



SEAN MICHAEL SHAW, ESQ.
INSURANCE CONSUMER ADVOCATE

VIA ELECTRONIC TRANSMISSION

November 6, 2009

Mr. Michael Milnes, Deputy Director
Property and Casualty Product Review
Office of Insurance Regulation
200 East Gaines Street
Tallahassee, FL 32399-4206

RE: In the Matter of Olympus Insurance Company
OIR Filing No.: 09-17588
Written Comments and Actuarial Expert Testimony

Dear Mr. Milnes:

I respectfully submit the attached written comments and actuarial expert testimony related to the above referenced matter authored by Mr. Stephen A. Alexander, FCAS, MAAA, MBA actuary for the Office of the Insurance Consumer Advocate. These written comments and actuarial expert testimony are to clarify and amplify Mr. Alexander's oral testimony at the hearing on October 29, 2009.

Sincerely,

A handwritten signature in blue ink, appearing to read "Sean Michael Shaw".

Sean Michael Shaw, Esq.
Insurance Consumer Advocate

cc w/ attachments: Kevin McCarty, Insurance Commissioner
Belinda Miller, Deputy Commissioner
Robert Lee, Actuary, Office of Insurance Regulation

REPRESENTING ALEX SINK, CHIEF FINANCIAL OFFICER, STATE OF FLORIDA
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SUMMARY

The provision in the company's catastrophe load for losses in excess of the company's surplus and reinsurance (19.5% of catastrophe losses and 7.4% of current premiums) should not be loaded into the company's rates, because these losses will not be paid by Olympus Insurance Company (Olympus). Such losses will be paid by either all the policyholders in the state of Florida through assessments on their policies made by the Florida Insurance Guaranty Association (FIGA) or, for losses not reimbursed by FIGA, will be retained by Olympus policyholders. In essence all assessable policyholders in the state of Florida or the company's own policyholders provide reinsurance for this excess layer of loss.

It is recommended that Olympus provide more evidence that its expenses are not in violation of the statutory standard: "rates shall be deemed excessive ... if expenses are unreasonably high in relation to services rendered" 627.062(2)(e)(1) F.S. The Insurance Consumer Advocate (ICA) has a general concern that a company operating through an exclusive wholly owned managing general agency (MGA), such as Olympus, may use the MGA to inflate insurance company expenses.

Finally, before any rate action is taken, it is recommended that Olympus be required to re-inspect a representative sample of its homes that received mitigation discounts. If a significant percentage of these sampled homes' mitigation discounts are found to be excessive or fraudulent, then Olympus should be required to re-inspect all of its homes that received mitigation discounts, before any rate action is taken.

PROVISION IN THE CATASTROPHE LOAD FOR LOSSES IN EXCESS OF THE COMPANY'S SURPLUS AND REINSURANCE

The provision in the company's catastrophe load for losses in excess of the company's surplus and reinsurance (19.5% of catastrophe losses and 7.4% of current premiums) should not be loaded into the company's rates, because these losses will not be paid by Olympus Insurance Company (Olympus). Such losses will be paid by either all the policyholders in the state of Florida through assessments on their policies made by the Florida Insurance Guaranty Association (FIGA) or, for losses not reimbursed by FIGA, will be retained by Olympus policyholders. In essence all assessable policyholders in the state of Florida or the company's own policyholders provide reinsurance for this excess layer of loss.

Florida law provides that "the cost of reinsurance" be considered in each rate filing (627. 062(2)(b)8 F.S. OIR has consistently interpreted this provision of the law to mean that the net cost of reinsurance may be loaded into rates. The net cost of reinsurance is computed as the reinsurance premium less expected reinsurance recoveries.

In the case of losses in excess of the company's surplus and reinsurance, Olympus pays no reinsurance premium and the expected recoveries from FIGA or retained by the company's own policyholders are simply the expected losses in the excess layer. Therefore, the net cost of reinsurance provided by FIGA or the company's own policyholders should be included as a negative fixed reinsurance expense in the Olympus rate indication.

It is believed that this treatment of losses in excess of the company's surplus and reinsurance is not a violation of 627.0628(3)(d) F.S., because it does not "modify or adjust" a hurricane model but simply accounts for expected recoveries under a statutorily provided reinsurance mechanism for insolvent insurers.

EXCESSIVE EXPENSE LEVELS

It is recommended that Olympus provide more evidence that its expenses are not in violation of the statutory standard: "rates shall be deemed excessive ... if expenses are unreasonably high in relation to services rendered" 627.062(2)(e)(1) F.S. The Insurance Consumer Advocate (ICA) has a general concern that a company operating through an exclusive wholly owned managing general agency (MGA), such as Olympus, may use the MGA to inflate insurance company expenses.

Attached is an exhibit documenting the unusually high expense levels of Olympus. Out of 61 domestic insurers writing homeowners insurance in the state of Florida in 2008, Olympus had the third highest level of expenses after eliminating some small companies that probably have not reached full economies of scale.

There are several advantages for owners of Florida domestic homeowners insurance companies to set up wholly owned exclusive MGAs. Unfortunately, all of these advantages are disadvantages to all Florida policyholders, because they increase the likelihood of insolvencies and the consequent likelihood of assessments to all Florida policyholders.

First, the MGA typically has no insurance risk. So, owners of an insurance company can pay commissions to themselves through a wholly owned exclusive MGA and those commissions will no longer be at risk for payment of insurance company losses. This creates an incentive to move funds out of the insurance company and into the MGA, which increases the likelihood of insurance company insolvencies and assessments on all Florida policyholders.

Second, MGA contracts typically contain a profit sharing provision that provides that if the insurance company is profitable, the MGA will participate in those profits. However, there typically is no such provision requiring the MGA to share profits with the insurance company. Furthermore, there is typically no provision in MGA contracts for the MGA to share in insurance company losses. So, in years without hurricanes, the substantial "profits" that a homeowners insurer will typically earn, are shared with the MGA rather than retained in the insurance company as reserves for future hurricanes.

However, these "profits" in years without hurricanes are illusory and should not be shared with an MGA, because they will be needed to fund hurricane losses in subsequent years. Therefore, the typical profit sharing provision in an MGA agreement is simply another mechanism that allows owners to move funds out of the insurance company to shield them from future insurance company losses. This again, increases the likelihood of insolvency and assessments on all Florida policyholders. Moreover, once insurance company "profits" are shared with the MGA, the owners are free to use them to declare dividends to themselves.

Third, in years in which the insurance company loses money due to excessive claims, the MGA can make money, because its revenues are typically based on a fixed percentage of written premiums plus a fixed fee per policy, while its expenses are relatively fixed except for those loss adjustment expenses that vary directly with losses.

Fourth, by setting up a wholly owned exclusive MGA, the owners remove the MGA's operations from the regulatory scrutiny of the OIR and make it possible for the owners to charge expenses to the insurance company that should have been charged to the MGA. An MGA typically assumes by contract most of the functions of an insurance company, such as: underwriting, policy issuance, bookkeeping, and adjusting claims. However, it is not unusual for the MGA to be housed at the same location as the insurance company and to share employees, office space and equipment with the insurance company.

Under these circumstances it becomes difficult to separate costs between the insurance company and the MGA, and it is possible that expenses may be charged to the insurance company that should have been charged to the MGA. This can raise the overall expense level of the insurance company and can result in lower insurance company profits and less growth of insurance company surplus (retained earnings). Again, lower insurance company profits and lower surplus growth translates into an increased likelihood of insolvency and assessments on all Florida policyholders.

EXCESSIVE OR FRAUDULENT MITIGATION DISCOUNTS

Before any rate action is taken, it is recommended that Olympus be required to re-inspect a representative sample of its homes that received mitigation discounts. If a significant percentage of these sampled homes' mitigation discounts are found to be excessive or fraudulent, then Olympus should be required to re-inspect all of its homes that received mitigation discounts, before any rate action is taken.

Olympus testified at hearing that the average mitigation discount was \$1,050. If the average cost to re-inspect each home that received a mitigation discount is \$150, then the company will break even if every seventh mitigation discount is found to be 100% in error ($1,050 / 150 = 7$), assuming the company is able to retain each policy after taking away the mitigation discount.

At hearing the company expressed concern that it may lose some of these policies found to have excessive or fraudulent mitigation discounts. The ICA considers this to be a valid concern, and therefore recommends that a uniform re-inspection requirement be implemented as a prerequisite for the consideration of any residential property rate increase.

Liz Reynolds, National Association of Mutual Insurance Companies (NAMIC) Southeast state affairs manager, said recently that "there is strong anecdotal evidence showing that the home inspection system is flawed; that private inspections are inconsistent from one house to the next; and that "active" and "passive" fraud are rampant." (Insurance Journal, September 17, 2009, "*Insurers Join Call for Review of Florida's Insurance Mitigation Discounts*")

In August, the Florida Association of Insurance Agents (FAIA) issued a white paper charging that the (mitigation discount) program is riddled with fraud and inefficiencies and not doing its job of protecting homeowners. The agents said faulty implementation and apparent fraud in the inspection process are largely to blame.

Therefore, if a rate increase is granted without imposing any re-inspection requirements, Olympus policyholders not receiving mitigation discounts will be subsidizing those receiving excessive or fraudulent discounts, which is unfairly discriminatory and a violation of 627.062(2)(b) F.S.

Office of the Insurance Consumer Advocate
Review of OIR Filing Number 09-17588
Olympus Insurance Company

Homeowners Insurance Expense Ratios
Florida Domestic

Company	Written Premium	Earned Premium	Commission & Brokerage	General	Other Acquisition	Defense & Cost Containment	Adjusting & Other Expenses	Total
Service Ins Co	783	1,704	19.3%	62.2%	5.2%	11.9%	6.2%	104.8%
Auto Club Ins Co of FL	2,677	898	15.2%	37.9%	28.5%	2.7%	15.6%	99.9%
American Modern Ins Co of FL	2,404	1,527	31.7%	25.5%	4.0%	0.9%	3.9%	66.1%
American Keystone Ins Co	10,086	6,710	13.4%	14.4%	14.8%	2.2%	4.3%	49.2%
Argus Fire & Cas Ins Co	15,398	12,118	19.2%	7.8%	0.6%	4.5%	11.4%	43.5%
Ark Royal Ins Co	3,253	1,042	10.4%	16.1%	10.4%	6.2%	0.0%	43.2%
Northern Capital Select Ins Co	17,371	7,800	17.2%	0.0%	0.0%	4.4%	21.2%	42.9%
First Home Ins Co	35,993	26,255	25.7%	3.5%	1.6%	2.0%	9.3%	42.1%
American Bankers Ins Co Of FL	136,856	137,455	24.3%	4.8%	6.2%	0.6%	5.6%	41.6%
Olympus Ins Co	45,561	43,550	21.0%	6.4%	8.0%	0.8%	5.2%	41.4%
United Prop & Cas Ins Co	113,781	118,544	13.3%	8.9%	13.5%	3.8%	1.9%	41.3%
Southern Oak Ins Co	57,011	43,070	13.3%	11.3%	0.0%	0.5%	14.8%	39.9%
Homewise Ins Co	11,943	16,942	9.8%	21.6%	7.5%	0.2%	0.2%	39.2%
Homesite Ins Co of FL	3,039	3,145	5.8%	1.6%	19.3%	3.1%	8.8%	38.5%
Florida Family Ins Co	69,083	73,493	18.0%	16.3%	0.0%	2.1%	1.9%	38.2%
St Johns Ins Co Inc	278,742	257,882	28.1%	1.2%	1.2%	1.0%	6.0%	37.6%
Modern USA Ins Co	16,705	11,181	24.7%	4.6%	4.1%	0.7%	3.2%	37.3%
American Strategic Ins Corp	79,408	92,612	20.8%	6.4%	6.5%	1.3%	1.7%	36.7%
Privilege Underwriters Recp Exch	25,977	20,662	10.8%	24.0%	0.0%	0.5%	1.1%	36.4%
Sunshine State Ins Co	74,262	66,956	10.0%	5.8%	10.2%	1.9%	8.2%	36.2%
Cypress Prop & Cas Ins Co	50,975	61,465	19.1%	7.5%	4.7%	0.9%	3.2%	35.3%
USIC of FL Inc	810	935	20.0%	9.5%	1.1%	4.6%	0.0%	35.2%
Southern Fidelity Ins Co Inc	71,413	72,855	12.2%	5.1%	15.2%	0.0%	2.8%	35.2%
American Federation Ins Co	14,922	15,338	9.7%	3.5%	16.7%	0.8%	3.3%	34.1%
First Community Ins Co	24,448	24,847	15.8%	7.6%	6.4%	0.9%	2.8%	33.5%
Liberty Amer Ins Co	5,090	7,401	21.7%	2.0%	0.6%	7.8%	1.1%	33.2%
Liberty Amer Select Ins Co	8,214	10,356	20.4%	2.7%	0.9%	4.7%	4.2%	32.9%
Security First Ins Co	76,826	83,098	8.9%	10.8%	7.2%	0.8%	5.1%	32.8%
American Southern Home Ins Co	40,458	19,453	20.3%	7.0%	3.6%	0.9%	1.0%	32.8%
Homewise Preferred Ins Co	180,816	122,402	11.3%	11.3%	5.9%	3.4%	0.7%	32.5%
Peoples Trust Ins Co	22,651	5,288	24.0%	6.2%	0.5%	1.3%	0.5%	32.5%
American Integrity Ins Co of FL	54,334	50,299	13.2%	7.8%	6.1%	1.5%	3.8%	32.4%
Universal Ins Co of NA	125,225	144,834	12.3%	13.0%	0.0%	1.7%	4.9%	31.9%
Safe Harbor Ins Co	10,292	9,634	22.3%	2.4%	0.1%	0.7%	6.1%	31.6%
Gulfstream Prop & Cas Ins Co	33,682	46,500	13.7%	4.1%	4.9%	0.7%	7.7%	31.0%
Royal Palm Ins Co	172,663	208,881	22.0%	1.4%	1.2%	1.1%	5.3%	30.9%
Capitol Preferred Ins Co	39,998	43,147	11.2%	1.6%	14.1%	0.0%	3.7%	30.7%
Homeowners Choice Prop & Cas Ins Co	37,357	19,661	21.5%	1.3%	0.0%	1.1%	6.7%	30.6%
Tower Hill Prime Insurance Company	96,830	97,073	23.0%	0.8%	1.2%	1.8%	2.5%	29.3%
Tower Hill Preferred Ins Co	75,923	83,220	22.8%	0.9%	1.1%	2.2%	2.4%	29.3%
American Traditions Ins Co	38,887	38,932	19.8%	2.3%	3.4%	1.1%	2.6%	29.2%
Fidelity Fire & Cas Co	33,939	28,685	12.0%	9.9%	3.4%	0.2%	3.6%	29.1%
Tower Hill Select Ins Co	75,516	78,391	23.1%	0.9%	1.3%	1.4%	2.2%	28.9%
Old Dominion Ins Co	2,604	2,786	13.6%	4.1%	4.5%	3.1%	2.8%	28.2%
Universal Prop & Cas Ins	460,152	456,550	15.7%	1.5%	6.1%	0.7%	3.9%	27.8%
State Farm Florida Ins Co	1,131,724	1,320,416	11.3%	2.4%	6.6%	2.5%	4.9%	27.8%
Hillcrest Ins Co	24,526	24,894	12.0%	13.1%	0.0%	1.4%	1.2%	27.6%
First Protective Ins Co	80,136	87,935	11.7%	11.4%	0.0%	1.6%	2.6%	27.2%
ASI Assur Corp	97,587	103,695	18.5%	1.7%	4.1%	1.0%	1.8%	27.0%
Omega Ins Co	37,350	39,736	23.6%	0.2%	0.2%	1.0%	2.0%	27.0%
ASI Preferred Ins Corp	10,954	2,343	17.9%	2.1%	4.0%	1.1%	1.9%	27.0%
Florida Farm Bur Gen Ins Co	33,381	33,959	9.2%	2.4%	6.5%	3.5%	4.9%	26.6%
Federated Natl Ins Co	61,530	74,658	15.3%	3.2%	0.0%	2.8%	5.1%	26.3%
Avatar Prop & Cas Ins Co	8,603	3,304	15.1%	7.9%	1.8%	0.0%	1.5%	26.2%
Florida Farm Bureau Cas Ins Co	61,673	64,163	9.2%	2.4%	6.5%	2.9%	4.3%	25.4%
First Floridian Auto & Home Ins Co	37,622	60,729	13.7%	2.5%	7.3%	0.5%	1.0%	25.0%
Edison Ins Co	54,838	53,016	19.7%	1.6%	1.5%	0.3%	1.8%	24.8%
ACA Home Ins Corp	9,717	10,845	18.0%	0.7%	4.0%	-1.3%	3.1%	24.5%
Northern Capital Ins Co	53,263	49,241	19.4%	0.0%	0.0%	1.1%	0.0%	20.5%
Citizens Prop Ins Corp	1,035,506	1,257,427	7.7%	4.8%	0.4%	2.3%	3.0%	18.1%
Florida Peninsula Ins Co	144,660	112,151	9.3%	0.0%	0.0%	0.6%	0.0%	9.9%
Total / Median	5,637,428	5,974,089	15.8%	4.6%	4.0%	1.1%	3.2%	32.5%

Source:
2008 Insurance Expense Exhibits