

June 14, 2010

**Actuarial Analysis of**  
**Office of Insurance Regulation**  
**Filing Number 10-07504**  
**Homeowners Insurance**  
Hartford Insurance Company of the Midwest

**Office of the Insurance Consumer Advocate**  
State of Florida

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## **LIMITATIONS**

This report has been limited by the information and data contained in OIR filing number 10-07504 (Filing). The conclusions are developed in the accompanying text and exhibits, which together comprise the report. The conclusions in this report are related to its stated purpose only and may not be applicable for other purposes. This report should only be distributed in its entirety and should not replace the due diligence on behalf of any third party.

The author reserves the right to make or approve any changes to this report. Judgments as to the conclusions, indications, methods, and data contained in this report should be made only after studying the report in its entirety. The author is available to explain any matter presented herein, and it is assumed that the user of the report will seek such explanation as to any matter in question.

## CONCLUSIONS

The following table compares the selected rate components, indicated rate changes and selected rate changes of the Insurance Consumer Advocate (ICA) to those of the Hartford Insurance Company of the Midwest (Hartford) using the OIR standard methodology:

	Homeowners		Tenants and Condos	
	ICA	Hartford	ICA	Hartford
General Expense	3.4%	11.6%	8.3%	12.5%
Premium Trend	7.9%	5.6%	5.6%	4.6%
Loss Trend	12.4%	12.0% - 13.9%	16.4%	6.8% - 14.5%
Reinsurance	32.6%	32.8%	38.7%	39.4%
Loss Adjustment Expense	10.1% - 16.8%	12.4% - 17.0%	10.1% - 16.8%	12.4% - 17.0%
Taxes, Licenses and Fees	2.1%	2.3%	2.1%	2.3%
Indication	17.7%	35.9%	42.8%	44.8%
Selected	17.7%	24.0%	33.0%	33.0%

Since the ICA's selected average rate increase for the tenants and condos policies is the same as Hartford's, the remainder of this report will address the items at issue for the homeowners portion of the Filing. The following table shows the rate level effect of each of the above items at issue for the homeowners portion of the Filing:

<b>Hartford Indication</b>	<b>35.9%</b>
<b>General Expense</b>	<b>-7.9%</b>
<b>Premium Trend</b>	<b>-4.1%</b>
<b>Loss Trend</b>	<b>-0.9%</b>
<b>Reinsurance</b>	<b>-0.1%</b>
<b>Loss Adjustment Expense</b>	<b>-1.4%</b>
<b>Premium Taxes, Licenses and Fees</b>	<b>-0.3%</b>
<b>ICA Revised Indication</b>	<b>17.7%</b>

## **PURPOSE**

The purpose of this report is to conduct an actuarial examination pursuant to Section 627.0613 Florida Statutes, which provides that: “the Chief Financial Officer must appoint a consumer advocate who must represent the general public of the state before the department and the office. The consumer advocate must report directly to the Chief Financial Officer, but is not otherwise under the authority of the department or of any employee of the department. The consumer advocate has such powers as are necessary to carry out the duties of the office of consumer advocate, including, but not limited to, the powers to:

- 1) Recommend to the department or office, by petition, the commencement of any proceeding or action; appear in any proceeding or action before the department or office; or appear in any proceeding before the Division of Administrative Hearings relating to subject matter under the jurisdiction of the department or office.
- 2) Have access to and use of all files, records, and data of the department or office.
- 3) Examine rate and form filings submitted to the office, hire consultants as necessary to aid in the review process, and recommend to the department or office any position deemed by the consumer advocate to be in the public interest.
- 4) Prepare an annual budget for presentation to the Legislature by the department, which budget must be adequate to carry out the duties of the office of consumer advocate.”

## ANALYSIS

### ***General Expense***

The ICA general expense provision of 3.3% for homeowners is derived in Exhibit 3, Sheet 1. The Hartford Group's homeowners multi-peril insurance ratio of general expense to direct earned premium reported on its Insurance Expense Exhibit, Part 3, calendar year 2009 for all homeowners, tenants and condominium policy types was 6.8% (Exhibit 6).

Exhibit 3, Sheets 1 and 2 show how the 6.8% general expense provision for the Hartford Group was converted to a selected fixed general expense provision of \$60 per policy and then converted to ratios to current average premiums per policy in Florida.

According to the Filing, Hartford has not written any new business in the Florida AARP program since 2002. Furthermore, according to Hartford testimony at the hearing on June 1<sup>st</sup>, the Florida AARP business was written on a guaranteed renewable basis, which has limited Hartford's ability to cancel or non-renew policies. Consequently the number of Florida AARP policies has been slowly decreasing at a rate of approximately 5% per year over the last 5 years.

Hartford does not separately account for the expenses of administering its Florida book of AARP business. As a result, Hartford has judgmentally allocated general administrative costs to this business without consideration of the minimal servicing requirements and higher than average premium size of its Florida book of AARP policies.

Hartford contends that:

“In some other states Hartford Insurance Company of the Midwest is used for homeowners business written through our independent agency channel. The agency business has a lower general expense cost structure than the business written in Hartford Insurance Company of the Midwest in Florida, because the Florida business is direct channel business that is *sold and serviced* by Hartford Insurance Company of the Midwest staff.”

However, since Hartford is not selling any new AARP business in Florida, it is not clear that the general expense of servicing a stable book of Florida direct channel AARP business is greater than the general expense of servicing a less stable book of independent agency channel business.

Therefore, before any rate increase is granted in excess of the ICA's recommended increase, Hartford should be required to answer and provide additional support regarding the following questions concerning its administration of the runoff of the subject AARP policies:

- How much home office overhead should be allocated to this program and why?
- What is the annual cost to issue and bill renewal policies?
- How much does it cost to provide product management and actuarial support?
- How much does it cost to provide printing, postage and handling?
- What are the annual information technology expenses for this program?

## ***Premium Trend and Non-Hurricane Loss Trend***

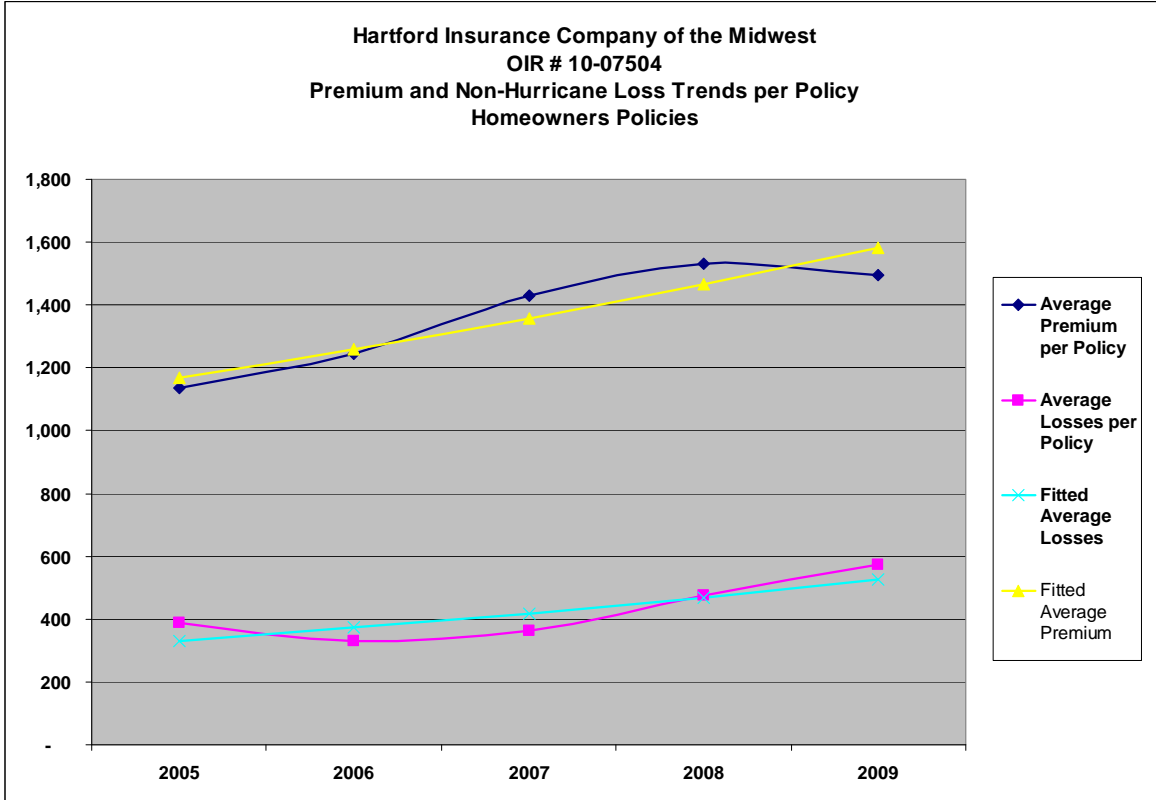
With regard to premium trend, Hartford contends that the:

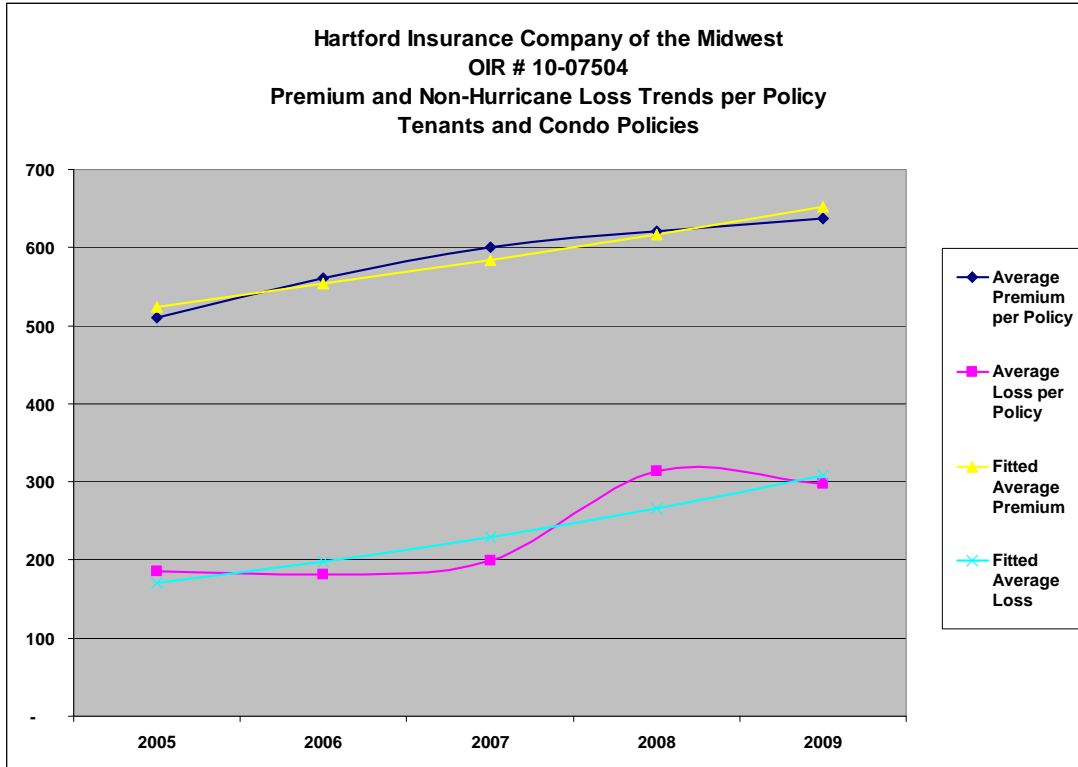
“The Consumer Advocate’s ... recommended 7.9% (premium trend) is unfounded based on our data. AARP Homeowners is a stable renewal-only book of business. Because this book is not affected by mix shift between new and renewal business, the prospective premium trend should mostly be correlated to ITV factors. ITV factors have historically been under 6% with the average being 4-5% (please refer to Exhibit III, Sheets 1b and 2b). The Consumer Advocate suggested a 7.9% premium trend for Building; this is not supported by our ITV factors.”

Although “this book is not affected by mix shift between new and renewal business” it is affected by mix shift associated with policyholder non-renewal. The number of homeowners (HO 2, 3 and 5) policies written in this program has declined by 24.1% over the last five years, which affects premium trend. Furthermore, voluntary changes in other rating factors, such as policyholders voluntarily changing deductibles, and voluntary additions of coverage or increases in coverage limits by policyholders for liability, medical payments, or remodeling also affect premium trend.

Furthermore, Hartford contends that its “ITV factors have historically been under 6% with the average being 4-5% (please refer to Exhibit III, Sheets 1b and 2b)”. However, Hartford’s average earned on-level premium per HO 2, 3 and 5 policy (Column (5) x Column (6) / Column (3)) in its filed RIF indicates a five year average exponential premium trend of 7.9%. Therefore, ITV factors are not the only factors driving Hartford’s premium trend.

The ICA’s selected premium trends and non-hurricane loss trends are based upon exponential fits to the latest five years of Hartford data supplied in the Filing as illustrated in the following charts (Exhibit 5, Sheets 1 and 2):





## ***Reinsurance***

Hartford testified at the hearing on June 1<sup>st</sup> that they will not be purchasing TICL coverage for the 2010 – 2011 contract year. Consequently, the ICA has estimated the Hartford reinsurance expense for this Filing based on the purchase of private reinsurance in the TICL layer. The ICA has tested this assumption and found that it results in an average premium impact to policyholders of less than 10%.

The ICA reinsurance provisions have been derived based upon the following methodologies and assumptions: (1) the profit and expense loads have been eliminated from the net cost of private reinsurance that replaces the available FHCF TICL coverage for the 2010 – 2011 contract year by modifying the formula on Row (54) of Exhibits 1 and 2, and (2) the net cost of overlapping private reinsurance in Row (59A) of the Filing has been eliminated.

Section 627.0629 (5) Florida law provides that:

“...An insurer may include in its rate the actual cost of private market reinsurance that corresponds to available coverage of the Temporary Increase in Coverage Limits, TICL, from the Florida Hurricane Catastrophe Fund. The insurer may also include the cost of reinsurance to replace the TICL reduction implemented pursuant to s. 215.555(17)(d)9. However, this cost for reinsurance may not include any expense or profit load or result in a total annual base rate increase in excess of 10 percent.”

In addition to profit, premium taxes, licenses and fees are the only other variable expenses included in the Filing that would be subject to this prohibition. Therefore, in addition to profit, it is assumed that this provision precludes loading rates for premium taxes, licenses and fees for the portion of policyholder premiums representing the private reinsurance replacing available FHCF TICL coverage.

## ***Loss Adjustment Expense***

The ICA's selected loss adjustment expense provision of 16.8% of incurred losses is based upon the 2009 Hartford Group Insurance Expense Exhibit (Exhibit 6). However, since Florida is much more heavily exposed to catastrophe losses, loss adjustment expenses for expected catastrophes in the Filing have been reduced as a percentage of expected incurred catastrophe losses by 40.0%, because such expenses have historically been a lower percentage of incurred catastrophe losses.

It is believed that this reduction results from some catastrophe loss adjustment expenses being relatively fixed while others vary directly with catastrophe losses. Therefore, as the average claim size increases in catastrophes, catastrophe loss adjustment expenses increase at a lesser rate, and consequently catastrophe loss adjustment expenses as a percentage of catastrophe losses decrease.

The derivation of the 40% reduction in the catastrophe loss adjustment expense ratio is shown in Exhibit 8 based on the experience of the Citizens Property Insurance Corporation (Citizens). Citizens was chosen to illustrate this phenomenon, because it is a Florida only company that experienced significant hurricane losses in 2004 and 2005. Furthermore, Citizens loss adjustment expenses are free of transactions with affiliates. The reasonability of using Citizens' data is supported by Citizens 16.7% average loss adjustment expense in non-hurricane years, which is nearly identical to the 16.8% from the Hartford Group's 2009 Insurance Expense Exhibit.

***Taxes, Licenses and Fees***

The ICA provision for taxes, licenses and fees of 2.1% is based upon the state page of Hartford Insurance Company of the Midwest 2009 Statutory Annual Statement (Exhibit 7).



## **EXHIBITS**

Exhibits 1 – 8





Office of the Insurance Consumer Advocate  
Hartford Insurance Company of the Midwest  
OIR # 10-07504  
General Expense Ratios

Florida

	(1)	(2)	(3)	(4)
	1/1/2009	Annual Trend Rate	Trend Factor	9/29/2011
<b>Tenants and Condos</b>				
(5) Earned House Years	14,594			
(6) Direct Earned Premium on Level	\$9,301,706			
(7) Average Premium	\$637	5.6%	1.161	\$740
(8) General Expense Ratio	8.6%			8.1%
<b>Homeowners</b>				
(5) Earned House Years	45,974			
(6) Direct Earned Premium on Level	\$68,727,923			
(7) Average Premium	\$1,495	7.9%	1.232	\$1,841
(8) General Expense Ratio	3.7%			3.3%
<b>Combined</b>				
(5) Earned House Years	60,568			
(6) Direct Earned Premium on Level	\$78,029,629			
(7) Average Premium	\$1,288			\$1,576
(8) General Expense Ratio	4.3%			3.8%
(9) General Expense / Policy	\$55	2.0%	1.056	\$58
(10) Selected				\$60

Notes:

- (1) Exhibits 1 & 2, Columns (3), (5) & (6) for accident year ending 6/30/09
- (2) Exhibit 1 or 2, Row (B)  
actuarial judgment for general expense / policy annual trend rate
- (3)  $(1+(2))^{2.75}$
- (4)  $(1) \times (3)$
- (5) Exhibits 1 & 2, Column (3) for accident year ending 6/30/09
- (6) Exhibits 1 & 2, Column (8) / Exhibits 1 & 2, Column (7) for accident year ending 6/30/09
- (7)  $(6) / (5)$
- (8)  $(9) / (7)$
- (9) Exhibit 3, Sheet 2, Row (9)
- (10) based on actuarial judgment

Office of the Insurance Consumer Advocate  
Hartford Insurance Company of the Midwest  
OIR # 10-07504  
General Expense Ratios

Countrywide

	(1)	(2)	(3)	(4)
	2007	Annual Trend Rate	Trend Factor	1/1/2009
<b>Tenants and Condos</b>				
(5) Earned House Years	12,097,406			
(6) Direct Premium	\$2,822,894,635			
(7) Average Premium	\$233	5.6%	1.085	\$253
(8) General Expense Ratio	22.9%			21.7%
<b>Homeowners</b>				
(5) Earned House Years	62,439,948			
(6) Direct Premium	\$50,939,208,029			
(7) Average Premium	\$816	7.9%	1.120	\$914
(8) General Expense Ratio	6.5%			6.0%
<b>Combined</b>				
(5) Earned House Years	74,537,354			
(6) Direct Written Premium	\$53,762,102,664			
(7) Average Premium	\$721			\$807
(8) General Expense Ratio - Hartford Group	7.4%			6.8%
(9) General Expense / Policy	\$53	2.0%	1.030	\$55

Notes:

- (1) NAIC Report: 2007 Dwelling Fire, Homeowners Owner-Occupied, and Homeowners Tenant and Condominium/Cooperative Unit Owner's Insurance Market Distribution and Average Cost by Policy and Amount of Insurance
- (2) Exhibit 1 or 2, Row (B)  
actuarial judgment for general expense / policy annual trend rate
- (3)  $(1+(2))^{1.50}$
- (4)  $(1) \times (3)$
- (7)  $(6) / (5)$
- (8) Exhibit 6, Column (8)
- (9)  $(8) \times (7)$   
Analysis assumes Hartford Insurance Group countrywide average homeowners multi-peril premium equals the industry's countrywide average.

Exhibit 4  
Sheet 1Office of the Insurance Consumer Advocate  
Hartford Insurance Company of the Midwest  
OIR # 10-07504  
Net Cost of Reinsurance

## Homeowners

(1) Net Cost of Private Reinsurance Including Private TICL Layer Coverage	19,621,412
(2) Private TICL Layer Reinsurance Premium	3,961,154
(3) Expected Recoveries on TICL Layer Reinsurance Costs	878,130
(4) Net Cost of TICL Layer Private Reinsurance	3,083,024
(5) Net Cost of Private Reinsurance Excluding Private TICL Layer Coverage	16,538,388
(6) Florida Written Premium (year ending 12/09)	60,209,860
(7) Non-TICL Layer Private Reinsurance Net Cost	27.5%
(8) TICL Layer Private Reinsurance Net Cost	5.1%

## Notes:

- (1) Hartford Exhibit IX, Sheet 4, Row (19)
- (2) Hartford Exhibit IX, Sheet 6, Row (4)
- (3) Hartford Exhibit IX, Sheet 6, Row (4)
- (4) (2) - (3)
- (5) (1) - (4)
- (6) Hartford Exhibit IX, Sheet 4, Row (18)
- (7) (5) / (6)
- (8) (4) / (6)

Exhibit 4  
Sheet 2Office of the Insurance Consumer Advocate  
Hartford Insurance Company of the Midwest  
OIR # 10-07504  
Net Cost of Reinsurance

## Tenants and Condos

(1) Net Cost of Private Reinsurance Including Private TICL Layer Coverage	2,776,124
(2) Private TICL Layer Reinsurance Premium	461,182
(3) Expected Recoveries on TICL Layer Reinsurance Costs	102,341
(4) Net Cost of TICL Layer Private Reinsurance	358,841
(5) Net Cost of Private Reinsurance Excluding Private TICL Layer Coverage	2,417,283
(6) Florida Written Premium (year ending 12/09)	7,174,745
(7) Non-TICL Layer Private Reinsurance Net Cost	33.7%
(8) TICL Layer Private Reinsurance Net Cost	5.0%

## Notes:

- (1) Hartford Exhibit IX, Sheet 5, Row (19)
- (2) Hartford Exhibit IX, Sheet 7, Row (4)
- (3) Hartford Exhibit IX, Sheet 7, Row (4)
- (4) (2) - (3)
- (5) (1) - (4)
- (6) Hartford Exhibit IX, Sheet 5, Row (18)
- (7) (5) / (6)
- (8) (4) / (6)

Office of the Insurance Consumer Advocate  
Hartford Insurance Company of the Midwest  
OIR # 10-07504  
Net Cost of Reinsurance  
Annual Trend Rates

Homeowners

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Accident Year Ending	Earned House-Years	Earned Premium at Present Rates	Estimated Ultimate Non-Catastrophe Losses	Average Earned Premium at Present Rates	Average Estimated Ultimate Non-Catastrophe Losses per Policy	Fitted Average Earned Premium at Present Rates	Fitted Average Estimated Ultimate Non-Catastrophe Losses per Policy	Non-Catastrophe Loss Ratio	Fitted Non-Catastrophe Loss Ratio
6/30/2005	56,808.00	64,506.13	23,123.359	1,135.511	407.044	1,168.054	347.747	0.358	0.298
6/30/2006	53,886.00	67,101.56	18,592.844	1,245.250	345.040	1,259.937	390.805	0.277	0.310
6/30/2007	52,597.00	75,284.44	20,183.417	1,431.345	383.737	1,359.048	439.194	0.268	0.323
6/30/2008	49,706.00	76,199.18	24,890.082	1,532.998	500.746	1,466.260	493.732	0.327	0.337
6/30/2009	45,974.00	68,727.92	27,855.383	1,494.930	605.894	1,581.601	554.866	0.405	0.351
Annual Trend:						7.9%	12.4%		4.2%

Notes:

- (2) Exhibit 1, Column (3)
- (3) Exhibit 1, Column (5) x Exhibit 1, Column (6)
- (4) Exhibit 1, Column (37) / Exhibit 1, Column (36)
- (5) (3) / (2) x 1000
- (6) (4) / (2) x 1001
- (7) exponential fit on (5)
- (8) exponential fit on (6)
- (9) (4) / (3)
- (10) exponential fit on (9)

Office of the Insurance Consumer Advocate  
Hartford Insurance Company of the Midwest  
OIR # 10-07504  
Net Cost of Reinsurance  
Annual Trend Rates

Tenants and Condos

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Accident Year Ending	Earned House-Years	Earned Premium at Present Rates	Estimated Ultimate Non-Catastrophe Losses	Average Earned Premium at Present Rates	Average Estimated Ultimate Non-Catastrophe Losses per Policy	Fitted Average Earned Premium at Present Rates	Average Fitted Estimated Ultimate Non-Catastrophe Losses per Policy	Non-Catastrophe Loss Ratio	Fitted Non-Catastrophe Loss Ratio
6/30/2005	19,754	10,094	3,832	511	194	524	178	0.380	0.339
6/30/2006	18,338	10,293	3,489	561	190	554	207	0.339	0.374
6/30/2007	17,145	10,301	3,609	601	210	585	241	0.350	0.412
6/30/2008	15,903	9,884	5,270	622	331	617	280	0.533	0.454
6/30/2009	14,594	9,302	4,589	637	314	652	326	0.493	0.501
Annual Trend:						5.6%	16.4%		10.3%

Notes:

- (2) Exhibit 2, Column (3)
- (3) Exhibit 2, Column (5) x Exhibit 2, Column (6)
- (4) Exhibit 2, Column (37) / Exhibit 2, Column (36)
- (5) (3) / (2) x 1000
- (6) (4) / (2) x 1001
- (7) exponential fit on (5)
- (8) exponential fit on (6)
- (9) (4) / (3)
- (10) exponential fit on (9)

2009 INS EXPENSE EXH PART 3 - 270  
 914 - Hartford Fire Grp  
 Homeowners Multiple Peril  
 (\$000s)

Expense Ratios

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Premiums Written	Premiums Earned	Incurred Loss	Defense & Cost Containment Expenses Incurred	Adjusting and Other Expenses Incurred	Loss Adjustment Expense % of Incurred Loss	General Expenses Incurred	General Expense % of Earned Premium
1,122,779	1,107,934	730,195	38,491	84,175	16.8%	74,932	6.8%

Notes:

Source is NAIC I-Site Database

## Exhibit 7

Office of the Insurance Consumer Advocate  
Hartford Insurance Company of the Midwest  
OIR # 10-07504

## Premium Taxes, Licenses and Fees

(1)	(2)	(3)	(4)
Direct Premiums Written	Direct Premiums Earned	Premium Taxes, Licenses and Fees	Taxes, Licenses and Fees
67,485,020	69,428,007	1,434,724	2.1%

## Note:

State page of Hartford Insurance Company of the Midwest  
2009 Statutory Annual Statement

(4) (3) / (2)

## Exhibit 8

## 2009 SCHEDULE P PART 1 - SUMMARY - 031

## 10064 - Citizens Prop Ins Corp

	(1)	(2)	(3)	(4)
Calendar/ Accident Year	Direct and Assumed Premiums Earned	Direct and Assumed Losses Incurred	Direct and Assumed Loss Adjustment Expenses Incurred	(3) / (2)
2000	436,599	26,011	5,114	19.7%
2001	474,752	54,857	13,792	25.1%
2002	685,727	78,163	9,061	11.6%
2003	999,236	204,006	23,764	11.6%
2004	1,304,700	3,359,869	251,464	7.5%
2005	1,513,894	3,203,017	415,827	13.0%
2006	2,550,062	308,322	49,799	16.2%
2007	3,699,006	602,354	90,979	15.1%
2008	3,179,382	645,917	108,077	16.7%
2009	2,410,298	561,394	113,037	20.1%
Totals	17,253,656	9,044,073	1,080,990	12.0%

(5)	2004 & 2005	6,562,886	667,291	10.2%
(6)	Other Years	2,481,187	413,699	16.7%
(7)	Ratio			61.0%
(8)	Selected			60.0%

## Notes:

Source is NAIC I-Site Database

(7) (5) / (6)

(8) based on actuarial judgment