

STATE OF FLORIDA
OFFICE OF INSURANCE REGULATION

FILED

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STATE FARM FLORIDA
INSURANCE COMPANY,

08-4916

DIVISION OF
ADMINISTRATIVE
HEARINGS

Petitioner,

vs.

OIR File No.: FCP 08-14703

OFFICE OF INSURANCE REGULATION,

Respondent.

**SECOND AMENDED PETITION FOR ADMINISTRATIVE HEARING
INVOLVING DISPUTED ISSUES OF FACT**

State Farm Florida Insurance Company ("State Farm" or "Petitioner"), pursuant to Sections 120.569 and 120.57(1), Florida Statutes, and Chapter 28-106, Florida Administrative Code, respectfully submits this Second Amended Petition for Administrative Hearing Involving Disputed Issues of Fact and requests a formal administrative hearing concerning disputed material facts with respect to the August 25, 2008 Notice of Intent to Disapprove ("Notice") issued by the Office of Insurance Regulation ("OIR") concerning State Farm's July 16, 2008 rate filing HO-23746 seeking approval of homeowners' insurance rates (the "Rate Filing"). A copy of the Notice is attached as Exhibit A.

In support of its request, State Farm states as follows:

Affected Agency

1. The agency affected by this second amended petition is the Office of Insurance Regulation, 200 East Gaines Street, Tallahassee, Florida 32399-0330. The agency's file number concerning the Rate Filing is FCP 08-14703.

Petitioner and Notice of the Decision

2. The Petitioner is State Farm Florida Insurance Company, 7401 Cypress Gardens Blvd., Winter Haven, Florida 33888, telephone number (863) 318-3000. The name, address, and telephone number of petitioner's representative (C. Ryan Reetz) are set forth in the signature block of this petition.

3. The Petitioner received notice of the agency's decision by certified mail addressed to Mr. Adam Swope, Pricing Manager. A copy of the Notice is attached as Exhibit A.

Preliminary Statement of Law

4. Section 627.031, Florida Statutes, provides that the purposes of the rating law include protecting the public from excessive, inadequate, and unfairly discriminatory rates.

5. Subsection (1) of Section 627.062, Florida Statutes, also provides that rates "shall not be excessive, inadequate, or unfairly discriminatory."

6. Paragraph (2)(b) of Section 627.062 further provides that OIR is to review rates to determine whether they are excessive, inadequate, or unfairly discriminatory; and that OIR is to conduct that review by considering certain factors "in accordance with generally accepted and reasonable actuarial techniques."

7. As definitions of the terms "excessive" and "inadequate", paragraph (2)(e) of Section 627.062 further provides that

(e) After consideration of the rate factors provided in paragraphs (b), (c), and (d), a rate may be found by the office to be excessive, inadequate, or unfairly discriminatory based upon the following standards:

1. Rates shall be deemed excessive if they are likely to produce a profit from Florida business that is unreasonably high in relation to the risk involved in the class of business or if expenses are unreasonably high in relation to services rendered.

...

3. Rates shall be deemed inadequate if they are clearly insufficient, together with the investment income attributable to them, to sustain projected losses and expenses in the class of business to which they apply.¹

Thus, under these definitions, a statutorily inadequate rate (as the term is used in this petition) is one at which the insurer expects no profit, and indeed expects to lose money, even after consideration of investment income; and such rate is confiscatory in denying a reasonable rate of return.

8. As used in this petition, the phrase "excessive, inadequate, or unfairly discriminatory" and the terms "excessive", "inadequate", and "unfairly discriminatory" are used in the sense of the foregoing statutory language and the applicable statutory definitions.

Interests Substantially Affected

9. State Farm's interests will be substantially affected by the proposed agency action because disapproval of the Rate Filing would improperly prohibit State Farm from offering insurance within the State of Florida at rates which are neither excessive, inadequate, nor unfairly discriminatory, and which are therefore lawful. Moreover, disapproval of the Rate Filing would result in the continuation of current inadequate rates which will cause State Farm to

¹ This definition is substantially different from the concept of an "inadequate" rate under generally accepted actuarial standards and techniques. In order to be considered adequate under such standards, the rate and investment income attributable to it must be expected to cover all costs associated with the transfer of risk. Thus, the concept of actuarially adequate rates contemplates coverage of expected losses and expenses, and cost of capital (sometimes referred to as a reasonable profit or a reasonable rate of return).

sustain substantial losses (and thereby decrease the amount of its surplus as to policyholders to levels that pose a substantial risk that the company will be impaired) until it can either implement adequate rates or take other actions which would be costly to State Farm. More specifically, and without limitation,

- a. Failure to approve the filing would force State Farm to operate with premium levels and rates that are inadequate in that they are clearly insufficient, together with the investment income attributable to them, to sustain projected losses and expenses in the class of business to which they apply and therefore are confiscatory. Further, failure to approve the proposed rates or higher rates would deprive State Farm of both needed revenue and an essential step toward actuarially adequate rates;
- b. State Farm is presently experiencing substantial losses, even without a hurricane, in 2008; and
- c. Without the proposed increase, such losses are expected to continue in the future.

Challenge to Unadopted Rules

10. State Farm also asserts in this proceeding that the disapproval of its Rate Filing is based upon one or more invalid, unadopted rules that have been applied without notice to State Farm. As such, OIR's intended disapproval violates Section 120.57(1)(e), Florida Statutes.

11. Section 120.57(1)(e) provides in pertinent part that "any agency action that determines the substantial interests of a party and that is based on an unadopted rule is subject to de novo review by an administrative law judge." § 120.57(1)(e)1., Fla. Stat. State Farm therefore demands that this Second Amended Petition be forwarded to the Division of

Administrative Hearings so the issues raised herein can be resolved in accordance with Section 120.57(1)(e).

Disputed Issues of Material Fact

12. The following are disputed issues of material fact that require a hearing pursuant to Sections 120.569 and 120.57(1), Florida Statutes:

- a. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, the homeowners insurance rates proposed by State Farm in the Rate Filing are excessive;
- b. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, the homeowners insurance rates proposed by State Farm in the Rate Filing are inadequate;
- c. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, the homeowners insurance rates proposed by State Farm in the Rate Filing are unfairly discriminatory;
- d. Whether OIR has improperly relied on an unadopted rule to prohibit State Farm from averaging hurricane loss cost estimates derived from multiple models found to be accepted or reliable by the Florida Commission on Hurricane Loss Projection Methodology.
- e. Whether OIR has improperly relied on an unadopted rule to disapprove the Rate Filing based on State Farm's alleged failure to furnish OIR with information regarding hurricane loss cost models when State Farm is not required to do so under Section 627.0628(3)(c), Florida Statutes.

- f. Whether State Farm's current rates or the rates proposed by the filing are inadequate, and if so then the amount of additional increase that is supported by the record.
- g. If the rates proposed by the filing are found to be excessive or unfairly discriminatory, then what amount of increase is supported by the record.

13. The allegations of the Notice are vague in that they do not provide State Farm with sufficient notice of OIR's contentions in order to permit more detailed pleading by State Farm in this Second Amended Petition. For example, OIR contends in the Notice, without elaboration, that (a) the Rate Filing's deficiencies "include but are not limited to" 23 specified items, without identification or explanation of any other alleged deficiencies OIR may be contemplating; (b) State Farm has failed to "sufficiently support", or has "not provided sufficient support", or has "provided insufficient support", for multiple general matters (*see, e.g.*, alleged deficiencies numbered 2-17 and 22); (c) State Farm has failed to "reflect" various conclusory matters (*see, e.g.*, alleged deficiencies numbered 1 and 23), (d) State Farm has failed in an unspecified manner to "reflect reasonable judgment" (*see, e.g.*, alleged deficiency numbered 20); (e) State Farm has failed to answer questions that are not specified (*see, e.g.*, alleged deficiency numbered 21); and (f) the Rate Filing "does not provide sufficient documentation or justification to demonstrate that the proposed rates(s) comply with the standard of the appropriate statute(s) and rules(s)..." (*see* Notice, page 3). Without knowing the respects in which OIR believes that such support is insufficient, why OIR believes certain matters are not "reflected" in the rates, what judgment is alleged to be unreasonable, what questions are alleged to be unanswered, etc., State Farm cannot plead as to issues in dispute more particularly than as follows. State Farm has attempted to ascertain OIR's position from the Notice to the extent possible and has prepared this Second

Amended Petition with as much detail as is reasonably possible. Based upon the Notice, State Farm believes that the following are also disputed issues of material fact at the hearing, as to each “deficiency” alleged in the Notice:²

- a. Whether, as alleged by OIR, and after review conducted in accordance with generally accepted and reasonable actuarial techniques, “the rate filing and requested rate fail to reflect a reduction in policyholder premiums consistent with the expansion of the Florida Hurricane Catastrophe Fund coverage contrary to the intent and requirements of HB 1A.” and, if so, whether this results in rates that are excessive.
- b. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, the Rate Filing fully complies with HB 1A and appropriately reflects the effects of coverage available through the Florida Hurricane Catastrophe Fund through its calculation of reinsurance costs, and, if not, whether the resulting rates are excessive.
- c. Whether, as alleged by OIR, and after review conducted in accordance with generally accepted and reasonable actuarial techniques, “Company has not provided sufficient support that the reinsurance cost in the filing reflecting reinsurance premium amounts and expected recoveries does not result in

²

Some of these issues of material fact may be unnecessary to a determination that the Rate Filing must be approved, and by including them State Farm does not concede that all issues are necessary. In particular, State Farm contends that the only ultimate issue to be decided is whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, its rates are excessive, inadequate, or unfairly discriminatory (and, if so, which modified rate levels would meet the legal criteria). In addition, some of the grounds stated in the Notice as the basis for OIR’s intended action are unclear to State Farm. However, OIR refused to give State Farm an administrative hearing based upon State Farm’s initial request of August 29, 2008, and based upon State Farm’s amended request of September 12, 2008, and therefore State Farm is including additional issues of fact, without prejudice, based upon the guidance provided in OIR’s September 5, 2008 and September 18, 2008 letters of refusal in order to safeguard State Farm’s right to an administrative hearing.

excessive reinsurance cost related to services rendered not permitted per Section 627.062, F.S.” and, if so, whether the resulting rates are excessive.

- d. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, the reinsurance cost in the rate filing is excessive, and, if so, whether the resulting rates are excessive.
- e. Whether, as alleged by OIR, and after review conducted in accordance with generally accepted and reasonable actuarial techniques, “Company has not provided sufficient support for the Retained Hurricane Risk Provision reflecting requirements of Section 627.062, F.S.” and, if so, whether the resulting rates are excessive.
- f. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, State Farm’s Retained Hurricane Risk Provision, which is consistent with previous State Farm filings and with standard actuarial techniques and based on reasonable actuarial judgment, renders State Farm’s rates excessive.
- g. Whether, as alleged by OIR, and after review conducted in accordance with generally accepted and reasonable actuarial techniques, “Company has not provided sufficient support for reflecting in Expected Hurricane Losses an adjustment to results of model accepted by Florida Commission on Hurricane Loss Methodology meets requirement of Section 627.0628, F.S. [sic]” and, if so, whether this results in rates that are excessive.
- h. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, State Farm has estimated projected hurricane

losses using models or methods found to be acceptable or reliable by the Florida Commission on Hurricane Loss Projection Methodology, and in a manner otherwise consistent with the requirements articulated by Section 627.0628, F.S., and, if not, whether this results in rates that are excessive.

- i. Whether, as alleged by OIR, and after review conducted in accordance with generally accepted and reasonable actuarial techniques, "Company has not provided sufficient support that use of average of three models meets requirements of Section 627.062, F.S. that this be from a model or method accepted by the Commission on Hurricane Loss Methodology" and, if so, whether the resulting rates are excessive.
- j. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, State Farm's use, in its rate filing, of the average results of three models approved by the Florida Commission on Hurricane Loss Projection Methodology, which technique has been used in numerous State Farm filing approved by OIR and its predecessor agency, is a use of models or methods accepted by the Commission and, if not, whether the resulting rates are excessive.
- k. Whether, as alleged by OIR, and after review conducted in accordance with generally accepted and reasonable actuarial techniques, "Company has not provided sufficient support for Profit and Contingency provision reflecting requirements of Rule 69O-170.003, F.A.C" and, if so, whether the resulting rates are excessive.

- l. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, State Farm's provision for profit and contingency renders its rates excessive.
- m. Whether, as alleged by OIR, and after review conducted in accordance with generally accepted and reasonable actuarial techniques, "Company has not provided sufficient support in rate of return derivation [sic] of profit and contingency for the Policyholder Protection Fund amounts shown" and, if so, whether the resulting rates are excessive.
- n. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, the projected rate of return derived from State Farm's rates renders those rates excessive.
- o. Whether, as alleged by OIR, and after review conducted in accordance with generally accepted and reasonable actuarial techniques, "Company has not provided sufficient support in rate of return derivation of profit and contingency for rate of return reflecting application of the profit and contingency factor to reinsurance cost" and, if so, whether the resulting rates are excessive.
- p. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, the Rate Filing's application of the profit and contingency factor renders the rates excessive.
- q. Whether, as alleged by OIR, and after review conducted in accordance with generally accepted and reasonable actuarial techniques, "Company has not provided sufficient support for reflection of agent commission without any adjustment for reinsurance cost changes does not result in expenses unreasonably

high relative to services rendered not permitted per Section 627.062, F.S. [sic]" and, if so, whether the resulting rates are excessive.

- r. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, State Farm's agent commissions render the rates in the Rate Filing excessive.
- s. Whether, as alleged by OIR, and after review conducted in accordance with generally accepted and reasonable actuarial techniques, "Company has not provided sufficient support for reflection of other acquisition expense without adjusting for current acquisition activities does not result in expenses unreasonably high relative to services rendered not permitted per Section 627.062, F.S. [sic]" and, if so, whether the resulting rates are excessive.
- t. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, the Rate Filing's treatment of acquisition expense renders expenses unreasonably high relative to services rendered, resulting in excessive rates.
- u. Whether, as alleged by OIR, and after review conducted in accordance with generally accepted and reasonable actuarial techniques, "Company has not provided sufficient support for loss adjustment factor used for expected hurricane loss adjustment expense" and, if so, whether the resulting rates are excessive.
- v. Whether, after review conducted in accordance with generally accepted and reasonable actuarial techniques, the Rate Filing's application of a loss adjustment factor to determine expected hurricane loss adjustment expense is consistent with