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TO THE HOUSE COMMITTEE ON PUBLIC SAFETY & MILITARY AFFAIRS

TWENTY-SIXTH LEGISLATURE
Regular Session of 2012

Thursday, February 9, 2012
9 a.m.

**TESTIMONY ON HOUSE BILL NO. 1872 - RELATING TO HURRICANE PROPERTY
INSURANCE**

TO THE HONORABLE HENRY J.C. AQUINO, CHAIR, AND MEMBERS OF THE
COMMITTEE:

My name is Gordon I. Ito, State Insurance Commissioner ("Commissioner"),
testifying on behalf of the Department of Commerce and Consumer Affairs
("Department"). The Department has concerns with this bill and offers comments.

The bill would require insurers to use actual damages to develop their risk maps
for hurricane insurance rates and prohibit insurers from using predicted damages and
losses. Risk maps based entirely on previous losses would assign a high risk to those
areas that had suffered losses, whereas areas which escaped damage in hurricanes
would be assigned a low risk. This method would not be actuarially sound.

The proposed roll-back of premiums to 1992 levels does not consider whether
that rate would be excessive, inadequate, or unfairly discriminatory for today's market.
The rollback may be harmful to policyholders and consumers, where it deters insurers
from offering coverage thereby creating an availability problem.

We thank this Committee for the opportunity to present testimony on this matter
and respectfully request that this bill be held.



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TESTIMONY OF AMORI OGATA

HOUSE COMMITTEE ON PUBLIC SAFETY & MILITARY AFFAIRS
Representative Henry J.C. Aquino, Chair
Representative Ty Cullen, Vice Chair

Thursday, February 9, 2012
9:00 a.m.

HB 1872

Chair Aquino, Vice Chair Cullen, and members of the Committee, my name is Amori Ogata, Chief Operating Officer of Zephyr Insurance. I am here today representing Hawaii Insurers Council. Hawaii Insurers Council is a non-profit trade association of property and casualty insurance companies licensed to do business in Hawaii. Member companies underwrite approximately 40% of all property and casualty insurance premiums in the state.

Hawaii Insurers Council **opposes** HB 1872. This bill requires hurricane property insurers after December 31, 2013 to roll back rates to January 1, 1992 rates or if no hurricane coverage was provided by the insurer on January 1, 1992, charge rates based on the average 1992 premiums for similar property in similar locations until the insurer creates a geographic specific disaster model containing property zones depicting actual damages and losses from previous hurricanes. The map shall not take into account predicted damages and losses.

Hurricane property insurers like all catastrophe insurers are dependent on reinsurance obtained from the global reinsurance market. Imposing rates on hurricane property insurers to a period before large losses without any consideration of current expenses including reinsurance would likely cause capacity issues similar to those found after

September 11, 1992, post Hurricane Iniki, where the State needed to create the Hawaii Hurricane Relief Fund to support Hawaii's economy.

Additionally, hurricane property insurers utilize the predictive nature of modeling to determine the necessary capacity to reinsure. This bill's disallowance of taking into account predicted damages and losses will further cause hurricane insurance capacity issues.

For these reasons, we respectfully request that HB 1872 be held.

Thank you for the opportunity to testify.

**HOUSE COMMITTEE ON
PUBLIC SAFETY & MILITARY AFFAIRS**

February 9, 2012

House Bill 1872 Relating to Hurricane Property Insurance

Chair Aquino and members of the House Committee on Public Safety and Military Affairs, I am Rick Tsujimura, representing State Farm Insurance Companies, a mutual company owned by its policyholders.

State Farm is opposed to House Bill 1872 Relating to Hurricane Property Insurance.

Hurricanes are potentially solvency threatening events whose frequency and large variation in severity make them difficult to recognize in projecting future costs for ratemaking purposes. The direct loss experience from actual hurricane events is not sufficient to form a basis for projecting future hurricane costs due, in part, to the following reasons:

- The frequency and severity of historical hurricane activity has not been constant over time.
- The tremendous population growth and related demographic changes that the coastal United States has experienced since 1960, coupled with significant changes in construction practices, materials and costs, makes any direct insured loss experience that might exist from these earlier events of little use in projecting future costs for ratemaking purposes.
- In addition, the geographic pattern and physical characteristics of the historical hurricane record do not reflect the full range of possible hurricane events. Similarly, the specific landfall locations of the historical hurricanes, if interpreted literally, may provide a misleading picture of future exposure.
- As a result of the concerns with historical data, most insurers choose to use hurricane modeling for the development of the hurricane provision in pricing. The development of sophisticated hurricane models in recent years has reached the point where models are an accepted method for projecting future expected costs of the hurricane exposure and are more reliable than using only historical insured loss data.

The following bullet points are intended to get at the very basic concept of rate making. They are derived from the Statement of Principles Regarding Property and Casualty Insurance Ratemaking:

- Principle 1: A rate is an estimate of the expected value of future costs.
- Principle 2: A rate provides for all costs associated with the transfer of risk.
- Principle 4: A rate is reasonable and not excessive, inadequate, or unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer.

Consideration should be given to the impact of catastrophes on the experience and procedures should be developed to include an allowance for the catastrophe exposure in the rate. A rate set according to the proposed legislation will not meet the requirements set forth. The points to emphasize are that rates are based on expected future costs and are not retrospective. Having said that, we can and do use historical information to inform us and help us with our projections for the future when it is appropriate to do so. For catastrophic occurrences however, the usefulness of the historical data is dependent on the nature of the catastrophe. For catastrophes as infrequent as hurricanes and earthquakes, historical information isn't very useful. The other two points to take away are that the rate takes into account all future costs (this includes catastrophes) and if it does those things the rate is actuarially sound.

The bullet points in the following section are taken from Actuarial Standard of Practice No. 39 Treatment of Catastrophe Losses in Property/Casualty Insurance Ratemaking. The guidance in this Standard is something we, as actuaries, are bound to follow albeit there is an out for the occasion when following the law results in a deviation from the standard. The Standard, however, sets forth solid guidance for the ratemaking actuary to follow. The rate must include a provision for catastrophes. The actuary should evaluate the appropriate method to use to include such a provision. In Hawaii a perfect example of the concern highlighted in the first two bullets is the inclusion of Hurricane Iniki in the historical data would significantly change the results from one year to the next. That alone would indicate historical data is not appropriate for consideration in this circumstance (hurricane exposure). The last two bullet points speak to the need to include a modeled provision instead of historical losses.

- Evaluating Historical Insurance Data—. . . Thus, in determining a provision for catastrophe losses, the actuary should consider the sensitivity of the provision to changes in the historical insurance data relating to the following: (1) the frequency of catastrophes; (2) the severity of catastrophes; and (3) the geographic location of catastrophes.
- Stability of Outcomes Based on Historical Insurance Data—The actuary should consider the extent to which the provision for catastrophe losses would change if the catastrophe ratemaking procedure were to be carried out using different historical experience periods. If, in the actuary's judgment, the procedure is too sensitive to the inclusion or exclusion of an individual catastrophe or sets of years, the actuary should consider modifying the procedure to reduce the sensitivity.
- Use of Noninsurance Data and Models—If, after considering the items contained in section 3.3.1(a-f), the actuary believes that the available historical insurance data do not sufficiently represent the exposure to catastrophe losses, the actuary should consider doing one of the following: 1. use noninsurance data to adjust the historical insurance data; 2. use noninsurance data (including models based thereon) as input to ratemaking procedures; or 3. use models based on a combination of historical insurance data and noninsurance data. The actuary should be satisfied that the resulting ratemaking procedures appropriately reflect the expected frequency and severity distribution of catastrophes, as well as anticipated class, coverage, geographic, and other relevant exposure distributions.
- Using a Provision for Catastrophe Losses—In ratemaking, actuaries generally use historical data or modeled losses to form the basis for determining future cost estimates.

The presence or absence of catastrophes in any historical data used to form future cost estimates can create biases that diminish the appropriateness of using that data as the basis for future cost estimates. The actuary should address such biases by adjusting the historical data used to form future cost estimates and determining a provision for catastrophe losses (after consideration of the issues and practices found in sections 3.1-3.3).

And finally, the citation below is Hawaii's ratemaking statute. If the proposed legislation is headed where it appears, it would be impossible to comply with the proposed legislation and the existing insurance code, especially section 431:14-103, which reads:

- (a) Rates shall be made in accordance with the following provisions:
- (1) Rates shall not be excessive, inadequate, or unfairly discriminatory.
- (2) Due consideration shall be given to:
 - (A) Past and prospective loss experience within and outside this State; provided that if the claim does not exceed the selected deductible amount pursuant to section 386-100, and the employer reimburses the insurer for the amount, the claims shall not be calculated in the employer's experience rating or risk category;
 - (B) The conflagration and catastrophe hazards, if any;
 - (C) A reasonable margin for underwriting profit and contingencies;
 - (D) Dividends, savings, or unabsorbed premium deposits allowed or returned by insurers to their policyholders, members, or subscribers;
 - (E) Past and prospective expenses both country-wide and those specially applicable to this State;
 - (F) Investment income from unearned premium and loss reserve funds; and
 - (G) All other relevant factors within and outside this State.

For these reasons we believe the measure should be held.

Thank you for the opportunity to present this testimony.