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Randy Dumm  
Chair, Florida Commission on Hurricane Loss Projection Methodology  
State Board of Administration  
1801 Hermitage Boulevard, Suite 100  
Tallahassee, FL 32308

**Re: Recommendations for the Windstorm Mitigation Committee**

Dear Randy Dumm:

Thank you for the opportunity to offer suggestions to improve the windstorm mitigation credit system currently in place in Florida. This letter provides a summary of the most compelling suggestions that we think need to be in the final report. The primary focus of windstorm mitigation credits should be to promote active reduction in potential losses that will ultimately benefit the whole state. Currently this objective is frustrated by disjoints between the data collection, rating mechanisms, and insurance pricing signals. These suggestions focus on eliminating barriers and biases in the risk transfer chain between stakeholders – homeowners, primary insurance companies, reinsurance companies and FHCF.

Recommendations:

- 1. Make changes to the way wind rating variables are collected. Specifically:**
  - a. Collect data for EVERY house.**
  - b. Put the inspection process into the hands of the insurance companies.**

Currently data collection of windstorm rating variables in the Florida marketplace is biased. Only those properties that have beneficial loss reduction features are motivated to submit the Uniform Mitigation Verification Inspection (UMVI) Form OIR-B1-1802 to insurance companies and this is causing adverse selection to enter into the data stream. Adverse selection is causing significant premium erosion for primary companies, a disjoint between primary insurance rating and reinsurance pricing, and escalating levels of fraud in the inspection process.

We recommend that legislative language be drafted that will require all personal lines insurance companies to collect the information on the UMVI form for EVERY house, *and* allow the insurance companies to pass the cost of these inspection programs on to the policyholder as part of the premium. Allow time for this to happen (say over 5 or more years) such that the cost per year for each policyholder is in the range of 25-50 dollars per year.

This process would lead to improvements in several areas:

First – The ability of an insurance company to pass on the cost of inspection to the homeowners removes one of the largest barriers to proper collection of the information. The wind rating variables promulgated in the ARA study are not cheap to collect, but are important to differentiating risk properly. This practice has a direct analogy in the real estate market where appraisals are completed regularly as part of the mortgage process to the benefit of the bank but paid for by the purchaser.

Second - By putting the inspection process in the hands of the insurance companies, there will be less fraudulent inspection data in the marketplace. In an ideal market, insurance companies are self-interested to provide accurate data. If the homeowners are truly sensitive to pricing – and I believe that is especially true in the Florida market – then insurance companies will want to provide appropriate credits to compete for business, but will not want to provide credits unnecessarily. If they don't grant credits that other companies will, then the policyholder will likely move companies. This is basically a self-policing mechanism and will yield decent data across the entire industry over time. Thus, insurance companies will be motivated to invest in inspection programs/vendors with strong QA and verification elements to allow them to remain competitive while maintaining accurate data.

Third - The most critical idea here is to ensure that these detailed wind rating attributes are collected for every home – not just on a voluntary basis. This will have the benefit of removing the current disjoint between reinsurance pricing and the primary insurance layer mitigation credits, and ensure a rich set of data for further mitigation research.

- Currently, a lot of primary insurance companies have detailed mitigation attributes on approximately 20-40% of their portfolio. Because of the way this data is collected, it is biased towards containing only the attributes that reduce risk without explicit recognition of factors that elevate risk. Modeling based on these biased data sets will have a tendency to under predict the losses when the mitigation attributes are included in the model without offsetting modifications. Thus, there is strong motivation for reinsurance companies to ignore the mitigation information or provide very little credit for it. The effect we then see is that primary companies face increasing premium deficiencies as premiums drop, but reinsurance expenses do not. Only when the data collection approaches a level that covers a majority of locations will the mitigation variables be given weight in the models used by the reinsurers – and thus relieve the pressure that affects primary insurance companies.
- By ensuring consistent uniform data collection, the state and insurance companies will be uniquely positioned for further research after the next storm that will offer further verification and validation of the mitigation relativities based on actual loss experience.

**2. Adjust the language of the Florida statutes to allow these mitigation relativity features to be implemented with surcharges *and* credits with respect to the base rates.**

This will allow the mitigation relativity matrix to be renormalized. Ideally this renormalization should be based on company specific distributions of the mitigation features as identified through inspection programs. RMS believes that custom studies by individual insurance companies to establish new normalization points within either the ARA relativity matrix or another modeled relativity matrix by other modelers should be allowed, and actively promoted.

**3. Remove features and variables that are not actionable retrofit items from the mitigation relativity matrix, simplifying the credit/surcharge application.**

Homeowners cannot change their roof shape or wall construction, but they can install shutters, can replace roof coverings, and can re-nail roof decks. Because the purpose of the mitigation credits was originally designed to encourage homeowners to harden homes in the state rather than to suppress insurance rates, the mitigation relativity matrix should include credits for features homeowners can realistically change in their homes. Other variables, such as roof shape, are important to include in an accurate rating process, but belong in the base rate calculation – not the mitigation relativity matrix.

In addition, companies should be encouraged to review their rating territories for appropriate application to the hurricane peril.

**4. Modify the FHCF premium calculation process.**

The eligibility for FHCF coverage and pricing of the FHCF premiums are based on proportional contribution to the overall state level risk, and this principle is an appropriate one to continue to follow. However, the variables used to set FHCF premiums for individual companies are not the same variables promulgated by the UMVI form, and the values of the credits and surcharges should be commensurate with those charged by primary companies. Disjoints between the data used in the FHCF process and that used in the primary rates has the potential to cause discrepancies in the risk transfer process. Mandatory collection of appropriate factors (as described in #1 above) would help correct much of the disjoints. In addition, we think the following variables which have significant impacts on loss costs, should be included in the FHCF data call:

- i. Number of Stories
- ii. Roof Cover type (including presence of Secondary Water Resistance)
- iii. Roof Slope
- iv. Living area (square footage)

Thank you for the opportunity to present this information to the commission. Please reach out to us if you would like any clarifications or more information.

Sincerely,



Michael Young  
Senior Director of Mitigation and Regulatory Affairs