enacted legislation which sought to increase regulatory control over rates and roll back rates based on changes in the Florida Hurricane Catastrophe Fund (FHCF). The new legislation expanded the reinsurance coverage provided by the FHCF and insurers were required to reduce their rates to reflect this expansion of coverage which was priced below private reinsurance market rates. This requirement applies even if an insurer does not purchase reinsurance from the FHCF.

Table III.2

Disposition of HO Rate Filings in Florida: 10 Leading Insurers in 2005-2008

	2005			2006			2007			2008		
Company	Filed	Taken	Eff. Date	Filed	Taken	Eff. Date	Filed	Taken	Eff. Date	Filed	Taken	Eff. Date
	8.6%	8.6%	2/1/2006	58.8%	52.8%	8/15/2006	-7.0%	-7.0%	6/1/2007			
				11.9%	0.0%		-1.9%	-1.9%	12/15/2007			
State Farm Florida Ins. Co.				-1.0%	-1.0%	6/1/2007						
	13.3%	13.3%	4/1/2006	2.3%	-3.9%	1/1/2007	-18.2%	-18.2%	1/1/2007			
	16.4%	16.4%	3/1/2006				-10.7%	-10.7%	1/1/2007			
	44.9%	21.4%	1/1/2007				-21.2%	-15.6%	12/31/2007			
	20.4%	12.0%	1/1/2007				-4.7%	-4.2%	12/31/2007			
							-6.6%	-6.6%	1/1/2007			
Citizens Property Ins. Corp.							-14.3%	-14.3%	1/1/2007			
	8.7%	8.7%	8/15/2005				-1.3%	-1.3%	6/30/2007	-4.8%	-4.8%	11/13/20008
	17.7%	16.3%	10/3/2005				-14.2%	-14.2%	6/1/2007			
Allstate Floridian Ins. Co.							43.4%	0.0%				
	5.8%	5.8%	8/15/2005	33.2%	8.2%	2/11/2007	-2.6%	-2.6%	6/30/2007	-5.4%	-5.8%	11/13/2008
	26.1%	24.4%	10/3/2005				-13.2%	-13.2%	6/1/2007			
Allstate Floridian Ind. Co.							27.4%	0.0%				
				0.2%	0.0%		-0.2%	-0.2%	8/1/2007			
							-13.0%	-13.0%	6/1/2007			
Encompass Floridian Ins.							39.7%	0.0%				
				22.8%	0.0%		-0.5%	-0.5%	8/1/2007			
							-11.2%	-11.2%	6/1/2007			
Encompass Floridian Ind. Co.							41.6%	0.0%				
	28.2%	21.0%	9/8/2005	71.4%	51.8%	7/26/2007	-4.5%	-4.5%	6/1/2007			
							-0.5%	-0.5%	7/26/2007			
Nationwide Ins. Co. of FL							-15.2%	-15.7%	10/15/2007			
	10.4%	8.5%	1/1/2006	8.0%	0.0%		-4.4%	-4.4%	9/1/2007			
				8.0%	8.0%	10/1/2006	-0.2%	-0.2%	9/1/2007			
				4.0%	4.0%	1/13/2007	-3.1%	-3.1%	6/1/2007			
				40.0%	16.3%	2/8/2007	-2.9%	-2.9%	6/1/2007			
							51.3%	0.0%				
USAA							180.1%	0.0%				
				9.9%	9.9%	6/15/2006	-8.7%	-12.7%	6/1/2007	0.8%	0.0%	
				16.6%	13.0%	10/26/2006	-0.7%	-3.6%	1/19/2008			
Universal Prop. & Cas. Ins.												
	4.2%	4.1%	10/15/2005	19.4%	41.8%	9/1/2006	0.4%	0.4%	10/31/2007	-0.9%	0.0%	
				-0.3%	-0.3%	3/1/2007	-20.3%	-20.3%	6/1/2007			
							2.9%	0.9%	3/1/2008			
Universal Ins. Co. of NA							-1.1%	-1.1%	5/1/2008			
	22.3%	16.4%	4/11/2005	37.4%	13.3%	2/1/2007	-8.7%	-11.6%	6/1/2007			
Liberty Mutual Fire Ins. Co.	24.9%	25.1%	5/15/2006				9.2%	0.0%				
	15.0%	1.8%	6/1/2005	5.6%	5.6%	11/2/2005	-11.0%	-11.0%	6/1/2007			
				35.2%	35.2%	6/15/2006	-16.6%	-16.6%	6/1/2007			
St. Johns Ins. Co.				22.4%	0.0%		12.1%	11.5%	1/1/2008			
Federal Ins. Co.	1.9%	0.0%		6.0%	6.0%	5/28/2007						

Notes: Filings showing zero Proposed Overall and Final Rates not included. FHCF Recoupment filings may be included.

Some insurers may have more than one program for the Homeowners line of business. Each program may be filed separately.

"Eff. Date" indicates date for which rate change will become effective for renewal business.

Source: Florida Office of Insurance Regulation

Depending upon their pre-2007 position, insurers filed either a rate decrease to comply with the 2007 legislative requirement or a combination of a rate increase (to correct existing rate inadequacies) and a rate decrease. Based on media reports, it appears that regulators challenged some of the filed rate cuts for being too small relative to FLOIR estimates of how much insurers should decrease their rates based on implied FHCF reinsurance cost reductions.[15]

State Farm's experience is illustrative of the challenges faced by some major insurers. In July 2008, State Farm Florida filed a 47.1 percent overall rate increase that was denied by the FLOIR. The Florida Division of Administrative Hearings recommended that State Farm's rate request be denied; further appellate action has upheld this ruling. State Farm contends that it can no longer do business in Florida without the rate increase.[16] State Farm subsequently filed a plan for its withdrawal from the Florida homeowners insurance market which was approved by regulators with certain qualifications. State Farm expects to complete its withdrawal within two years. With more than a 20 percent market share and one million policyholders, State Farm's action will have a significant impact on the state.

The battle between insurers and Florida regulators and legislators continues on other fronts. On January 15, 2008, the Commissioner – Kevin McCarty – announced that he intended to suspend Allstate's license to write new auto insurance policies in the state. McCarty stated that the suspension would remain in effect until Allstate complied with a FLOIR subpoena for information related to its reinsurance program for property insurance and communications with other organizations. Allstate denied that it had failed to comply with the FLOIR subpoena and challenged the suspension in court. Florida

[15] See, for example, "5 Florida Homeowners Insurance Companies Seek Rate Increases," South Florida Sun-Sentinel, June 29, 2007 and "Florida's McCarty Again Rejects Property Insurers' Rates," BestWire, August 14, 2007.
[16] "Florida Judge Rules Against State Farm Rate Increase," *BestWire*, December 15, 2008.

recently lifted the suspension upon reaching agreement with Allstate regarding the submission of documents that the FLOIR had subpoenaed.

In May 2008, Florida enacted legislation to further tighten the regulation of insurers. The legislation replaced its file-and-use rating system with a prior approval requirement (effective in 2009). It also eliminated the state's arbitration program for settling rate disputes. The move to a prior approval system may simply codify what regulators were doing in practice. However, eliminating the arbitration program closes an avenue for resolving rate disputes short of traditional litigation. Together, these measures send another negative signal to insurers and further undermine the supply of private insurance.

The regulatory environment in Florida has had a chilling effect on property insurance markets. It is reasonable to surmise that this environment has caused insurers to reduce their writings in the state to a greater degree than they would if they were allowed to charge the rates they believe are needed. Florida's regulation also could be discouraging entry by new insurers – especially larger companies that are geographically diversified. The FLOIR has reported that 54 insurers have entered the market since 2005 but most of these insurers appear to be small companies.[17] These small entrants are either targeting narrow niches of exposures or writing larger blocks of business (including take-outs from the residual market). Some are concerned about the capacity of small, non-diversified insurers to underwrite relatively large amounts of high-risk exposures.

It is possible that the recent entrants into Florida's market have been given more pricing freedom and/or have been able to work within any pricing constraints they face.

[17] "McCarty: Despite Risks, Insurers Still Investing in Florida Market," *National Underwriter*, July 2, 2009.

Their emergence does not necessarily contradict this assessment of Florida's regulatory policies. Niche insurers can be more selective in their underwriting than larger established insurers and selective underwriting can compensate for broader pricing constraints. However, insurers assuming larger blocks of exposures may or may not be charging adequate rates relative to the risks they are underwriting. An insurer's viability in a coastal state depends on the interaction of a number of factors, including its: diversification/concentration of exposures; surplus; reinsurance; access to capital infusions; pricing; and underwriting, among others.[18]

Still, the full set of Florida's regulatory policies has caused the state to underwrite a substantial portion of its hurricane risk rather than enabling and encouraging private insurers and reinsurers to do so.[19] At the end of 2007, Florida Hurricane Catastrophe Fund (FHCF) had more than $2 trillion in exposures; its total capacity (including borrowing authority) was $27.8 billion. The Florida Citizens Property Insurance Corporation (FCPIC) has approximately $300-$400 billion in exposures (exact figures are no longer published) and it has moved most of its reinsurance from the private market to the FHCF.[20] Together, these two mechanisms have assumed a large amount of catastrophe exposure and could suffer substantial losses in the event of a severe hurricane or multiple hurricanes. Florida officials are becoming increasingly concerned about the potential burdens these entities may impose on the state's consumers and taxpayers. This concern has increased as tight credit markets could hamper the ability of these

[18] In theory, an insurer can use the "cat load" in its premiums to buy reinsurance and build up its surplus in hurricane-free years. However, small single-state insurers cannot take advantage of the broader geographic diversification of larger regional and national insurers. Also, based on a preliminary assessment of the financial reports of the new companies, it is not clear that all are retaining their earnings to bolster their surplus.

[19] Klein (2009b) reviews the increased risk assumed by Florida's government mechanisms.

[20] This little-noticed action effectively transferred a significant amount of catastrophe risk from private markets to the State of Florida.

mechanisms to borrow funds to pay claims if they suffer substantial funding shortfalls. Unfortunately, Florida's "poisoning of the private insurance well" may prove difficult to reverse and its hope for a federal bailout may not be realized.

2. Louisiana

From 2004 to 2007, Louisiana maintained a 10 percent flex-rating system with a 30-day deemer provision. However, unlike any other state, Louisiana had an Insurance Rating Commission (IRC) with prior approval authority on all insurer requests above (or below) the 10 percent band. The need for prior approval by a seven-member governor appointed group was considered a major barrier to a competitive market. Effective January 1, 2008, Louisiana implemented what it terms a modified prior approval system with a 45-day deemer provision.[21] Additionally, the IRC was abolished, vesting all rate regulatory authority with the Louisiana Department of Insurance (LDOI). This has effectively made Louisiana's rate regulatory system less burdensome than it was under the IRC.

The rate regulatory climate appears to be different in Louisiana than in Florida or Texas (discussed below). Louisiana has tended to approve more filed rate increases although it has not approved every filed increase in full. Table III.3 summarizes the disposition of 2005-2008 rate filings by major writers in Louisiana. The majority of rate increases were filed in 2006; there were fewer rate filings in 2007 and 2008. With only a few exceptions, insurers' rate changes have been approved in full.

[21] Lousiana's characterization of its rate regulatory system differs from the NAIC's definition of a modified prior approval system.

It appears that Louisiana regulators have sought to promote a more cooperative atmosphere in terms of negotiating acceptable rate changes with insurers in order to maintain the supply of insurance. While this philosophy may not be warmly embraced by all coastal property owners and legislators, it reflects an acknowledgment of certain economic realities and a desire to avoid an implosion of its private property insurance market. Further, the fact that Louisiana's insurance market is smaller than that of Florida and Texas diminishes its leverage in forcing insurers to accept lower rates.

Table III.3

Disposition of HO Rate Filings in Louisiana: 10 Leading Insurers in 2005-2008

	2005			2006			2007			2008		
Company	Filed	Taken	Action	Filed	Taken	Action	Filed	Taken	Action	Filed	Taken	Action
State Farm Fire And Cas Co	3.1%	3.1%	4/7/2005	3.3%	3.3%	2/24/2006				1.7%	1.7%	4/3/2008
				3.2%	3.2%	5/5/2006				2.1%	2.1%	7/17/2008
				1.8%	Withdrawn	5/5/2006				-2.1%	-2.1%	1/13/2008
				8.0%	8.0%	4/21/2006						
Allstate Ind Co				14.8%	12.6%	4/18/2006						
				9.1%	9.1%	6/28/2006						
				24.9%	24.9%	6/27/2006						
				2.2%	2.2%	5/8/2006						
				5.0%	5.0%	5/5/2006						
				7.6%	7.6%	4/21/2006						
Allstate Ins Co				3.1%	1.4%	4/18/2006						
							31.7%	7.0%	1/17/2007			
Louisiana Citizens Property Insurance							68.2%	68.2%	1/17/2007			
				-0.4%	-0.4%	5/12/2006	-2.7%	-2.7%	10/8/2007			
				-0.1%	-0.1%	5/12/2006	-0.5%	-0.5%	10/8/2007			
Louisiana Farm Bureau Mut Ins Co				49.2%	49.2%	3/15/2006	28.1%	28.1%	5/24/2007			
	-0.2%	-0.2%	6/21/2005	33.4%	33.4%	10/18/2006				9.1%	9.1%	11/17/2008
				9.8%	Disapproved	6/26/2006						
Farmers Ins Exch				-4.7%	-4.7%	2/3/2006						
	-0.2%	-0.2%	3/1/2005	9.9%	9.9%	3/24/2006				2.0%	2.0%	3/13/2008
							13.5%	13.5%	2/13/2007			
Liberty Mut Fire Ins Co												
Standard Fire Ins Co				18.7%	Withdrawn							
	10.0%	10.0%	10/20/2005	46.2%	23.3%	1/18/2006	10.0%	10.0%	3/23/2007			
	-3.5%	-3.5%	5/20/2005									
ANPAC LA Ins Co												
	-0.9%	-0.9%	5/24/2005	8.2%	8.2%	6/1/2006	9.9%	Disapproved	11/27/2007	17.7%	17.7%	10/27/2008
				9.9%	9.9%	5/22/2006	9.9%	9.9%	7/5/2007			
USAA												

Source: Louisiana Department of Insurance "Action" refers to the date when filing is approved, etc.

3. Alabama

In Alabama, property-casualty insurance rates are subject to prior approval by the insurance commissioner. Beyond its prior approval law, there are few restrictions or mandates on insurers with regard to rate making practices. Alabama has initiated several rate filing processes and regulations that are designed to reduce the time in which insurers are able to file-and-use rate changes. The first is a 30-day deemer provision after which a filing is deemed approved and can be used until the Commissioner finds it is unacceptable. Although the deemer provision would seem to encourage a timely review process, it does not always work to that effect. Insurers are hesitant to implement a rate change that has been deemed approved when there is a chance that it can ultimately be disapproved and required to be withdrawn for some reason. The costs involved in implementing rate changes for customers that may later need to be rescinded may discourage insurers from implementing such changes until they are assured that they will be allowed to remain in effect.

Table III.4 summarizes the disposition of rate filings by major writers in Alabama from 2005 through 2008. We do not have information on the original amount of the rate changes that were filed, nor on the impact of the overall rate changes in coastal areas. Based on the information that we were able to acquire, the rate increases that have been approved have ranged in the area of 2-20 percent on a statewide basis with the median increase in the area of 10 percent. These increases appear to be more modest relative to those in Florida but it should be noted that coastal areas in Alabama represent a much smaller portion of statewide rate levels than in Florida.

Alabama has implemented the NAIC SERFF system and made its use mandatory as of November 1, 2007. Regarding the use of catastrophe model results, Alabama has in-house rules that prohibit insurers from filing rates based on near-term loss projections.

4. Mississippi

Mississippi is a prior approval state in which the insurance commissioner has the authority to disapprove property insurance rates within 30 days of an insurer's filing for rate change. Rates must comply with the general insurance ratemaking standards that rates not be excessive inadequate or unfairly discriminatory. Further, any homeowners insurance policy filed with the Commissioner that offers a percentage wind deductible is required to contain a buy-back provision for that deductible which is actuarially sound.[22]

Table III.4
Disposition of HO Rate Filings in Alabama: Selected Insurers

	2005		2006		2007		2008	
Company	Eff. Date	Approved	Eff. Date	Approved	Eff. Date	Approved	Eff. Date	Approved
State Farm Fire & Casualty	5/15/2005	-1.0%	7/15/2006	-2.6%			9/15/2008	-0.9%
Alfa Mutual Insurance Co.				4.8%				
Allstate Insurance Co.					10/1/2007(1)	1.2%(1)		
Allstate Indemnity Co.					5/21/2007	18.2%		9.9%
Allstate Indemnity Co.	1/24/2005	4.6%			10/1/2007(1)	1.2%(1)		
Fire Insurance Exchange					5/16/2007	14.9%	10/16/2008	16.9%
Auto Ins of The Hartford					7/13/2007	4.8%	3/16/2008	2.0%
Auto Ins of The Hartford							10/17/2008	6.0%
USAA Casualty			9/1/2006	4.9%	9/1/2007	8.6%(2)		
Alfa Mutual Gen Ins C								
Foremost Insurance Co.	1/1/2005	9.7%			9/1/2007	5.8%		
Foremost Insurance Co	4/1/2005	5.7%						
Nationwide Mutual Fire					10/20/07	8.1%	12/20/2008	12.4%
Nationwide Mutual Fire							12/20/2008	13.1%

(1) Reinsurance
(2)Tenants coverage
Source: Alabama Department of Insurance

Table III.5 summarizes rate changes made by insurers from 2005-2008. Rate increases have generally ranged between 3 and 16 percent with a few exceptions. State Farm filed a 53.7 percent rate increase scheduled to become effective on June 15, 2008. Among the selected insurers shown, two filed rate decreases during this period.

[22] An insurer may request a waiver from this subject to solvency considerations.

While the law provides that certain filings of rate adjustments not involving a change in expense relationship or rate classification are subject to "file-and-use," the Mississippi Department of Insurance advises that it processes all filings under its prior approval process.

Table III.5
Disposition of HO Rate Filings in Mississippi: Selected Insurers

	2005		2006		2007		2008	
Company	**Eff. Date**	**Filed**	**Eff. Date**	**Filed**	**Eff. Date**	**Filed**	**Eff. Date**	**Filed**
State Farm Fire And Cas Co							6/15/2008	53.7%[(2)]
State Farm Fire And Cas Co	4/15/2005	3.7%					11/1/2008	13.6%[(3)]
Mississippi Farm Bureau Cas Ins Co							5/1/2008	-9.0%
Allstate Prop & Cas Ins Co	4/11/2005	4.5%			5/21/2007	29.6%[(1)]	9/22/2008	13.9%[(4)]
Nationwide Mut Fire Ins Co			9/9/2006	16.4%			1/15/2008	14.8%
Allstate Ins Co					5/21/2007	29.5%*	9/22/2008	14.1%[(4)]
Nationwide Prop & Cas Ins Co			11/18/2006	12.6%			1/17/2009	6.9%[(5)]
Shelter Mut Ins Co					4/15/2007	7.0%		
Shelter Mut Ins Co					4/15/2007	15.9%		
Farmers Ins Exch			4/16/2006	-1.2%	12/16/2007	34.0%	7/16/2008	5.50%
Foremost Ins Co					9/1/2007	7.6%		
Economy Premier Assur Co					9/5/2007	19.7%	N/A	10.10%

(1) Capped at 90% for individuals in 3 low coast counties; capped at 80% in 3 high coast counties.
(2) State Farm changes range from -3% to 48.5% (33% -48.5% for wind coverage in 3 lower coastal counties)
(3) Earthquake coverage only
(4) Capped at 90% for individuals
(5) Effective January 2009
Source: Mississippi Department of Insurance

Insurers licensed in Mississippi to write fire and allied lines insurance, which includes homeowners multiperil and commercial multiperil policies, are required to become members of the Mississippi State Rating Bureau (MSRB) and utilize its services as an advisory organization and for loss cost development in property insurance ratemaking as well as for submitting property insurance rate filings. The existence of state advisory/rating organizations for property insurance is not common among the states but there are exceptions, such as Mississippi.

5. South Carolina

South Carolina is a flex-band state in which property insurance rate changes require the prior approval of the Director of Insurance only when they fall above or below an overall average of seven percent statewide. Rate changes within the seven percent band may take effect on a file-and-use basis after 30 days. In order for the file-and-use provision to remain effective for rate changes filed within the seven percent band, the Director of Insurance must make a determination that a reasonable degree of competition exists. No more than two rate increases within the seven percent band may be implemented during any twelve-month period and the second rate increase filing in the twelve-month period is subject to prior approval. Private insurers that write wind-hail coverage for the South Carolina coastal area may file and use any rates which result in rates of ninety percent, or less, of the rates then approved for the South Carolina Wind and Hail Underwriting Association.

South Carolina rating standards for property insurance rates follow the basic standards in that insurers are required to develop rates that are not unreasonably high or inadequate for their safety and soundness and do not unfairly discriminate between risks in the state involving essentially the same hazards. The Director is also required to make a determination as to whether a reasonable degree of competition exists in a particular line of insurance using the same criteria that are applied in Louisiana. Table III.6 summarizes recent rate filings by major writers in South Carolina.

Table III.6
Disposition of HO Rate Filings in South Carolina

Company	2005 Action Date	2005 Rate Change	2006 Action Date	2006 Rate Change	2007 Action Date	2007 Rate Change	2008 Action Date	2008 Rate Change
State Farm					8/16/2007	8.2%		
State Farm Bureau Mutual			2/21/2006 8/17/2008	6.2% -1.6%	3/7/2007 7/31/2007	-1.0% 1.5%		
Allstate Ins. Co.	9/29/2005	-14.0%			6/4/2007	10.0%		
Allstate Indemnity	9/12/2005	-1.3%	7/25/2006	11.3%	4/6/2007	6.4%		
Nationwide Mutual Fire	1/12/2005	5.2%						
Nationwide Prop. & Cas.			7/13/2006	-4.2%			4/14/2008	14.1%
Auto Ins. Co. Hartford	1/18/2005 7/20/2005 10/12/2005	5.2% -1.7% -5.6%	8/24/2006	12.4%				
Foremost Ins. Co.	4/4/2005	4.0%						
Standard Fire Ins. Co.	1/18/2005 7/20/2005 10/12/2005	5.2% -1.7% -5.6%	9/14/2006	12.4%				

Source: South Carolina Department of Insurance

South Carolina rates are subject to "excess profit" provisions in which the Director determines the insurer's average rate of return and whether there are any excessive or unreasonable profits earned by the insurer that are required to be returned to policyholders with interest.

The imposition of excess profit constraints raises issues in the context of catastrophe risk. Regulators must consider the particular circumstances of property insurance in areas subject to catastrophe risk. The cat load in rates can result in large "profits" in hurricane-free years. However, this is something that would be expected and profits exceeding an insurer's cost of capital, ideally, should be retained as surplus to help fund catastrophe losses in future years. Unfortunately, under current statutory and GAAP accounting rules, insurers cannot move funds into catastrophe reserves. If cat reserving was enabled, it would help to dispel the perception that premiums from cat loads are profits rather than funds that should be set aside to cover future losses.

As of December 31, 2007, rating plans for wind-hail property insurance in the coastal or seacoast areas of South Carolina are required to include discounts and credits or surcharges and debits based upon certain factors related to hazard mitigation and policy terms. These factors include: use of storm shutters; use of roof tie downs; construction standards; building codes; distance from water; elevation; flood insurance; policy deductibles; and other applicable factors involving the risk or hazard. Mandated mitigation credits are common in coastal states.

The Department may by regulation define how the implementation of these factors qualify for credits or discounts, specifying what evidence or proof the policyholder or applicant must present to obtain the credit or discount. In considering any rate filing for insurance premium rates for wind-hail coverage in the coastal area or in the seacoast area, the Director may consider past and prospective expenses and recoveries associated with catastrophe reinsurance and past and prospective loss experience including windstorm catastrophe models and simulations.

There have been few reports on specific insurer rate increases in South Carolina. The lack of media reports probably, in part, reflects the fact that there have not been significant disputes between insurers and regulators on any rate increases that have been filed. Homeowners in the coastal areas of South Carolina have seen substantial increases. A January 2007 report by the South Carolina Department of Insurance noted that the largest approved overall rate level increase in 2006 was 12.4 percent with increases for coastal areas ranging from 50-65 percent (South Carolina Department of Insurance, 2007). Since then, statewide rate increases filed by standard companies have been between 6.5 and seven percent with increases along the coast in the range of 20-25 percent.[23] This suggests that rates may be "leveling out" and further rate increases may be unnecessary if insurers' assessments of catastrophe risk do not change. Insurers and regulators may not be in exact agreement on rates in South Carolina, but the lower level of risk and market pressure would be expected to narrow the disparity between the rates that are filed and the rates that are approved.

6. Texas

Of all the states in our comparison, Texas may be the most prone to rate filing disputes between regulators and insurers next to Florida. Table III.7 summarizes the disposition of recent rate filings by major writers in Texas. In May 2006, State Farm Lloyds filed for an overall rate level increase of 10.7 percent (23 percent in Dallas County) which was disapproved by regulators. In the latter part of 2006, the state's windstorm pool requested a 20 percent rate increase but regulators reduced it to 4.1 percent. In the summer of 2007, Allstate filed a 5.9 rate level increase and Farmers filed a 6.6 percent rate level increase. The insurance department indicated that it would not approve either rate increase. Farmers chose to withdraw its rate filing while Allstate has indicated that it will implement its rate increase under the state's file-and-use rating system.

Allstate's filing is for its Allstate Texas Lloyds company. It originally filed for a 6.9 percent increase but reduced this to 5.9 percent when regulators indicated they would disapprove the 6.9 percent increase. Still, regulators disapproved the 5.9 percent increase as well as an additional 2.1 percent increase to cover reinsurance costs. The Texas Insurance Commissioner stated that he will seek to resolve the rate dispute but

[23] SC Insurance News Service.

coincidentally issued an order requiring any further rate increases to be subject to prior approval.[24]

Table III.7
Disposition of HO Rate Filings in Texas: Selected Insurers

Company	2005 Eff. Date	2005 Filed	2005 Approved	2006 Eff. Date	2006 Filed	2006 Approved	2007 Eff. Date	2007 Filed	2007 Approved
State Farm Lloyds				Withdrawn Disapproved	9.1% 10.7%	0.0% 0.0%	3/1/2008	3.6%	Under Review
Allstate TX Lloyds				1/1/2006 4/24/2006 6/19/2006	-0.1% -4.8% 5.4%	-0.1% -4.8% 5.4%	8/20/2007	7.6%	7.6%
Travelers Lloyds of TX	5/9/2005	-6.2%	-6.2%				1/26/2007	1.4%	1.4%
Farmers Ins Exch	3/16/2005	-18.4%	-18.4%	11/16/2006	-0.3%	-0.3%	2/16/2008	5.8%	2.5%
USAA Texas Lloyds				9/15/2006	-4.0%	-4.0%	6/2/2007	-0.2%	-0.2%
TX Farm Bureau	4/15/2005	-11.4%	-11.4%	4/1/2006	11.5%	11.5%	7/18/2007	0.0%	0.0%
Nationwide Lloyds				1/7/2006	-10.8%	-10.8%	8/25/2007		3.0%

Source: Texas Department of Insurance

In May 2008, the Texas Department of Insurance (TDI) announced it had settled its dispute with Allstate for rate changes it had implemented but were subsequently disapproved by the Department. Allstate Texas Lloyds will pay $71.3 million in refunds, credits and other concessions to Texas homeowners it insures. In addition, Allstate has agreed not to increase its rates during the period between June 2, 2008 and June 1, 2009.

In another interesting development, the 3rd Texas Court of Appeals has ruled that State Farm will not be required to refund $650 million to its policyholders as ordered by the TDI. In 2003, the TDI ordered State Farm to lower its rates by 12 percent. State Farm refused the order and during its legal fight with the Department the alleged overcharges

[24] "Allstate Home Rate Hike Blocked in Texas," *National Underwriter*, August 22, 2007.

have accumulated to $650 million, including penalty interest. The Appeals Court sent the dispute back to the TDI to review State Farm's rates under a more stringent standard.

Under the state's file-and-use system, an insurer may implement a rate change without the prior approval of the insurance department but the Department has the authority to retroactively disapprove the increase and require an insurer to refund any additional premiums it collected under the disapproved change. It should be noted that regulators' concerns about these rate filings do not pertain to the overall increases which are fairly modest, but the rate increases that would be implemented for the highest-risk areas, which are considerably higher than the statewide increases.

In reflecting on the situation in Texas, it is important to note at least several factors that are likely influencing its regulatory policies. First, in the early 2000's, many insurers filed for significant rate increases because of concerns about mold claims and the increase in weather-related (non-hurricane) risks. Second, like Florida, Texas has a large insurance market and, hence, is in a position to try to exercise greater leverage in controlling insurers' prices. Third, Texas has a long legacy in terms of taking of taking a fairly tough position on insurers' rates and other actions.

E. Comments on Rate Regulatory Policies

In sum, Florida has exhibited the greatest degree of regulatory stringency toward property insurance rates but its behavior is consistent with its economic and political situation. Rates in coastal areas of Florida were already high and consumer and voter tolerance in these areas was strained by the most recent waves of rate increases in 2005-2006. Property insurance rate regulation has tended to be more moderate in other states subject to hurricane risk, even after the 2004-2005 storm seasons, with some exceptions.

There has been some “rate tempering” in Texas compelled by regulators. It appears that a similar phenomenon occurred in Louisiana when the IRC was part of the process, but the tempering may have been less than what has occurred in Texas. The information on the disposition of rate filings in the other target states is inadequate but there is not any evidence of significant rate disputes in these states.

Risk and cost pressures have been lower in states other than Florida which decreases the tension between insurers’ rate needs and what regulators are willing to approve. Also, even in other states subject to relatively large increases in 2005-2006, e.g., Louisiana, previous rate levels had been lower than in Florida. Finally, regulators in states with smaller markets do not have the leverage to extract rate concessions from insurers that larger states posses.

The situation for rate regulation in coastal states still remains fluid at the time of the writing of this paper. No significant hurricanes struck the US in 2006-2007 but several hurricanes/tropical storms hit the Gulf and Atlantic coasts in 2008 causing more than $13.5 billion in estimated insured losses (Insurance Information Institute, 2009b). It is apparent that major insurers perceive rates to be severely inadequate in Florida as several filed large rate increases in 2008 which were disapproved by the FLOIR. Whether insurers will further pursue rate increases in other states is uncertain. Although regulators appear to be more “accommodating” in states other than Florida, there also may be limits to their tolerance of higher rates. Much will depend on how insurance market conditions evolve. If rate pressures ease and the supply of insurance rebounds, further regulator-insurer clashes over rates may be avoided. However, if market conditions worsen or do not improve, there is a greater potential for binding regulatory constraints on insurers.

Hence, issues concerning the pricing of property insurance in coastal areas and its regulation will likely continue to receive attention. Insurers argue that the rate increases are necessary and consumer advocates argue that the rate increases are excessive and should be restricted by regulators. Advocates of binding regulatory constraints on insurers' rates might offer at least a couple of arguments to support their point of view (Hunter, 2007). One argument might be that insurers are overreacting to recent losses and have overestimated the increase in hurricane risk. This is associated with consumer groups' criticism of the accuracy of the catastrophe models used by insurers to develop the catastrophe component of their rate filings and the use of short-term time horizons.[25] A second argument might be that the lack of regulatory constraints allows too much volatility in insurers' pricing and that regulators need to dampen this volatility.

Some initial responses to these arguments are warranted. It is true that opinions differ on appropriate risk estimates and rate levels/structures that are necessarily based on a set of assumptions and require some judgment.[26] Risk modelers' and insurers' risk estimates are inherently imperfect and it is not possible to divine the "true" risk of loss due to "parameter uncertainty."[27] However, insurers voluntarily commit their capital to underwriting property exposures in high-risk areas and their ability to charge what they believe to be adequate rates affects their willingness to continue to commit capital to such a risky venture. Insurers could be right or wrong and their rates may swing depending on

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[25] As discussed above, the debate about short-term and long-term models is one aspect of the broader controversy over catastrophe modeling.

[26] The pricing of catastrophe risk is not subject to ex post validation within a relatively short period of time in contrast to lines such as personal auto insurance.

[27] The term "parameter uncertainty" refers to uncertainty over the "correct" probability of loss distributions that insurers use to develop rates. Parameter uncertainty is a greater problem for pricing catastrophe risk than it is for other perils and lines` of insurance, such as personal auto liability.

their perceptions and risk appetite, but arguably, this is inevitable in underwriting catastrophe risk if reliance on private insurance/reinsurance will continue.[28]

Although it may take some time, market forces and competition should ultimately establish a new equilibrium in terms of prices and the supply of insurance if legislators and regulators can loosen the reins on the market, assuming that there is not a further escalation in hurricane risk. However, pragmatists understand that political-economic factors may not permit this to happen, especially in states subject to significant market pressures such as Florida. When and where a new equilibrium would be established will also be affected by hurricane risk projections and storm activity over the next several years.

IV. Regulation of Policy Terms

Regulation of the policy terms that insurers can use can have a significant impact on hurricane-prone insurance markets. All policy forms and the related rating plans and rules must be approved by regulators. Some provisions may be incorporated into a policy that are not a matter of choice for the insured, i.e., the provision is not written in such a way that it presented as an option for the insured to include or not include in the policy they buy. Other provisions, such as the selection of deductibles, particularly wind/hurricane deductibles, may be arranged so that the insured can choose from an array of options (with corresponding implications for the premiums they are required to pay).

[28] Proponents of government catastrophe reinsurance might contend that such programs would help to lower and stabilize rates, but insurers' views on the need for such programs differ and this paper does not attempt to resolve this debate.

There are other standard endorsements or exclusions that insureds can choose at their discretion.

Policy provisions can be tied to underwriting in that insurers may be willing to sell coverage in some areas or for some risks on the condition that insureds agree to certain policy provisions. For example, if permitted by regulators, insurers may only offer policies with substantial wind/hurricane deductibles in high-risk areas. Further, the pricing of some policy options may make certain choices very costly for insureds, e.g., low wind/hurricane deductibles. This section discusses the regulation of certain policy terms that are highly relevant to property insurance in high-risk areas.

A. Deductibles

Insurers began introducing higher deductibles for homeowners insurance following Hurricane Andrew. The most significant development was the introduction of specific or “named” wind or hurricane deductibles that were higher than the deductibles for other perils. Wind/hurricane deductibles can be stated in dollar amounts but the more common approach is to set them as a percentage of the Coverage A (dwelling) limit on a homeowners multiperil policy. Initially, insurers’ wind/hurricane deductibles were set at one or two percent of the dwelling limit. More recently insurers have mandated or offered optional percentage wind/hurricane deductibles higher than two percent usually with options to buy back broader coverage for an additional premium.

Depending on the law an insurer may impose a mandatory wind/hurricane deductible or a mandatory standard deductible on policyholders in higher risk areas of a state. Higher deductibles allow insurers to better manage their catastrophe risk exposure and losses and also allow some homeowners to lower their premiums by accepting higher deductibles. Of course, higher deductibles require insureds to retain more risk but for many this may be preferable to paying substantially higher premiums or being forced into the residual market. The trigger for the application of hurricane deductibles to a loss is generally the declaration of a named storm by the National Weather Service. Eighteen states and the District of Columbia now have hurricane deductibles including all of the states in this study.

Deductibles are typically applied for each "occurrence" of covered losses. Hence, if an insured has losses from two hurricanes within the policy period, the deductible will apply again to their losses from the second hurricane. This became a matter of some concern in Florida in 2004 when some homeowners were struck by more than one hurricane during that year. Florida law now prohibits insurers from imposing more than one hurricane deductible per season. Similar provisions may be introduced in other states.

The concern about per-occurrence deductibles is understandable because the losses retained by an insured can mount if they are hit by more than one hurricane. At the same time, per-occurrence deductibles greatly aid insurers in managing their catastrophe risk and helping to reduce their rate level needs. If regulators compel insurers to apply deductibles on an "aggregate" basis (rather than per-occurrence) it could have a negative effect on the supply of insurance and increase rate pressures. Still, a state may require that wind/hurricane deductibles be applied on an aggregate basis rather than per occurrence.

1. Alabama

In the Alabama voluntary market, hurricane deductibles may be mandatory or optional, depending on the insurer. At least three of the top five insurers have mandatory hurricane deductibles ranging from 2 percent to 15 percent. At least one insurer in the top five uses a wind-hail policy deductible ranging from $1,000 in areas where the vulnerability to hurricane damage is severe to $250 where it is low. Hurricane deductibles apply to direct physical loss or damage to covered property caused by wind, wind gusts, hail, rain, tornadoes or cyclones caused by a hurricane. The deductible is activated by each hurricane occurrence. Wind-hail only policies available through the Alabama Wind Insurance Association – the state wind pool for beach and gulf-front properties – are subject to a five percent deductible. Wind pool policies for coastal properties are subject to deductible options of two or five percent.

2. Florida

According to The Florida Insurance Council, 70 percent of homes in Florida now have a two percent deductible for hurricanes and five percent is common on higher-priced homes. In exchange, policyholders receive a discount of 10 to 20 percent for the wind portion of their insurance premiums. Insurers are allowed to offer up to 10 percent wind or hurricane deductibles in Florida for homes with dwelling coverage limits between $100,000-$500,000. There is no limit on hurricane deductibles for homes with dwelling limits in excess of $500,000.

By Florida statute, the application of hurricane deductibles to windstorm losses is triggered by a storm system that has been declared to be a hurricane by the National Hurricane Center. They take effect at the time a hurricane watch or warning is issued for any part of Florida and remain in effect for the time period during which the hurricane conditions exist anywhere in the state, ending 72 hours following the termination of the last hurricane watch or warning. Wind damage from storm systems other than declared hurricanes is not subject to the hurricane deductible but to the general deductible.

Hurricane deductibles and their triggers are set by law and are the same for the voluntary market as well as the Florida Citizens Property Insurance Corporation (FCPIC). Homeowners pay the deductible only once during a hurricane season so it constitutes an aggregate deductible rather than a per-occurrence deductible. The Florida mandate on aggregate deductibles stems from the complaints of homeowners that paid multiple deductibles during the 2004 season. While the aggregate deductible has advantages for insureds, it creates problems for insurers.

Under Florida law, for any personal lines residential property insurance policy containing a separate hurricane deductible or inflation guard rider, the insurer must compute and prominently display the actual dollar value of the hurricane deductible on the declarations page of the policy.[29] For policies containing the inflation guard rider, the insurer is required to notify the policyholder of the possibility that the hurricane deductible may be higher than indicated when loss occurs due to application of the rider.

3. Louisiana

In the Louisiana voluntary market, hurricane deductibles range from two to fifteen percent. Mandatory hurricane deductibles range from one to five percent. Before Hurricane Katrina, 57 companies had permission to use hurricane deductibles in Louisiana. Since the storm, 31 others have filed plans to use them. Optional deductibles can be as high as 15 percent although very few policyholders select a deductible higher than 10 percent. Mandatory “wind-hail policy only” deductibles are $250 to $1,000 or

[29] F.S. 627.701.

one percent. There are also optional wind-hail policy deductibles of $500 to $2,500 and one, two and five percent.

Prior to 2009, the state's three-year protection rule prevented companies from changing the deductible in a policy that had been in effect for three years unless the change was mandated on a statewide basis. As a result, about 80 percent of policyholders in the state had homeowners policies that contain named storm deductibles.

After Hurricane Katrina, Allstate and State Farm, with more than 54 percent of the market between them, sought ways to reduce or limit their probable maximum loss (PML) exposure in Louisiana. Louisiana's 3-year consumer protection rule prevented either company from dropping policies in high risk areas.[30] Allstate, however, had not purchased catastrophe reinsurance and was finding it difficult to purchase reinsurance with its level of exposure in Louisiana. Citing a need to sufficiently reduce its exposure in many states in order to maintain its financial credit rating and to obtain reinsurance, Allstate imposed a five percent named storm deductible on all Louisiana policies as its only legal option. The company also filed an eight percent statewide rate increase to cover its reinsurance costs. State Farm has raised its mandatory minimum deductible from 1/2 percent to 2 percent. After Hurricane Katrina, insurers in Louisiana were required to disclose whether an increased deductible is required for hurricane damage. The disclosure has to be displayed prominently on the front of the policy.

Named storm deductibles for wind-hail policies in the Louisiana FAIR plan are two percent with optional deductibles of $500 to $10,000. About 93 percent of FAIR Plan

[30] Louisiana law prohibits an insurer from canceling, non-renewing or increasing a deductible in a personal lines policy that has been in effect for more than three years unless the action is imposed on all of the company's policyholders.

policyholders have the deductible. In the Coastal Plan, deductibles are five percent with optional deductibles of $500 to $10,000.

Prior to 2009, Louisiana was the only state that required insurers to set a statewide deductible. In July 2008, legislation was enacted (that became effective January 1, 2009) that allows an insurer to file a request to change a homeowners policy deductible based on the property's distance from the Gulf of Mexico. In its request, the insurer must include a plan to write new business in the area in which the new deductible would apply. Any increase in a policyholder's deductible must be tied to an actuarially-sound reduction in the premium with the savings itemized on the declaration page of the policy. The law also prohibits any policy provision that could effectively require a policyholder to pay more than one deductible for a single incident and caps deductibles at four percent of the value of the property insured on any policy that has been in effect for more than three years.[31]

4. Mississippi

In Mississippi, windstorm deductibles may be a percentage of coverage or a specified amount. Insurers that require a mandatory deductible must provide buyback options to their policyholders. In the voluntary market, hurricane deductibles range from one to 15 percent; wind-hail deductibles range from $250 to $2,500. In the state's wind pool, dwellings (one to four units) including farm dwellings, trailers and mobile homes located in six coastal area counties are subject to a mandatory wind-hail policy deductible

[31] Named deductibles applied to claims that resulted from Hurricanes Gustav and Ike were not subject to this cap as the new law will not take effect until January 2009 and the Commissioner must promulgate rules setting forth the criteria for such filings. At the time this paper was written, State Farm had indicated some interest in using zone deductibles; Allstate which has stated it does not want to increase its market share has indicated it will not apply to use zone deductibles.

of $500. Commercial residential policies with up to $500,000 coverage are subject to a wind-hail policy deductible of $1,000. Commercial property policies are subject to a two percent (minimum $750) deductible. The policies are also subject to a minimum two percent named storm deductible.

In 2007, the Mississippi Insurance Department approved rules that allow wind pool policyholders to lower their premiums by choosing optional named storm deductibles of five percent, 10 percent, 15 percent and 20 percent. In the state's FAIR Plan, the deductible for all perils is $500.

5. South Carolina

In the South Carolina voluntary market, deductibles are mandatory or optional, depending on the insurer. Hurricane deductibles are two to five percent in beach territories with optional deductibles of 10-15 percent available in other areas of the state. Flat dollar deductibles of $1,000-$20,000 are also available from some insurers. In the state's wind pool, policies only carry a standard one percent or optional two percent deductible. In June 2008, the state enacted legislation that allows homeowners to set up tax-deductible hurricane savings accounts to fund large deductibles or cover their damages if they do not have insurance.

6. Texas

In Texas, there are deductibles that apply to any type of windstorm. In the voluntary market, wind-hail policy deductibles range from 0.5 percent to 25 percent and from $100 to $5,000. Some insurers require a minimum deductible, typically 2 to 5 percent. In the state wind pool, deductible options of $100, $250 or one percent are available unless an optional “large” deductible is selected. The large deductible applies to damage from any wind and hail, whether from a hurricane or other storm. Optional large deductibles of 1.5 percent, 2 percent, 2.5 percent, 3 percent, 4 percent or 5 percent are available and are subject to the appropriate premium credits. Deductibles apply to dwellings, personal property and dwelling outbuildings on a per item basis. In the state’s FAIR Plan, there is a standard one or optional two percent deductible for all perils.

B. Exclusions

Another issue is insureds’ ability to have wind coverage excluded from their policy or allowing insurers to offer wind/hurricane exclusions. Legislation in both Florida and Louisiana made this option more readily available to buyers of homeowners insurance.[32] While an insured could obtain significant premium savings by opting for a wind exclusion, it does place them in a position of retaining any wind losses they might suffer. Presumably, lenders would not allow someone with a home mortgage to opt for a wind exclusion, but it would be an option for homeowners without a mortgage. The more common scenario is for a private insurer to exclude wind coverage on a homeowners policy and the insured obtains their wind coverage through a state facility. For example, in Louisiana, an insured may purchase homeowners coverage that excludes wind-hail in the voluntary market and purchase a wind-hail only policy from the FAIR or Coastal Plan. If a policyholder is required to exclude wind-hail coverage as a condition of renewal, the insurer must reduce the premium accordingly. The law also states that a

[32] A number of Florida homeowners obtain their wind coverage through the state residual market mechanism but this is a different action than forgoing wind coverage from any source. It is not known how many homeowners have chosen the latter course but it is likely that at least a few have and this number may be growing.

policyholder who chooses not to accept the renewal policy without wind-hail coverage many not be considered cancelled.

In 2007, the South Carolina Director of Insurance expanded the coastal area eligible for wind-hail coverage through the South Carolina Wind and Hail Underwriting Association (SCWHUA). The boundaries were moved inland to attract new insurers into the market while preventing insurers already providing coverage from shedding their existing policies indiscriminately. The SCDOI expected some insurers to justifiably adjust and reduce their wind coverage within these areas and engaged in extensive discussions with them beforehand to preserve the voluntary market to the extent possible and ensure that the wind pool remained a market of last resort. To date, all indications show that the voluntary market remains strong, even in the newly expanded areas now covered by the SCWHUA. The SCDOI will monitor the effects of the expansion on the number of policies issued with and without wind coverage on a quarterly basis (South Carolina Department of Insurance, 2007).

C. Other Policy Terms

In Louisiana, an insurer may convert an entire class of homeowner policies to another homeowner policy form, which has been submitted to and approved by the Commissioner, as those homeowners policies are renewed. The terms and conditions of such policies, subject to the conversion, must be continued for the remaining term of the policy. The conversion does not constitute the cancellation or nonrenewal of any policy and cannot be grounds for the cancellation or nonrenewal of any policy by the insurer. All homeowners insurance policies, which have been properly filed and converted and the conversion of which will result in a rate change, are subject to the state's laws and rules governing rate changes.

Louisiana legislation (effective in 2008) requires insurers to offer homeowners policyholders in disaster-declared areas of the state the option to exclude personal property coverage on uninhabitable homes or obtain a dwelling-only policy until the home has been repaired or the policy is terminated. The substitute coverage may not be considered a new policy and an appropriate reduction in premium must be provided to the policyholder.

V. Regulation of Underwriting

There are significant concerns about insurers' underwriting policies and decisions in coastal areas following the 2004-2005 storm seasons. These policies and decisions fall into two basic categories: 1) those that pertain to the characteristics of specific properties; and 2) those that constitute broader actions which apply to all properties in a given coastal area. Insurers' efforts to selectively or more broadly reduce their exposures in coastal areas can create significant availability problems. Property owners who lose their coverage are forced to find another insurer that will offer them a policy or obtain coverage in state residual market mechanisms. The "availability problem" is as significant if not more significant than the "insurance cost problem."

Both insurers' concerns and regulators' concerns are understandable. Many insurers have sought to reduce their coastal exposures to what they consider more viable levels. Their considerations include both the problem of catastrophe losses that would bankrupt or severely impair their financial condition as well as the negative earnings and earnings volatility associated with coastal exposures. Regulators and other public officials are concerned about maintaining the supply of insurance that is essentially a necessity for most property owners. It is difficult to reconcile insurers' and regulators' concerns and objectives. Regulators must be cautious in terms of any constraints they may seek to impose on insurers' underwriting decisions and related areas such as pricing and policy terms. Severe constraints could provide short-term relief to coastal property owners but could cause much greater problems for the supply of insurance in the long term.

Underwriting is a key function performed by insurance companies and integral to their financial performance and risk management. Insurers seek to establish and maintain balanced portfolios of exposures consistent with their rate structures and financial capacities. They also seek to avoid adverse selection and writing exposures that are either "uninsurable" or present a very high risk of loss. Beyond these basic objectives, insurers also seek to limit their vulnerability to catastrophe losses.

The states regulate insurers' discretion in accepting new insurance applications or renewing existing policies in different ways. At a minimum, regulators may prohibit the use of certain underwriting criteria but the regulation of underwriting can extend significantly beyond such minimum prohibitions. Regulators may constrain insurers' discretion by more broadly limiting the criteria they can use in underwriting or interfering with insurers' attempts to reduce their portfolios of exposures to more manageable levels. While there has been some regulatory resistance to insurers' decisions to reduce their exposures there is generally little that regulators can do to prevent such reductions in the long term.[33] It appears that the regulators have generally imposed advance notice requirements on insurers intending to non-renew policies but have not sought to impose more restrictive measures (beyond limited moratoriums following hurricanes).

There are examples of statutory or regulation-based underwriting restrictions. In Louisiana, insurers are prohibited from terminating policies that have been effect in for three or more years, except for "cause." In New York, insurers may not reduce their exposures by more than 2 percent per year. Most states also do not allow insurers to reject insurance applications solely on the basis of the age of a home. Additionally, the states are increasingly imposing constraints on insurers' ability to use credit scoring in underwriting auto or home insurance.

A. Applications and Declinations

Generally, most states give insurers fairly wide discretion in developing and applying their underwriting guidelines that determine the policy applications they accept and decline. However, there are some underwriting factors that are prohibited or restricted. For example, many states do not allow insurers to reject a home solely on the basis of the age or market value of the home. Some states also may constrain an insurer's ability to decline an application based on a home's location. This constraint has tended to be applied principally to urban areas and not to coastal areas subject to high hurricane risk. From what can be ascertained, no states currently prohibit an insurer from declining

[33] Florida issued a moratorium on policy cancellations and nonrenewals following Hurricane Andrew and Louisiana and Mississippi did something similar following Hurricane Katrina. Additionally, regulators may require insurers to explain the basis for broad cutbacks in the policies they write in designated areas. Beyond these measures, regulators are limited in what they can do to prevent an insurers' retrenchment from certain areas in a state.

all applications for new policies in designated coastal areas. However, the regulations governing the cancellation or nonrenewal of existing policies can be more strict.

It would be helpful to have access to data on the number of insurance applications, declinations and nonrenewals on a sub-state basis for coastal states. However, states vary in the degree to which they monitor and compile data related to property insurance policy applications and declinations. State laws also vary as to whether the information compiled is made public or remains confidential. Hence, it was not possible to analyze such data for this paper.

B. Cancellations and Non-Renewals

1. Florida

The Florida Legislature enacted a moratorium on policy cancellations and nonrenewals following Hurricane Andrew in 1992. Florida did not impose such a moratorium following the 2004-2005 storm seasons. Insurers' underwriting adjustments post-2005 were more gradual and this factor probably explained why a moratorium was not imposed. Florida regulators have required insurers to explain their decisions to not write new business or nonrenew existing policies in coastal areas. Florida's 2007 legislation included a provision that requires auto insurers in the state to also offer homeowners insurance if they sell homeowners insurance in other states.

2. Louisiana

The Louisiana Insurance Code does not allow an insurer to cancel or non-renew a homeowners policy or increase the policy deductible for policies that have been in force for more than three years with some exceptions, (e.g., nonpayment of premium, two or more claims in three years, etc.). This provision of the law may be well intended, but it could have a detrimental effect on the supply of insurance in the long term. It could discourage some insurers from writing new policies if it limits their flexibility in shedding these policies in the future.

Immediately after Hurricane Katrina, the LDOI issued Emergency Rule 23.[34] The regulation suspended the right of any admitted insurer or surplus lines insurer to cancel or non-renew any personal residential, commercial residential, or commercial property insurance policy insuring a dwelling, residential property or commercial property located in Louisiana that sustained damage from Hurricanes Katrina and Rita. This prohibition was effective until 60 days after substantial completion of the repair and or reconstruction of these properties or December 31, 2006 (subject to the specific exceptions).

Admitted insurers and surplus line insurers who intended to claim that there has been "a material change in the risk being insured" were required to take the following actions:

1. Conduct a physical inspection of the subject property thirty days prior to the termination of Emergency Rule 23 or thirty days prior to any action to cancel or non-renew the policy of insurance after the termination of Emergency Rule 23.

2. Send a preliminary written notice to the insured advising that it is the opinion of the insurer that there has been "a material change in the risk being insured" that sets forth, in detail and with specificity, each and every reason why the insurer is of the opinion there has been a "material change in the risk being insured" that would justify cancellation or non-renewal. An insurer must also give the insured at least thirty days to either substantially correct the alleged deficiencies and maintain the insurance policy or provide the insurer with contrary information and or documentation that the alleged deficiencies have been corrected.

Several emergency rules and directives on issues related to policy non-renewals and insurance company withdrawals related to Hurricanes Katrina and Rita expired at the

[34] Emergency Rule 23; LSAR.S. 22:635.3 - 636.6 October 27, 2006.

end of 2007. The Commissioner subsequently issued a new directive that requires insurance companies to provide the Department with 60 days advance written notice prior to the non-renewal of policies when five percent or more or more than 250 policies of a company's existing book of business will be non-renewed. Upon the Governor's Declaration of a State of Emergency in Louisiana when Hurricane Gustav hit on August 28, 2008, Commissioner Donelon issued Emergency Rules 24 and 25 suspending the cancellation and nonrenewal provisions on policies in 43 parishes until October 1, 2008.

3. Alabama

In January 2007, the Alabama Insurance Department issued a bulletin that required insurers to give certain policyholders 60 days prior notice on non-renewals. This rule applied to non-renewals based on an insurer's decision to reduce its exposure to catastrophe losses. In addition, any insurer planning to non-renew homeowners coverage in a specific area of the state was required to provide written notice to the department 90 days prior to the effective date including the type of policy being non-renewed, the category and number of consumers that would be affected, and the names of the counties in which the affected policyholders resided. In April 2007, Regulation 136 was adopted that extended the written notification time to the Commissioner to 150 days prior to the effective date of a restriction or non-renewal and 120 days notice to the policyholder.

4. Mississippi

After Hurricane Katrina, the Mississippi Insurance Department issued a moratorium on policy cancellations and non-renewals for non-payment for 60 days from August 29, 2005 through October 27, 2005. This was extended for an additional 30 days in the hardest hit counties of Jackson, Harrison and Hancock. Insurers were required to work with victims to establish a payment plan for premiums that became due during the moratorium.

5. South Carolina

In South Carolina, the Omnibus Coastal Property Insurance Act, implemented in June 2007, amended property insurance law relating to policy cancellation provisions. A policy cannot be cancelled because of a substantial change of risk assumed by the insurer which is based on changes in climatic conditions unless the cancellation is based on statistical data related to South Carolina that has been approved by the Director of Insurance as a basis for substantial change in the risk assumed.

A company can non-renew a policy for any reason so long as the two requirements mandated by law are met. First, the company is required to put in writing the precise reason for the non-renewal. Second, the company must give 60 days advance notice for any non-renewal that would be effective between November 1 and May 31 and 90 days advance notice for any non-renewal that would be effective between June 1 and October 31. There is, however, one exception. A policy can be non-renewed for claims even if the claims were not the fault of the policyholder unless the only claims that have been have been filed were caused by "Acts of God."[35] "Acts of God" claims cannot be used when determining claim frequency.

[35] The terms "Acts of God" essentially refer to perils beyond the control of insureds, e.g., weather-related perils.

6. Texas

In Texas, the insurance code requires an insurer to provide a policyholder with written notice of any difference between each form of the policy offered to the policyholder on renewal and the form of the policy held immediately before renewal. This requirement applies to homeowners, fire and residential allied lines, farm and ranch owners, and farm and ranch insurance policies.[36]

C. Placement of Insureds in "Non-Preferred" Companies

Another aspect of underwriting is insurers' movement of some of their exposures into "standard" or "non-standard" as well as single-state companies within their groups. One of the factors prompting this development is that "standard" and "non-standard" companies are allowed to have higher rate structures than "preferred" companies and many insurers elect or are compelled to use this approach rather than expanding their rate structures within their main or preferred companies. Hence, it is a way in which an insurer can effectively raise rates for certain insureds without filing a rate increase. This is a tactic that regulators may seek to control by confining the criteria which insurers are allowed to use in accepting or declining insureds for coverage in their preferred or lowest-rate companies.

The establishment of single-state companies by national insurers is motivated by the desire to make their financial performance attributable to a state more transparent and obvious, rather than combining it with the financial results from other states. Also, from a legal perspective, if a single-state company were to become insolvent, the parent group could let the company go and not attempt to bail it out with funds from other companies

[36] Texas Insurance Code Ch. 2002.001.

within the group. While this has not occurred to date, some insurer groups may wish to retain this option if the losses of a single-state company were large enough to significantly affect the financial condition of the group, especially if regulators in the state had constrained the company's rates or other efforts to manage its exposures.

In its recent legislation, Florida has sought to restrain the use of single-state companies and the segmentation of Florida losses from insurers' experience in other states. The legislation prohibits the further establishment of single-state insurers by national groups and requires insurers writing auto insurance to sell homeowners insurance in Florida if they sell it in other states. These actions could discourage new insurers from entering the state and existing insurers from remaining in the state.

In another interesting twist, the Florida Legislature recently passed a bill that would allow certain "large" insurers to operate on a "less regulated" basis. The legislation appears to be a response to State Farm's decision to withdraw from the state's home insurance market and intended to encourage national insurers to write more business in Florida, albeit at higher rates. This approach to expanding the supply of insurance seems similar to the Texas "unregulated market" and also could be analogized to allowing surplus lines insurers to write homeowners insurance. However, the Florida Governor vetoed the legislation and its prospects for becoming law seem dim.

D. Tying Homeowners Coverage to Purchase of Other Coverages

An issue that has recently arisen is whether an insurer can require a homeowner to buy his or her auto insurance from the insurer as a condition for being able to buy homeowners insurance. There have been some media reports of insurers employing this requirement but it is not clear whether it is widespread. Based on available information, it appears that regulators in certain states have prohibited insurers from apply such tying requirements. It is common for insurers to offer premium discounts to insureds who buy their auto and home insurance from the same company but this is a different practice that states generally allow.

The Alabama Department of Insurance issued a bulletin February 14, 2008 stating that the Alabama unfair trade practices act prohibits an insurer from requiring an applicant to purchase an additional type of insurance as a condition to purchase homeowners insurance and from renewing a homeowners insurance policy based on a policyholder having other coverage with the insurer (except that the purchase of insurance for a secondary residence can be contingent upon also having a policy for a primary residence).

New York is another state that has explicitly barred insurers from non-renewing home insurance customers in coastal areas who are not willing to buy their auto and life insurance products as well. The New York action was prompted by complaints from consumers who received non-renewal notices from their insurers that cited this reason, among others, for the non-renewal. Several insurers indicated that they would stop the practice and renew the insureds that they had dropped. According to the New York insurance department, insurance tying requirements are prohibited by state law.[37]

E. Requirements to Write Property Insurance

Regulators may seek to impede or challenge insurers' decisions to stop writing homeowners insurance in some or all parts of a state. The only real leverage that a state can employ is to try to force an insurer to exit all lines of insurance if it seeks to reduce

[37] "N.Y. Stops Insurers From Tie-Ins for Coastal Customers," *National Underwriter*, August 27, 2007.

its property insurance exposures. It is not clear that regulators would prevail in such an effort but they may threaten such action. This can result in a game that neither side desires to take to its ultimate limit but each must be prepared to do so in order to exercise bargaining power. The game often involves rate regulation as insurers may respond to rate filing disapprovals by tightening their underwriting and regulators may approve a rate increase conditional on an insurer's agreement to continue to write a certain number of high-risk insureds.

While not explicit, Florida's suspension of Allstate's authorization to sell other forms of insurance could be cited as an example of this kind of regulatory strategy. The stated reason for the suspension was Allstate's alleged failure to produce certain documents but deeper tensions between Allstate and Florida regulators also could have motivated this action by the FLOIR. This suspension was lifted after Allstate and Florida reached an agreement on Allstate's submission of the subpoenaed documents.

F. Other Areas

Louisiana has taken an interesting tack in the establishment of its "Insure Louisiana Incentive Program" in 2007 to attract more insurers to the state. The program sets aside $100 million in matching funds for insurance companies willing to enter the state and write new business. Qualifying companies receive funds ranging from $2-$10 million and must meet specific solvency requirements and take 25 percent of their new policies from the LCPIC. To date, seven insurers have applied for and received such grants.[38]

[38] "Six Insurers Seek Grants to Offer, Expand Coverage," *Times-Picayune*, November 7, 2007.

The application requirements for the program are important. Regulation 82, issued by the Department of Insurance in 2007, specifies all the rules and requirements of the program. Qualifying companies must:

1. Maintain capital and surplus of at least $25 million;
2. Maintain a risk-based capital ratio of 500 percent; and
3. Show proof of an existing certificate of authority or filed application.

There are other financial requirements for qualifying insurers that are specified in Regulation 82. These include an A.M. Best Rating of B++ or better (or an equivalent rating by another rating organization) and a premium to surplus ratio of no greater than 4 to 1. The regulation does not stipulate any requirements that specifically pertain to the management of its catastrophe risk. However, implicitly, in order to maintain a high claims-paying ability rating, an insurer would have to meet the catastrophe risk management requirements of rating agencies. Typically, the major rating agencies (A.M. Best, Standard and Poors, Moody's, and Fitch) require an insurer to demonstrate that it could survive a 100-year PML for hurricanes and a 250-year PML for earthquakes to obtain a favorable rating. All of the companies that have received a grant to date have a B++ rating or better, either from A.M. Best or Demotech.

Beyond these requirements, grant applications must satisfy additional criteria that determine whether an insurer will receive a grant and the amount of the grant that it will receive. A partial listing of these criteria is provided below.

1. Net written premiums must be at least $2 for each $1 of combined insurer capital, which includes insurer allocated capital and the matching grant.
2. The property insurance written must be residential, commercial, mono-line or package property and include equal wind and hail coverage.

3. At least 25 percent of net written premiums must be from policyholders formerly insured by the LCPIC, with 50 percent located in the 37 parishes included in the Gulf Opportunity Zone Act, the parishes most affected by hurricanes Katrina and Rita.

4. By the end of the second year, at least 50 percent of net written premiums must be received from policyholders located in the 37 parishes included in the Gulf Opportunity Zone Act.

Based on the program's criteria and the grants that have been issued it is difficult to determine whether Louisiana's program is obtaining a good "return on its investment," but it may be doing so. Technically, under the governing regulation, an insurer participating in the program must commit an amount of its own capital to writing property insurance in Louisiana that is at least equal to the grant that it receives. Further, the insurer must write at least \$2 in premiums for every \$1 of combined capital (insurer capital plus grant) committed to Louisiana property insurance. These conditions may not be as favorable to the state as state officials would prefer, but the ultimate effect of the program could be to attract more private capital than that required under the program's rules. Time and further evaluation can ultimately determine the success of Louisiana's incentive program and the return on its investment of public funds.

Florida also has had a \$250 million incentive program that it has used in its residual market depopulation efforts. From what we can ascertain, Florida provides a matching capital grant to insurers qualifying for the program. It appears that for each grant, the FLOIR negotiated the amount of policies that an insurer will remove from the FCPIC and possibly other matters. A Florida grant could be higher than a Louisiana grant – at least one company has received a \$25 million grant. The grants were funded from the FCPIC's surplus or reserves. It also appears that, in some respects, Florida imposed less stringent solvency requirements on insurers receiving grants than Louisiana. For example, a company that had received a grant from Florida also applied to Louisiana for a grant but was rejected (probably because its 200 percent RBC ratio fell far below Louisiana's 500 percent requirement). On the other hand, Florida requires "takeout insurers" to submit information indicating that they are adequately managing their catastrophe risk. It should be noted that Florida did not renew its incentive program in its 2008 legislation.[39]

A brief comment on the 2 to 1 premium/surplus ratio requirement is warranted. The desire to encourage insurers to write more policies if they receive an incentive grant is understandable. On the other hand, the average premium/surplus ratio for homeowners insurers is 1 to 1 or 100 percent. If a state incentive program imposes a higher leverage requirement, regulators will need to be especially vigilant in ensuring that participating insurers purchase sufficient catastrophe reinsurance to protect themselves from hurricane losses.

VI. Regulation of Marketing and Distribution

The regulation of insurers' marketing and distribution activities can be important but its relevance to the catastrophe risk problem is not as great as other areas of regulation. Marketing and distribution can affect the availability of insurance which is why it is briefly discussed in this paper. One principal regulatory concern is that marketing and distribution can be used as implicit devices to avoid writing certain kinds

[39] Concerns about the financial capacity of the FCPIC may have contributed to this decision.

of business. If an insurer is explicitly constrained in terms of rejecting applications of insurance, it may limit or eliminate its marketing channels in areas where it wants to avoid writing insurance. Hence, a property owner seeking to buy insurance cannot find or contact an agent to sell them insurance. While no evidence of the use of this tactic with respect to the supply of property insurance in coastal areas has surfaced, it is something that regulators may wish to monitor. Several states do monitor the location of agents in "underserved areas" within their jurisdictions and some, including Texas, make the information publicly available. Louisiana monitors agent locations, appointments and terminations but does not compile this information in a report.

There are other aspects of marketing and distribution that could be linked to the supply of insurance. For example, an insurer could seek to reduce its business by lowering agent commissions. Lower commissions could discourage agents from attempting to place business with an insurer. It could also motivate independent agents to move policies from the insurer to other companies that offer higher commissions. Again, there is no evidence that would indicate that insurers are using this tactic to limit their exposures in coastal areas.

Other potentially relevant aspects of marketing and distribution include the performance of agents in fully informing consumers about terms of coverage and available discounts and credits. Ideally, an agent will inform consumers about their coverage needs and options and the tradeoffs associated between the amount of coverage they purchase and the premium they will pay. If they fail to do this or engage in other practices that are not in the best interests of consumers, it could contribute to the insurance problems faced by property owners in coastal areas. Arguably, this problem did contribute to the large number of property owners in Gulf Coast states that failed to purchase flood insurance.

VII. Regulation of Claims Adjustment/Settlement

The adjustment and settlement of hurricane claims have been matters of some concern to affected states. The issues associated with insurers' claim processes are complex. One principal issue has been whether insurers have properly investigated and adjusted claims and offered insureds fair settlements. A second issue is how quickly claims are settled and paid. A third issue is the determination of damages arising from wind and other covered perils and damages arising from flooding or surface water. If an insured has purchased flood insurance, this issue is essentially confined to how an insurer allocates losses between it and the NFIP. If an insured has not purchased flood insurance, the issue becomes more significant because he or she will not receive compensation for losses determined to be caused by flooding.

Hurricane claims present special challenges to insurers. One challenge is the large number of claims that need to be adjusted under difficult conditions. Insurers generally utilize special "cat teams" of adjusters to help deal with the large volume of claims as well as contract adjusters. Insurers are also conscious of the financial implications of the general policies and guidelines they follow in adjusting/settling claims. More "generous" policies can significantly increase their losses. Less generous policies can raise concerns that insurers are applying arbitrary rules that may result in a less than adequate settlement for a specific insured. There is an inherent tension in settling claims quickly and settling them properly.

Tables VII.1 and VII.2 provide information on the number of claims filed due to Hurricanes Katrina and Rita by state. According to information compiled by the NAIC, Hurricane Katrina generated more than 1.3 million claims and Hurricane Rita generated more than 400,000 claims. As of December 31, 2006, claims payments accounted for only 63 percent of the total estimated gross losses for Katrina. The comparable number for Rita was 57 percent. These figures indicate the large volume of claims caused by both events as well as the time involved in fully settling claims.

Following a storm-related catastrophe, it is extremely important for property owners to be able to file a claim with their insurance companies as soon as possible so they can begin the process of rebuilding their homes and businesses and reestablishing their lives. The first step in that process is usually the adjustment of claims. Professional claims adjusters are generally employed or contracted by insurance companies to assess property damages according to established methods of loss valuation. Some states allow insureds to utilize the services of public adjusters who are not affiliated with insurance companies and instead act on behalf of the insured to file claims and negotiate settlements with an insurance company.

Both types of adjusters are required to be licensed by a state which involves background checks, registration with the state insurance department, passing exams and the payment of appropriate fees. Claims adjusters may not be affiliated with building contractors or others who offer repair or compensatory services to policyholders. Most states that are prone to hurricanes or other natural disasters have initiated emergency procedures for allowing claims adjusters to bypass some licensing procedures and register with the state to provide adjustment services for a limited amount of time – usually three to six months. Inevitably, catastrophes may force some insurers to augment experienced property claims adjusters with less experienced adjusters. It is not clear that this has had a material effect on the proper settlement of claims but it could contribute to problems that arise in the claims process for catastrophes.

Table VII.1
Hurricane Katrina Claims by State
Data as of December 31, 2006

State	Claims Information		
	Claims Reported	Claims Determined to be a Total Loss	Total Claim Payments
Alabama	107,739	2,239	$853,955,542
Florida	127,550	3,139	$971,619,473
Louisiana	664,717	76,848	$17,083,762,919
Mississippi	431,195	30,237	$7,592,068,709
Texas	660	31	$19,549,564
Total	1,331,861	112,494	$26,520,956,207

Source: NAIC

Table VII.2
Hurricane Rita Claims by State
Data as of December 31, 2006

State	Claims Information		
	Claims Reported	Claims Determined to be a Total Loss	Total Claim Payments
Alabama	887	38	$12,713,333
Florida	4,861	146	$24,099,227
Louisiana	179,624	6,948	$2,293,467,227
Mississippi	5,337	61	$58,373,422
Texas	220,641	3,257	$2,818,005,552
Total	411,350	10,450	$5,206,658,760

Source: NAIC

Regulators may pressure insurers to settle hurricane claims within a reasonable period of time. The concern is that protracted claim settlements could delay the recovery of property owners that have suffered losses. However, settling some claims arising from a hurricane could involve more time than typical homeowners claims for reasons cited above as well as others. Of course, disputes about the appropriate payment can prolong the settlement process.

Finally, regulators may urge insurers to offer "adequate" settlements to claimants and not take an excessively hard line on the amounts they pay. Typically, regulators will not intervene in claim settlements unless they see patterns that they consider to be unacceptable or clear violations of state regulations and insurance contract provisions. Insureds can file complaints with their insurance department and/or file lawsuits. Generally, regulators will not get involved in factual disputes but will intervene if there are potential violations of laws, regulations or contract provisions.

A. Rules and Practices

In 2006, Louisiana implemented Public Act 783 – The Claims Adjuster Act – which sets forth all requirements for licensing and registration of claims adjusters on both a permanent and emergency basis. The use of public adjusters is not allowed. There are also state reciprocity provisions which enable claims adjusters licensed and certified as being "in good standing" in other states to forego examinations and certain other requirements in order to provide their services in Louisiana.

In 2007, the Mississippi Legislature passed the Public Adjuster Act that provides for the regulation and licensure of public adjusters in a manner similar to that required for other insurance adjusters. The bill provides that public adjusters must ensure that all contracts for their services are in writing, signed by the insured and the public adjuster, and that a copy be provided to the insured upon execution. It also limits compensation to public adjusters to no more than ten percent of any insurance settlement.

Florida requires insurers to report data on their handling of hurricane claims and subjects insurers to claims audits. While these measures may not explicitly require insurers to pay claims more quickly or offer higher settlements, they can be used to apply implicit pressure.[40] The FLOIR also performs targeted market conduct examinations of insurers' handling of hurricane claims which can result in sanctions if regulators determine than an insurer has failed to adjust and settle claims in an appropriate manner. For example, the FLOIR accused Nationwide of underpaying 2004 hurricane claims and forced the company to review how it handled these claims.[41] The Florida Governor also set deadlines for insurers' settlements of 2004 hurricane claims.[42]

B. Dispute Resolution

In order to assist claims settlements, particularly following catastrophic events in which there are likely to be an extraordinary number of claims, states have implemented mediation programs. Mediation is a process where a neutral third party, who is a trained professional skilled in resolving disputes, meets with the policyholder and the insurance company to help resolve insurance claim disputes. Unlike arbitration where the arbitrator makes the decision, mediators help the various parties focus on the issues and understand each other's viewpoints. Mediation is not binding and there is usually a grace period in which a claimant may change his or her decision regarding an agreed upon settlement.

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[40] These requirements are specified in Rule 69O-142.015 Standardized Requirements Applicable to Insurers After Hurricanes or Natural Disasters issued on June 12, 2007.
[41] "Nationwide Agrees to Review Hurricane Claims in Florida," *Columbus Dispatch*, October 15, 2005.
[42] "Deadline is Set for Insurers to Settle Storm Claims," *Palm Beach Post*, October 27, 2004.

Louisiana, Florida and Mississippi have mediation programs through their state insurance departments. In Louisiana, a policyholder may request mediation after an insurance company has denied a claim or made a settlement offer that the policyholder believes is less than satisfactory. In Mississippi, nearly 2,500 requests for mediation have been filed through the insurance department's Hurricane Katrina Mediation program and the program reports an 85 percent success rate.

C. Other Legislative/Regulatory Measures

Most homeowners insurance policies exclude damage caused by floods. Flood insurance is provided through the National Flood Insurance Program (NFIP). When Hurricane Katrina hit the Gulf Coast, the damage was so severe in some areas it was difficult to determine whether flood (including storm surge) or wind was the specific cause of loss or how much of the damage to a property was caused by each peril. Further complicating the issue in Louisiana was the catastrophic flood damage caused by levees that burst.

Rather than wait for a determination as to the percentage of damage caused by flood versus wind, flood claim adjusters were instructed to pay flood policyholders the full limits of coverage under their policies. In many cases, claims adjusters for homeowners insurers declared damages to be fully the result of flood based on the use of flood water marks on the walls of houses even if it had been blown off its foundation. As a result, emergency insurance department regulations and ultimately state laws were passed in Louisiana and Mississippi that placed the burden of proof on insurers to definitively assess the portion of property damage attributable to wind before denying any homeowners insurance claim where wind and flood were both a cause of loss.

In Louisiana and Mississippi the issue of whether hurricane damages that occurred were the result of flood or wind led to numerous disputes that ultimately required court resolution. There were two essential issues in the litigation. The first was whether the flood exclusion in homeowners insurance policies was enforceable. The second issue involved insurers' determinations on whether and how much damage was caused by wind versus water. Despite some early reversals in lower courts, insurers have generally prevailed in their appeals to higher courts on the issue of the flood exclusion. The allocation of damages has and continues to be litigated as this is essentially a factual dispute rather than a matter of contract law.

The actions of the Mississippi Attorney General to force companies to settle their customers' property insurance claims despite the flood exclusions ultimately resulted in State Farm's decision to withdraw from the state. An insurer's uncertainty about future claims obligations in the event of a hurricane could have negative effects on the supply of insurance in coastal areas. As in the case of State Farm's experience in Mississippi, this uncertainty could cause an insurer to withdraw or retrench from coastal areas to a greater extent than it would do so otherwise. It could also contribute to higher rates to compensate for higher costs that might arise from wind versus water disputes and associated litigation.

VIII. Financial Regulation

A. General Policies and Standards

Regulators also are responsible for regulating insurers' solvency and financial condition, including their level of catastrophe risk. Regulators are placed in a position of balancing solvency requirements with their desire to lower the magnitude of rate increases and preserve the availability of insurance coverage. In markets subject to tight supply and high costs, regulators may sometimes tip the balance further in favor of improving "availability and affordability" given this is the greatest and most immediate concern to consumer-voters in high-risk areas.

This kind of regulatory tradeoff is especially relevant to Florida given the market pressures it has faced. Beginning in the mid-1990s, Florida allowed start-up insurers to write large blocks of exposures in high-risk areas. In fact, many of these start-up insurers drew a significant amount of their initial capital from bonuses they received for taking policies out of the residual market. There were also some existing small regional insurers that entered or expanded their writings in the Florida market to absorb the exposures shed by other insurers. These insurers can purchase reinsurance to bolster their capacity but there are limits to how much they can reduce their risk from writing large concentrations of high-risk exposures. Even the most generous catastrophe reinsurance contracts still require the ceding insurers to retain a significant amount of risk at lower layers that can only be supported by surplus. An insurer with a greater amount of surplus and a more diversified portfolio of exposures is in a better position to absorb hurricane losses not covered by reinsurance.

Fortunately, the lack of significant hurricane losses till 2004 enabled the start-ups to escape their "precarious" position if they chose that route. They were allowed to drop the policies they took out of the residual market after three years. An analysis by Grace, Klein and Liu (2006) indicated that a number of the start-ups did substantially reduce their coastal exposures as they were allowed to and sought to increase their geographic diversification across the state to lessen their catastrophe risk. Some of the start-up insurers appeared to exit the Florida market entirely. However, the data indicate that other Florida-concentrated insurers substantially increased their writings which necessarily increased their exposures in high-risk areas.

The diversification strategy appeared to work for those start-up insurers that employed it – none of these insurers were bankrupted or even impaired as a result of the 2004-2005 storm seasons. However, five of the insurers that retained substantial concentrations of high-risk exposures were placed into receivership after the storms. Three members of the Poe Group – Atlantic Preferred, Florida Preferred, and Southern Family – became insolvent and are in liquidation. Vanguard has also been placed into liquidation. Florida Select is under the control of state regulators but has not been placed into liquidation. Four additional insurers received substantial downgrades from A.M. Best (three of them members of the Tower Hill Group) but have not been formally seized by regulators.

Issues concerning the financial regulation of incumbent property insurers and market entrants remain relevant. Florida has reported that approximately 54 companies have entered the state since 2005 and other coastal states have also received market entrants to a lesser degree. The Florida Insurance Council predicted that Florida domestic companies will account for 50 percent of the state's homeowners insurance market by the end of 2008.[43] Some of the entrants in Florida and Louisiana have been attracted by the states' residual market depopulation and financial incentive programs. Others have entered without taking advantage of these incentives which also carry a requirement to write a certain amount of coastal business and/or take policies out of the states' residual market facilities.

Market entrants can employ different business strategies. One strategy is "niche" marketing. In this strategy, an insurer selectively writes exposures consistent with its financial capacity. The objectives in this strategy are both profitability and survival. It appears that insurers following this strategy are being careful in terms of avoiding writing an excessive concentration of coastal exposures that could result in their insolvency due to hurricane losses.

A second strategy is more aggressive and involves a greater gamble on the part of an insurer. In this strategy, an insurer will write a larger amount of coastal exposures which could significantly raise its default risk. In essence, such an insurer is "betting" that it can earn substantial profits until it is hit by a hurricane.[44] The longer it can write business before a hurricane occurs, the greater the profits it can accumulate and pay to its owners. If the insurer becomes insolvent, its owners will lose whatever equity that is still held within the company and the unpaid claims obligations will be passed on to the state through the guaranty association. This strategy could yield net gains to owners if they can extract more profits from the company than the capital they initially invested.

[43] "Florida Domestics Grab Increasing Market Share," *National Underwriter*, December 11, 2008.

[44] As discussed above, an insurer can retain such "profits" in their surplus which increases its capacity and ability to cover the retentions in its reinsurance arrangements. However, it is not clear that all of the new insurers are doing this.

Unfortunately, a state's insurance consumers and taxpayers suffer the downside of such a gamble. Ultimately, only regulators can control this behavior by forcing these insurers to limit their catastrophe risk and retaining adequate surplus.

The fact that Florida regulators had allowed insurers to write large concentrations of high-risk exposures prior to 2006 raises questions about the adequacy of the companies' financial oversight. It should be noted that US regulatory capital requirements (both fixed and risk-based) do not consider catastrophe risk.[45] Further, there is no uniform policy or standard across the states that require insurers to rigorously assess and manage their catastrophe risk.[46] Some states may use their regulatory discretion to require insurers to perform catastrophe risk modeling but this would be a matter of choice and not mandated by law or regulator-issued rules. For example, Florida now requires insurers to submit reports on their catastrophe risk management. However, it is difficult for "outsiders" to assess the rigor of this process.

One could advocate differing views on how stringent solvency regulation should be for insurers that are absorbing a large number of high risk exposures. On the one hand, less stringent solvency regulation allows more companies to absorb high-risk exposures, which eases pressure on established insurers to retain these exposures. On the other hand, more lenient solvency requirements can result in insolvencies and the associated costs are

[45] Insurers are subject to both state-determined fixed capital requirements and risk-based capital (RBC) requirements developed by the NAIC and adopted by the states. Insurers are required to meet the higher of the two requirements. Since most state fixed capital requirements are in the area of $1-$2 million, RBC requirements tend to be the binding constraint faced by most insurers. However, RBC requirements do not explicitly consider insurers' catastrophe risk. It also should be noted that insurers are subject to a number of other financial requirements and, in theory, are expected to maintain their default risk within certain reasonable boundaries. How the various states may actually enforce financial risk limits probably varies and is not readily transparent to non-regulators.

[46] The NAIC has considered adding a catastrophe risk component to insurers' RBC requirement but proposals have been subject to substantial debate and there is no prospect for a resolution of the issues in the near future. Rating agencies do impose more rigorous catastrophe risk management requirements on insurers but smaller, single-state and new insurers are generally not rated by a major rating agency.

passed on to solvent insurers and their policyholders, as well as taxpayers.[47] From a public policy perspective, allowing small or regionally concentrated insurers to underwrite an excessive number of high-risk exposures creates several problems including moral hazard among overly exposed insurers as well as diminishing their insureds' incentives to better control their disaster risk.

The story of the Poe companies is a good illustration of the "go for broke" strategy that some insurers employ when they encounter financial difficulty. Poe insured more than 300,000 homes with most concentrated in the high-risk areas of Palm Beach, Broward and Miami-Dade counties. Despite major losses from the 2004 storms and declining capital, Poe aggressively added more policies in 2005, gambling that it would not incur more storm losses. Such gambling is encouraged by a regulatory system in which an insurer can shift its losses to the state (i.e., insurance consumers and taxpayers) through the insolvency guaranty association. An insurer's owners reap the potential upside of such gambles and stick the public with the potential downside. The downside scenario became fact when the Poe companies became insolvent after the 2005 storm season generating approximately $988 million in payments (as of year-end 2007) by the Florida Insurance Guaranty Association (FIGA) for 46,162 claims from Poe's policyholders (Florida Insurance Guaranty Association, 2007). There is no evidence that Florida regulators attempted to constrain Poe's actions until 2006.[48]

It is interesting to note that the entrepreneurial spirit still prevails as more new insurers have been formed to write business in Florida. Based on media reports, it appears

[47] Some established insurers may still find this preferable if insolvency costs are spread broadly across all insurers and other lines. Also, state and federal laws allow insurers to recover at least some of their guaranty association assessments through rate surcharges and/or tax credits or deductions.
[48] See "Insurance Failures Spawn New Levy on Florida Policies," *Palm Beach Post*, October 30, 2007.

that some of the initial post-2005 entrants are being cautious and selective in the policies they write – behavior that would be consistent with a prudent business plan and long-term viability and profitability. However, such prudence may or may not be exercised by other entrants or small insurers that expand their Florida business. Based on the latest information from the FLOIR, 17 insurers are participating in its takeout program.[49]

Hopefully, all of these insurers will choose or be compelled by regulators to adopt prudent, long-term business strategies that will ensure their viability when more hurricanes strike the state but this is difficult to verify. Florida's claim that the takeout insurers exceed its "rigorous" capital requirement of $5 million by two to three times is vacuous. Capital adequacy can only be ascertained by assessing an insurer's total risk exposure and its management of that risk. This is especially the case with insurers assuming relatively high concentrations of coastal exposures. An insurer can readily blow through $15 million in capital if it sustains significant hurricane losses. Insurers can buy substantial amounts of reinsurance but cat reinsurance arrangements typically require significant retentions by ceding insurers that can only be covered by their surplus.

While new or smaller, regionally-concentrated insurers can provide some relief, their capacity tends to be limited and it is questionable whether they are positioned to safely absorb large concentrations of high-risk exposures. A more prudent strategy would encourage more national, geographically-diversified insurers to each assume digestible shares of high-risk exposures at adequate rates. Unfortunately, current policies in Florida are not encouraging this kind of development.

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[49] The FLOIR requires these insurers to submit analyses of their catastrophe risk management. In turn, these insurers must receive approval from the FLOIR to remove specified blocks of exposures from the FCPIC. This process could be administered so as to limit these insurers' catastrophe risk within reasonable bounds. It is also our understanding that the policies to be removed from the FCPIC are west of I-95 (Insurance Information Institute, 2009b).

Louisiana appears to be employing a safer two-prong strategy – encouraging existing insurers to stay and attracting new insurers both national and regional in scope. Louisiana will need to be careful in allowing smaller insurers in writing large concentrations of high-risk exposures if they wish to avoid to the kind of insolvency risk that Florida has encountered. The LDOI's recent denial of American Integrity's grant application because it failed to meet the incentive program's capital requirements reflects Louisiana's tighter explicit standards. The same company received an incentive grant from Florida. However, the stringency of a state's solvency regulation is determined by the full array of standards it enforces and how it enforces them. Other coastal states also report the entry of new insurers.

B. Reinsurance

Developments concerning collateral requirements for non-US reinsurers warrant brief mention. The NAIC has been involved in intensive discussions concerning adjusting these collateral requirements according to the financial strength and regulation of non-US reinsurers (see Klein and Wang, 2009). Unfortunately, strong differences of opinion among primary insurers, US reinsurers, non-US reinsurers, and regulators have prolonged this discussion. In December 2008, the NAIC adopted a new framework for determining reinsurers' collateral requirements which could expand the supply and lower the cost of reinsurance from non-US reinsurers. This could aid the supply and lower the price of primary coverage. Impatient with the slow progress at the NAIC, New York and Florida have issued their own proposals for relaxing collateral requirements for reinsurance purchased by insurers operating within their jurisdictions. New York has issued a proposed regulation which has not been implemented. The Florida insurance commissioner has been authorized to modify collateral requirements for foreign reinsurers at his discretion. Hence, this issue is clearly important and will continue to receive significant attention as the states and insurers continue to seek to enhance catastrophe risk financing.

IX. Mitigation Activities

Although not an explicit element of insurance regulation per se, state efforts to mitigate the risk associated with hurricanes and tropical storms do have significant implications for insurance markets and their regulation. Mitigation efforts have taken several forms. One form is state and local building codes and their enforcement. A second form is state grants and other financial incentives to assist homeowners with mitigation. Other aspects of mitigation include mandated and optional premium credits for certain mitigation measures and other regulatory policies that directly or indirectly involve loss reduction activities.

The growing interest in mitigation and its effects on insurance markets are understandable. Both the location of structures and their resiliency to hurricane winds can substantially affect their risk of loss and the catastrophe risk assumed by insurers. Flood mitigation efforts are also important in areas subject to coastal storm surges and other flooding associated with hurricanes/storms, although flood mitigation and risk primarily involve the NFIP and FEMA's array of mitigation activities. The hope is that mitigation will sufficiently reduce the risk faced by insurers (at least over time) to the extent that it will increase the supply as well as lower the cost of insurance for property owners. How quickly this hope will be realized will depend on the success of mitigation in reducing losses and risk and how insurers will interpret and respond to mitigation effects.

It appears that insurers and cat risk modelers have refined and enhanced their consideration of the structural features of properties in risk analysis, pricing and underwriting. Insurers have access to data that are fairly detailed in terms of the structural features and associated wind resistance of homes. The extent to which these data are employed in their rating plans and underwriting guidelines is less clear and could vary among insurers but the potential for more refined rating plans seems fairly evident.

1. Alabama

Alabama does not have a statewide building code nor does it have a statewide residential code in effect. The state does mandate in all jurisdictions that state buildings, hotels, schools and motion picture theaters meet the requirements set forth in the 2003 International Building Code (IBC). Any municipality in Alabama may adopt any model building code published by the Southern Building Code Congress International and the National Electrical Code published by the National Fire Protection Association.

Since Hurricane Katrina, several bills have been proposed in the Alabama legislature addressing the status of an Alabama state building code. House Bill 653 of 2006 created the Alabama Building Code Study Commission (ABCSC). The Commission was charged: 1) to identify minimum standards for construction to respond to federal requirements for the FEMA aid after a natural disaster such as a tornado, flood, hurricane, fire, or earthquake; 2) to address concerns from national insurers who may be limiting their new or renewal business because of a lack of building standards in many areas of Alabama; and 3) to promote the health, safety, and welfare of the public.

Most recently, HB121 sponsored by Rep. Mike Hill, R-Columbiana, would institute a standard building code and create an oversight council of 10 voting and 12 non-voting members. This bill implements the recommendations of the ABCSC and is supported by each of the commission member groups.

2. Florida

Florida has demonstrated that a strict building code can save money and lives. Hurricane Andrew provided substantial evidence of inadequate building codes and enforcement which contributed to insured and uninsured losses. Following this experience, Florida sought to implement a statewide building code and required insurers to offer credits for certain mitigation efforts, such as the installation of storm shutters. Studies of the effects of 2004 hurricanes showed that mitigated structures suffered less damage than non-mitigated structures (Institute for Business and Home Safety, 2006).

Florida also has a fairly extensive grant program to assist homeowners in inspecting and retrofitting their homes to be more hurricane resistant. The "My Safe Florida" program provides matching grants of up to $5,000 for each qualifying applicant and also inspects homes. Program administrators report that it had awarded 36,254 matching grants. It also had received 300,000 applications and inspected more than 400,000 homes.[50] The program is shutting down its grant portion, but will continue to inspect homes until the program sunsets on or before June 30, 2009. Program administrators estimate that 60 percent of homeowners who have submitted inspection reports to their insurers have received an annual average premium discount of $200.

[50] "Fla. Program Certifies Hurricane Mitigation for More Than 200,000 Homes," *BestWire*, May 23, 2008.

3. Louisiana

Louisiana has adopted one of the strongest statewide construction codes and is utilizing recovery funds to implement and enforce them. In December 2005, Louisiana enacted the State Uniform Construction Code (Act 12 of 2005). The law requires that the International Residential Code (IRC) for homes and the IBC for businesses be enforced uniformly statewide and implemented within 90 days in the 11 southernmost parishes damaged by hurricanes Katrina and Rita and implemented in the remainder of the state by January 1, 2007.

In order to meet the Act's requirements, it was necessary to train builders in the new standards and open new code offices with International Code Council (ICC) certified inspectors to assure compliance with the code. At the time Act 12 was passed, there were only seven code offices in the state and 42 ICC-certified inspectors. At present, there are almost 200 code offices providing inspections throughout the state served by approximately 400 ICC certified-inspectors and plan reviewers, including third party providers, architects and engineers.[51]

Intergovernmental agreements between local jurisdictions enabled smaller offices to band together into economically-feasible code offices. Two regional planning organizations (South Central and Rapides) have each organized a code office using this mechanism and some larger cities have entered code office agreements with their parish or surrounding smaller towns. An out-of-state non-profit organization, the Institute of

[51] Louisiana Property and Casualty Insurance Commission Report 2007.

Building Technology and Science (IBTS), was hired to provide 70 certified inspectors to do the inspections and plan reviews and to train new inspectors.

In north Louisiana, the IBTS has set up regional offices with which small rural jurisdictions contract for inspections and plan reviews. About $34 million in funding from state and federal sources has been used to arrange training classes for builders, certifications for inspectors, and establish code offices throughout the state.

4. Mississippi

Prior to 2008, Mississippi did not have a statewide building code but has created a commission charged with developing a voluntary statewide code. Roughly 50 percent of its population is living in an area that has adopted some version of the IBC. Compelled by provisions required by the Legislature after Hurricane Katrina, five counties on the Coast have adopted the new building codes – Harrison, Hancock, Jackson, Pearl River and Stone. Effective October 1, 2007, credits against premiums for fortified construction designed to lessen damage from windstorms became available. The buildings must meet IBHS standards. In March 2008, legislation was enacted that requires new building codes adopted by cities and counties meet codes established and promulgated by the Mississippi Building Codes Council (MBCC). Codes adopted prior to 2000 must meet the MBCC standards by July 1, 2010.

5. South Carolina

The South Carolina Omnibus Coastal Property Insurance Reform Act includes provisions that established the South Carolina Hurricane Grant Damage Mitigation Program also known as SC Safe Home. The program provides grants to South Carolina property owners to assist with the retrofit of their homes to make them more resistant to loss due to hurricane damage. The program also provides grants for the mitigation of damage to or the enhancement of manufactured homes, funds ongoing training for building inspectors, and provides matching grant funds to local governments for projects that reduce hurricane damage to single family residential properties. Additionally, property owners can obtain sales and income tax deductions for mitigation investments.

6. Texas

In January 1, 2002, Texas adopted the IRC. In January 2006, SB 1458 was passed to implement the IBC for use in all municipalities, except unincorporated areas. Pursuant to Article 2210.251 of the Texas Insurance Code, Texas adopted the latest version of the 2006 IRC and IBC for use as the windstorm building code for all 14 counties along the Texas Coast that border the Gulf of Mexico and parts of Harris county east of Hwy 146. This is not a mandatory building code for these counties. However, homeowners and business owners who wish to obtain windstorm and hail insurance coverage through the Texas Windstorm Insurance Association must have their structures built to meet the requirements of the Windstorm Building Code. The Texas Department of Insurance is responsible for the enforcement of the Windstorm Building Code.

X. Summary and Conclusions

This review of Southeastern states' regulatory polices toward property insurance suggests that that most are taking a fairly reasonable and prudent course in serving insurance consumers and promoting the restoration of the supply of insurance in coastal areas. For example, Louisiana officials appear to recognize that draconian actions and severe constraints on insurers would likely worsen insurance availability problems and cripple the state's recovery. The state's policies and their implementation have involved making some tough choices and coastal property owners have suffered hardships. However, this cannot be avoided if Louisiana is going to rely primarily on private capital to underwrite catastrophe risk.

How quickly Louisiana's property insurance market will rebound and what a new market equilibrium will look like is uncertain. This will be affected by the attraction of new insurers into the market and other insurers' decisions to expand their business or reverse their retrenchment from the state's coastal areas. Beyond the state's effort to sustain a favorable regulatory environment, much will depend on insurers' perception of the adequacy of their rates and the sustainability of their operations. Many factors affect insurers' business decisions beyond regulation and these factors are still fluid. While most assessments of the risk of future hurricanes remain high, insurers' actual loss experience and profitability inevitably influence their appetite for underwriting catastrophe risk. The 2008 storm season reaffirmed the high level of hurricane risk along the Atlantic and Gulf coasts.

Louisiana's efforts to restore and maintain the viability of its property insurance markets in coastal areas will likely become a permanent element of its activities. Barring a dramatic, long-term decline in the frequency and severity of hurricanes (an unlikely development), regulators will need to continue to monitor market conditions. Hopefully, its markets will reach a new, sustainable equilibrium to which both insurers and insureds will acclimate. However, the achievement of such an equilibrium would not preclude future market disruptions. Some industry observers believe that the occurrence of infrequent hurricanes would not plunge insurance markets into another frenzy. Although insurers have ramped up their estimates of hurricane risk and made associated adjustments in their pricing and exposures, it is not clear that such adjustments would be considered adequate if the experience of the 2004-2005 storm seasons becomes the norm.

Consultations with insurers and reinsurers could assess how they would be expected to react to various scenarios and identify those that would create additional challenges for regulators. There are the questions of how far the private market will go in terms of underwriting homes in high-risk coastal areas and what more the Louisiana government can do to promote the supply of insurance. Further analysis could help shed some light on these questions, but ultimately time will tell how property insurance markets will evolve in the future.

Regulatory policies in other states vary. On the whole, regulation in Alabama, Mississippi and South Carolina does not appear to be causing major market dislocations. Texas has imposed more constraints which could be having a negative effect in coastal areas but the large size of its home and auto insurance markets would be expected to mitigate the adverse impact of such constraints. Of all Southeastern states, Florida's regulatory policies are clearly the most restrictive. Arguably, its policies have likely exacerbated problems with respect to the supply of insurance and caused the state to assume more risk than necessary. There is some indication that Florida legislators and regulators are beginning to recognize the problems created by current policies. This could lead to some positive changes but the prospects for this are uncertain.

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