I am W. Minor Carter and I am testifying on behalf of the Maryland Association of Mutual Insurance Companies ("MAMIC"). We welcome the opportunity to present our views on the availability and affordability of personal and commercial property and casualty ("p/c") insurance in the coastal areas in Maryland.

MAMIC is made up of six mutual p/c companies that are either domiciled in Maryland or Maryland companies that were merged with out of state mutual companies. MAMIC members write a substantial portion of their books of business in Maryland, although not all companies write everywhere in Maryland. All companies write in coastal areas.

MAMIC members write property coverages including homeowners, mobile homes, farmowners, commercial property, commercial packages, dwelling fire policies, automobile, boats, and other lines. Companies have wind and hail deductibles ranging from $2,000 or 2% whichever is higher; $5,000 or 5% whichever is higher.

Mutual insurance companies are owned by their policyholders and, as such, only have two methods of raising capital:

1. Underwriting profit
2. Investment income

MAMIC members believe that the market is presently working and no changes are warranted at this time. However, given the increasing number of catastrophes and the introduction of new hurricane models, there may be constriction to the marketplace due to lack of capacity in the future.

Our Key Points

The key points of this paper are:

1. The Maryland insurance market is working at this time, but demands for increased reinsurance coverage could restrict the market. Smaller companies with a relatively concentrated geographic area may have difficulty if capacity is reduced. Nonetheless, at this point, action by regulators is not warranted.

2. A.M. Best's ratings have a significant impact on a company's ability to write insurance.

3. Any significant change to the Maryland insurance market place, whether by government, implementation of new models for hurricanes, or other cause, could cause serious market disruption.

4. A strong statewide building code should be enacted.

5. Statutory notice requirements must be changed to become an effective tool to educate insureds on the coverage their insurance policies provide.

Statistical Background

The Maryland market for property/casualty insurance continues to operate well despite record-setting catastrophe losses. Insurers are financially sound and will be able to continue providing essential financial protection to consumers and businesses alike.

The term "catastrophe" in the property insurance industry denotes a natural or man-made disaster that is unusually severe. An event is designated a catastrophe by the industry when claims are expected to reach a certain dollar threshold, currently set at $25 million, and more than a certain number of policyholders and insurance companies are affected.

Global Catastrophe Loss Summary – First Half

Already the highest loss year on record globally.

$260 billion in economic losses globally.

$55 billion in *insured* losses globally; more than double 1st half 2010

$50 billion in economic losses in US as of Oct. 31st

More than double through the same period in 2010

Approximately $25 billion in *insured* losses in the US arising from 100 plus Cat events – close to tripling through same period in 2010

2000 et al is the decade of disaster –

Combined ratio points associated with catastrophe losses are increasing substantially

1980s	1.31
1990s	3.39
2000s	3.52
2010s	4.15

Thunderstorms – average thunderstorm losses are up more than 8 fold since the early 1980s. They are consistent producers of large scale loss and 2008-2011 have been the most expensive years for thunderstorm losses.

Winter storm losses are up 50% since 1980.

Inflation adjusted US catastrophe losses by cause of loss, 1990 – 2011 (first half)

42.7%	Hurricanes & Tropical storms
31.8%	Tornadoes – the number and damage is increasing
8.0%	Winter Storms
6.6%	Terrorism
4.9%	Geological Events
3.4%	Wind/Hail/Flood
2.4%	Fires
0.2%	Other

WIND LOSSES ARE, BY FAR, THE CAUSE OF MOST CATASTROPHE LOSSES, EVEN IF HURRICANES AND TORNADOES ARE EXCLUDED.

Source: ISO's Property Claim Services Unit

Federal Disasters by State 1953 – Nov. 13, 2011

Maryland is ranked 40th with 22 declarations.

According to the Insurance Information Institute (III) report released in August 2011, Maryland ranks 8th in total population change

in coastal counties from 1960 to 2008, adding 885,309 people to those areas. It should be noted that the definition of coastal counties has also been expanded. Some years ago, only ocean front counties were considered coastal, now counties on the Chesapeake Bay are included as well as some counties on tributaries. The report further states that Maryland ranks 18th in the value of insured coastal properties vulnerable to hurricanes as of 2007; the value of those Maryland properties is $14.9 billion.

Data from the Census Bureau show that in 2008, 35.7 million people were seriously threatened by Atlantic hurricanes, compared with 34.9 million in 2006.

Writings in coastal areas for homeowners insurance, based on direct premiums written in 2010, are concentrated in four companies (State Farm – 21.6%; Allstate – 14.8%; Travelers- 12.7%; Nationwide – 10.1%) that write a combined 59.2% of the market. Commercial insurance is more diverse with the top six writers totaling 36.2% of the premium volume. Travelers had the largest market share of 7.7%.

Prior to Hurricane Andrew, insurance companies accounted for hurricanes and other catastrophes with a special premium discount known as a "catastrophe loading" to spread the risk over a period spanning 30 to 40 years. Sometimes they used data from several states subject to the same kind of catastrophes to develop an average annual cost of catastrophes. However, since the mid 1990s, more sophisticated computer modeling techniques have become available. Insurers now base their rates, in part, on sophisticated computer models that combine meteorological data with their own exposure data.

The recent and dramatic change by the primary modeling company used by the industry, RMS, has had a significant impact, particularly on those companies writing business in Texas and the Mid-Atlantic. RMS has stated that the changes are a result of more sophisticated models utilizing improved meteorological data and statistics from recent hurricanes. The largest change is that the "reach" of a hurricane is far more inland that previously modeled (as demonstrated by Hurricane Ike striking Texas and becoming one of Ohio's largest catastrophe losses in history), meaning that the damage to structures is significantly greater.

The models of the second largest modeling company, AIR, have significant increases, but not as great as RMS.

Hurricane models are based on return periods – the likelihood of severity. A.M. Best, as discussed in a subsequent section, requires a 1 in 100 year storm reinsurance hurricane capacity and prefers 1 in 250 year storm reinsurance hurricane capacity. The reported RMS v11 median change for Mid-Atlantic carrier exposure by return period is approximately:

Storm	Percentage Increase
1 in 10 year storm	400%
1 in 25 year storm	205%
1 in 50 year storm	150%
1 in 100 year storm	135%
1 in 250 year storm	125%

1 in 500 year storm	100%
1 in 1,000 year storm	90%
1 in 5,000 year storm	120%
1 in 10,000 year storm	130%

An actual example from a Maryland company: they presently have hurricane capacity reinsurance for 1 in 480 year storm, almost twice the Best's standard 1 in 250. Under this new rating model, their premium for a 1 in 480 year storm would only be sufficient for a 1 in 100 year storm – Best's minimum standard.

Obviously, this is a serious issue for smaller companies, such as members of MAMIC, but every company, both insurers and reinsurers, may find itself in a significantly different financial position.

The models are utilized as a tool for carriers to review their exposure not only against hurricanes, but severe storms (tornado, hail, etc.) and winter storms as well. Depending upon a carrier's footprint in the Mid-Atlantic area, the modeled results can vary greatly from a company's present position in terms of purchasing reinsurance. While the change percentages set forth previously are medians, the industry range for Mid-Atlantic exposure changes with RMSv11 for 1 in 100 and 1 in 250 vary from 75% to 590%.

These changes are forcing carriers to look hard at their territorial and aggregate exposures in an effort to spread risk. Because the models show significant exposure in areas far inland (i.e., Central and even Western Maryland), it may not be sufficient for a carrier to simply reduce exposure/business in "coastal areas" in Maryland.

Due to the changes in the new model, what was once thought of as conservative property catastrophe programs are now insufficient to address the mandated return period minimums (i.e., 1 in 100, 1 in 250). Carriers are then required to evaluate how much additional reinsurance coverage to purchase to protect their A.M. Best rating. Since the change in return period is high from top to bottom, the cost to modify these programs is not limited to the higher layers which typically have a lower reinsurance rate.

In addition, reinsurers' rates are also under pressure due to the increase in disasters in the U.S. as well as worldwide.

A.M. Best's role

Given the potential losses from a catastrophe, State insurance departments are concerned over solvency issues. However, A.M. Best Company, the most widely recognized rating agency dedicated to the insurance industry, provides the most comprehensive insurance ratings coverage of any rating agency and, as a result, its ratings and reports of a company's financial strength have strong implications for a company. The objective of their rating system is to provide an opinion of an insurer's financial strength and ability to meet ongoing obligations to policyholders.

The assigned rating is derived from an in-depth evaluation of a company's balance sheet strength, operating performance, and business profile as compared to Best's quantitative and qualitative standards. An important component of the evaluation process requires an interactive exchange of information with the insurance company's management, a meeting that many company executives compare to a dental appointment without painkillers!

The Best ratings are by grades:

Secure Best's Ratings:

A++, A+, A, and A- are rated Superior to Excellent

B++ & B+ are rated Very Good

Vulnerable Best's Ratings:

B & B- are rated Fair

C++ & C+ are rated Marginal

C & C- are rated Weak

D are rated Poor

E are rated Under Regulatory Supervision

F are rated In Liquidation

S are rated Rating Suspended

Any rating below A- may be problematic while any rating below B+ is problematic for an insurer. Many banks and financial institutions will not accept insurance policies on homes and other property from companies rated below A-. In commercial lines, a rating below A- may result in the loss of a significant amount of business for an insurer.

A.M. Best considers catastrophic loss to be a primary threat to the financial strength and credit quality of p/c insurers because of the significant, rapid and unexpected impact that can occur. While many other exposures can affect solvency, no single event can affect policyholder security more instantaneously than catastrophes. Moreover, immediately following a significant event, the insurer retains

its exposure and subsequent events can occur prior to the implementation of any risk mitigation strategies.

A.M. Best, in a release dated Dec. 5, 2011, stated that "its estimates for catastrophe-related losses experienced by the U.S. property/casualty (P/C) industry through the first nine months of 2011,.... show that losses so far have nearly doubled total year-end 2010 losses." They estimate total net pretax accident-year catastrophe-related losses were $38.6 billion, up $22.5 billion. Of course, this includes tornado losses, flooding, and other widespread loss events across the United States.

Given the increased frequency and severity of catastrophic events in recent years, insurers and reinsurers have been challenged to further improve their catastrophic risk management systems and controls and to provide stronger capitalization to support the risk.

A.M. Best assesses catastrophe risk management of primary insurers and reinsurers alike. Insurers knowingly accept risk with the intent of diversifying the loss, and to maintain their ratings, must demonstrate their ability to effectively manage catastrophe risk and the financial wherewithal to absorb potential losses.

Today, most insurers utilize sophisticated catastrophe modeling tools, primarily those provided by specialized firms with extensive meteorological, seismological, statistical, and technological resources to provide loss estimates. The models depend on the veracity of the data input, subject to manipulation through the use of various options that can add to or reduce the net probable maximum loss.

To establish and maintain data quality, proper coding of loss exposure is essential to ensure meaningful model output is developed. Key items are quality data, accurately mapped locations, property coding and the models used to assess property values.

While catastrophe models are extraordinarily useful in the analytical and underwriting process, they are only tools and cannot be solely relied upon for the management of maximum exposures. A.M. Best believes the catastrophe models are valuable tools in monitoring an estimated distribution of potential catastrophe losses, and will continue to utilize modeled output in its evaluation of capitalization through Best's Capital Adequacy Ratio (BCAR).

A.M. Best believes that those companies that utilize models to merely manage to the lowest case loss estimates, rather than realistic loss scenarios, have demonstrated weakness in business practices that will be reflected in their ratings, regardless of apparent capitalization.

As part of their evaluation, A.M. Best wants insurers to purchase reinsurance for a 100 year storm at a minimum and prefers that companies purchase reinsurance for a 250 year event. As stated above, this could present a significant problem in the future.

Reinsurance

Primary insurers buy reinsurance to protect their bottom line. Reinsurance is sold in layers, reaching up into the millions of dollars to protect insurance companies from possible, but statistically highly unlikely events. Retentions and coinsurance, through which insurers share the risk at various levels with their reinsurers, as well as coverage amounts have increased dramatically over the past decade.

As the frequency and severity of catastrophic losses increase, both insurers and reinsurers will increase their premiums. Reinsurers are also must consider modeling results and consider their own cumulative exposures by geographic areas. As a result, a reinsurer must add a risk load to the premium. "Risk load" means the factor that the reinsurer adds over and above the insurer's loss ratio and other underwriting factors in order to have sufficient capital to withstand a catastrophic event. As the Mid Atlantic exposure estimates increase, the Mid Atlantic insurers need to buy more capacity from the reinsurers. In turn, the reinsurer must either raise more capital to support the needs of the insurers or the reinsurer must restrict its writing. In either event, the reinsurance rates will increase.

However, insurer deductibles can attenuate increases in reinsurance rates.

Wind and Other Deductibles

After Hurricane Andrew, with computer-based models of storms, coastal development patterns and increasing values all indicating how vulnerable insurers were to large weather-related losses, homeowners insurers had difficulty finding the reinsurance coverage they needed to protect their own bottom line. Many homeowners' insurers couldn't obtain reinsurance coverage unless they agreed to greatly reduce their potential maximum losses from such events through higher deductibles. These deductibles exist in regions prone to hail as well as hurricane damage. They are generally equal to a percentage of the structure's insured value as opposed to a straight dollar amount, such as $1,000.

Percentage deductibles for windstorm losses, which may be mandatory in some coastal areas of a state, vary from 1 percent of the home's insured value to 15 percent, depending on many factors that differ from state to state, and sometimes from insurer to insurer, including the home's insured value and the "trigger," the nature of the event to which the deductible applies. In some states or portions of a state, policyholders have a "buy back" option – paying a higher premium in return for a traditional dollar rather than a percentage deductible. The percentage deductibles may apply to the entire state or just part of it.

As stated earlier, wind losses, by far, cause the most catastrophe losses, even if hurricanes and tornadoes are excluded. Percentage wind deductibles play a key role by reducing the exposure of a company, reducing reinsurance costs, and reducing the need for additional capital are essential for companies to maintain a presence in Maryland.

Notices from Insurers to Insureds

Clearly a problem exists in Maryland as well as other jurisdictions: an insured does not understand what is in their insurance policy, particularly their homeowner's policy. Despite legislatively mandated notification requirements such as the Homeowner's Bill of Rights (I admit that MAMIC was the only organization that opposed and remains opposed to this legislation), sewer backup coverage, etc. By delivering a blizzard of notices, the average consumer is more confused than ever as to what coverage they have and what coverage they should have.

MAMIC strongly recommends a thorough review and revision of statutes requiring various notices with the goal of achieving effective education of insureds. The more completely a homeowner or other

potential insured realizes what coverages they are purchasing, the fewer complaints there will be.

Building Codes

One weakness in Maryland, as in other states, is the lack of a strong statewide building code. The facts are stark!

In the mid 1980s, a study of the damage caused by Hurricanes Alicia (1983) and Diana (1984), two storms of roughly equal size and intensity, found that the level of building code enforcement affected the cost of claims. Hurricane Alicia hit Texas, causing $675 million in insured damage, of which close to 70 percent was attributed to poor code enforcement. By contrast, Hurricane Diana hit North Carolina, where codes were effectively enforced. Researchers found that only 3 percent of homes in that state suffered major structural damage as a result of the hurricane. Insured losses in North and South Carolina totaled $36 million.

This research and a similar assessment after Hurricane Hugo prompted the National Committee on Property Insurance, now the Institute for Business & Home Safety (IBHS), to study coastal municipal building code departments in southern states. Researchers found that building officials and inspectors in about half the communities surveyed were not enforcing the building code wind-resistance standards on their books.

In the aftermath of Hurricane Andrew's destruction of property in Florida in 1995, the Insurance Research Council determined that:

"Conservative estimates from claim studies reveal that approximately 25 percent of Andrew-caused insurance losses (about $4

billion) were attributable to construction that failed to meet code due to poor performance, as well as shoddy workmanship."

The National Institute of Building Sciences estimates that society saves an average of $3.65 for every federal dollar spend on mitigation.

Many states have passed legislation requiring insurers to offer discounts for strengthening their homes, including Louisiana, and North and South Carolina. However, Louisiana is the only state among those most affected by Katrina to enact a strong statewide building code.

Legislation has been introduced in the Maryland General Assembly to create a statewide building code, but the counties have opposed it, claiming that building codes are their responsibility.

Impact of Coastal Markets

As set forth in the reinsurance section, as capacity decreases, the cost of insurance will increase and, in some cases, may become unavailable in some markets. Coastal markets in locations like Ocean City have a large number of vacation or second homes. If the insurer of the primary home cannot underwrite the second home, it is probable that the only facility available to the owner will be the FAIR plan with its limitations.

Thank you for the opportunity to address the panel. I will be happy to provide further information and material if requested.

Minor Carter

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