From: BE97 [mailto:be97@stanford.edu]
Sent: Sunday, January 03, 2016 4:29 PM
To: DOI.HOI.2015 (DOI)
Subject: Correction to Email of December 31 re Comment on Homeowners Insurance

January 3, 2016
Daniel R. Judson
Commissioner
Department of Insurance
1000 Washington Street, Suite 810
Boston MA 02118-6200

Dear Commissioner Judson:

This is a request to revise a comment sent on December 31, 2105 in the matter of the recent requests submitted to the DOI by several property and liability insurers for rate increases for homeowner policies. This request is beyond the final date, December 31, 2015, for acceptance of comments but this revision only adds an omitted word to clarify.

In the comment, this statement appears: "(In the filings, at least one insurer forecasts nominally-valued non-hurricane weather-related claims applying a univariate trend (time series) analysis to a small sample. In general, insurers should acknowledge the low statistical of small samples, support choice of method and avoid use of arbitrary weights on sample observations or arbitrary selection of a distribution.)" The word "power" should appear after the word "statistical".

The complete revised text with the omitted word appears below with the newly included word in italics:

December 30, 2015

Daniel R. Judson
Commissioner
Department of Insurance
1000 Washington Street, Suite 810
Boston MA 02118-6200

Dear Commissioner Judson:

This is a comment on the recent requests submitted to the DOI by several property and liability insurers for rate increases for homeowner policies and to request under the Public Records Act that the DOI provide electronic copies of analyses prepared by staff to evaluate these rate requests. This comment does not include a complaint about a specific insurer. This comment responds to this DOI web site statement: " The Division will continue to accept comments through December 31, 2015 on the Massachusetts voluntary market for homeowner's insurance. Please send your comments to DOI.HOI.2015@state.ma.us"

The available filings of Commerce, Bunker Hill and Safety are not directly comparable because they use different methods. Moreover, none provides a summary which maps the requested rate increase to major causes like weather related claims from last winter's snow. Instead, it is preferable to initiate a stakeholder process, assisted by a consultant, to develop a standard modeling process. For the major insurance lines (e.g., residential homeowner), the modeling process should begin with identification of the primary elements subject to uncertainty in the insurer balance sheet (e.g., claims, policy count, asset

returns) and then should compare alternative forecasting methods, which at least should include the apparent current default of trended time series with more conventional and viable univariate or multivariate statistical methods. Then a simple single period expected value process finds the premium which generates a return sufficient to attract investment given forecasted values in the balance sheet. (In contrast, a dynamic stochastic optimization process finds the optimal premium path sufficient to attract investment, given the distribution of forecasted values, but this is much more difficult and problematic, given that a major uncertainty lies in the effect of regulation and the unknown extent of price coordination among insurers.)

To implement this process, each insurer must provide recent data. Each insurer can still submit the results from its own modeling process. As an example of a reduced form multivariate model for non-hurricane weather-related claims for the residential homeowner line, the dependent variable could be real dollar claims and the explanatory variables could include the count of insured houses (not claims, given it uses similar explanatory variables) and measures of non-hurricane weather related effects from snowfall, wind and rain as measured by seasonal total (or perhaps integrated extreme values) and other housing and insured characteristics. (In the filings, at least one insurer forecasts nominally-valued non-hurricane weather-related claims applying a univariate trend (time series) analysis to a small sample. In general, insurers should acknowledge the low statistical *power* of small samples, support choice of method and avoid use of arbitrary weights on sample observations or arbitrary selection of a distribution.)

The setting of premiums should also consider that repairs from claims due to the very severe weather of last winter could strengthen many houses sufficiently to limit claims in subsequent years. Moreover, the setting of premiums should recognize the role of 'moral hazard'; for example, the insurer should set deductibles and/or larger coinsurance percentages to encourage efficient roof maintenance and design. Finally, an evaluation of premiums could consider the size of premiums in neighboring states with similar regulatory frameworks.

The DOI should also initiate a parallel stakeholder process, again assisted by a consultant, which evaluates the nature of the DOI review of the insurer requests for premium increases. Does the DOI prepare an independent analysis (possibly including use of its own model) of each request or does the DOI rely primarily on the analysis submitted by each insurer and the assumption that the threat of entry by a rival insurer will limit premiums and profits? If the DOI relies on the threat of entry, has the DOI studied the effectiveness of this assumption periodically? Such a study should evaluate barriers to entry (e.g., use of agents, reputation or advertising), the extent and impact of actual entry, the competition for customers among incumbents and the extent and impact of market concentration and/or price coordination through use of rating bureaus ***or*** mandated ceilings on rate changes. This evaluation should analyze the relationship between the DOI review of requests for premium increases and its reliance on entry threat; does the DOI review imply that the threat of entry is ineffective or does the threat of entry imply that the DOI review is *pro forma*? This evaluation should also compare rates for similar risks under the voluntary and FAIR plans.

Finally, one insurer included a report about the possible increased weather uncertainty due to global warming; this impact could increase the variance of weather related claims without *necessarily* raising the expected value, but in either case the Commonwealth should consider ex post recovery if it prices such uncertainty more efficiently.

Thank you for the opportunity to submit this comment.

Sincerely,

Kathleen Benson
Robert Berry
PO Box 335
Barnstable, MA.