Consumer Federation of America

CENTER FOR ECONOMIC JUSTICE

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STATE INSURANCE REGULATORS FAIL TO PROTECT CONSUMERS FROM EXCESSIVE PROPERTY INSURANCE RATES BASED ON DISCREDITED HURRICANE PROJECTIONS

For the second time in a year, national consumer groups called on state insurance regulators and the National Association of Insurance Commissioners (NAIC) to reject severely flawed hurricane projections used by insurers to sharply increase rates on property insurance policies in states along the Atlantic and Gulf coast.

The computer catastrophe models are developed for insurers by organizations like Risk Management Solutions (RMS), Applied Insurance Research (AIR) and EqeCat to estimate future damage caused by weather related events and are then used to set homeowner's insurance rates. The models have historically been based on over a hundred years of historical data. However, last year, RMS announced that it would dramatically increase projected catastrophe losses in some coastal areas based on a "near-term" forecast of only five years. RMS claimed that this change was necessary because hurricane activity over the next few years will be above the historical average. This has led to rate increases of 25 percent in Maine to 50 percent or more along the Gulf Coast.

After the ad hoc adjustment to the models, the Consumer Federation of America (CFA) and the Center for Economic Justice (CEJ) called on state insurance regulators to protect consumers from arbitrary loss projections and excessive rates.

"We informed the NAIC a year ago that modeling changes made by RMS would lead to unjustified rate increases for consumers, but the NAIC and every state with the exception of Florida and Georgia failed to act to protect consumers," said J. Robert Hunter, CFA's Director of Insurance. "Since that time, rates have risen sharply in coastal areas and impartial scientists have strongly criticized the use of "near-term" projections by RMS and other firms that have increased estimated loss costs by up to 90 percent in some areas," he said. "Even one of the firms that markets catastrophic risk models, AIR Worldwide Corporation (AIR), has criticized the practice."

"It is a sham for RMS to claim that its catastrophe models are scientifically sound when they make an ad hoc adjustment at the end of the process that doubles loss projections," said Birny Birnbaum, Executive Director of CEJ. He added, "The NAIC claims the primary job of state insurance regulators is consumer protection, but it has done nothing to protect consumers from massive and unjustified rate hikes. It is a sad commentary on state insurance regulation that consumer groups have to repeatedly demand that regulators take action to stop these dramatic and unfair increases."

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Scientists and insurance experts have increasingly questioned the scientific legitimacy of the modeling changes. An investigation by the *Tampa Tribune* earlier this year found that scientists consulted by RMS no longer support the changes to its catastrophe model. Scientists not employed by RMS are also speaking out. "It's ridiculous from a scientific point of view," Mark S. Frankel, director of the Scientific Freedom, Responsibility and Law Program at the American Association for the Advancement of Science told the *Tampa Tribune*. Charles Watson, an engineer who specializes in numerical hazard models also told the *Tampa Tribune* that RMS acted irresponsibly. Even RMS's competitors have stated that the methodology for the 5-year model does not represent good science. In an article in *Contingencies*, the magazine of the American Academy of Actuaries, AIR's Senior Vice President, David A. LaLonde, said, "We continue to believe, given the current state of the science, that the standard base model based on over 100 years of historical data and over 20 years of research and development remains the most credible model."

"The wheels are coming off of the 'science' that RMS said it employed," said Hunter.

In announcing the change last year, RMS admitted the shift to a "near-term" loss projection was done in consultation with its insurer clients.

"RMS has become a vehicle for collusive pricing," Hunter stated. "The huge increase in rates that ultimately occurred because of inaction by NAIC and several states was due to pressure from insurers."

Not all states have ignored this development. Florida did not allow the new model to be used by primary insurers nor, it appears, has Georgia. However, residents of the 16 other states along the coast have been paying higher rates solely because of the changes adopted by RMS and other modelers.

The Consumer Federation of America (CFA) and Center for Economic Justice (CEJ) wrote the NAIC last March and again earlier this month urging it to reject the new modeling methods and immediately increase regulation of non-insurer organizations whose work has a significant impact on insurance rates and availability. The letters can be found at:
http://www.consumerfed.org/pdfs/Insurance_NAIC_RMS_Letter_032706.pdf
http://www.consumerfed.org/pdfs/Insurance_NAIC_RMS_Letter_031907.pdf

CFA is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education.

CEJ is a non-profit organization that works to increase the availability, affordability and accessibility of insurance, credit, utilities, and other economic goods and services for low income and minority consumers.

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