Model indicates coastal insurance rates should be lower, so why don’t they drop?

AL.com Alabama

Are most residents of the Mississippi and Alabama coasts due big price cuts for homeowners insurance — maybe as much as 34 percent in Baldwin County, for example? That’s one of the findings suggested in an analysis presented by modeling firm Risk Management Solutions to Alabama Insurance Commissioner Jim Ridling and Mississippi Insurance Commissioner Mike Chaney. The Press-Register has already reported that the new model unveiled by RMS earlier this year predicts lower wind speeds, and thus lower damages, in areas just inland from the coastline. It also predicts higher wind speeds and damages in areas as far north as the Tennessee state line. That’s important because loss projections are a key element in setting insurance rates. The reality is that hurricane risk hasn’t changed for any one structure, just the best estimate of what losses could be. And insurance rates factor in other anticipated losses — fire, theft and the like — that this model doesn’t address. California-based RMS sent employees to Montgomery in April to present projections for the states to the two commissioners. The firm had previously declined to give specific numbers to the Press-Register. The Homeowners Hurricane Insurance Initiative, an Alabama citizens’ group lobbying for lower rates, obtained a copy of the presentation and provided it to the newspaper. (Read the document here.) The presentation shows that when the new RMS model is compared to the calculations used since 2003, the anticipated average annual loss declines steeply from Gulfport eastward into the Florida Panhandle. In both Baldwin and Mississippi’s Jackson counties, expected hurricane losses are projected to be more than 40 percent lower under RMS’ new model. That, in turn, could mean an average 34 percent drop in overall premiums in Baldwin County, RMS found. Such a drop would be worth more than $500 a year for most area homeowners. But it’s not as simple as policyholders calling their insurance agents and asking for a one-third price cut. For starters, most insurers average RMS projections with those provided by the other top modeling firm, AIR Worldwide Corp. Because there’s no change in the AIR model, averaging the two would cut RMS’ projected premium savings in half. Insurers are still examining the RMS projections, which are actually much closer to projections in AIR’s existing model, said Charles Angell, the staff actuary for the Alabama

Department of Insurance. Angell said he didn't think any Alabama insurers had yet used the new RMS data when filing for rate changes. "State Farm is vetting the RMS model information to gain a better understanding of the report's findings," said David Majors, the spokesman for the largest homeowners insurer in Alabama and Mississippi. "Once complete, we will move forward and include it with other models we consider in our multi-model approach to assessing our future premium need." He would not say how many different models the company uses. Angell and Ridling said that Alabama didn't plan to allow companies to shift away from using RMS to prevent rate decreases. View full size"Live by the sword, die by the sword," Angell said. "We think you need to be consistent in your approach." The amount of additional inland damage projected in any one area is pretty small. For example, projected losses in Alabama's Franklin County, just south of Muscle Shoals, are expected to rise from basically zero to $4.50 a year on a typical $150,000 home. If a company just used RMS calculations, that would bump overall rates by 2 percent a year. But even those small increases, because they are in states stretching from Texas to Maine, outweigh projected coastal savings, raising RMS' projections of total losses in the new model. That means insurers are being pressured by their ratings agencies to raise capital reserves or buy more reinsurance to cover higher losses, Mississippi's Chaney said. Overall, though, he said that he doesn't expect rates to change much. Jackson County could expect small decreases at most, he said. RMS' new projections of Mississippi's statewide losses fall only 3 percent. The new model projects a belt of south Mississippi counties running from Hattiesburg to Natchez will have substantially higher losses than under the old version. Matthew Nielsen, senior manager for natural catastrophe and portfolio solutions for RMS, says the new model finds that storms will retain strength as they move through marshy areas of southeastern Louisiana and across Lake Pontchartrain, which means more damage is projected across the state line in Mississippi "There's a lot of standing water," Nielsen said. "To the hurricane, it doesn't seem that it's going over land." Alabama's annual losses fall by 34 percent under the new model, and Alabama's Angell said he believed that "there's a real good chance" rates could go down in coastal areas because of the model change. Already, the Alabama Insurance Underwriting Association, which sells policies to people in Mobile and Baldwin counties who have trouble getting coverage from traditional insurers, lowered average rates by 6.2 percent this summer. Members of the Homeowners Hurricane Insurance Initiative said that the RMS analysis supports their demands for lower coastal premiums. "It tends to validate the belief that the risk and costs of repair to Alabama's coastal counties has been overstated," said Dan Hanson, one of HHII's leaders. "Premiums ought to come down some." Beyond that, Hanson and his group insist that the insurance industry as a whole is too reliant on computer modeling. Karen Clark, who developed the first hurricane catastrophe model in 1983 and

founded AIR, has become an outspoken critic of how models are used. She says that insurers, reinsurers and rating agencies are wrong to use models to calculate precise loss forecasts, and that the big swing in loss projections from the old to new RMS model proves her point. “These models cannot pinpoint average annual loss by location or ZIP code at nearly the level of certainty they are promising,” Clark said. “It’s a false precision. We are never going to have an accurate model. These models are not and will not be accurate in my lifetime. We don’t have the data.” She says that the models should be used, along with human judgement, to forecast a range of possible losses. And because models are imprecise, coastal premiums may not be due for a cut. The modelers reject Clark’s contentions. RMS’ Nielsen said his company’s new version is a clear improvement, with much more data about inland wind speeds and the damage that hurricanes cause. “We now have twice the amount of information we used before,” Nielsen said. “We hope that, over time, the changes (from version to version) will get smaller and smaller.” HHII says the swing in modeled losses is an argument in favor of its demand that insurers make public years worth of premium and loss data by ZIP Code. A proposed law, which the group calls the clarity bill, failed in the Legislature last year, but is likely to be considered again by Gov. Robert Bentley’s Affordable Homeowners Insurance Commission. “The need for the historical data that the clarity bill requires is adamantly demanded as a way to check the results produced by these models,” Hanson said. Though HHII would like to force insurers to use only historical data to calculate rates, a return to that older method appears unlikely. Advocates for modeling say far too few hurricanes have hit any particular location in recorded history to produce reliable loss projections.