NAIC Public Hearing on Catastrophe Modeling
September 28, 2007
CFA/CEF Presentation

• At this time CFA will present, on behalf of CFA and CEJ, the issues we have raised with the NAIC over the last year and a half and comment the current state of regulation of CAT modeling.

• Later in the hearing, CEJ will present our proposals for solving the issues we have raised.
PART 1 -- THE ISSUES

• Presented by J. Robert Hunter

• Director of Insurance, CFA

• Former Texas Insurance Commissioner and Federal Insurance Administrator

• Fellow, Casualty Actuarial Society and Member, American Academy of Actuaries
1992 -- Hurricane Andrew

• A wake up call to the insurance industry -- They effectively said “we did not know what we were doing before Hurricane Andrew, but trust us...now we do.”

• Steps taken by insurers and approved by the states to stabilize the market included cutting coverage (e.g., hurricane deductibles, caps on replacement cost), creation of taxpayer-supported pools to take wind coverage or high risk homeowner policies and the adoption of much higher rates based on scientific models.

• Promises were made that this would bring long-term stability to the coastal insurance markets. Consumers were assured that, although hurricane activity is cyclical, they would not see significant price decreases during periods of little or no hurricane activity, nor price increases during periods of increased activity since models were long-term and forward-looking.
2005 -- Hurricane Katrina

• While Hurricane Andrew caused a net loss in 1992, Hurricane Katrina did not stop the current string of record profits in 2004, 2005 and 2007, totaling $157 billion! The first half 2007 net income was an additional $32.6 billion, bringing the 3 1/2 year total to $190 billion (i.e., a profit of $633 for every man, woman and child in America!).

• The changes made after Hurricane Andrew, including the use of Models, worked very well for the insurers, not well at all for America’s consumers.
P/C INSURANCE INDUSTRY NET INC

- Source: Best’s Aggregates and Averages
The changes made after Hurricane Andrew were not enough for the insurance companies. Once again, the insurers asked the states to approve wholesale changes in how they do business along the nation’s coasts. They broke their promises of a stable market and used CAT models to justify slashing coverage, withdrawing from the market, much higher rates and more government/taxpayer largesse.
The new round of precipitous changes by insurers shows that they either:

- Mismanaged the post-Andrew learning curve, or
- Are gouging us today.

It has to be one or the other.

Which brings us to models.
CFA/CEJ Letter of 3/26/06

In your packet, you will find a letter we wrote to the NAIC after RMS announced the change in models to a short-term basis.

In the next slides, I will review some of the issues and questions we raised in this letter.
• **Issue 1** -- We urged rejection of the unjustified increases being sought by the short-term models.

• **Issue 2** -- We urged immediate steps to regulate third-party organizations (not just modelers but credit score companies and other “black box” providers of ratemaking services to insurers) whose work has significant impact on insurance rates and availability of insurance.

• **Issue 3** -- We raised the issue of collusive pricing through RMS and the other modeling and requested that the NAIC “request and, if necessary, subpoena information on their contacts with the insurers…”
• **Issue 4** -- We pointed out that it was “shocking and unethical that scientists at the modeling firms appear to have completely changed their minds at the same time after over a decade of using models they assured the public were scientifically sound.” How did that happen?

• **Issue 5** -- We asked for public discussion of the key assumptions that underlie the model results. The assumptions include the time horizon (e.g., 5-years vs. long-term), the pricing return period (e.g., 1 in 50 years vs. 1 in 100 or 1 in 250)

• **Issue 6** -- We requested exploration if any collusive activity, since it was not regulated by the states, is protected by the McCarran-Ferguson Act antitrust exemption.
CFA/CEJ Letter of 3/19/07

• In this letter, also in your packets, we pointed out that we had not received a response from the NAIC.
• We pointed out that the scientific community had severely criticized the near-term projections in hurricane models. (See series of articles in the Tampa Tribune. (Can be read at http://insurancetransparencyproject.com/88/))
• We also reiterated the issues we raised in our earlier letter that I have already itemized in this presentation.
• We asked why, when the different models were run with the same data, they produced wildly different results.
STATE/NAIC REACTION

• As far as we know, this hearing is the first reaction by the NAIC to the issue of CAT modeling. We thank you for taking this action.
• Florida has taken strong action to disapprove the short-term models for the insurers it regulates. (Reinsurers still use these unscientific models and this is an issue for consideration)
• Florida has also developed a regulatory, transparent state model to test the outputs of the private modeling firms.
• Louisiana has followed Florida in disallowing these models.
• Some states, like Georgia, have never allowed models to be used.
• Sadly, most states have done nothing.
Consumers at Risk

• The idea that insurers can justify any rate increase it seeks or withdrawal from all or part of a state or take other anti-consumer action and justify these Draconian measures by simple reference to an unregulated “black box” is intolerable.

• Consumers need protection. The NAIC must, at long last, step up to the plate and deliver this protection!
PART 2 -- SOLUTIONS

• Later in the hearing, Birny Birnbaum will present recommendations for reform on behalf of CFA and CEJ.