

“A Plague on Your Houses”

What's Wrong With Homeowners Insurance Markets

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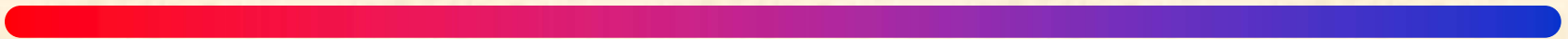
Presentation Outline

- **Homeowners Insurance Market Financial Performance**
- **P/C Insurance Industry Financial Overview**
 - **The truth about insurer investment performance**
- **Impact of Rising HO Insurance Costs and Tighter Underwriting on Real Estate Industry & Homebuyers**
- **Use of Credit Information in Underwriting Homeowners Insurance**
- **C.L.U.E. Reports**

HOMEOWNERS INSURANCE:

Recent Financial

Performance

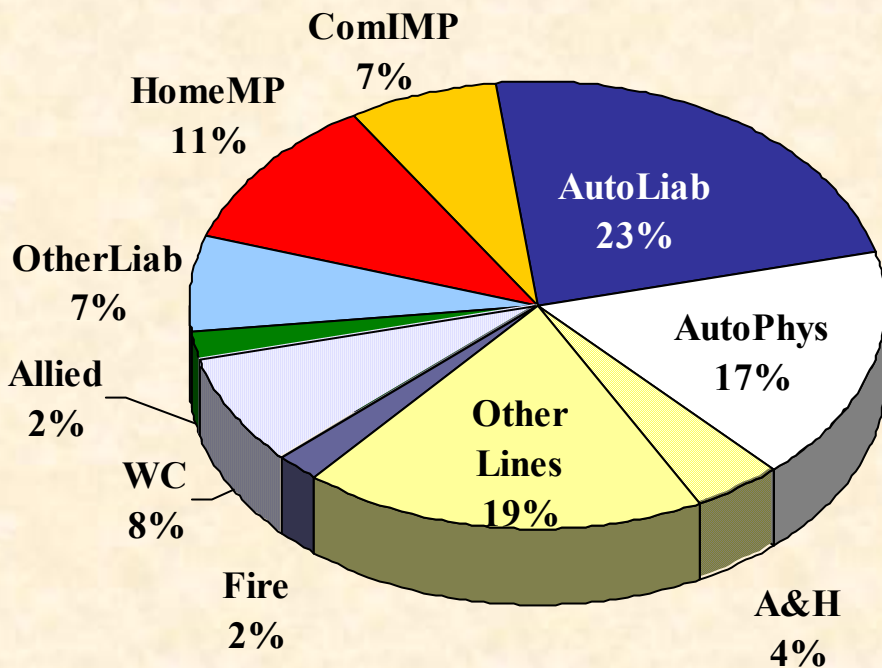




Industry Net Premiums Written by Product Lines

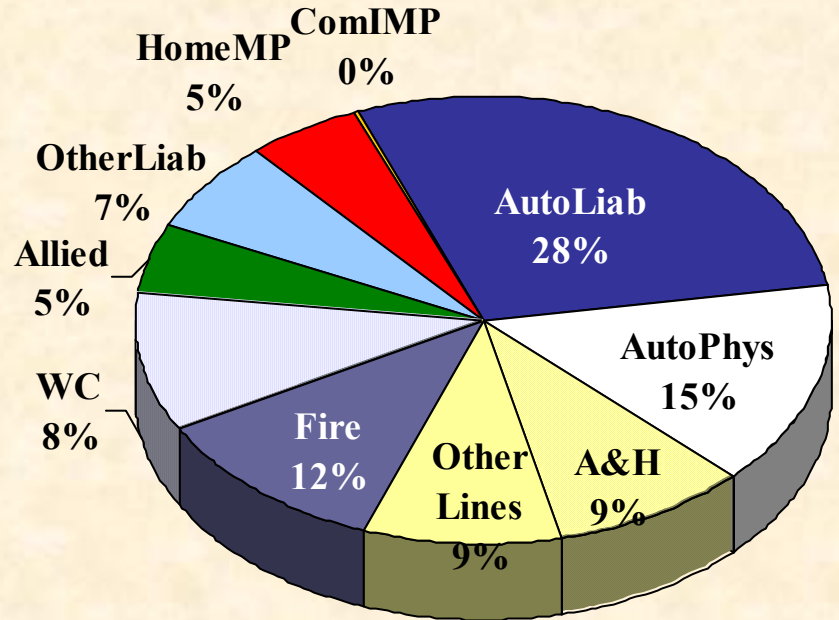
2001

NPW=\$369.1 Billion



1960

NPW=\$14.7 Billion

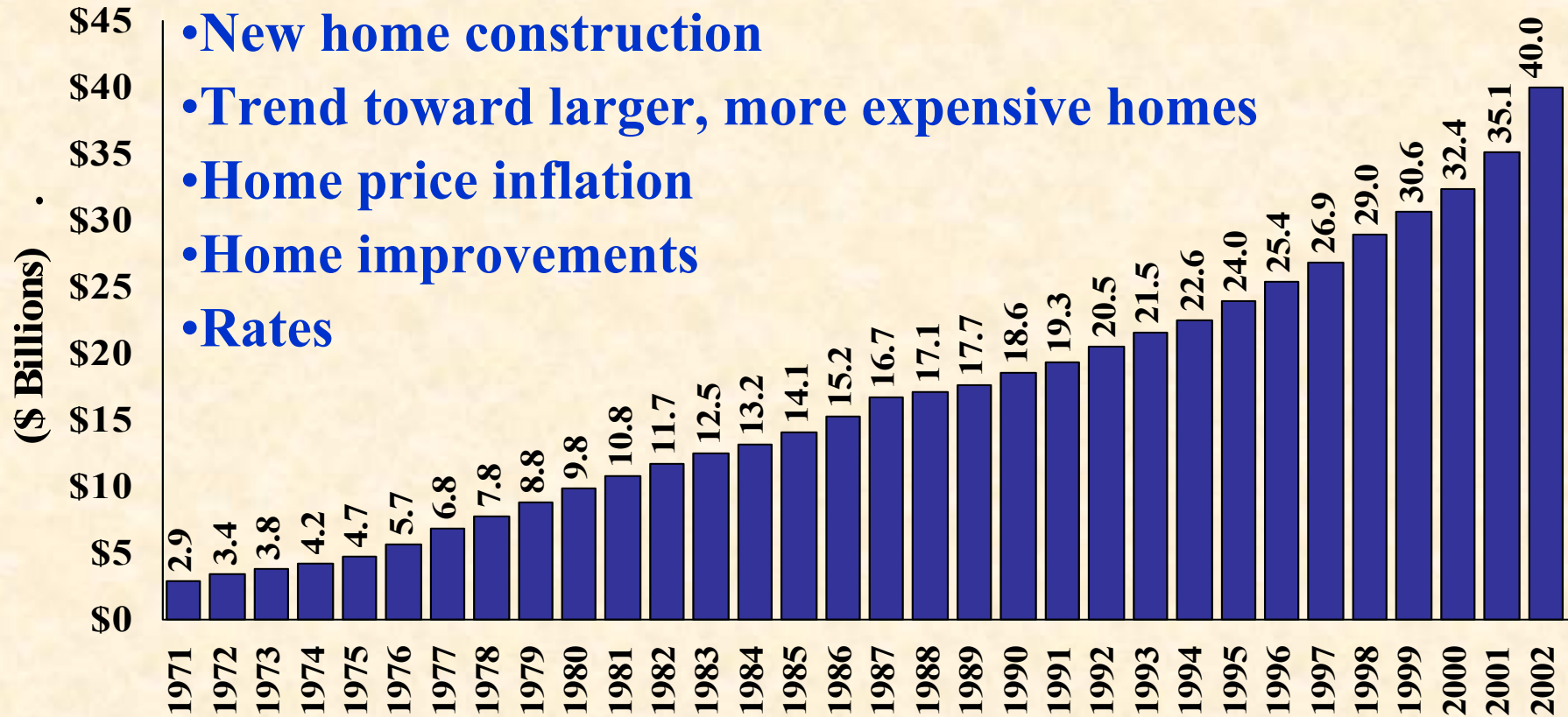




Homeowners Multi-Peril Insurance Net Premiums Written

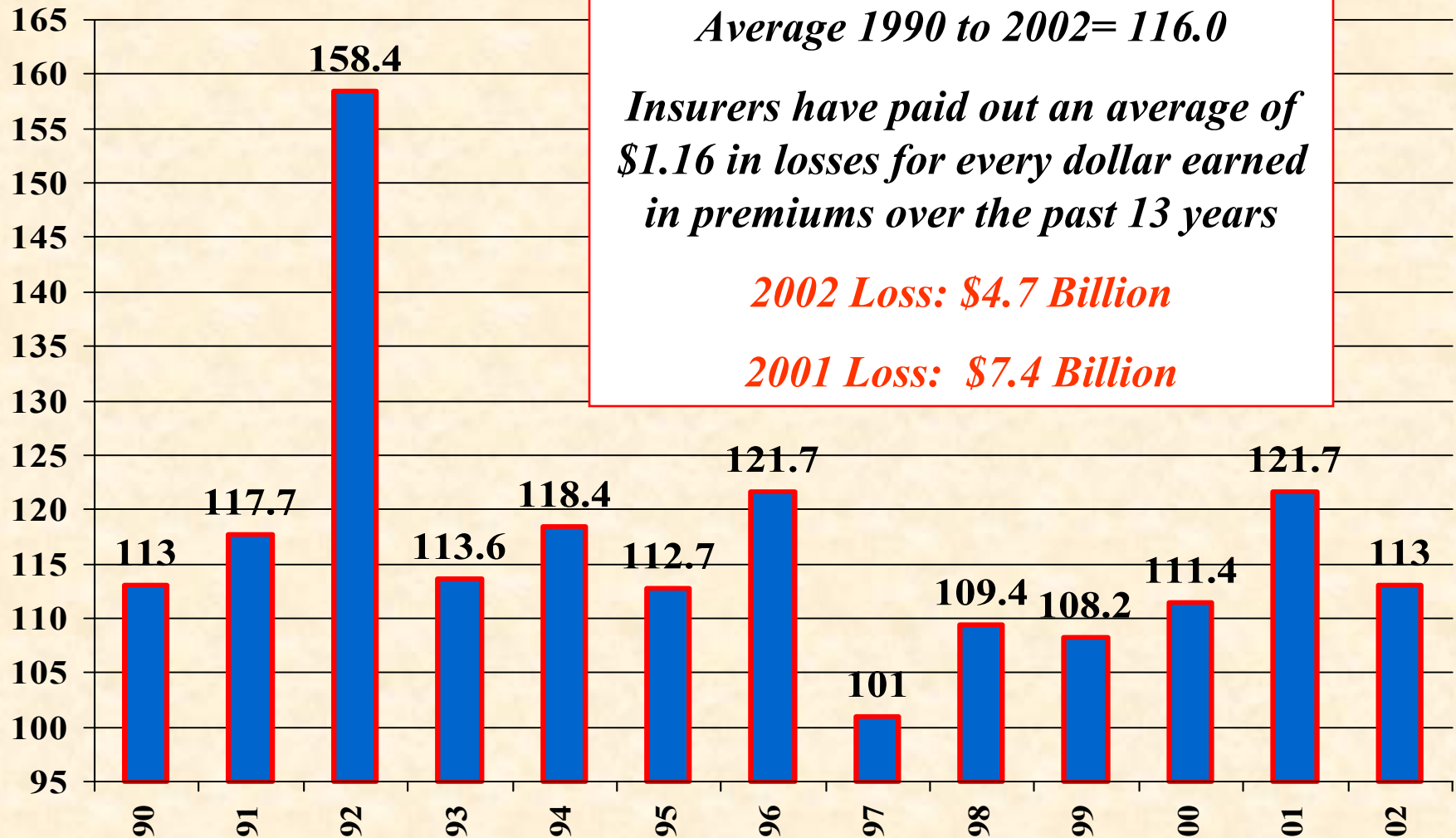
Revenue Growth Drivers:

- New home construction
- Trend toward larger, more expensive homes
- Home price inflation
- Home improvements
- Rates



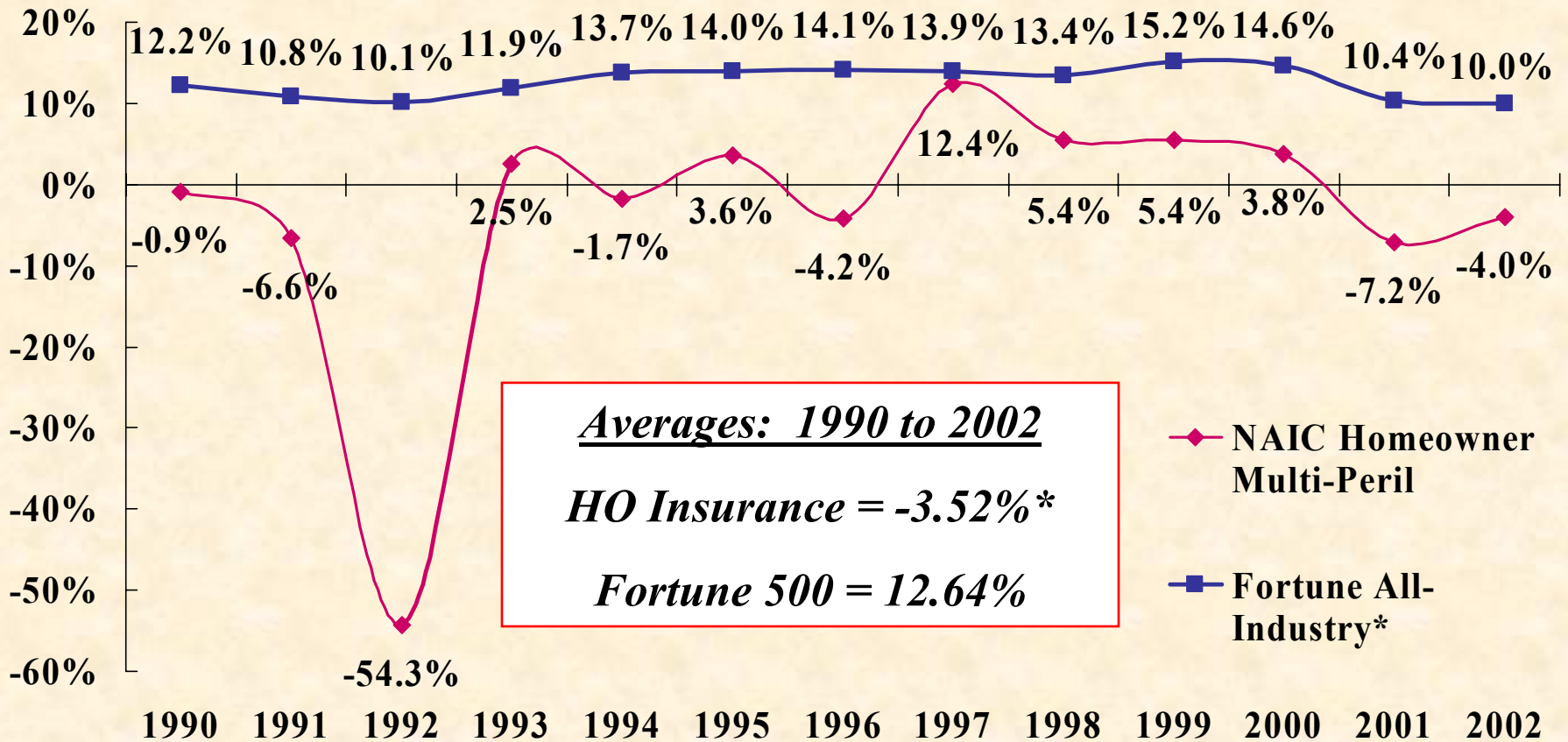


Homeowners Insurance Combined Ratio





Rates of Return on Net Worth



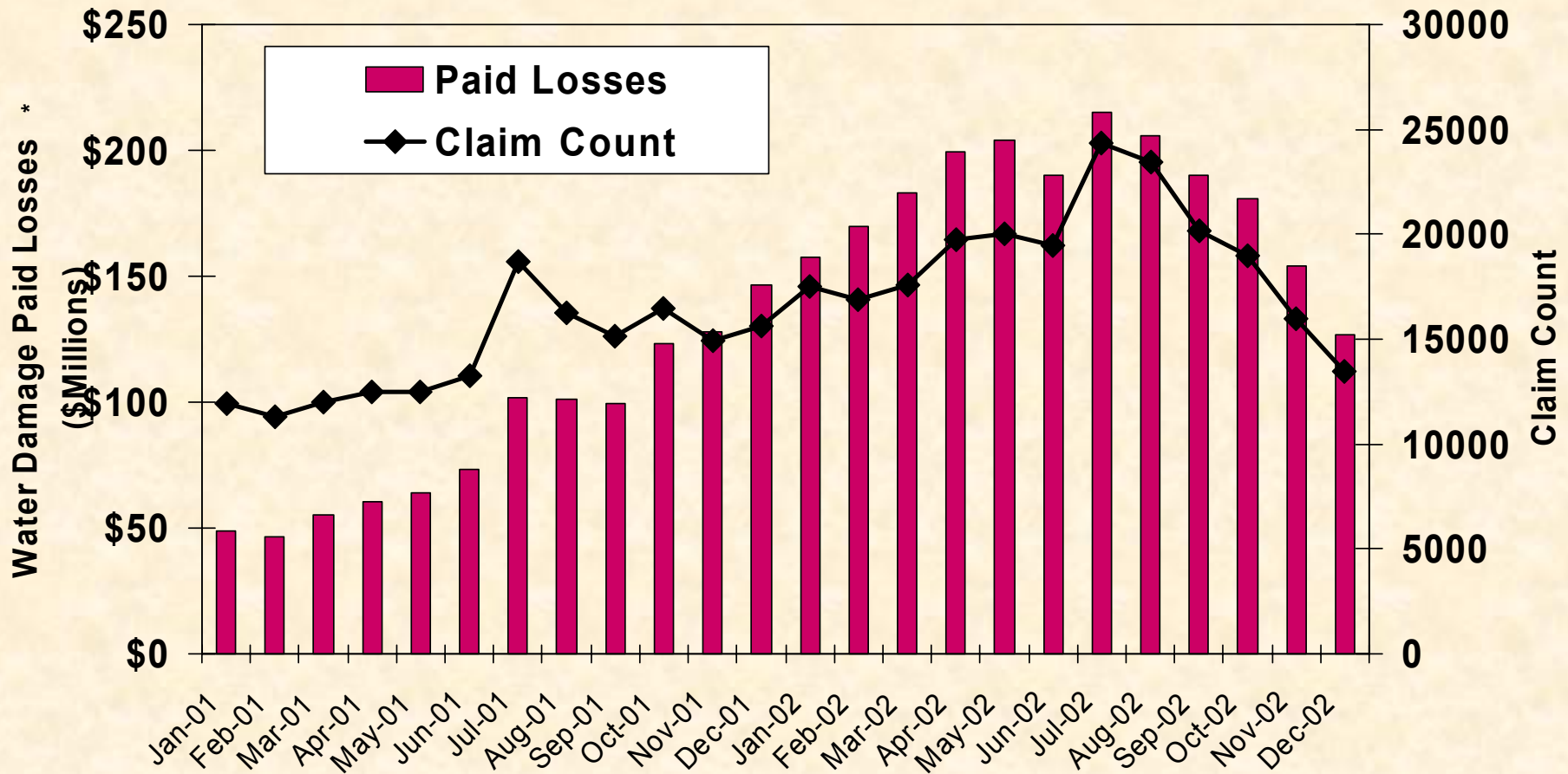
Source: NAIC, Insurance Information Institute

* Average is 0.71% if excluding 1992 (year of Hurricanes Andrew and Iniki).

Note: 2002 Homeowners figure is III estimate.



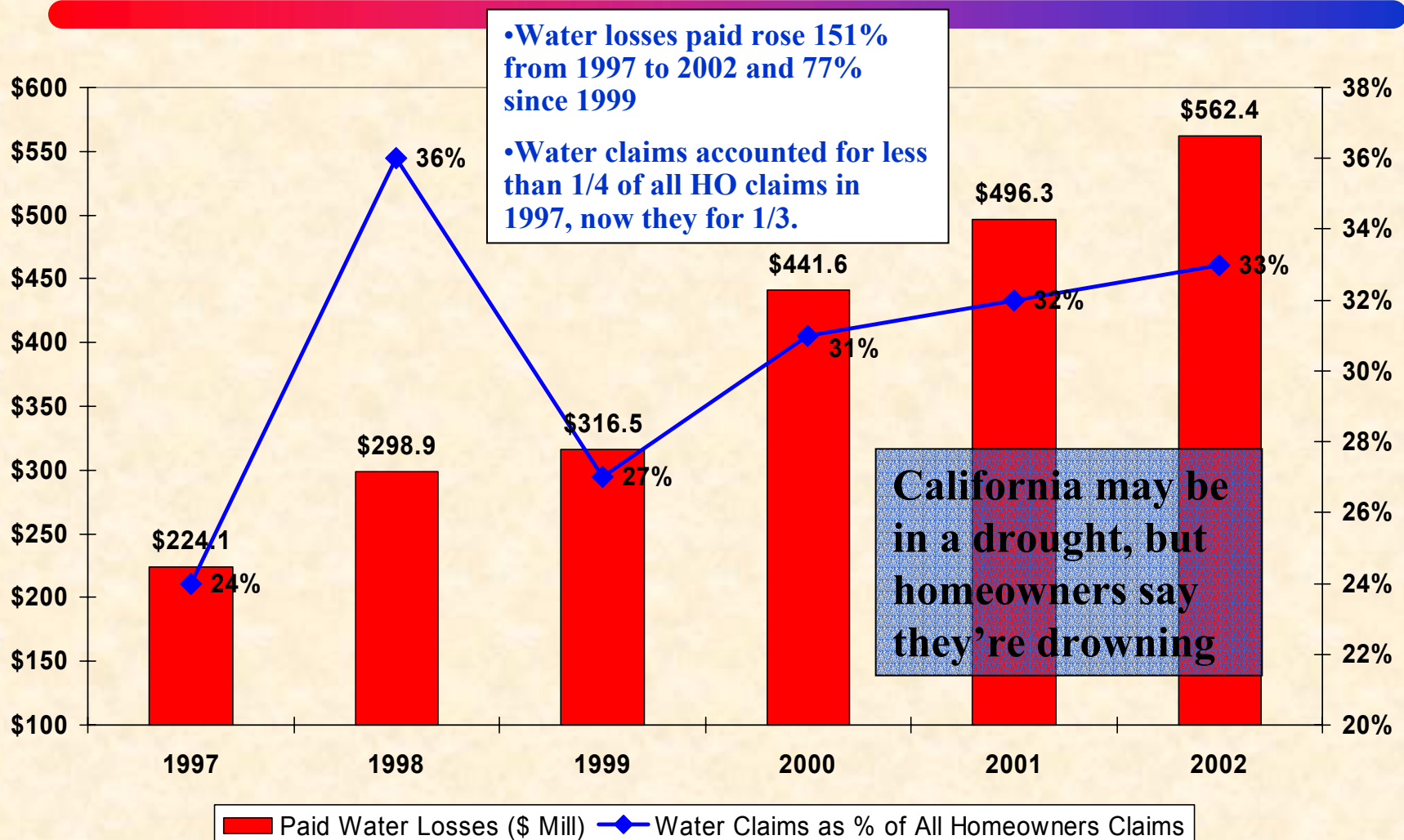
Texas: Mold Losses/Claims Are Finally Moderating*



* Data are for TDI Cause 61: Discharge – Other Damage. Not all claims in cause 61 are mold and mold claims may also arise from other (non-water) causes of loss.

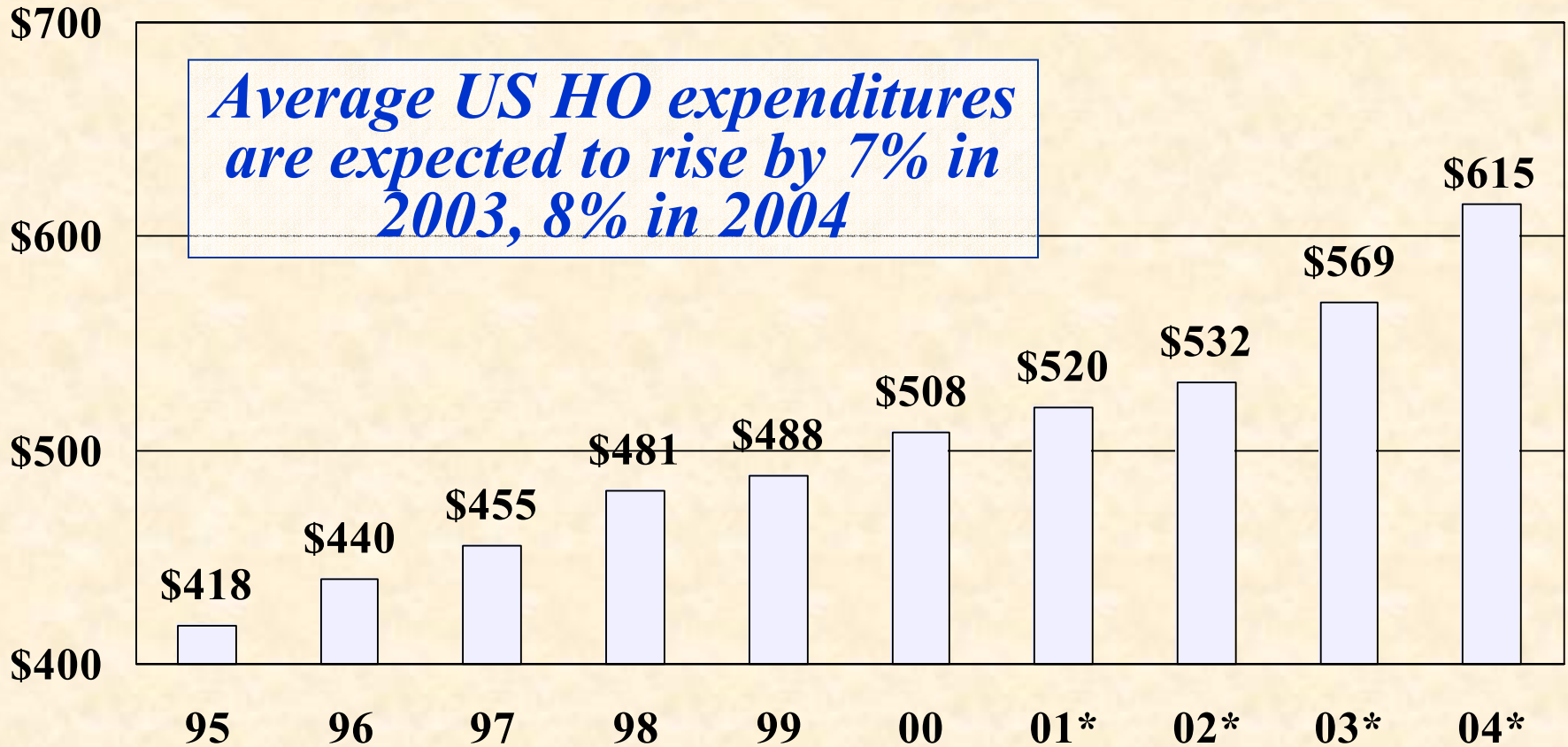


California: Surging Water Claim Frequency and Costs: Symptom of Growing Mold Problem





Average Expenditures on Homeowners Insurance: US



*III Estimates; Estimates for 2001-2003 based on BLS CPI data for tenants and household insurance.
Source: NAIC, Insurance Information Institute

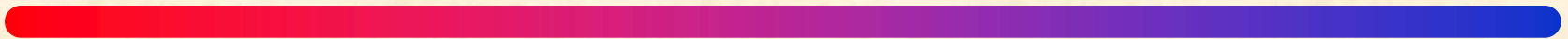
Reasons for Rising HO



Insurance Prices

- Enormous underwriting losses are the primary reason for rising homeowners insurance rates today
 - Function of frequency/severity of claims and events
- Home price/repair inflation
- Constant threats:
 - CAT losses (>\$100B since 1990); Not just hurricanes/earthquakes, but also major hail/wind events
- New issues such as “toxic” mold cost billions; no prior premium collected
- Litigation is a problem (property & liability related)
- Falling capacity; Rising reinsurance costs
- Attempts to weaken insurers ability to underwrite
 - Credit restrictions raise costs for millions (WA, MD & others)
 - CA “emergency” reg. preventing insurers from using claims history in coverage decisions (Safeco moratorium on new HO policies)

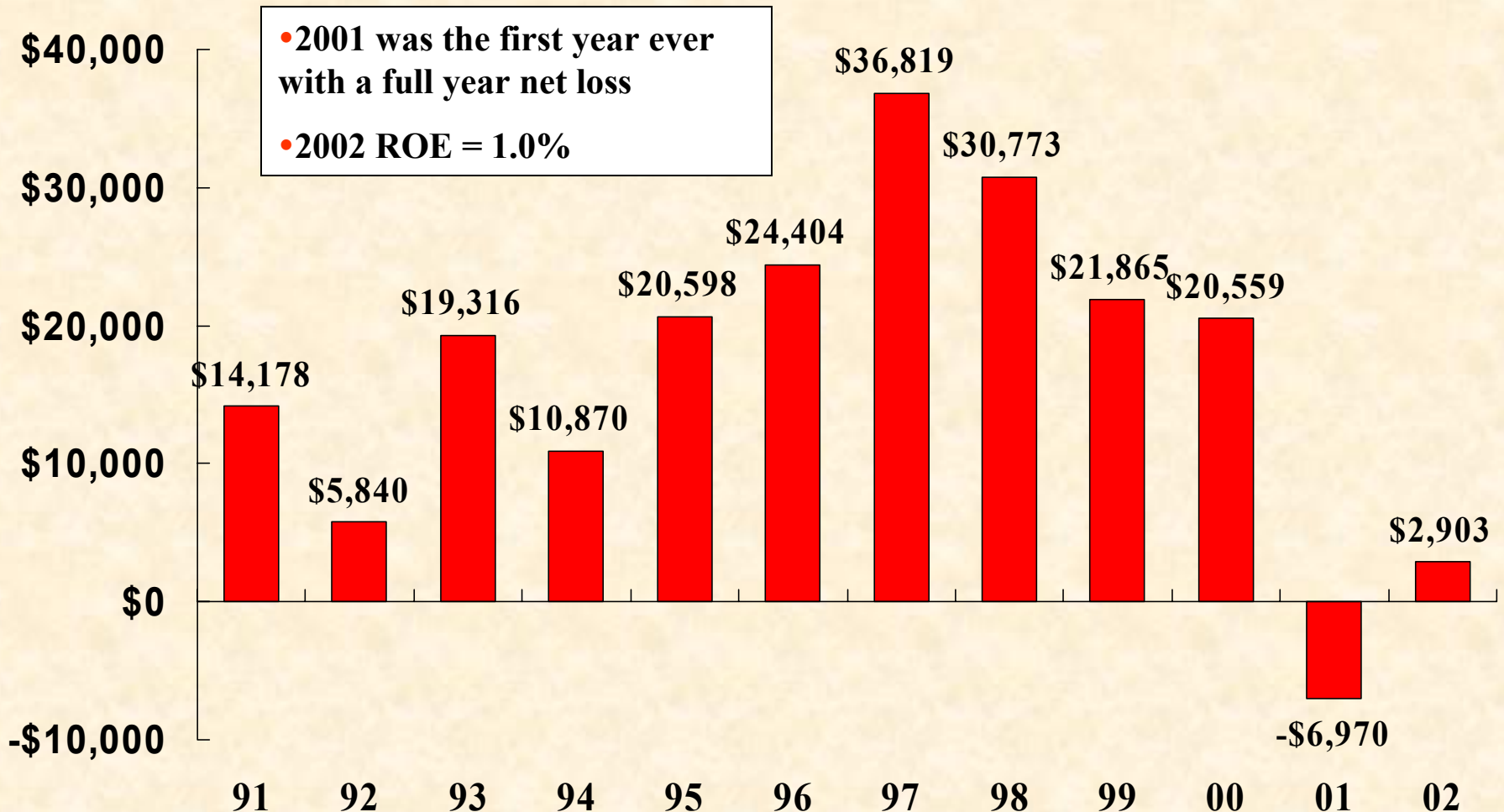
***PROPERTY/CASUALTY
INSURANCE INDUSTRY:
Recent Financial
Performance***





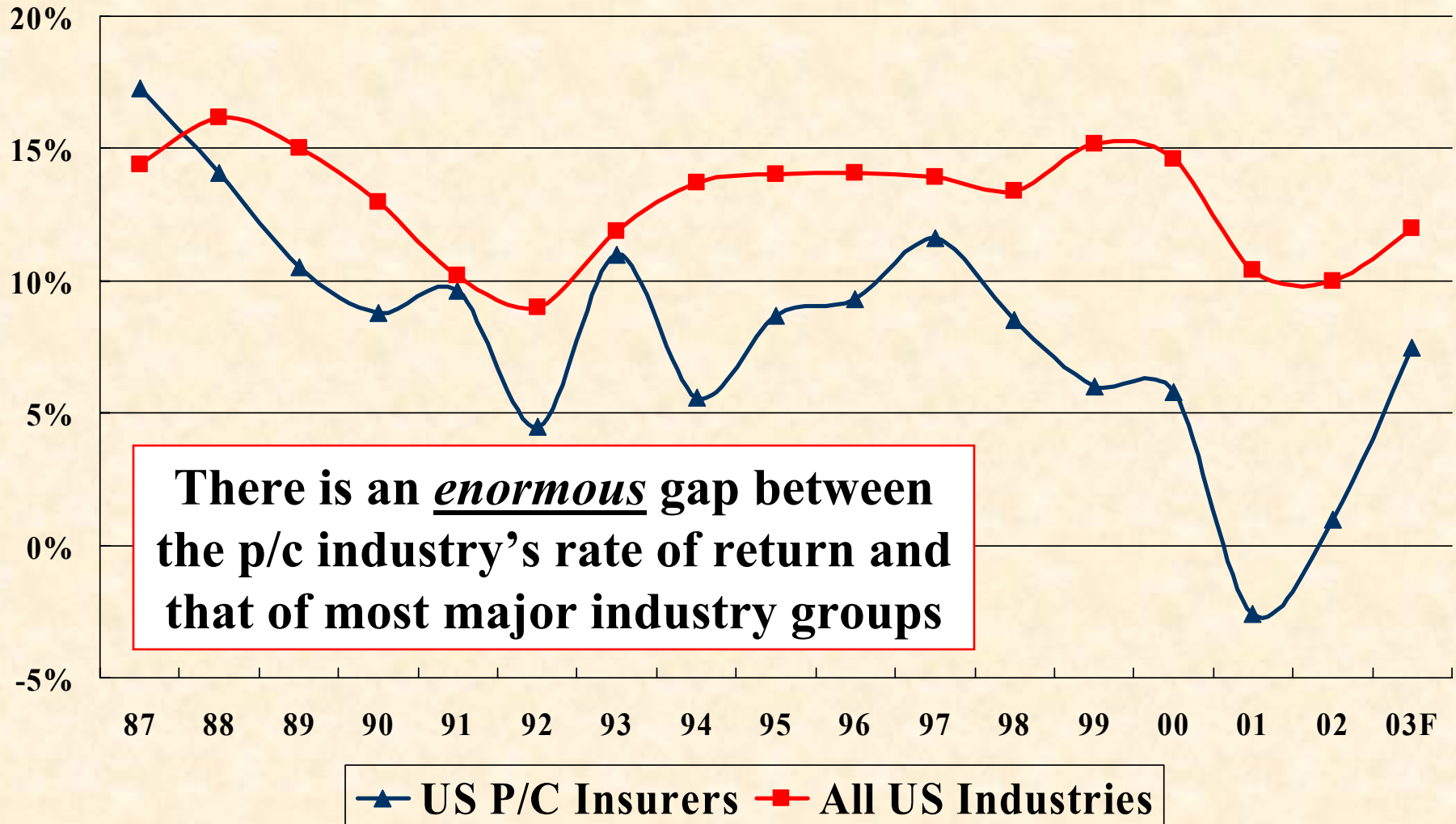
P/C Net Income After Taxes

1991-2002 (\$ Millions)





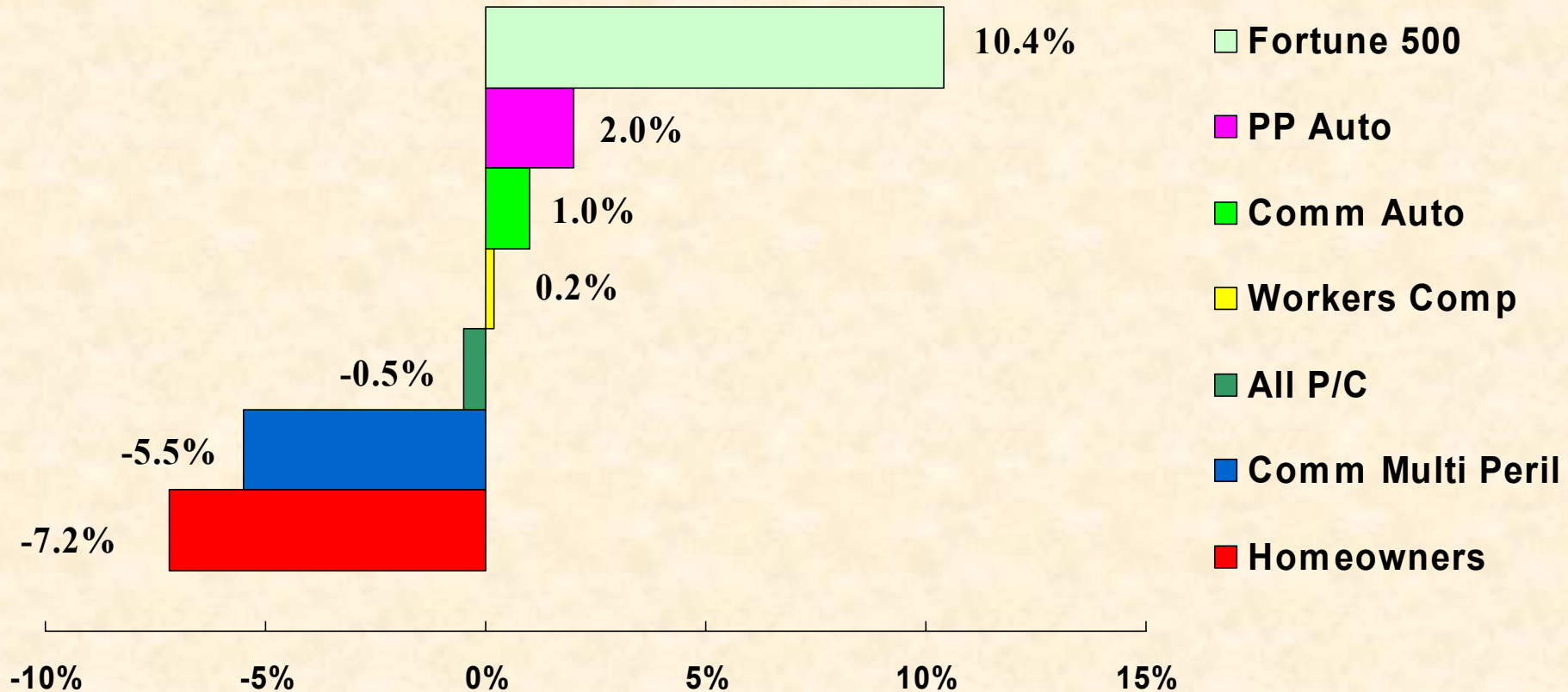
ROE: P/C vs. All Industries 1987–2003F





2001 Return on Equity (Profitability)

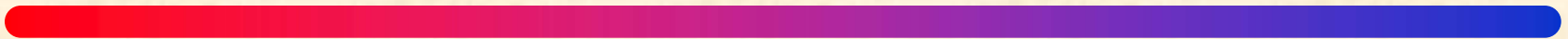
2001 (Selected Lines)



Source: National Association of Insurance Commissioners, Insurance Information Institute

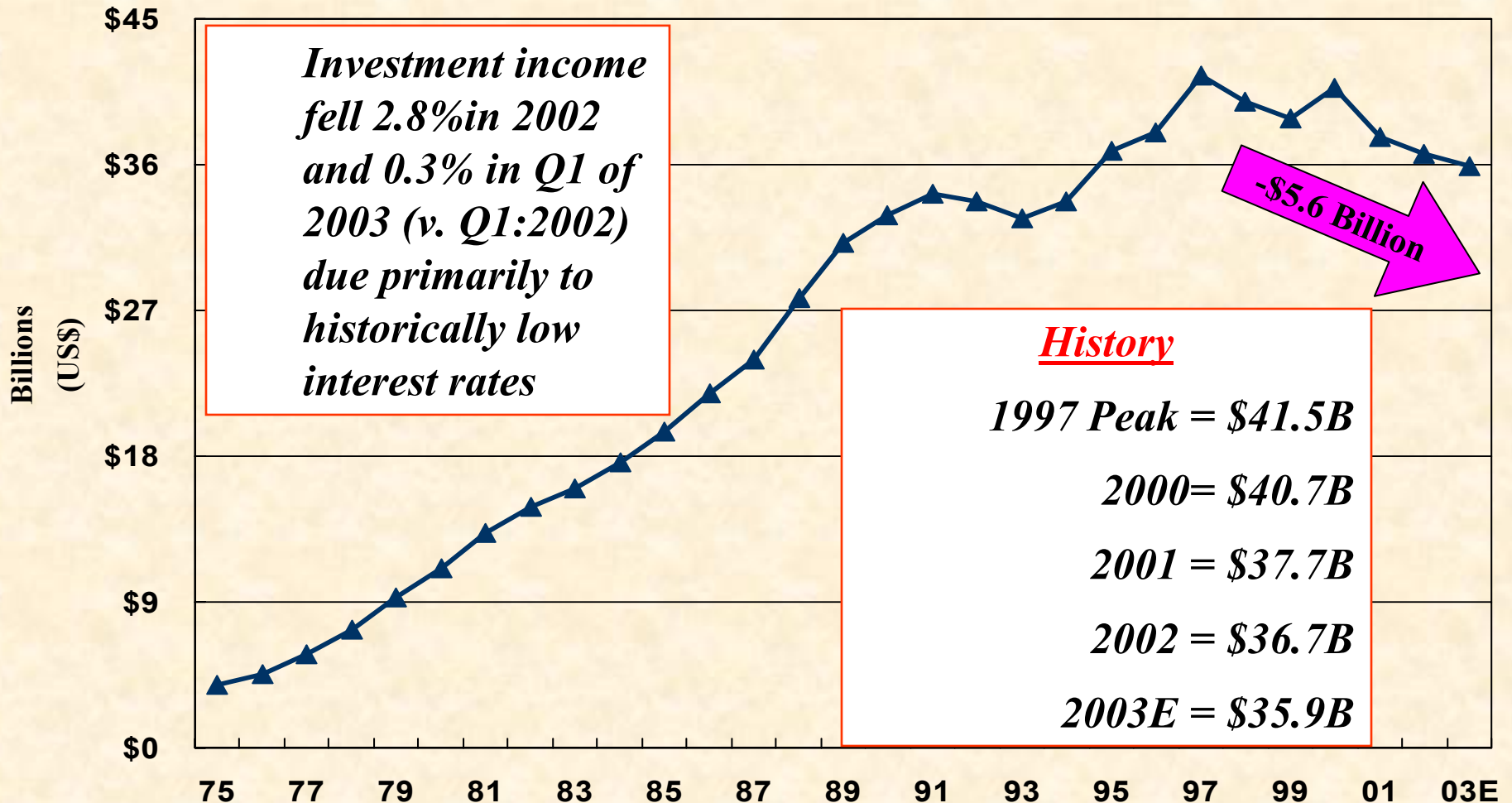
Investment Issues:

*The Truth About P/C Insurer
Investment Performance*





Net Investment Income

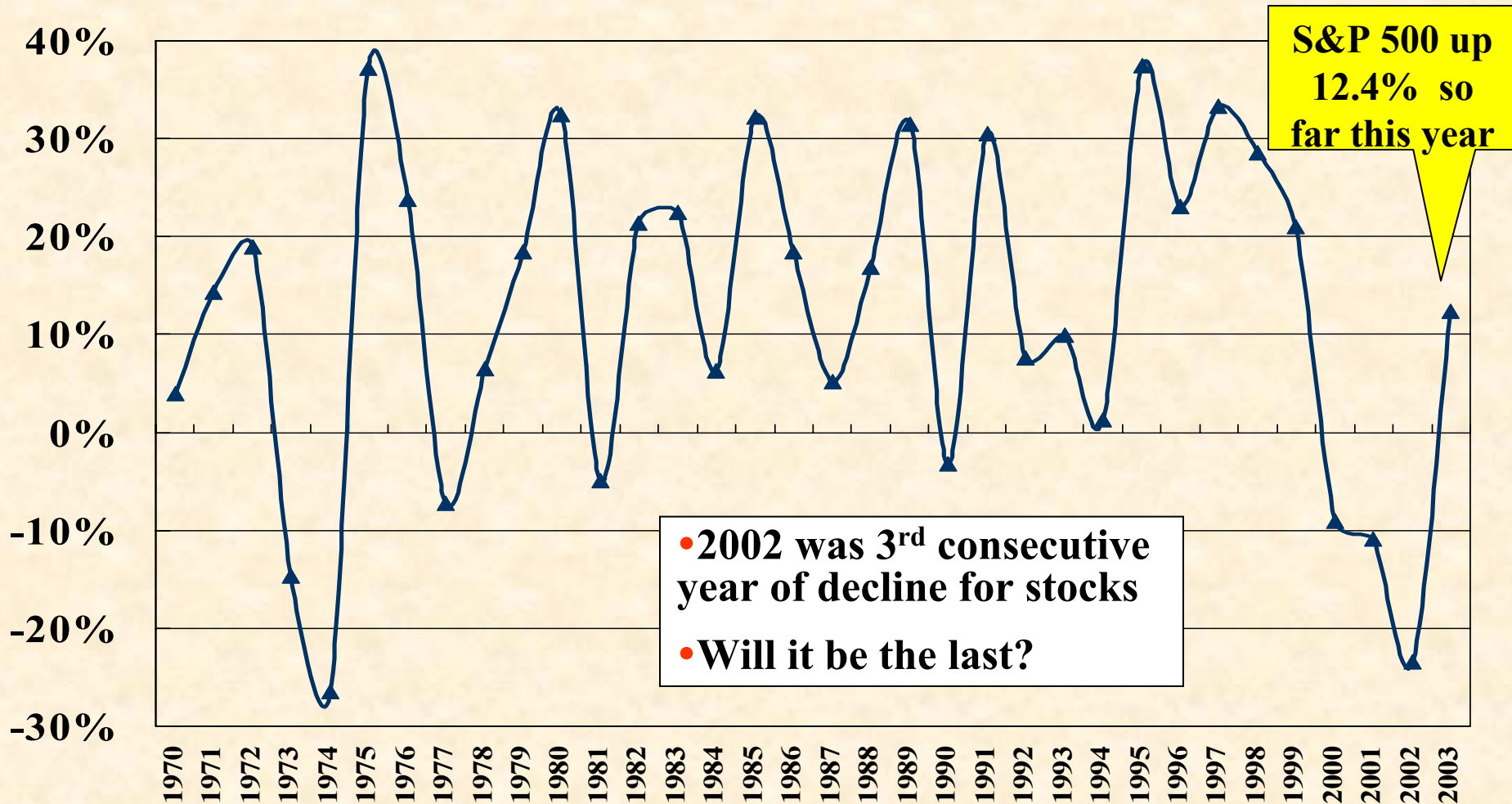


Note: 2003 estimate is based on annualized first quarter investment income of \$8.984 billion.

Source: A.M. Best, Insurance Information Institute



Total Returns for Large Company Stocks: 1970-2003*

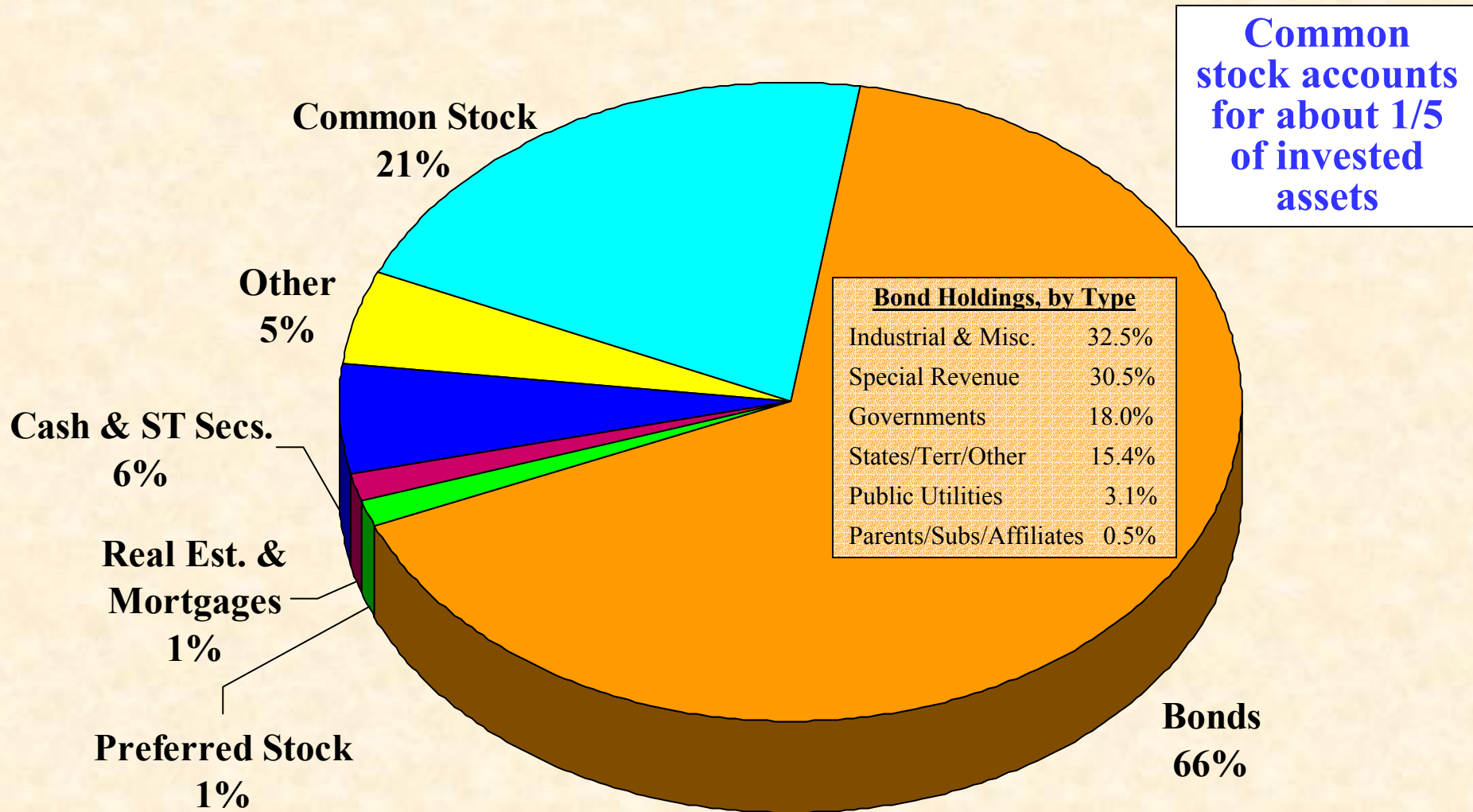


*As of July 23, 2003.

Source: Ibbotson Associates, Insurance Information Institute



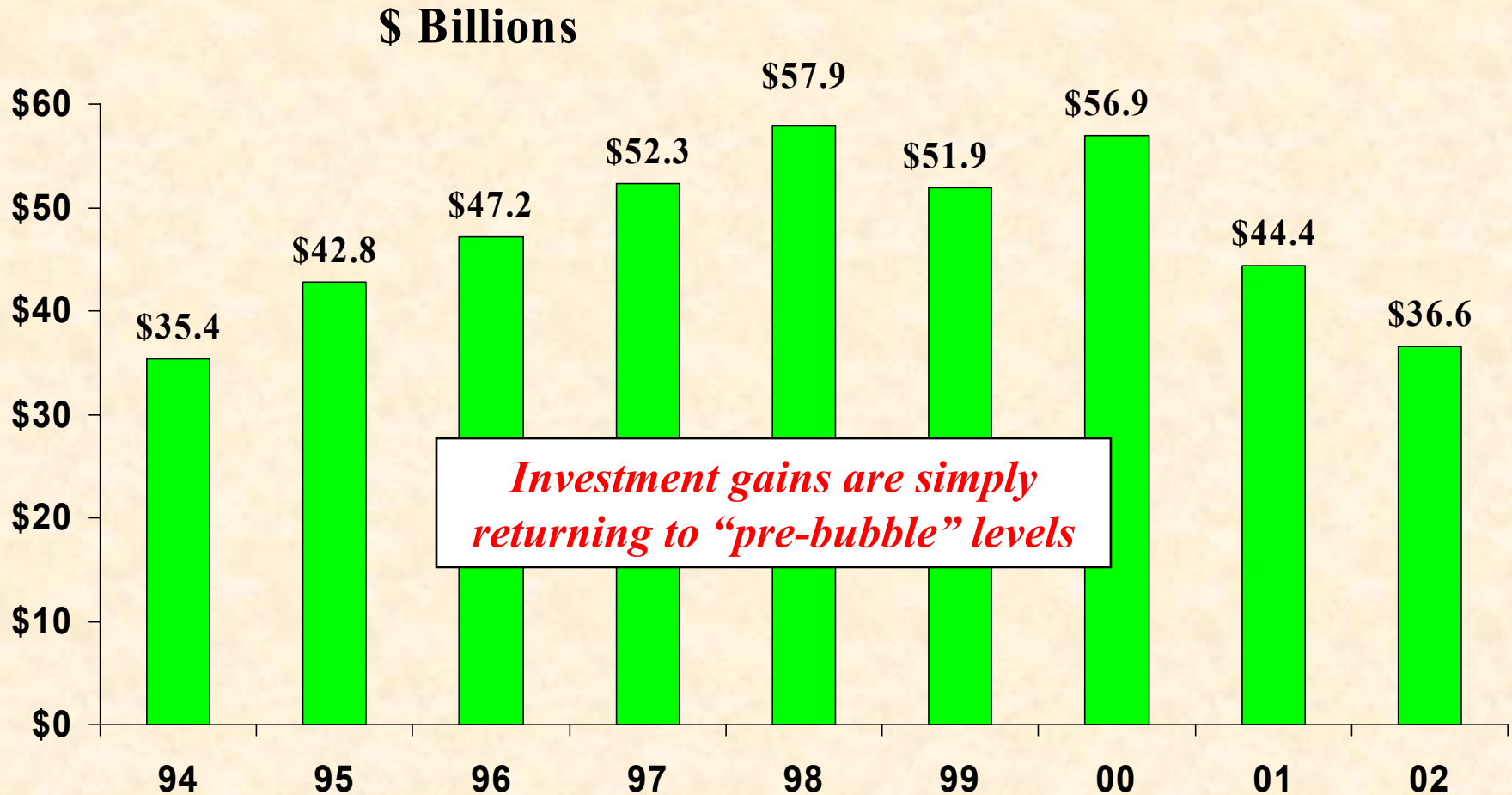
P/C Industry Investments, by Type (as of Dec. 31, 2001)



Source: A.M. Best, Insurance Information Institute

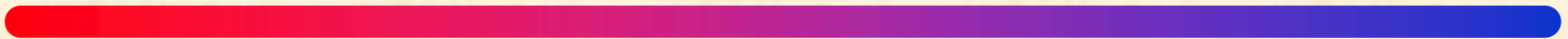


Property/Casualty Insurance Industry Investment Gain*



*Investment gains consists primarily of interest, stock dividends and realized capital gains and losses.
Source: Insurance Services Office; Insurance Information Institute estimate annualized as of 9/30/02.

HOUSING MARKETS:
Recent
Performance &
Insurance Impact



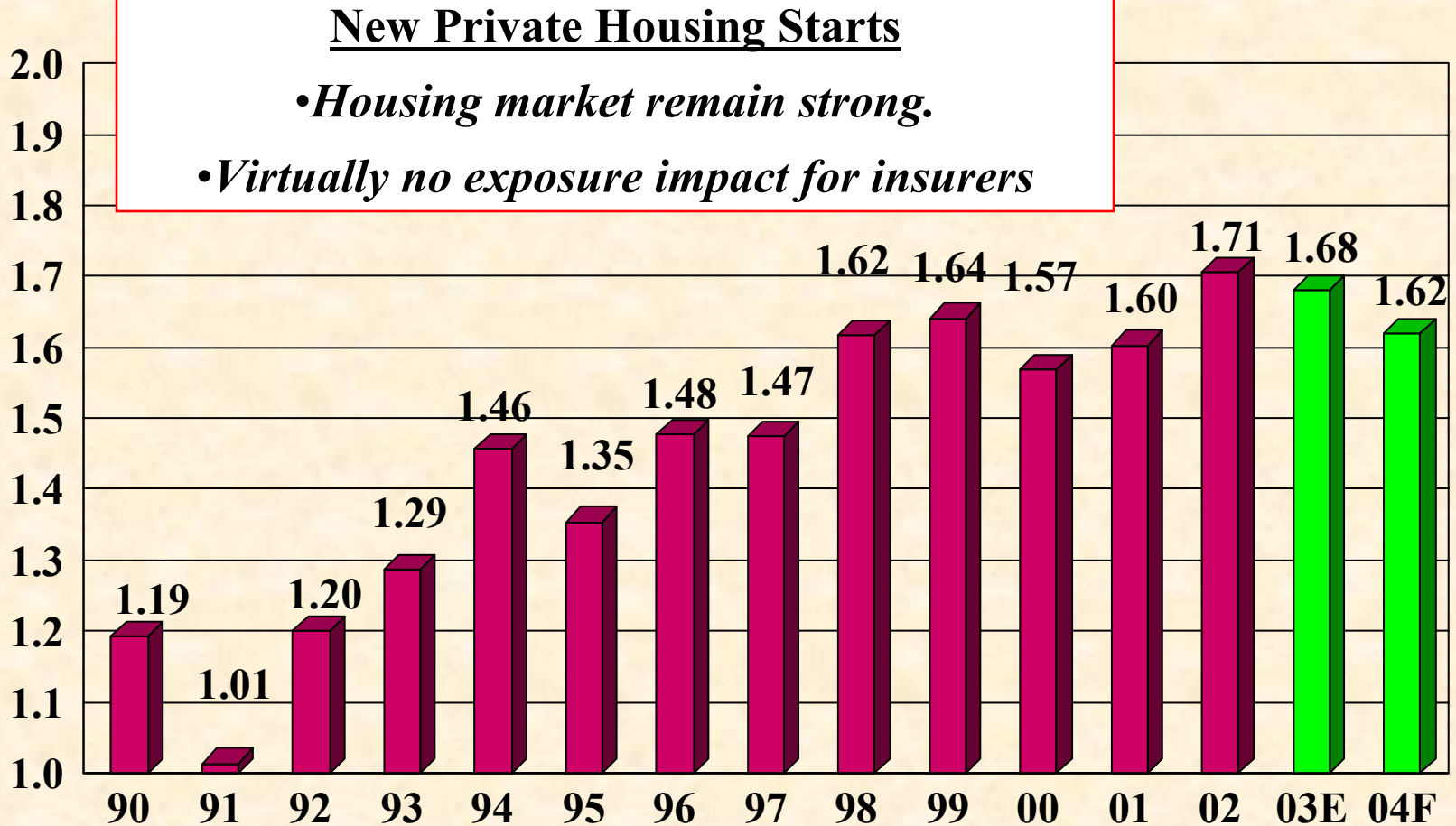


Difficult to See Where Insurance Issues Significantly Harming Residential Real Estate Markets

- **“Record for Home Sales Likely in 2003”**
 - *“Record low mortgage interest rates, a growing number of households, rising consumer confidence and an improving economy mean probably will set a **third consecutive record for both existing- and new-home sales this year.**”*
 - David Lereah, NAR Chief Economist, June 3, 2003
- **“Existing Home Sales Still on a Roll in April”**
 - *“Sales of existing homes single-family homes rose in April 2003 and are at the **fifth highest level of activity ever recorded.**”*
 - As reported on www.realtor.org on June 13, 2003
- **“Most Metro Area Home Prices Rising Above Norms”**
 - *“...short supply is continuing to put pressure on home prices in many areas, with more buyers than sellers...”*
 - David Lereah, NAR Chief Economist, February 12, 2002



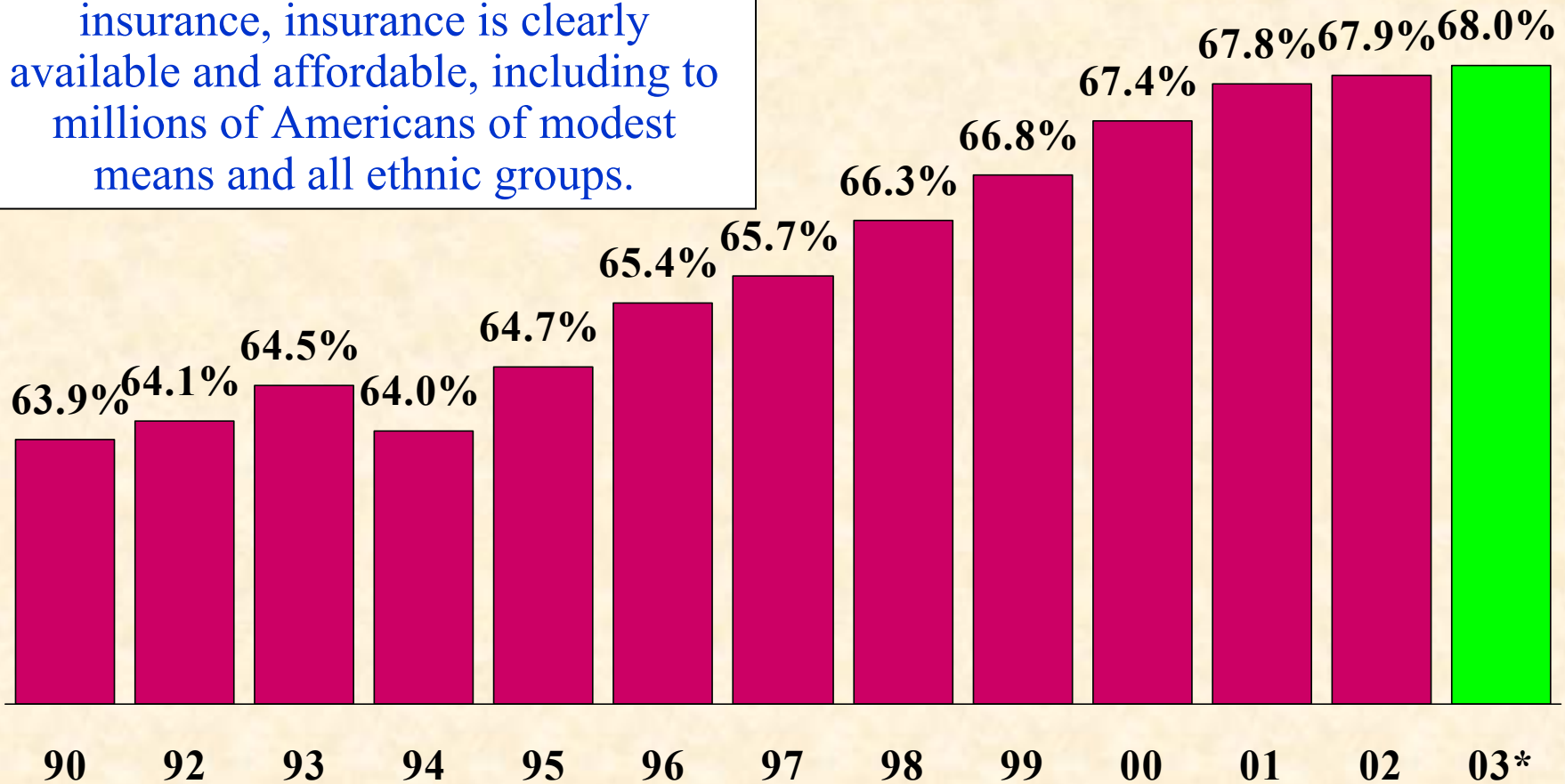
New Private Housing Starts *(Millions of Units)*





Homeownership Rates, 1990 to 2003*

Homeownership is at a record high. Because you can't buy a home without insurance, insurance is clearly available and affordable, including to millions of Americans of modest means and all ethnic groups.

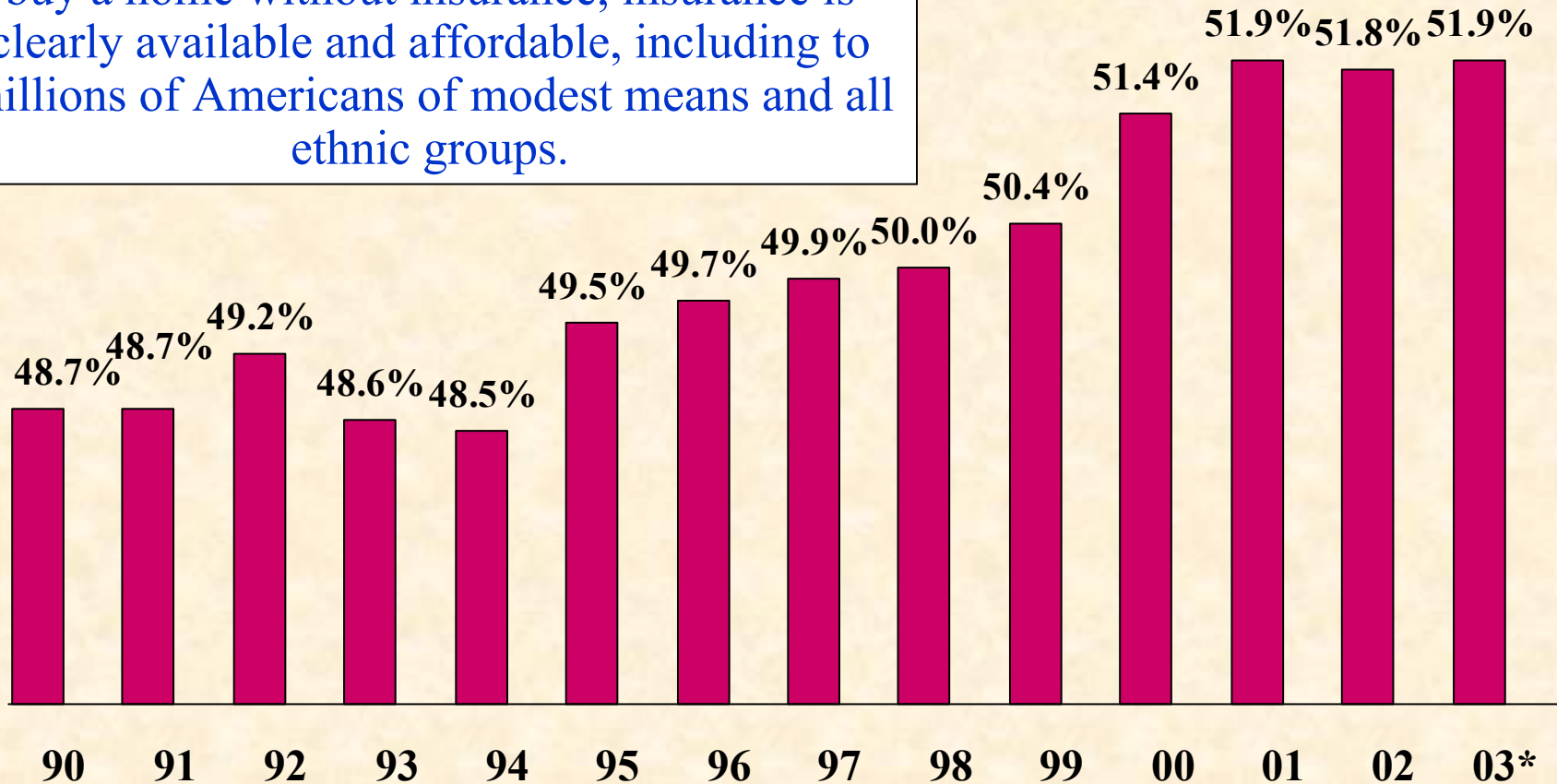


* First Quarter
Source: U.S. Census Bureau



Homeownership Rates in Central Cities, 1990 to 2003*

Homeownership rates in central cities is rising to record/near record levels. Because you can't buy a home without insurance, insurance is clearly available and affordable, including to millions of Americans of modest means and all ethnic groups.

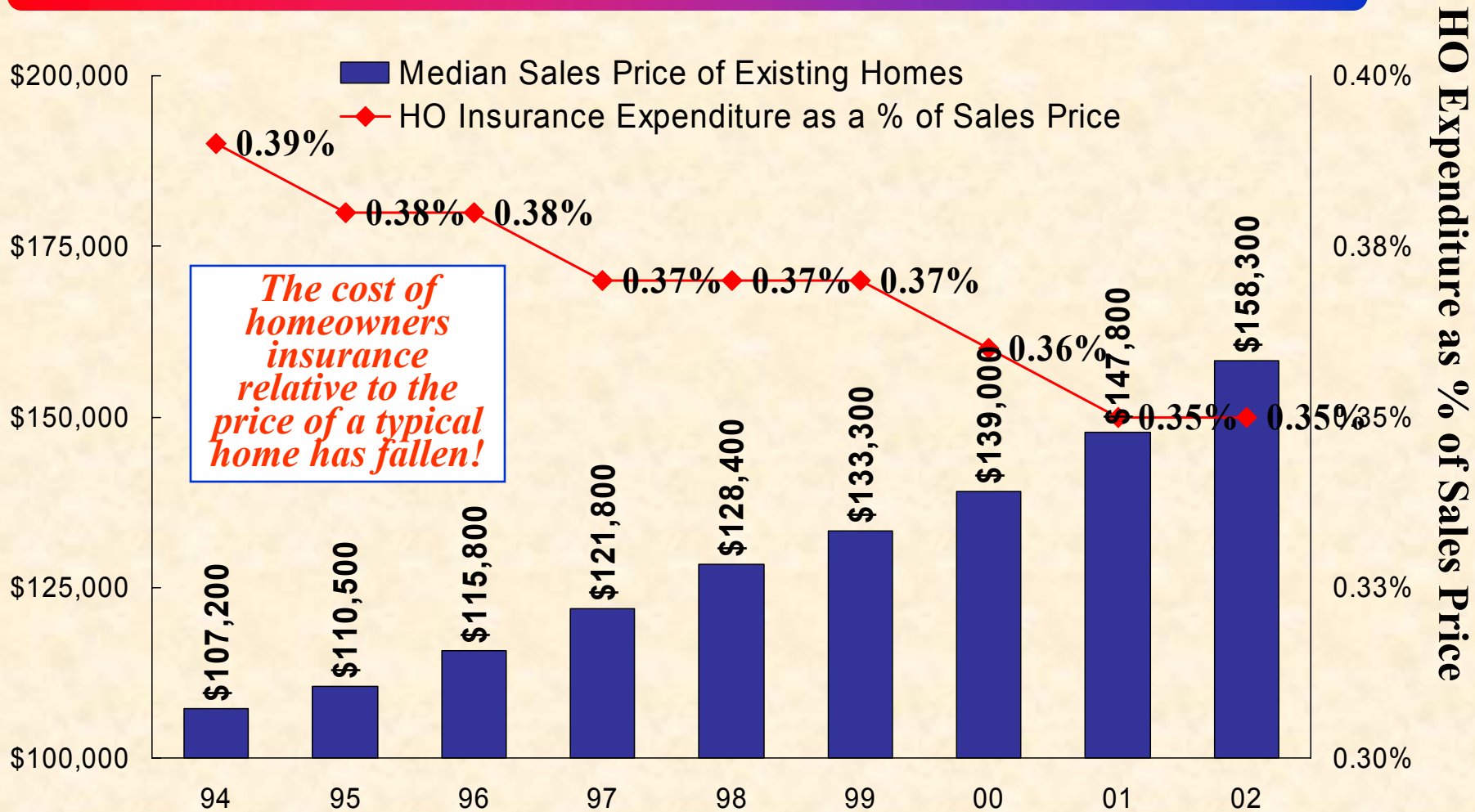


*First quarter 2003.

Source: U.S. Census Bureau



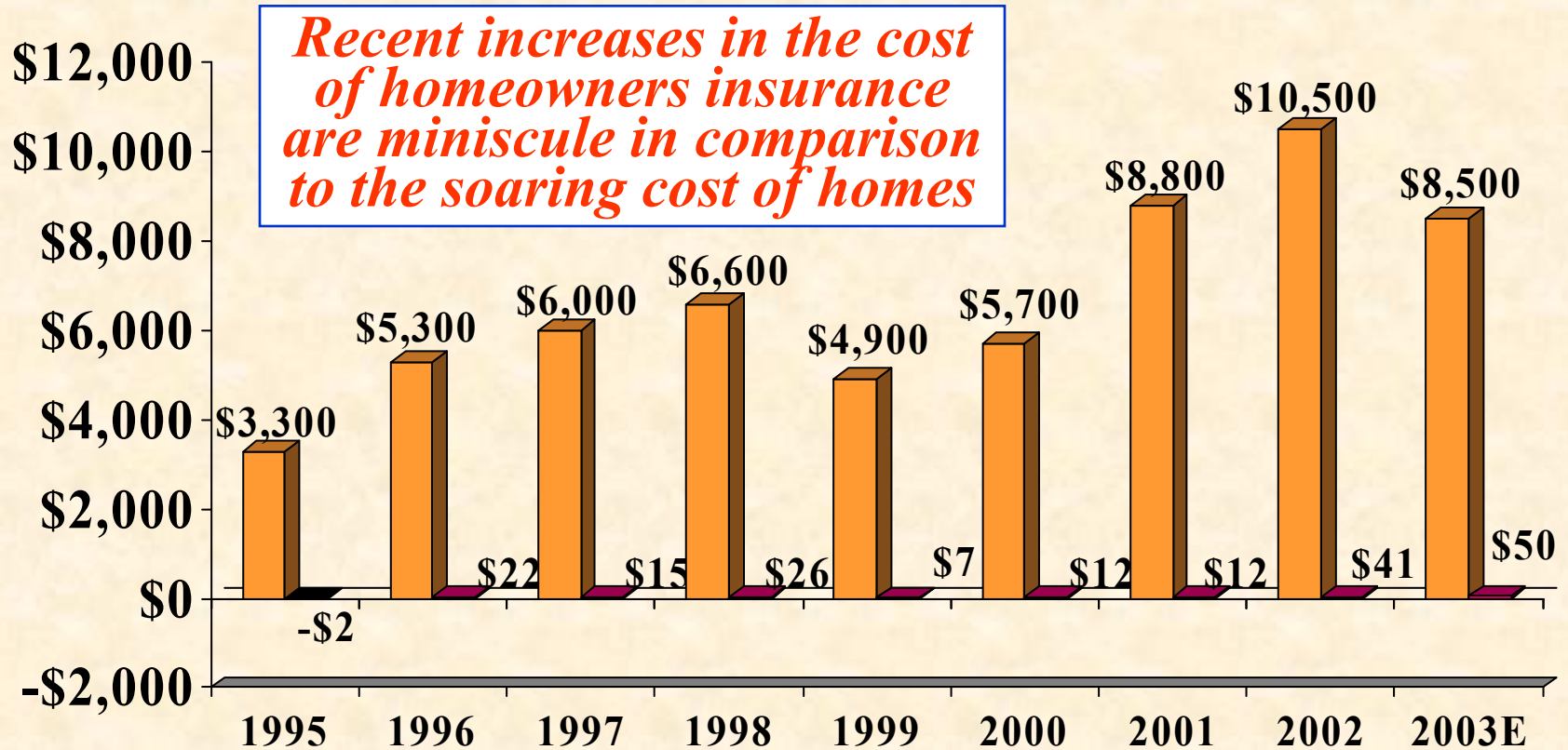
Homeowners Insurance Expenditure as a % of Median Home Price



Source: Insurance Information Institute calculations based on data from National Association of Realtors, NAIC.



Change in Cost of Homes vs. Change in Cost of Homeowners Insurance



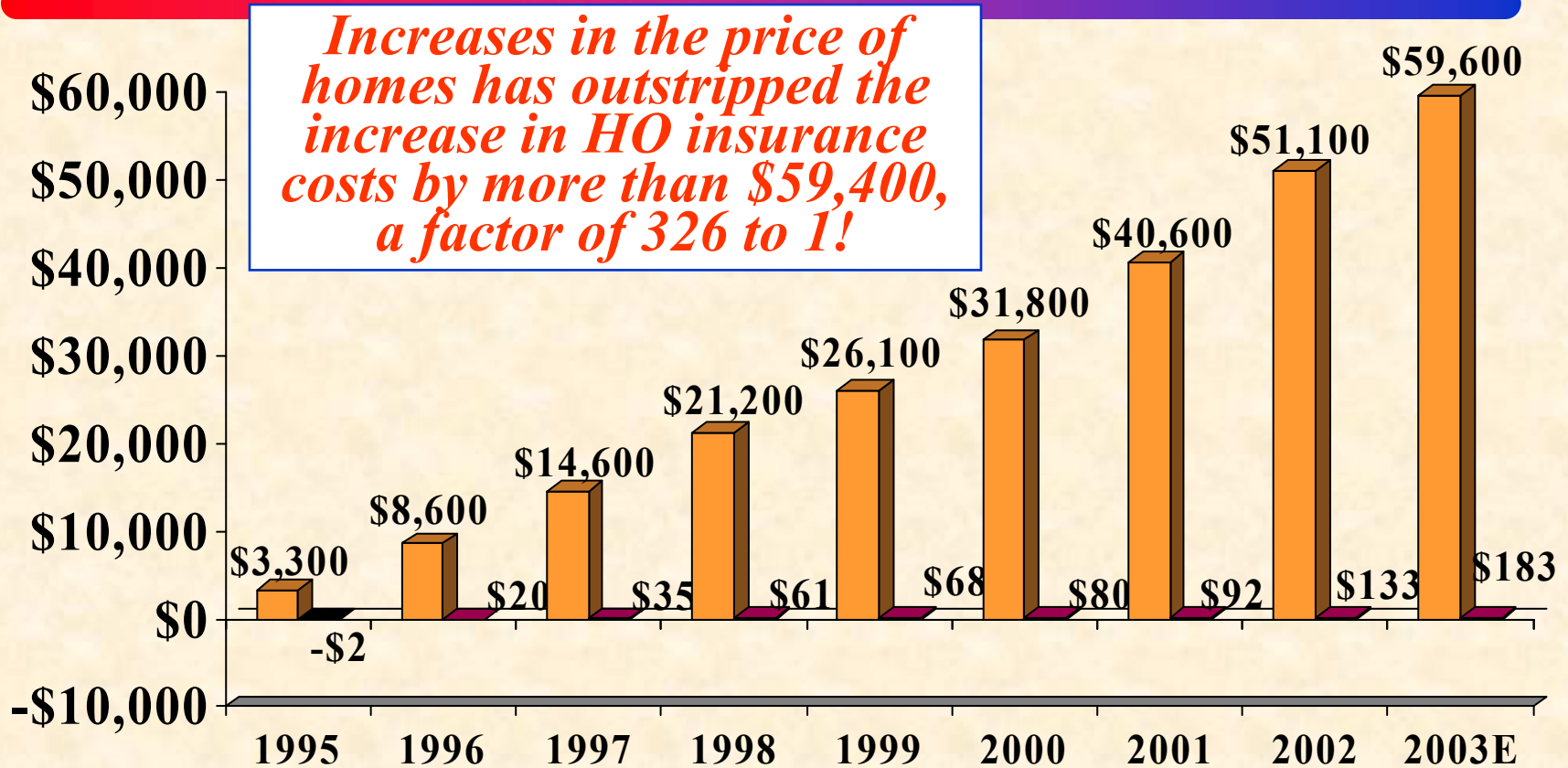
- Change in Cost of Median Existing Home
- Change in Average Homeowners Insurance Expenditure

Note: 2003 home price increase based on NAR's est. of \$166,900 median home for 2003.

Source: Insurance Info. Inst. calculations based on data from Natl. Association of Realtors, NAIC.



Cumulative Change in the Price of Homes & Homeowners Insurance



- Cumulative Change in Cost of Median Existing Home
- Cumulative Change in Average HO Insurance Expenditure

Note: 2003 home price increase based on NAR's est. of \$166,900 median home for 2003.

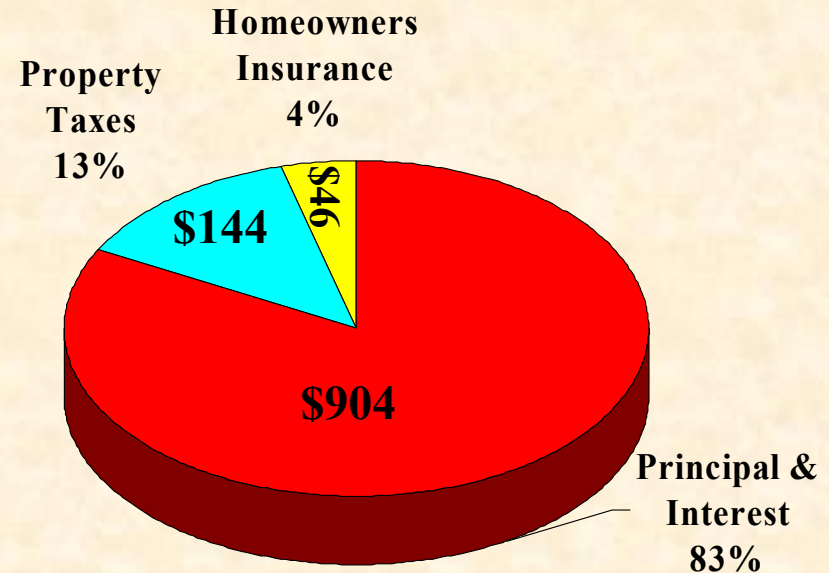
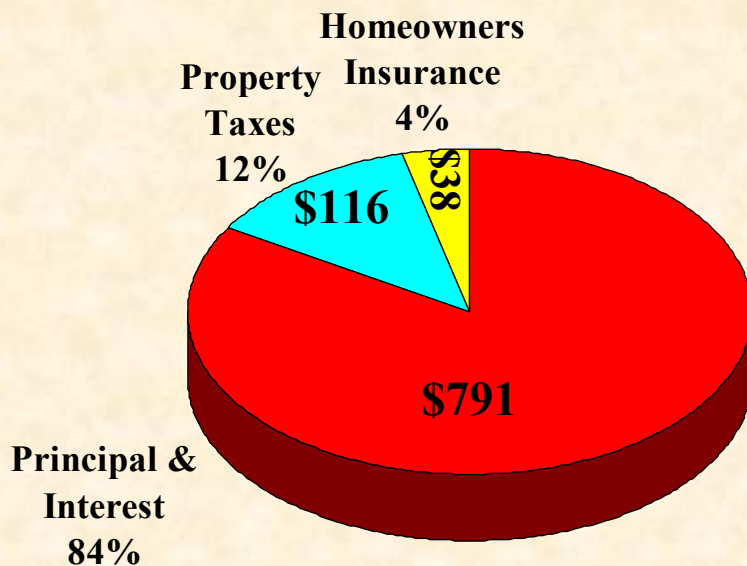
Source: Insurance Info. Inst. calculations based on data from Natl. Association of Realtors, NAIC.



Composition of Monthly Homeowners Payments

1997 Total Monthly Payment: \$945

2002 Total Monthly Payment: \$1,094

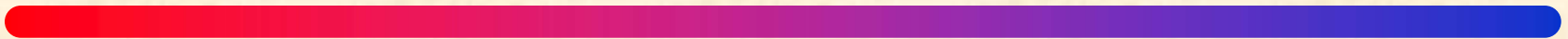


	<u>Median Home Price</u>	<u>Mortgage Rate (30-yr)</u>	<u>Principal & Interest*¹</u>	<u>Property Taxes*</u>	<u>Homeowners Insurance*</u>
2002	\$158,300	6.54%	\$10,851	\$1,726	\$553 (est.)
1997	\$121,800	7.83%	\$7,495	\$1,390	\$455

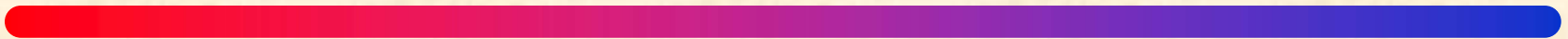
*Annual basis. ¹Assumes 90% of purchase price is financed (i.e., 10% down payment).

Sources: Mortgage interest rates: Freddie Mac; Median Home Price (existing homes): National Association of Home Builders; Property Taxes: US Census Bureau; Homeowners Insurance: Ill and NAIC.

***THE USE OF CREDIT
INFORMATION IN
HOMEOWNERS INSURANCE
UNDERWRITING***



Why Do Insurers Use Credit Information?

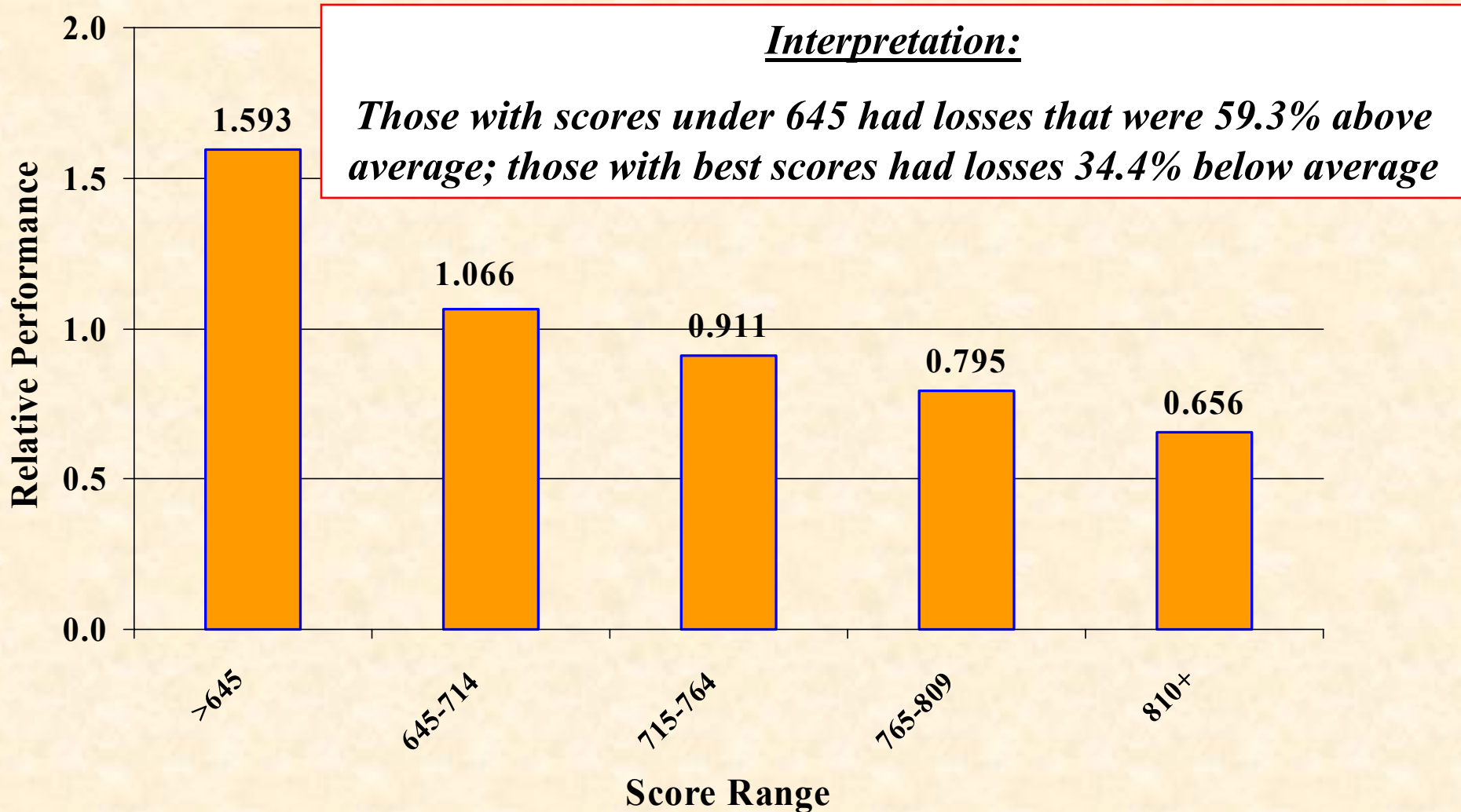


Why Insurers Use Credit Information in Insurance Underwriting

1. There is a **strong correlation** between **credit standing** and **loss ratios** in both auto and homeowners insurance.
2. There is a **distinct** and **consistent decline** in relative **loss ratios** (which are a function of both claim frequency and cost) as **credit** standing **improves**.
3. The relationship between credit standing and relative loss ratios is statistically **irrefutable**.
4. The odds that such a relationship does not exist in a given random sample of policyholders are usually between 500, 1,000 or even 10,000 to one.

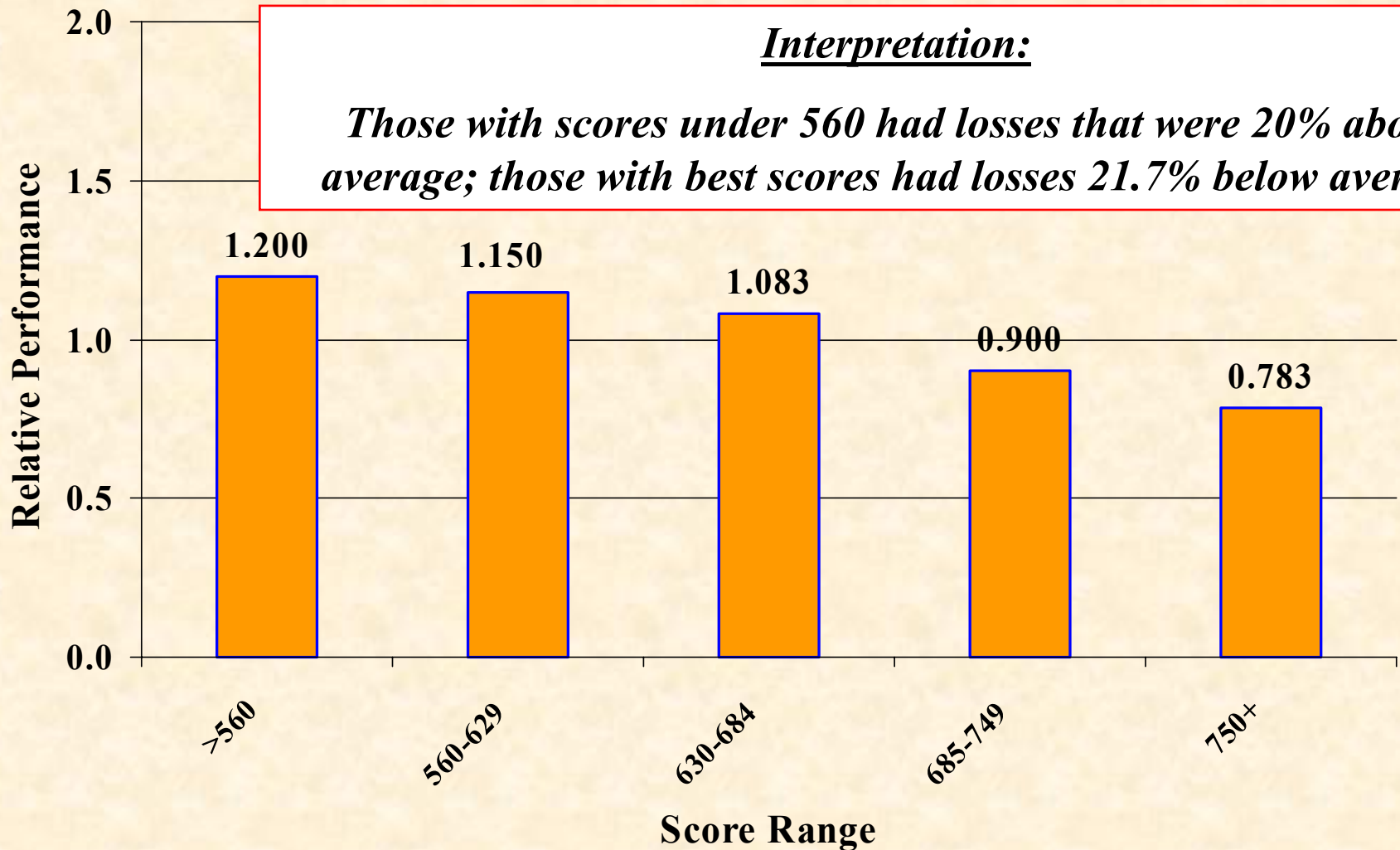


Homeowners Company A



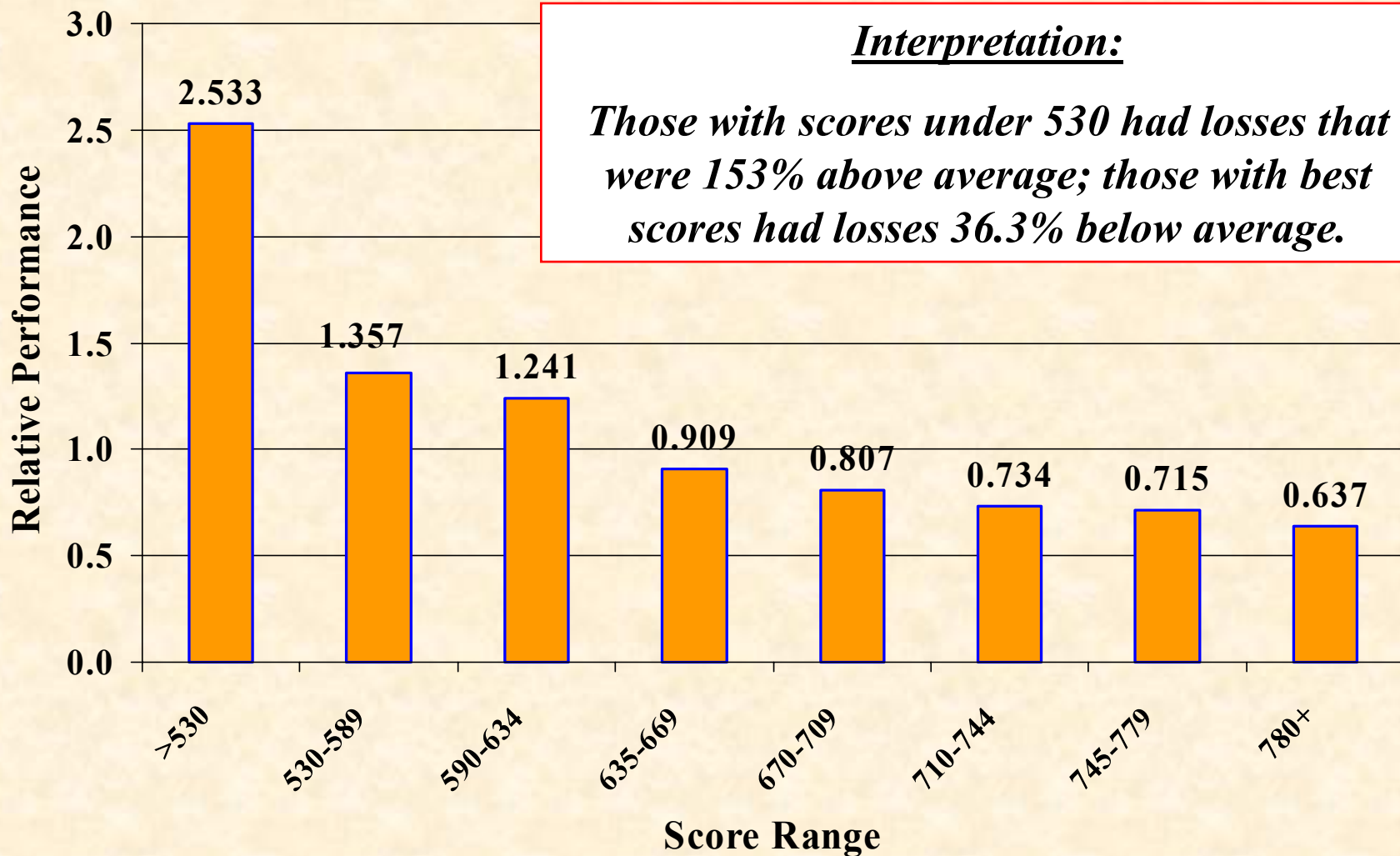


Homeowners Company B





Homeowners Company C

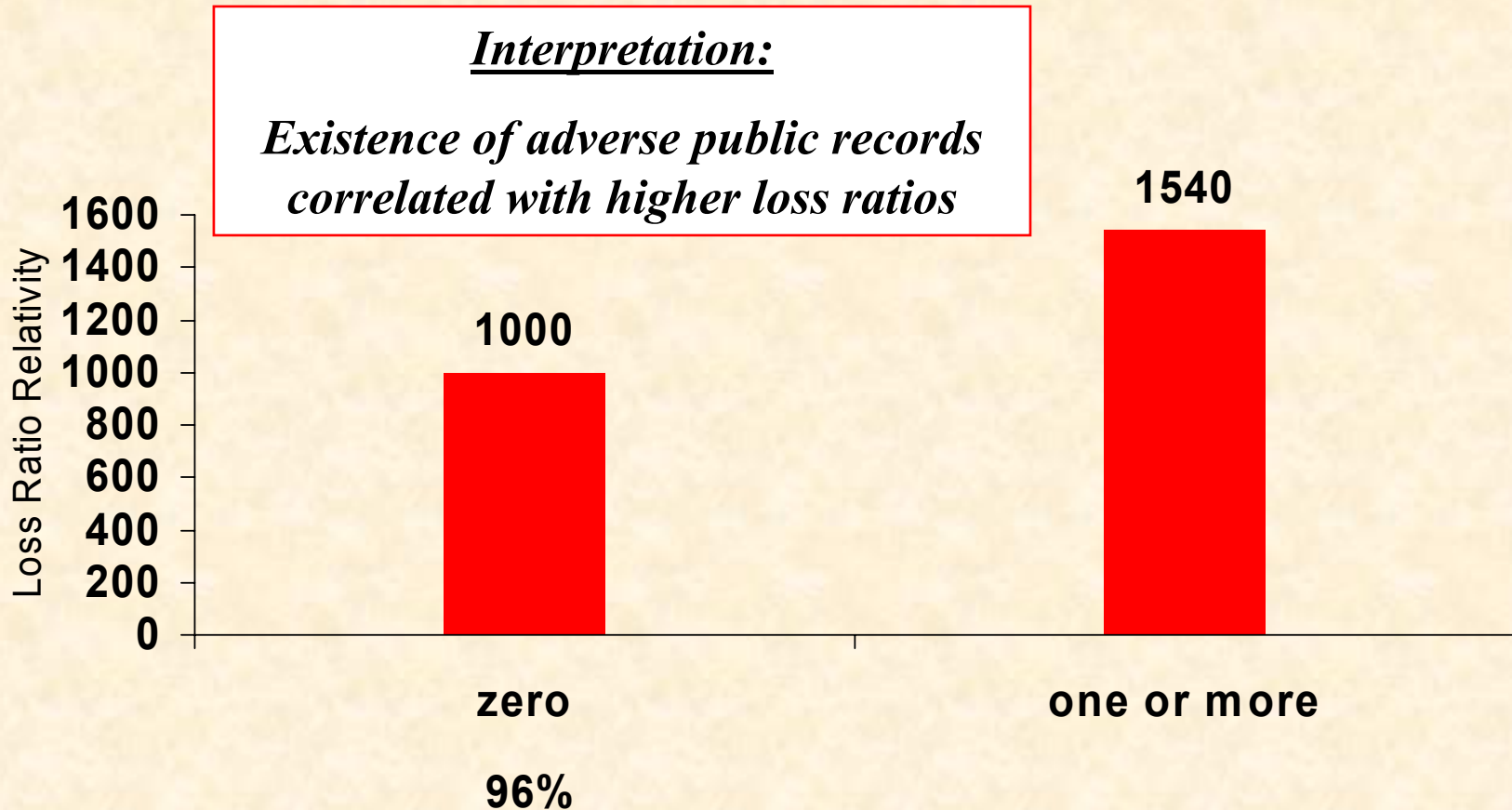




Statistical Correlation

Homeowners HO - 3

Number of Adverse Public Records





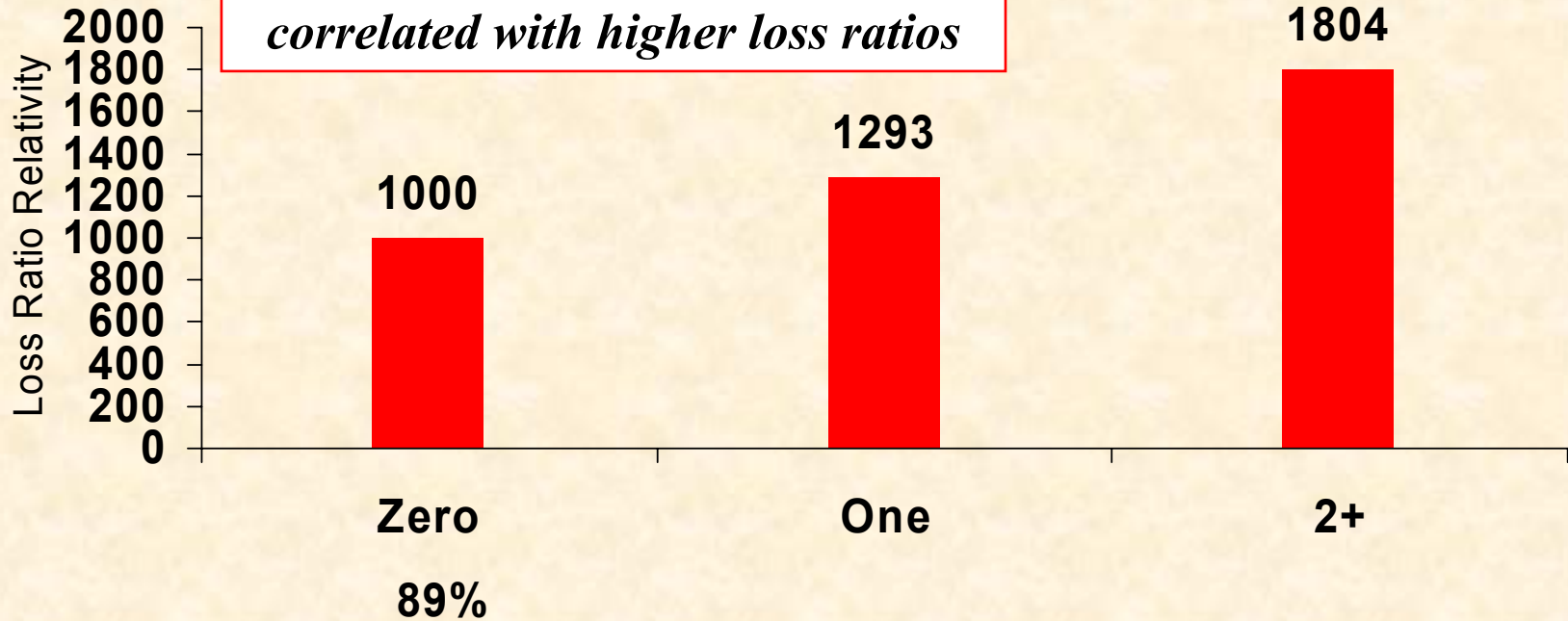
Statistical Correlation

Homeowners HO - 3

Number of Trade Lines 60+ Days Delinquent in
Last 24 Months

Interpretation:

***Higher number of delinquencies
correlated with higher loss ratios***





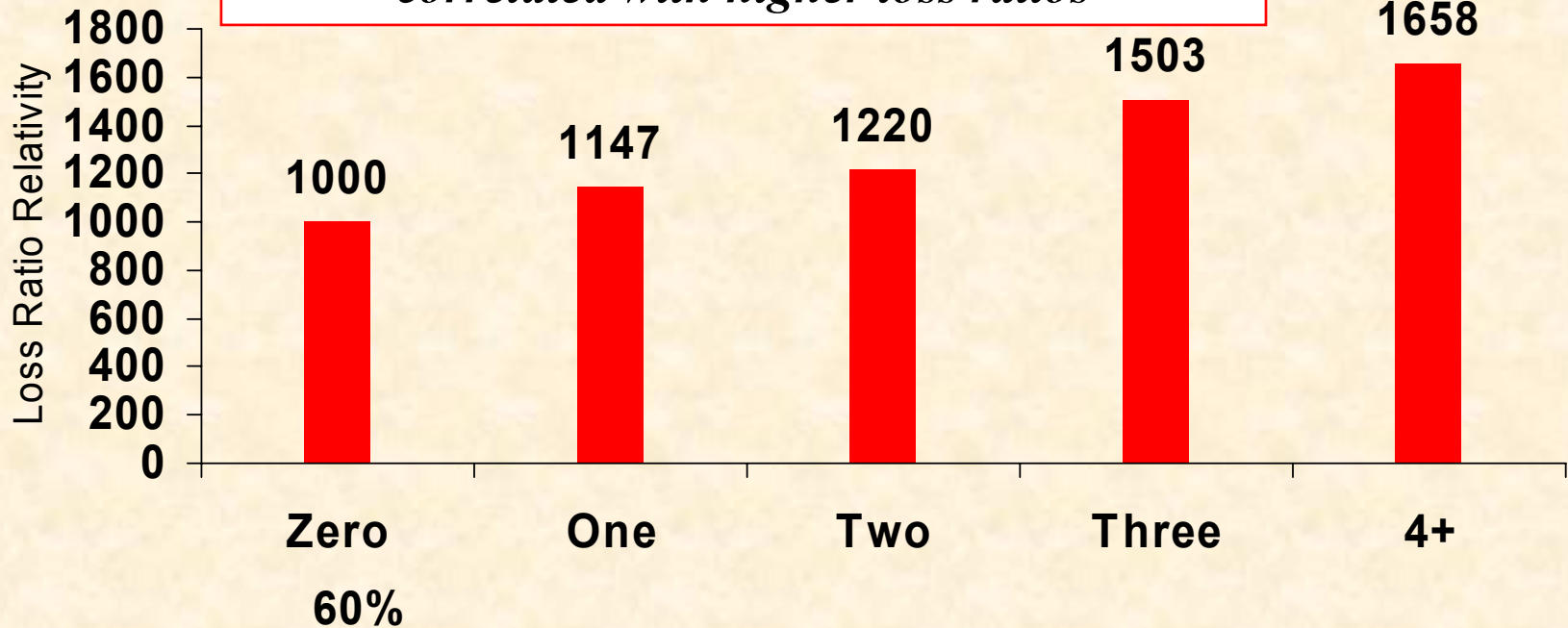
Statistical Correlation

Homeowners HO - 3

Number of Trade Lines Open in Last 12 Months

Interpretation:

*Higher number of trade credit lines opened
correlated with higher loss ratios*





*Intuition Behind Insurance Scoring**

1. Personal Responsibility

- Responsibility is a personality trait that carries over into many aspects of a person's life
- It is intuitive and reasonable to believe that the responsibility required to prudently manage one's finances is associated with other types of responsible and prudent behaviors, for example:
 - Proper maintenance of homes and automobiles
 - Safe operation of cars

2. Stability

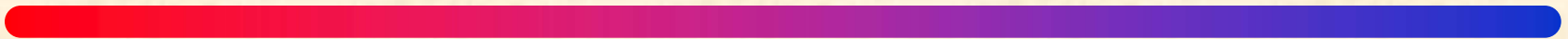
- It is intuitive and reasonable to believe that financially stable individuals are likely to exhibit stability in many other aspects of their lives.

3. Stress/Distraction

- Financial stress could lead to stress, distractions or other behaviors that produce more losses (e.g., deferral of car/home maintenance).

*This list is neither exhaustive nor is it intended to characterize the behavior of any specific individual.

The Controversy Over C.L.U.E. Reports





Comprehensive Loss Underwriting Exchange Reports (CLUE)

Why Insurers Use CLUE:

- Enormous informational asymmetry between homeowner and insurer
 - Reduction of that asymmetry means that policyholder pays a price more closely associated with the risk assumed
 - Overall pricing system is more fair, equitable
 - Claim frequency depends on property AND owner

Consumers Who Learn About CLUE, Like It!

- Majority of Americans, when CLUE is explained to them, believe CLUE is a good idea
- Most buyers would want to see seller's CLUE report
- Most sellers want buyers to see their CLUE report
- *Why do some realtors want to hide info from buyers?*



Some Groups Want to Ban C.L.U.E. Reports



Did you know that the insurance companies keep a secret database with information about you and your property called the Comprehensive Loss Underwriting Exchange or C.L.U.E.? If you didn't, you're not alone. C.L.U.E. keeps a record of every time you contact your insurance company with questions about possible claims and counts them against you!

What They Know About You

Here are just some of the "Causes of Loss" to insurers C.L.U.E. tracks:

- Workers Compensation
- Damage to Property of Others
- Dog Bites
- Fire/Smoke Damage
- Flood/Water Damage
- Slip/Fall
- Vandalism/Theft
- Lost Property-Wedding Ring

Some of these things have nothing to do with property damage.

Did you also know that with C.L.U.E....

- Two claims in three years your insurance policy can get cancelled?
- Homebuyers are getting their policies cancelled after they move into their new home because insurance companies didn't check their own database?
- Previous owners' claims on the property can affect your insurance?

C.L.U.E. not only promotes property stigmatization and redlining practices, it also is detrimental to homeowners' abilities to find insurance at affordable prices.

PROTECT THE AMERICAN DREAM OF HOMEOWNERSHIP!

It's time for legislation to protect homeowners from C.L.U.E.!

- **Ad run by realtors in AZ in January 2003: But how would homeowners be helped if CLUE is banned?**
- *CLUE helps protect homebuyers by letting them see what problems a house has had before they buy it*
- *A house without problems or that has been properly repaired will command a premium, benefiting sellers*
- *A house can be made safer and less expensive to insure if repairs have been made properly*
- **Don't YOU want to know what you're buying before you make the biggest investment of your life???**



Comprehensive Loss Underwriting Exchange Reports (CLUE)

CLUE is:

- Available to homeowner for just \$12.95
- Can be shared online by property owner
- Can help a homeowner sell a home at a premium
 - No claims
 - Claim properly addressed (e.g., new roof, plumbing upgraded)

**Realtors who oppose CLUE are on the
wrong side of this issue**



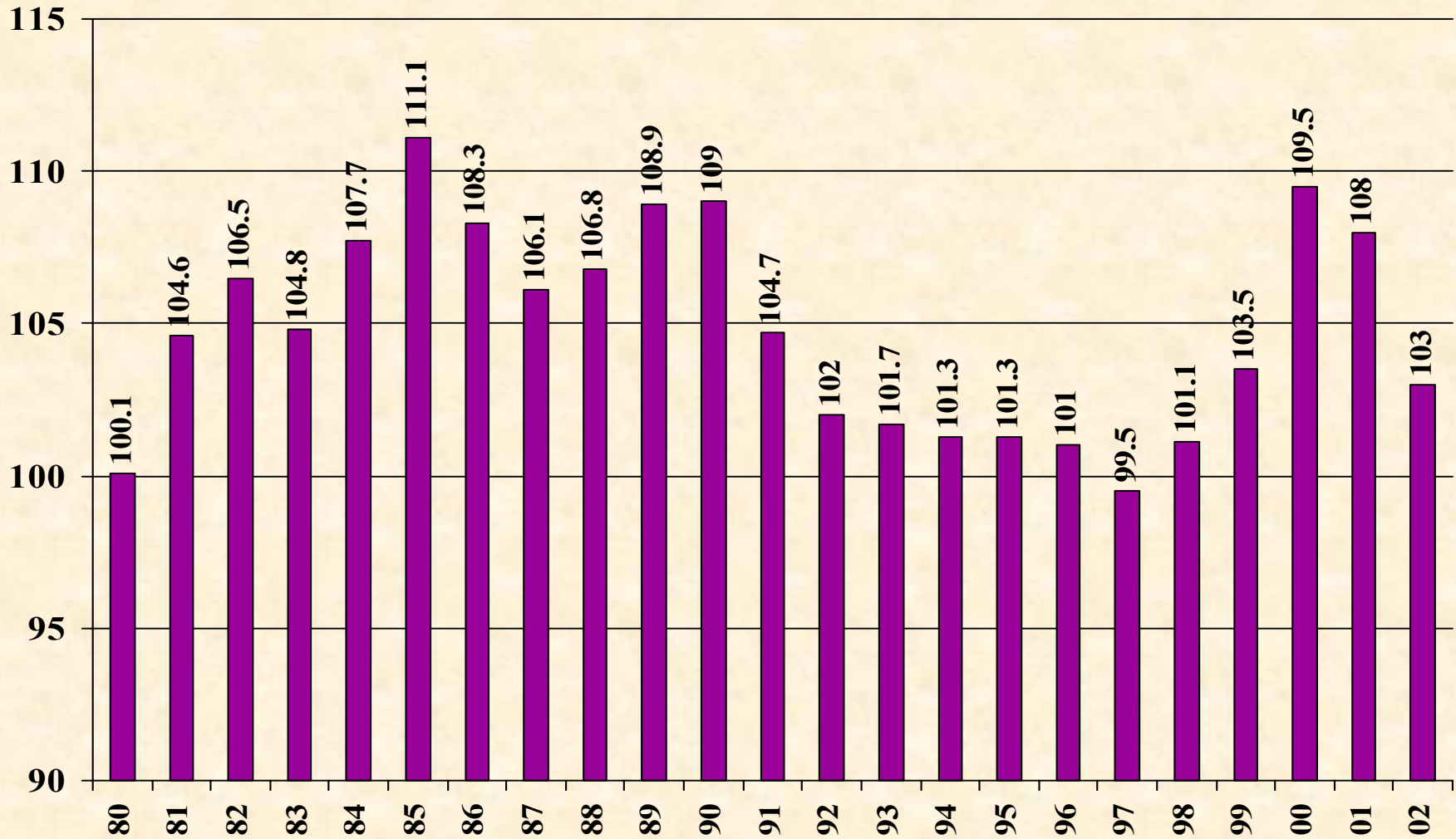
Insurance Information Institute On-Line

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*If you would like a copy of this presentation, please
give me your business card with e-mail address*



Auto Combined Ratio *(1980-2002E)*



Sources: A.M. Best; III