American Property Casualty Insurance Association
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Testimony of

American Property Casualty Insurance Association (APCIA)

House Economic Matters Committee

House Bill 333 Homeowner's Insurance - Weather-Related Claims and Notice of Cancellation or Nonrenewal

February 20, 2020

Letter of Opposition

The American Property Casualty Insurance Association (APCIA) is a national trade organization representing nearly 60 percent of the U.S. property casualty insurance market. APCIA appreciates the opportunity to provide written comments in opposition to House Bill 333. APCIA strongly opposes this bill which would eliminate the ability of an insurer to cancel or non-renew a homeowner's policy due to 3 or more weather related claims in the preceding 3-year period. In addition, it adds an additionally formalized protest process where there is already a less formalized one in existence. Additionally, the bill ignores the fact, that a consumer has the option of placing coverage through a non-admitted carrier in the surplus lines market or through MD Joint Insurance Association, MD's Fair Plan. [1] https://www.mdjia.org

Concept of Spreading Risk

Insurance is a method of reducing the uncertainty of financial loss through the transfer of risk by many individuals to an insurer. Since individuals generally cannot bear the financial consequence of a large loss, policyholders contribute premium payments to a common fund that covers losses and expenses. The policyholder thus exchanges the possibility of an unknown large loss for a comparatively small certain payment.

Insurers face the challenge of measuring risk; they need to know whether to accept a risk and how much to charge. Ratemaking involves measuring the probability of the occurrence of losses and the financial impact that may be expected to result from the hazards or perils against which insurance is provided. Since rates are determined before all future costs are known, the insurance pricing function is more difficult than that of most other businesses, making it among the most important and intricate company operations. Hence, the insurance industry is unique in American business because it cannot price its product like other businesses with full knowledge of costs and be guaranteed a return on investment. Each state, nevertheless, subjects insurance ratemaking to a specified type of statutory regulatory control; that is, rates may not be "excessive, inadequate, or unfairly discriminatory."

The initial estimates made by insurers were necessarily on a judgment basis, but as experience became available and the knowledge of the ratemaker increased, companies were able, by means of collecting statistics, to develop and refine methods of analyzing rating techniques. By compiling enough data, the insurance company is able to predict, with some accuracy, how often various types of claims are incurred and how much they might cost. Rates are based on past experience. After reviewing data from the past and analyzing trends and developments that have occurred, the ratemaker can estimate future losses and expenses. The greater the probability of occurrence or the financial impact of the event, the greater should be the price of insurance. In other words, to be fair, the price of insurance should be in proportion to the risk being exchanged.

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[1] The JIA offers Homeowners, Dwelling and Commercial property insurance for qualified properties. The Maryland Joint Insurance Association is comprised of all voluntary market insurance companies which are licensed and writing basic property insurance, homeowners insurance and property insurance components of multi-peril policies in the State of Maryland. The Association is regulated by the Maryland Insurance Administration.

The basic principle underlying the development of insurance rates is the estimate of claims for the varying risks being insured during future months and a determination of whether current rates are adequate or inadequate to pay these losses. Loss experience is measured by two fundamental elements: (1) claim frequency; and (2) average loss or claim severity. Claim frequency is usually expressed as the number of claims occurring per housing units during one year. For example, homeowner claims occurring at the rate of 10 per 100 unit a year have a frequency of 10 percent. The average loss is the average cost of each claim paid or incurred for a particular coverage. The combination of these two factors is the loss cost, or the average amount of loss paid or incurred by the insurer for each housing unit covered.

The Concept of Risk Assessment

In response to public demands and needs, insurers have attempted to market increasingly competitive rating plans. Every individual must be charged a premium commensurate with his or her exposure to loss. This premium should be the same for all persons with essentially the same exposure. For insurers to price their product equitably, different traits need to be identified in order to determine those policyholders who are more likely to incur losses than others. Hence, this concept of assessing risks using certain characteristics was developed to reflect statistically well-defined categories having substantially different loss potential and loss costs.

For rating purposes, risk characteristics must be broad enough in the number of exposures (i.e., insured units) to permit the development of statistics that are credible. The principle of the law of large numbers states that, as the number of occurrences increases, actual results tend to equal expected results and a regular pattern can be observed. The greater the volume of experience reflected by each trait, the more significant the pattern of claim frequencies and claim costs will be.

Volume alone, however, is not sufficient. Risks within the same group must also be reasonably homogeneous so that the expected loss of each individual is relatively close to the average expected loss of that group. As no two risks are identical nor are they exposed to precisely the same hazards or perils, some amount of heterogeneity in any group will exist. However, the degree of such heterogeneity is not directly observable. Overlapping of distributions of expected losses between groups may for the most part be inevitable but, in any case, it cannot be verified or measured.

Formalized Protest Process

Additionally, SB 333 creates a formalized protest process where an insured currently has a general right to protest proposed cancellation or nonrenewal on a homeowner’s insurance policy. The current review process under Md. Code Ann., Ins. § 27-613 allows the Maryland Insurance Administration to place proposed actions on hold while it reviews the protest prior to a formalized hearing. The proposed amended language would require the Commissioner to hold a hearing on protects of homeowner’s insurance cancellation or nonrenewal within 30 days of the mailing of notice. This requirement places a costly administrative burden on the Commissioner and insurers alike. The current review process used by the Maryland Insurance Association provides greater flexibility, efficiency and protection for the involved parties than the process being proposed.

Conclusion

SB 333 would restrict fair and adequate risk assessment, prohibit competition and bring about forced subsidies for some consumers at the expense of others. Requiring insurers to continue providing coverage to a risk with high frequency of loss would likely raise the cost of insurance for all other policyholders. The current voluntary competitive system is far better, more flexible and fairer than one that is based upon ignoring economic realities.

For all these reasons, the APCIA urges the Committee to provide an unfavorable report on House Bill 333.

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