Testimony of

American Property Casualty Insurance Association (APCIA)

House Economic Matters Committee

House Bill 641- Homeowner's Insurance - Weather-Related Claims

February 11, 2021

<u>Letter of Opposition</u>

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 641. APCIA strongly opposes this bill which would prevent an insurer from considering a claim for a weather-related event, in a three-year period, for the purposes of canceling or refusing to renew coverage if the claim is: for an amount of loss that is less than the insured's deductible under the policy, or resolved with no payout to the homeowner by the insurer. While it may seem superficially that not including claims below the deductible amount or with no payout would not significantly impact either party to an insurance policy contract, the truth is that such limitations would significantly impair insurance risk assessment and rate calculations in a competitive market. Additionally, the bill ignores the fact, that a consumer has the option of placing coverage through MD Joint Insurance Association, MD's Fair Plan. [1] https://www.mdjia.org

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 -- including claims data, 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. The proposed limitation of cancellation or non-renewal due to external criteria based on the characteristics of individual policies works against accurate determination of risk.

Risks within the same group must 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.

Conclusion

HB 641, by disallowing use of claims made below the deductible amount or without a payout from cancelation and non-renewal determinations, would adversely impact fair and adequate risk assessment, potentially limit competition, as well as 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 other policyholders. The current 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 641.

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