

**Statement of Robert Detlefsen
on behalf of the
National Association of Mutual Insurance Companies**

Property and Casualty Insurance (C) Committee
Catastrophe Modeling Public Hearing
September 28, 2007

A pair of letters written by J. Robert Hunter and Birny Birnbaum in the course of the last 18 months to two successive NAIC presidents suggests that the purpose of today's hearing is to provide a forum for these two self-anointed "consumer representatives" to publicly express their grievances against catastrophe modeling firms. They are particularly angry that one cat modeler—Risk Management Solutions (RMS)—has in recent years begun using models based on near-term projections to forecast hurricane-related losses, which in turn have been used by their insurer-clients to plead for permission to substantially raise premiums for property insurance in high-risk coastal regions.

As is customary on such occasions, Hunter and Birnbaum have responded by demanding that the NAIC exert tighter regulatory authority over the enemies of "economic justice." In letters dated March 19, 2007 and March 27, 2006, Hunter and Birnbaum base their case for greater regulatory oversight on three accusations: Catastrophe modelers are incompetent; models that incorporate near-term projections are based on "politics" rather than science; and modelers and insurers are engaged in "collusion." None of these accusations is credible.

Are modelers incompetent? In their March 2006 letter, Hunter and Birnbaum ask, "[G]iven the fact that RMS initially developed its model in the wake of Hurricane Andrew, why [were] its prior projections [...] so off the mark? Did insurers and modelers not know what they were doing then? Do they not know what they are doing now?" Anyone who is the least bit familiar with the evolution of climate science during the decade and a half since Andrew understands that the field has been remarkably fluid during this period. Leading researchers have developed, tested, and in some cases rejected numerous hypotheses about the formation of hurricanes, the factors responsible for increases in hurricane frequency and severity, and how to predict the behavior of hurricanes. Science is a process of discovery, and practitioners who use science to make informed decisions have no choice but to utilize the science that appears to them to be most plausible at the time when they must make their decisions. So it is with catastrophe modelers and insurers who wish to tap into the evolving field of climate science. It is churlish to proclaim that practitioners who based their predictions on plausible scientific theories "did not know what they were doing" simply because the theories ultimately proved incorrect.

Are models that incorporate near-term projections based on politics rather than science? Hunter and Birnbaum base this charge on the fact that such models have been criticized by some climate scientists and apparently by other modelers. But these criticisms tell us nothing more than that the world hosts a broad enough diversity of scientists, with varying backgrounds and different creative ways of approaching problems, that they sometimes disagree. To assume that a

given theory or model must not only be wrong but illegitimate simply because it attracts criticism is itself an attempt to politicize science.

Do insurers and modelers collude to fix prices? According to Hunter and Birnbaum, “RMS seems clearly to be engaged in collusive pricing activity” and “RMS has become the vehicle for collusive pricing.” Yet they offer no evidence to support this charge, which, if true, would be actionable under the laws of every state. They write that “AIR also seems to confirm the possibility of collusion between modelers and insurers, stating that, ‘...many in the industry challenged catastrophe models and called for a change.’” They fail to explain why someone’s criticism of models should be understood as confirmation of collusion by others.

What should the NAIC do? The wisest course would be to ignore Hunter-Birnbaum’s scientifically illiterate tirade against catastrophe models. Models are tools that provide plausible projections of catastrophe losses. No catastrophe model should be considered an unerring prediction, and we should acknowledge their flaws and imperfections. But it would be a mistake for regulators to assume that they can somehow determine whether a particular model is valid or useful. They cannot.

Just as we are fortunate to have competitive property insurance markets in the United States, so too are we fortunate to have a competitive market for catastrophe models. To the extent that different catastrophe modeling firms develop different approaches to constructing their models, they provide their clients and prospective clients with a variety of options from which to choose. As of now, no one can claim to know for certain which models will prove most adept at predicting catastrophe risk over time. That is reason enough for regulators to avoid taking any action that will inhibit further innovation in the development of these critically important risk management tools.