LOUISIANA DEPARTMENT OF INSURANCE

Feasibility of Prohibiting Insurers from Imposing More Than a Two Percent Deductible

Submitted in response to HR 18 (2011 Regular Session)

February 9, 2012

Office of Property and Casualty Insurance

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HR 18 (2011 Regular Session)
Feasibility of prohibiting insurers from imposing more than a two percent deductible

The Louisiana Department of Insurance (LDI) was tasked by House Resolution 18 of the 2011 Regular Legislative Session to study the feasibility of prohibiting insurers from imposing more than a two percent deductible, including but not limited to a named-storm or hurricane deductible, on any homeowner's insurance policy. In 2009-2010, the LDI conducted a study in response to HR 71 of the 2009 Regular Legislative Session. HR 18 of 2011 is identical to HR 71 of 2009.

History & Background

While HR 18 accurately depicts the situation that homeowners' policyholders are often subject to two separate deductibles, depending on the nature or cause of the loss, two areas of the resolution's concern have been addressed by legislative acts.

As a result of legislation passed in 2008, the two deductibles cannot be stacked. LSA-R.S. 22:1265 (G) was adopted in 2008. It prohibits residential insurance companies from applying multiple deductibles to a loss resulting from a single event.

Additionally, during the 2009 Regular Session, the legislature enacted LSA-R.S. 22:1337, which became effective June 25, 2009, under the authority of Act 134 (HB 333) of the 2009. This law limits homeowners' insurers to applying named storm or hurricane deductibles only one time during a calendar year.

2009 Study Methodology

The LDI surveyed major carriers writing homeowners insurance in the state of Louisiana and also sought input from the residual market through Louisiana Citizens Property Insurance Corporation. The LDI did not seek input from carriers who are not doing business in Louisiana, nor did the LDI seek input from surplus lines carriers writing homeowners in Louisiana.

Voluntary carriers contacted included both major carriers and other insurers who have small market share in Louisiana but who are actively taking policyholders out of the residual market.

Together, these insurers represent slightly more than 63 percent of the Louisiana market in homeowners insurance (as determined from the companies' 2008 writings).

Attached as Exhibit A is a copy of the letter that was sent to these carriers on August 7, 2009. It was sent along with a copy of HR 71, which is identical in wording to HR 18 of the 2011 Regular Session. Responses were provided by November 1, 2009. In summary, the survey letter directed the insurers to react to HR 71 in two specific ways:

1. What the company's individual or industry-wide concern would be;
2. What the company's market response would be to legislation that capped all deductibles to two percent.

Written responses were received from only three carriers. Several other carriers indicated their willingness to respond, but failed to do so. Others provided brief responses by phone because they were concerned about the proprietary nature of the information.

The companies' responses both written and by phone indicated various concerns to a limitation by law to a maximum deductible level of two percent for all perils, not limited to named storm deductibles. Insurers' concerns included how such a cap would impact their access to reinsurance, their A.M. Best ratings and a carrier's ability to manage its exposure. At least one insurer also pointed out that consumer choice would be eroded by such a mandate, as many consumers today choose to control their premium costs by choosing higher deductibles.

Because of individual companies' reluctance to provide information, additional information was sought through trade associations and from the academic arena. Feedback from these sources on the feasibility of implementing a mandatory cap of two percent on a homeowner's deductible is also included.

Company Responses

Reinsurance Access and Cost

Companies pointed out the fact that placing a cap by law on permitted deductibles would result in additional exposure and frequency of claims than they currently bear. Stated otherwise, a lower deductible would result insurers bearing a greater portion of the loss, and more often, than is their current practice. This greater exposure would result in a higher cost for reinsurance (assuming the same number of policyholders and same value of the insured property). Both the increase in reinsurance costs and claims administration expenses would be passed on to consumers either in the form of higher premium or by limiting, restricting or reducing their homeowners' books of business in Louisiana.

A.M. Best Ratings

Companies who cited concern about A.M. Best ratings explained that favorable A.M. Best ratings provide insurers with the ability to obtain and generate capital from outside sources. These carriers were concerned that a cap by law on permitted deductibles would ultimately negatively impact their A.M. Best ratings. If companies increased their overall expenses in order to obtain more reinsurance without increasing their overall income, their rating would suffer; furthermore, if they failed to adequately cover their book of business with reinsurance, their rating would suffer. To maintain their A.M. Best rating, companies would pass on the cost to policyholders in the form of higher rates.

Exposure Management

One company that writes a high concentration of homeowners in hurricane prone areas stated that higher named storm deductibles allow primary companies to mitigate some of the hurricane risk, thereby allowing them to write more homes in areas with higher levels of hurricane exposure. Lowering the deductibles in the storm prone areas would increase the amount of risk to a company's surplus and the cost of reinsurance to the insurer.

Trade Association Response (collected from member insurers)

- A legislative mandate to cap deductibles encourages the industry to increase caps to the maximum for all deductibles offered.
- Mandated deductible caps encourage DOI suppression of adequate rates based on political pressure. Lower deductibles increase loss payments and drive the cost of insurance higher. This would become a major issue.
- Why penalize/restrict all companies, especially those that are writing their "fair share" of property business in southern Louisiana parishes?
- Higher deductibles allow policyholders to better control the cost of their homeowners insurance.
- The use of named storm/hurricane deductibles has allowed the industry to continue to provide property markets in South Louisiana.
- The use of larger deductibles has allowed the industry to continue to provide property markets in South Louisiana.
- Companies that have abandoned South Louisiana probably are not concerned about mandated deductibles, but it is not fair to penalize those companies that are active in writing business in the southern parishes.
- Industry losses from hurricanes striking Louisiana have driven companies to bankruptcy, forced them to withdraw from the State, and have wiped out profits for years for those companies that have remained. Why encourage more companies to leave?

Academic Response

Robert W. Klein, a research Fellow at the Independent Institute and director of the Center for Risk Management and Insurance Research and associate professor of Risk Management and Insurance at Georgia State University offered the following comments. Prior to joining the faculty of Georgia State University, Dr. Klein was the director of research and chief economist for the National Association of Insurance Commissioners.

According to Dr. Klein, if what the legislature intends is to allow only a two percent deductible maximum for all insurers for all customers, it would be a mistake. While there is the issue of insurers offering coverage only when an insured is willing to take on a high deductible, a two percent cap could also force some people to higher deductibles than they would otherwise choose. While the market has been shifting to higher deductibles, Dr. Klein attributes most of the movement to have been voluntary, where policyholders trade off higher deductibles for premium savings. The ability to offer higher deductibles contributes to insurers' willingness to write business on the coast. There is such a potential downside to the two percent deductible cap that Dr. Klein does not recommend it. He said he was not aware of a movement among states to restrict what or how insurance companies write in this manner, and if Louisiana were to adopt such a restriction, the state would become an outlier. Dr. Klein stated that such a restriction runs counter to Louisiana's efforts to encourage its voluntary insurers to stay in the state and to continue writing coastal risks.

Exhibits/Additional Resources

Exhibit A: Letter to Louisiana insurers requesting their insight on a two percent deductible cap.

Exhibit B: Two consumer publications from Lending Tree**.**

> **B.1** "Save on Homeowner's Insurance Premiums," a consumer publication explaining how homeowners can reduce their premium cost 12 ways, including by electing higher deductibles.
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> **B.2** "Should You Increase Your Homeowner's Insurance Deductible?" a consumer publication explaining how insurance deductibles affect premiums and risk.

Exhibit C: "Reinsurance," Insurance Information Institute, January 2012. This white paper provides both an historic perspective on the reinsurance business and also recent developments in the financial and market conditions affecting reinsurance.

Exhibit D: "Hurricane and Windstorm Deductibles," Insurance Information Institute, September 2011. This white paper defines relevant terms and summarizes the both the market and political conditions on hurricane deductibles in 18 states.

Exhibit E: "Natural Catastrophe Planning," Viewpoint, Summer 2009, pages 6-8,24. Viewpoint is a publication of the American Association of Insurance Services. This article contains responses from four distinctly different segments of the insurance industry on the subject of homeowner insurance pricing, effect of risk based pricing on catastrophe prone properties, and the role of insurers, reinsurers, state and federal governments in financing losses from natural disasters.

Exhibit F: "Hurricane Risk and the Regulation of Property Insurance Markets," July 27, 2009.

A research paper by Robert W. Klein, Center for RMI Research, Georgia State University. 88 pages.

Abstract: This paper analyzes the regulation of property insurance markets in selected Southeastern coastal states subject significant risk from tropical storms and hurricanes. The severe storm seasons of 2004-2005 and subsequent actions by insurers raised a number of issues and prompted a range of government reactions in various states. The 2006 and 2007 seasons were relatively quiet but hurricanes returned with a vengeance in 2008 and reaffirmed the region's image as a locus of storm activity. This paper examines and compares regulatory policies in Alabama, Florida, Louisiana, Mississippi, South Carolina and Texas. All of these states are dealing with similar issues at one level but their specific circumstances and policies also vary. The evidence suggests that Alabama, Louisiana, Mississippi and South Carolina have taken a less restrictive approach to regulation than Florida and Texas. Of the six states, Florida and Louisiana face the greatest problems because of the large size of their coastal areas in relation to their statewide markets. Hence, their different approaches to regulation are of interest in terms of their motivations and effects.

Exhibit A

Date

[Company Representative]
[Title]
[Company]
[Mailing address]

Re: House Resolution 71
Louisiana Legislature
2009 Regular Session

Dear Company Representative:

During the 2009 Regular Session of the Louisiana State Legislature, Representative Joe Harrison of the Louisiana House of Representatives authored House Resolution 71, wherein a request was made of the Louisiana Department of Insurance (LDOI) to "study the feasibility of prohibiting insurers from imposing" deductibles in excess of two percent (2%) in homeowners policies issued anywhere in the state of Louisiana. The deductibles in question are inclusive of all deductibles including, but not limited to, named-storm or hurricane deductibles. A copy of House Resolution 71 has been attached for your convenience.

In an effort to comply with the provisions of House Resolution 71, this correspondence serves as a plea from the LDOI for your company's assistance with our fact finding study. The LDOI is requesting that your company provide a response that would illustrate: 1.) what your company's individual or industry-wide concerns would be or 2.) what your company's potential market reaction could be in response to any legislation that would prohibit the imposition of deductibles in excess of two percent (2%), statewide. All forms of support and analysis for your company's proposed response to such legislation are encouraged.

The LDOI requests that your response be provided to the LDOI no later than **November 1, 2009**. If you have any questions or if you need any additional information, please feel free to contact me via the information provided below. Thank you, in advance, for your assistance.

Sincerely,

Ed O'Brien
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