NATIONAL FLOOD INSURANCE PROGRAM

FLOOD INSURANCE MEETING

Scottsdale, Arizona
January 18, 2001
8:40 o'clock a.m.
Day 3 of 3

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(COPY)

P R O C E E D I N G

commenced at 8:40 o'clock a.m. on January 18, 2001, at the La Posada Resort, 4949 East Lincoln Drive, Scottsdale, Arizona, before MICHAELA HERMAN DAVIS, a Certified Court Reporter, in and for the County of Maricopa, State of Arizona.

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GROUP SPOKESPERSONS:

GROUP 1 - MR. LARRY PALMER
GROUP 2 - MR. LARRY MOSER
GROUP 3 - MS. RHONDA KLEINE
GROUP 4 - MR. ROGER TROITTIER

R E C E S S E S T A K E N

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Scottsdale, Arizona
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MR. PALMER: Good morning, everybody. I kind of feel like I'm at a Write Your Own conference where I'm doing a panel here.

MR. CONNOR: You are at a Write Your Own conference.

MR. PALMER: I guess we can look at it that way.

It was my pleasure to be part of an exceptional group. As coincidence would have it, the majority were smaller Write Your Owns, and that added a unique perspective to how we were looking at this. But we also tried to look at it from a perspective of the larger companies too. And so hopefully our short- and long-term ideas here will kind of reference both.

We had a chance to review all five points for the models of discussion, and we spent probably the first 45 minutes to an hour, I think, in very candid discussion of some of the concerns we had that would relate to the fee. It kind of -- you can't have one without the other. You have to look at the components of the expenses that the companies have, what's driving some of the costs up, and then trying to make it work with the fee.

But anyway, after we had a chance to kick it around and went to lunch, we started to gel pretty quickly. You just see the light bulbs clicking on real quick. And to coin a phrase, we started recognizing a subtle set of principles from which to build our thoughts on.

And it basically came down to a combination of model Number 1 and 2 to build from and swirling in 3, 4 and 5 with some ideas for the long term. And that's what we're going to try to do with our presentation here this morning. I think I can probably read those charts from here. I'll sure try. I'm glad I took some notes here yesterday.

Basically we're going to try to tweak the incentives a little bit and revisit the A. M. Best aggregate and averages fee. And yes, we're going back to the famous midpoint between two of -- the direct and the net as a base to build from. And from that, go back and try to fine-tune the incentives for some meaningful incentive bonus for the Write Your Own companies, but at the same time, being fair to the program as well.

And first I'm going to talk about -- so the concept of midpoint for the short-term solution of -- the midpoint between the net and the direct as our base. And then going with the incentive concept that we have now, and we'll talk about the retention bonus. That troubled us a little bit. We understand now there's a three-year average that calculates the base for the retention, and you can earn up to -- and group, help me if I'm misstating something -- but you had five increments of points to earn up to an additional half point against your written premium. The key there is where you set your baseline each year.

Now, I was at the meeting at Chicago where this concept first came up, and the idea then was to do a three-year average. And at that point in time, the idea was to offset the problems many of the companies have gone through with El Nino. You had that situation where the threat of flooding was pretty prevalent throughout the United States, and you didn't really have to push the sell of a flood policy very hard, in California in particular. The consumers perceived the risk and were buying the policies voluntarily. And I can speak from my book at Redland Insurance Company, that we essentially picked up about a million dollars of additional new premium that I didn't budget for and I was pleasantly surprised with.

That helped that year tremendously.

But converse to that, the following year, about 80 percent of that million dollars in new premium nonrenewed because the threat of El Nino had subsided, and the people that had voluntarily purchased the coverages were letting them lapse. And I don't know that Redland was unique in the situation. I saw some statistics from California that seemed to indicate it was the same situation out there.

So what are we going to change with that? Do we still do a three-year average? Well, maybe not. Now, I think there was some good collaborative thinking on this to have the bureau help us with the then current average as you start the new fiscal year of the retention rate for the entire Write Your Own program. And I presume that would also include the direct.

Do you think that was where we were coming from, Wally?

And I think Kevin Brown was sitting in with us and indicated that he thought the bureau would be -- since it's pretty much calculated each month on all the statistics, the Write Your Owns submit to you pretty much in the fiscal year in September with the then average of the retention rate for the whole program. And we would use that going into October of the new fiscal year as the baseline from which the bonus could be earned. And that would change each subsequent year, so we would all benefit.

So if the whole industry clicked up with the retention rate getting higher, that would be our base point from which we would have to grow that fiscal year. And that would really challenge each of the Write Your Owns to put -- strut their best stuff, so to speak, on whatever efforts they have to do the retention of those policies. And you could be rewarded accordingly. At least you're not going to be handicapped by having to go back to some average that may put you way below the baseline to even get there. But everything else would remain the same.

And we're the last two hang-ups there on the wall. I use that term in the respect that it's just there to look at and not a problem. But you can still, for example, a real life example, I think, we used over there -- did we start at 84?

Let's say at the end of fiscal year 2001, in September, the industry average for renewals for all the Write Your Owns and direct is 85. That would be the baseline. 84, I'm sorry. And then we could earn up to half a point in equal increments to maximize --

AUDIENCE MEMBER: Larry, on that 84, you are taking with the company's retention and not the program's?

MR. PALMER: Not the individual.

AUDIENCE MEMBER: The sum of the WYOs without the rollover? Because the statistics we showed was 84 percent and 87 percent.

MR. PALMER: We thought the difference was between 84 and 87. Somebody help me from our group. The idea there was to have it handicapped to the point where we're not being penalized from the roll-outs.

Is that where you're coming from, Bruce?

So the retention rate of your policies would be kind of along the theme of the genuine new business and not encouraging the rollovers between the companies.

Group, does that make sense? Is that it?

MR. CONNOR: Well, it's just that that, actually, from our standpoint, simplifies it because what that does is automatically neutralize the rollovers, and we don't have to worry about whether a policy that you lost went out of the program or went to somebody else because it will still show up as a policy that the program retains.

MR. PALMER: And what we're trying to do here is not create a reward for companies to go out and continue to churn. I think we need to get that behind us and focus on the market and our retention of the policies we're getting. And we don't necessarily want to reward anybody for that. But anyway, that's that concept.

MR. CONNOR: I want to make sure I'm clear. The average will include the direct side as well?

MR. PALMER: It's kind of a work in progress here. We can think that through. We also want to go back and put the key pad to the screen and put the pencil to the papers and work the number out to make sure the arithmetic is there. But if we're going to be fair, we have to look at our industry, and the industry includes the direct. And, I believe, Denny, if you're in here, if the PIF count we see on the charts you prepare includes the direct, then we should keep that same mind set. Again, it's just an idea and we can tweak it.

The idea is get away from the three-year average, go to the reality, and at the end of the fiscal year, apply that as the base going into the new fiscal year. We recognize that the bureau is probably going to have to take a couple months before it digests everything that we put on the stat tapes, and we can live with that. We'll have a general idea where we think the retention rate is going, but if the whole industry is having a problem with retention, it goes down, let's say, to 80, and that's where we start, and we can earn our bonus based on that.

Does everybody understand that?

AUDIENCE MEMBER: And I assume that the calculation for each company then -- these are the numbers of policies you had a year ago. This is what of those policies renewed, so a company that rolls business into their policy base is not getting credit for a renewal without a policy in their base which would then distort or raise their retention?

MR. PALMER: Let's think about that.

AUDIENCE MEMBER: Rollovers wouldn't be counted.

MR. PALMER: And that's the idea here.

AUDIENCE MEMBER: If you lost the policy, no matter if it was rolled to another company or you lost it altogether, it would hurt you -- your retention would be lower.

MR. PALMER: That's right. But let's talk about the reality of the typical nonrenewal. That's what we're all faced with and we want to keep. That is -- that's definitely going to impact the renewal retention. The only thing that in my mind I'm thinking that won't impact the renewal rate is the roll-outs, is what it comes down to. Is that making sense?

AUDIENCE MEMBER: The reason I'm making that point is it's like you buy an agency, one agency buys another agency. So now we're down to just the agency level. Their renewal ratio the following year is grossly distorted because it doesn't go into their base. It goes into their renewals, and it would -- they could have over 100-percent renewal ratio because you don't have apples and apples anymore.

MR. PALMER: And it's like acquiring a company.

AUDIENCE MEMBER: So really, the only way to truly measure it is, okay, this is how many you had in force a year ago and these are all available for renewal. How many of them renewed?

MR. PALMER: I'm wondering if the situation wouldn't go into the overall averages. You acquired a book of a large number of policies.

AUDIENCE MEMBER: Then those have to go into the base.

MR. PALMER: Would that be a handicap? I mean --

AUDIENCE MEMBER: How does that differ from rollovers as opposed to --

MR. PALMER: I see your point.

AUDIENCE MEMBER: We're trying to deal in the very specific issues of how to get out, and our feeling yesterday that that should be left to another group to sort that out to come up with the true number. It's the concept in short term in relation to what we have now that --

AUDIENCE MEMBER: The point I'm trying to make is there shouldn't be any benefit to churning.

MR. CONNOR: That's what you're trying to accomplish. Whatever the formulation is, that's what we're trying to get at.

MR. PALMER: We did -- by the way, our whole premise -- maybe that's why we got done so early -- was to keep it simple.

AUDIENCE MEMBER: I was told it was you saw the weather was good and that's how it got done early. But our group didn't figure that one out.

I stand corrected on the figures I gave you earlier. Just for clarification, for the numbers Denny gave us, I think in October the renewal including roll-offs was 85.7 percent for 1999. Excluding roll-offs was 82.2. So about 3 and a half percent were roll-offs. So I had said 84 and 87, and it's more like 85 and 82. So it's just a matter of adjusting the numbers on our thinking.

MR. PALMER: It's just a concept we wanted to present here, but the idea is keep it simple, going forward with the most current number we can get off the prior month basically. The bureau's first impression was they could do that, and we start with the new base established. Going into it, you're doing a budget a couple months not knowing exactly, but we could have some rolling averages going from the IBHS flood committee that would probably help us.

That's our retention bonus side. I'll move on to the next part. If there's any other questions?

AUDIENCE MEMBER: Just one quick one. Did you do any thought with doing away with retention bonus?

MR. PALMER: The idea here is if you're going to be -- they go hand in glove. We can write a heck of a lot of new business, but if we can't figure out a way to keep it on the books, other than the three-year policies, Mr. Bender -- five-year you were proposing, I forgot. But that puts a little pressure on us.

But if you think about it, it steers us all in the right direction to figuring out ways to keep that consumer happy and keep the policy. Because on one hand, we have the Reform Act of '94 that keeps it there for the term of the mortgage. That's a finite limit of number of policies out there. We need to figure out a way to attract that preferred risk type customer and the one in the Midwest that has their home paid off and has no federal law requiring them to keep the policy.

MR. CONNOR: Let me make one comment. One of the reasons that we did break the incentive partly into new growth, as well as retention, is the fact that obviously we have a variety of companies in this program. And there are a number of smaller companies particularly that kind of serve niche markets, and their potential for new growth isn't as great as some of the larger companies.

And so the real benefit we derive from those companies is in service, and service translates into retention. So we thought it would be fair to companies like that to reward something apart from growth because the way they operate doesn't necessarily generate as much new growth as again, certainly, nationwide companies. But that's part of the background to the retention, breaking out some reward for retention.

AUDIENCE MEMBER: My question was just philosophical.

MR. PALMER: And a good one at that.

Then moving into Phase 2 for short term is the growth bonus, and our concept there was -- basically comes down to this. The 18 percent we thought was a little hefty. Rolling that back to a 10-percent increase and change the increment proportionately. And we have portrayed that on the hang-up there.

And where you -- basically to maximize the additional 1.5 percent against your written premium, instead of having to increase your base a full 18 percent, which is difficult, click it back to 10 percent and keep the increments equal from 1 percent -- one-point increases to 10-point increases. You can tell there. It goes this way. If you -- in order to earn a .15-percent bonus, you'd need to increase your base 1 percent.

Is that right, group?

And converse to that, if you are down to a 10-percent increase, that's where it calculates out to the 1.50 and you can see it there. We figured the 18 percent was just hanging that carrot out there way too far and wasn't realistic. And we thought if we had a goal that we believed was attainable, you could work a little harder to try to get it, as opposed to having something out there where we just can't do it and muster the resources against it.

MR. CONNOR: Larry, what was your definition of "new growth"?

MR. PALMER: I think it's the -- now I'm saying my personal feeling because I don't think our group got into that. But my impression is that it would be the definition that's there now. Genuine new policies.

Again, we don't want to encourage just taking the 4 million policies we got out there and see how we can move that around on the chess board. We want to expand that market venue and attract genuine new business and be rewarded for it.

On the other hand, all of us in this business are very mindful of our break-even points, and whether it's a rollover or a genuine new policy, that helps. Having said that, I think the emphasis should still be on new policy penetration.

And also where we -- if I could take a little shot here, and I don't mean it as a shot over the bow, but just an idea. It would probably be a good idea to know what the population of potential new policies really is out there today. We have talked about this in meetings, but I don't know that we've ever pulled together any reports, new current ones that would give us ideas. Is there another 4 million to get out there? Or is there only another million that we're all going to fight for? I think it kind of puts things in perspective for us.

And then the last footnote is at the compliments of Wally here is short term, no new initiatives without compensation. And by that what we mean is, let us deal with that challenge that we're talking about, retention and policy growth, but don't -- and we realize with the new administrator there just may be something out there that's going to put a burden on Write Your Owns that's going to cost us some money. But if you're going to do that this time around, wouldn't it be a shame if we're able to pick up that extra point and a half or 2 and wind up having to spend it for some initiative that we weren't planning on?

And so we should probably swirl into the short-term concept some backup where if we are required to do some additional initiatives, that we get reimbursed for them. And that's where items 3, 4 and 5 under the models for discussion can be swirled in for discussion.

I take it you did not want us to go into the long term?

MR. CONNOR: I thought it might be good if we just wrapped up the short-term discussion first and then move on to the long-term discussion.

Let me ask one question about the new initiatives. Did you talk at all about what constitutes baseline and what a new initiative is? How to define it?

MR. PALMER: Well, yeah. We talked about the initiatives we had on our plate right now, the PRP rewrite, the repetitive loss issues. And gosh knows what a new administrator would think would be a new initiative.

MR. CONNOR: It would be helpful to us if you could come up with some way, if not defining, at least describing, what constitutes a new initiative in terms of how it affects your day-to-day operation. What kinds of steps you have to take that -- because there are certain -- you know, there are certain ad hoc kinds of problems you're dealing with on a regular basis. And in some cases, a new initiative may just be a bit of ad hoc in terms of the impact on the individual company. Just maybe a little bit bigger ad hoc as opposed to, quote, a new initiative. So that would help us to understand how to define or what we can really call a new -- it's really the impact on a company.

MR. PALMER: And Wally's point was the training initiative. And we looked at it and I think we tried to be pretty fair. We're saying, What's expected of us under the fee we get paid for this program? We know what the A. M. Best aggregate and averages said that components are made up of. But for the 30.9, some of the dollars or percentage swirled into that should be going to training anyway. So we should be doing some minimal -- not minimal, but we should, from the perspective of our own companies, be doing training. I'm being paid that for consideration for earning that fee and producing flood policies. Yes, some of that money should be going towards training, but if it goes above and beyond, then we need to be compensated for that.

And I don't know if I should make this comment about the commissions, but I think I'll just do it. We also recognize that while there's a lot of concern about the fee clicking down, the Write Your Owns have to also be concerned about what they have done to elevate their expenses in this. And the small companies from our perspective are sensitive about these obscene -- I used the wrong term there. What's the politically correct term there?

AUDIENCE MEMBER: Obscene is okay.

MR. PALMER: Okay. I can use it now. Overly excessive commissions. But how, on one hand, do you balance trying to defend our fee and then having commissions five points above the A. M. Best aggregate and averages? And when you look back at the last five years, you see the commissions in our industry starting to come down. We're not doing the job here if we don't want to look at this very parochially.

Another thing is E-commerce. And under the economy of scale, we should be able to do more with less expense. And so if we don't bring this up, somebody from Congress one day will, if not John Stossel on Fleecing of America. So we have to look -- we have to be able to defend what we're doing. You know, what's expected for that piece of the fee we've got and are we using it that way and can we justify at the same commissions saying, Don't lower our fee, we can't afford it, without looking at that too. I guess when we talk about our long-term goals is when we'll make comments on that.

I have to ask the group, did I overlook anything?

Is there any other questions?

AUDIENCE MEMBER: Just kind of on add-on to, Ed, your comment. One of the many things our group talked about -- I think we lasted until 5 -- was that if the FIA could identify what is important to them, whether it be an underwriting issue, a claim issue, a growth issue, really making the program more sound. And in your planning process, let us know that those are the key objectives of the FIA for the year and then base some incentive on what your goals are.

And one of the other points that we brought up is, give us enough time to gear up. If your issue is reunderwriting the PRPs, then maybe incentivizing us in doing a good job and let us know well in advance so we can add the resources to do it correctly and be able to plan for it. As opposed to, oh, we have this issue, let's throw it in and then we deal with the mess on the back end.

So I know that we've been -- the incentives have been centered on true growth, and we all think that that's good, but maybe there's some other things that are important too.

MR. CONNOR: As a matter of fact, I think that's very consistent with the policy. When we started that incentive, it was, in fact, growth that was our highest priority. We were getting that imposed on us from above, and it was, in fact, our highest priority, and so that's what we incentivized.

At the same time, as you're saying, particularly over the last couple of years, there have arisen other very important priorities that we haven't treated in the same way as we have treated growth. And no, I think that's an excellent point.

AUDIENCE MEMBER: To add to that, when we discussed it and we were talking about it, even later, even after we ended at 5 --

MR. CONNOR: Were you in that group?

AUDIENCE MEMBER: Yes. If the FIA defines what it wants in regards to incentives, as Rhonda mentioned, then we've got ways that we can guide the companies with instructions as to what we mean with thresholds. Such as, if underwriting is important, we set certain thresholds for the underwriting reviews. If claims are important, we set certain thresholds in claims reviews. We maybe look at what about performance for anything that comes before the standards committee? What about certain thresholds for accounting and financial reviews? And there are all kinds of ways to be able to measure that type of performance and what are the kinds of initiatives that we want to emphasize that are over and above just growth.

MR. PALMER: Well, you know, there's ways to quantify that today. First of all, the standards that are set in the Write Your Own arrangement. Sophisticated as computers are, you can use those to measure on an average basis how long it's taking a Write Your Own company to turn a claim around. The ones that are able to turn them around quicker should get a good grade and some reward for that.

And also, when you do your audits, I don't know how you would measure this, but the arrangement does specify you have so many days on which to get a policy out the door, to handle and respond to a written complaint, you know.

And then on the other hand too, it's getting a little personal when you go into operational to do an operational review. That was a pleasant experience, by the way. Thanks. But they take a look at -- the insurance departments require this, and so should the NFIP. They take a look at your complaint log, flood-related specific complaints. Were they underwriting concerns? Were they claims issues?

And you're always going to get the person harping about the wet carpet and why you couldn't be there in four hours and you get a discount for that. But, I mean, the serious complaints. Communication broke down, timeliness, Fair Claims Practice Act wasn't followed. So there may be a way you can put together a little checklist.

And maybe I'm getting myself in trouble with my brethren. My other brother Larry has a question right now.

AUDIENCE MEMBER: The only issue I have is trying to tie incentives -- those are specified in the arrangement. We shouldn't get an incentive for that.

Secondly, it would become way too subjective and it could be a matter of personalities as to who's doing the review. Whereas, if you've got everybody with established incentives, it's totally objective.

MR. PALMER: Were you on the Palm Beach Recount Committee on those chads? I can just tell now.

AUDIENCE MEMBER: Well, I voted four times.

AUDIENCE MEMBER: I would also agree and kind of echo what Larry is saying. We have minimums and that's a requirement to be in the program. When we talk about incentives, I think we need to be careful that the incentives are focused clearly on where FIA wants the program to go.

We can't focus our energies on every one of those things at every given year and be successful at moving the program in the direction you want all at one time. It's going to take us, you know, give us the ability to focus our resources on the one and the two. We have the growth and retention. Is that what we always should be focused on? If there's any time though in growth, you want us to focus on a certain area of growth. But I think you have to be clear in that so we're not overloaded with too many incentives.

MR. CONNOR: One of our concerns always is when you hang incentives on anything, measurability is just so important. If you've got kind of vague measures, it's not as though they are inappropriate, but to the extent they are subject to interpretation, we are going to be constantly haggling.

The concept is good, and I think it's something that maybe -- but I think the things that we do try to incentivize, we have to try to ensure that they are -- that there's a clear understanding as to what constitutes achievement and accomplishment and what doesn't.

MR. PALMER: And I agree with Corise that those are the expectations under signing a contract with you folks. And the -- yes, they should be the minimum. I guess you have to look at a company that's not meeting the minimum. And it is hard.

MR. CONNOR: We have other ways of dealing with that. Well, we don't need to get into all of that, but there are various ways of dealing with problems associated with companies. And I think we've been reluctant to -- we regard starting to hang some of the allowance on that as a fairly drastic measure that I don't think we want to get into.

MR. PALMER: And I'll get off stage here, but Frank, in the early days of the program when they were talking about the A. M. Best aggregate and averages as a base for calculating the fee, were there any expectations in the group there that, okay, for this fee, here's what we're expecting from the Write Your Own companies?

I know in general terms, to market and policy administer. But maybe we can use this as a bridge to now say, Look, Write Your Owns, at the beginning of the fiscal year for what we're going to pay you, whatever amount plus these incentives, here's our expectations. So we know what to emphasize.

AUDIENCE MEMBER: And I think that should be a joint effort in terms of establishing those goals.

Just to cite an example, before we moved to new apps and we were still on PIF growth, we were being held to a scale of 10-percent growth while the FIA had built in a 5-percent plan. So obviously, we weren't on the same page. If we had all been involved in the goal-setting, we would have had a realistic goal for everyone.

MR. CONNOR: That was another time, Larry.

AUDIENCE MEMBER: Larry, I have a question. Maybe it's more for Ed. The five lines, is that still the lines that are used for the average in

Best?

MR. LEIKIN: Were you going to respond?

MR. REILLY: They were putting their name on the policy and that they would do everything they could to develop a quality insurance product to the customers and producers.

What I tried to say yesterday is in the '80s, there was an expectation on top management, one, is to be a meaningful part of President Reagan's private sector initiative, and number two, is an expectation that they were going to be able to work out some kind of arrangement with the federal government with relation to other natural hazard insurance problems.

So they were looking at a big picture. They wanted a totally defensible position. They made no issues on start-up course. They really wanted to demonstrate to the Reagan administration, A, property insurance, a federal program, is properly held in the private sector, and number two, that they could enter a joint venture with the government that involved a hell of a lot of money and keep total financial control. So I think they were the big issues.

There was no actuarial review on how -- whether or not how much shortfall or anything else the formula gave. But it presented -- I think they all thought that very good image to say to Congress and the administration and many of the critics, that under this approach, the flood program would be making a reasonable contribution towards the existing property insurance infrastructure that would carry out their responsibilities under the flood program.

And that was the original, and no one's taken a real hard look now since some of the -- obviously the Reagan administration isn't around anymore. And number two, I think -- well, it's my personal opinion, there is kind of disillusionment that there are going to be in the foreseeable future some accommodations to the industry's concern on these other natural hazards. So a lot of the incentives that came into the program, you know, what I'm hearing over and over again is now that same management saying, We want to be able to justify on a cost basis our participation in the program. And therefore, you're into all of these things that impact costs, which were never laid out with this detail when the original formula was devised.

Did I answer your question?

AUDIENCE MEMBER: Frank, a comment. I

think in the early '80s before we got the increase in catastrophes, there was a better positioning on the industry on the P&C side that existed after the years of late '80s and early '90s which has given rise to the cost-controlling management requirement. We're much more cost conscious now than at that point in time.

MR. REILLY: And there are a lot of other forces, and it seems reasonable that now on a long-term ongoing basis, we should get a better means by which the companies are in the aggregate, meeting cost requirements.

And I think that's what the exercise is. But it's in two pieces. It's what could be done to step in that direction in the short term and continue discussions on those kind of things that -- and maybe there's some ways to put numbers to it and get that done over the longer term. At least it's a demonstrated evidence that we're moving in the direction to a goal that's being defined, which is to get the best way to reimburse the Write Your Own over the course of participating in this.

MR. MOSER: To start with, you know, we understand the rationale behind moving from a net to a direct and taking out that reinsurance component in the calculation, although we didn't like the fact that the amount went down. And there wasn't a person in our group that disagreed with the fact that the amount isn't adequate to cover the cost of running our flood programs.

So we started with, let's start with where we are today with the direct, but because running flood is a lot different than other lines of insurance, we felt there needed to be a baseline adjustment.

Now, if you look at the five lines that are used to calculate the expense allowance amount, which, I mean, we could probably debate it all day as to which lines really should be counted. The fact is, homeowners, which is probably the most cost-efficient property line of insurance we write, drives down the percentage. If you take homeowners out of the calculations, you come up with a percentage that's probably much closer to what it really costs to run a flood program.

Or you could say, well, look at other catastrophes. Earthquake is 33.4. Is that closer to flood? Probably. Doesn't happen that often. Can be catastrophic. So we figured that we needed -- rather than say, let's go back to what we had -- because I don't know how you sell that. I don't know how you convince Congress, well, we're going to move back to the net only because we should be getting more, as opposed to the rationale behind raising it, because flood is different than everything else.

Then when you look at the various things that we've been asked to do over the past five years. As you can see -- well, it's a little hard to read. It's in red.

Were we running out of ink?

The PRP ineligibles, the AR zones, the CBRA problems, 120-day loss. And earlier somebody made a comment about claims. We are not -- there's no benefit to a company to delay the payment of a claim. We're not paid until we -- until we close the claim. So having a claim open for 120 days is not intentional. It's normally because there's a problem.

But that creates work. It creates taking our eye off the ball as to what we're trying to do to grow to focus on answering responses like, Where are the files? Why is it not closed? Just the lag effect. The government stats are always two to three months behind what the current month is. You could have already fixed the problem, but it's not reflected yet.

The Monroe County, repetitive loss problems. The fact that we lost premium, we lost revenue to our companies, plus we had to do a lot of work to move the policies. And I've had agents call me and say, Larry, I don't understand, the policies no longer say Allstate on them. How do I get them back to Allstate? I said, Once they are offered mitigation, get them to make the changes. The biggest complaint I'm getting from customers is it doesn't say Allstate on the policy. And I said, Well, you're still getting compensated. He said, That's not the issue. The issue is who's servicing the business.

Address corrections, the policy rewrite, special audits, litigation expense, quick claim reporting. That's probably most of the things we've been asked to do over the past five years, and we feel that when we're asked to do that -- I think it's number 68, the one about reevaluating every policy in B, C or X zone, which we're -- most people, I think, are very opposed to that initiative only because of the fallout caused by the PRP ineligibles.

We see that as a very costly proposal, and if we were told to do this, we would say, Well, this is what it's going to cost, which is what the cost benefit is, and we should be compensated for this. That shouldn't be just considered part of the day-to-day operation. And we figured that as a 1-percent contingency.

Profit component. You use the calculation in Best aggregates. There's no profit in those numbers. You know, when you look at other lines of insurance, you say, well, even if you ran a break-even on underwriting profits, you're going to make investment income. That's not true with flood because we don't hold the money. The small portion of money that's left from the allowance after you pay your expenses and say, Well, I can invest that, that's not comparable to the large amount of dollars available from homeowners.

Also, looking at the expense of operating a program, considering homeowners, the average premium for a homeowners policy maybe $600 compared to 350 for flood. Are the expenses that much different? So if you said, okay, let's apply the 30 percent to $600 and we'll get $180 for processing every flood policy. That works out to a 50-percent expense ratio. Obviously we'd have a hard time selling that, wouldn't we?

But the point is, they are not directly comparable. And when you look at what it costs to actually process a policy, forget about the premium, it's probably much higher than the 30 percent, as one of our companies has detailed stats to show exactly what it costs. I don't question it. I'm going to go back to my accounting department because ours are probably just as high.

We feel that there should be a profit component. What is that number? We couldn't agree. We figured a reasonable profit. And then incentives should be above and beyond that.

Did I miss anything?

AUDIENCE MEMBER: I'd just like to highlight a couple things you said. One of the major differences, I think, between the first proposal and the second is we feel incentives are totally independent of what we need to carry out the objectives of the program. Just the expense part of the component.

In other words, we're expected to meet our objectives and comply with the arrangement and satisfy our customers and do all this training and advertising and so on and so forth. But if we're not even getting an amount which meets our expenses, and Larry alluded to the fact that we've provided an actual number based on two years of experience, we'll have a third year soon, that is the actual direct expense -- our actual direct expenses based on Regulation 30 which is the accepted way you allocate expenses and all property lines of business.

We feel very comfortable that those numbers are accurate, and I encourage whoever makes the decisions to utilize figures that are actual versus making up formulas. And one of the reasons I didn't present this is because I have a little bit of a problem with coming up with formulas based on subjective information.

And I think Larry raised a good point about the Best -- the five programs and the Best averages. The homeowners line is heavily weighted because of the volume. The homeowners line is typically a couple points lower than many of the other lines, which are more typical of the manual processing which occurs in the flood program as a result of elevation certificate requirements, zone determination expenses, and I can go on and on.

But we provided some numbers, and I can't believe that our numbers are a whole lot different than what the other companies are incurring. And now there could be some higher, some lower, but that's -- I think that needs to be seriously considered because they are actual figures.

MR. MOSER: And actually, if we were to talk about the interim and long term right now as well, we would say that line on the statement that says flood, if every company followed Regulation 30, that number would probably be accurate. So what we need companies to do is make it accurate, and then it's truly reflective of what it costs to run the flood program and it's not a hybrid of other lines that we could argue about. What does the CMP have to do with flood?

AUDIENCE MEMBER: We didn't move as far as you did. We didn't think we could achieve all those in the short run.

MR. MOSER: We want to make them retroactive. We're going back to fiscal year of 1999.

AUDIENCE MEMBER: You didn't define what your incentives were.

MR. MOSER: We are comfortable today short term with the incentives that we have, but the incentives should be above and beyond the cost of doing business.

AUDIENCE MEMBER: I think we discussed the schedules, and we all agreed that the way the incentives are currently couched and the way the schedules are structured is flawed.

AUDIENCE MEMBER: I think that what we were told was that that incentive piece would need to be discussed a little beyond this group, but we essentially agreed with the current formula subject to some minor modification, particularly on the retention side.

MS. KLEINE: I hope you-all can hear. I guess overall we spent hours going through the short term, the long term, various alternatives. But at the end of the day, and literally at the end of the day, with the frustration in the group because we could not agree on really which way to go, is that we came out with the fact what we're getting paid today is too little. And we all agree.

MR. CONNOR: It's a little bit like therapy.

MS. KLEINE: And really, what we found ourselves doing is trying to back into a number to raise it. So we were coming up with all these different complicated schemes to try to get the number where we think it is, yet we really couldn't agree on where we thought the number should be. So we went through various short-term scenarios, and I think most of you can read through here.

There's nothing really new, but what we thought was, let's use the net versus the direct, and then let's assist the FIA in evaluating and justifying why we think the net is the way to go. Because it's the biggest number. And basically, it's higher. Whatever number is higher. Because we think we need that additional dollar amount to run the program.

And so these were some items, and I know with some of the others, you could use those as well, to really justify why we think that number is the correct number. And basically, the lower average premium flood versus the average P & C premium, the flood dollar amount is lower. I mean, it really takes a lot more to process a flood policy than another policy.

The program has high costs. The TRPP versus the state. They are higher than normal lines. The zone determination expense, et cetera. Additional ad hoc costs. Those things that we're asked to do up and beyond things that we have been told we've got two or three months to implement or we get the information late. We have a change in April, then we have another change in May and a change in October. We can't work our systems around those things.

Profit. There's no dollar amount built

in for profit. And then the program changes that we've implemented actually reduces our premium that we have and the expense allowance to run the program. So basically -- and I would hope we all agree here, we have to do something to justify to the FIA and then the highers-to-be why we think we need that extra money to run the program.

We did agree with Larry Palmer's group in that we felt like the incentives should be based on the average for the program and that what the companies get paid should not be arbitrary. And I know it wasn't totally arbitrary, but an amount identified up front. But it should be based on how the program in general, the statistics of the program, and then evaluate those companies based on how well they do within the program scale.

And then, I think we mentioned this a little earlier. We need to understand where the FIA is going, and we need to understand what those priorities are. And then let us know so we can gear up for the programs, so we know what kind of expense allowance we're going to get, and then we can adjust based on where you're going and where the objectives are.

And I may be getting a little bit off,

but I guess that's kind of what our group did. But we also spent some time on trying to identify what is the true meaning of the incentive. What are you really trying to change in the behavior of the companies? Where are you really going with it? And once we identify the purposes of the incentives, then we can identify what they should be and how they should be measured. Clearly, it should be attainable and it shouldn't be the base amount or making up for the base. A lot of us in the group felt like the incentives have made up for that base that was taken away.

We identified a number of incentive alternatives, I guess, in discussion on how to concentrate the marketing efforts into various areas. I'm not going to go through that.

MR. CONNOR: Just one question. The other groups spoke about either a contingency, or I think one group talked about a midpoint on the business allowance. You're basically saying that you would go back to the net because that's --

MS. KLEINE: Or the higher.

MR. CONNOR: So you're not looking for any kind of additional moneys for other programs or other changes that may come along?

MS. KLEINE: We talked about that in the long term. But I want to get back to what Jack has said, in that we don't know and we're not sure how we can get at the true cost to run the program. Maybe with everybody providing their expense data, maybe we'll have that information. But we want to be as objective as possible. We know that you have to justify where the number is coming from, and this seemed like a logical place. And quite frankly, it seemed to have worked for 15 years, and then all of the sudden, the impression is now it's being lowered.

So yeah, I mean, I would prefer to really look at the program and try to figure out what the direct cost is. I don't think it's practical, and again, I'm speaking from my personal standpoint. I don't think you're ever going to get to that point because each company has its uniqueness. You have the direct writers, your captive agents, the independent agents. You have the niche companies and you have United States companies. They all do business in different ways and have idiosyncracies about them, so I don't think it's practical.

AUDIENCE MEMBER: Without the actual expense numbers from the companies, we did try and look at other alternatives. One of the things we continued to discuss after 5, Frank and I, was the issue that was brought up that Rhonda mentioned that our percentage in picking the five lines as compared to our average premium.

Well, our average premium reflects a shortfall because of the subsidies of the program, whereas the percentages in the industry in Best doesn't reflect subsidies. Therefore, full actuarial premiums.

And that's what was also mentioned earlier; that if you go back and look at our policy base and the percentage of our policies, that the premiums are subsidized. Factor that, which Frank did the infamous cocktail napkin calculations last night as we're sitting there. And then factor out things such as what part of the premium does the company not get a fee on, such as taxes and commissions and so forth and so on. And you come down to a factor and you apply that.

It winds up somewhere between 2 or 2 and a half percent above the 30.9 where we currently are. So that would bring it up to 33 or between 33 and 33 and a half if you simply made that kind of a focus.

That gets away from the other approach we tried to take that was taken over here. We were saying all these FIA special projects, if we could figure out a percentage, 1 percent, three-quarters of a percent, just to figure there's going to be so many of those every year. Why worry about how many there are? Why don't you fix a percentage of the fee and add it to the base?

Instead of doing that approach, when we tried this other one last night, if you recalculate it taking into account the subsidy, that's when we get at the higher level that I mentioned. And we believed, when we were sitting talking about it further, that then you wouldn't need to factor in an additional fee for all the FIA special projects because the higher percentage based on actual actuarial premiums would take all that into account. Just another approach.

AUDIENCE MEMBER: Just to -- kind of on that same note, I think it would be difficult first, as Ed Pasterick mentioned to Larry, to define what new initiatives are. We'd have to clearly have that defined on an annual basis what's expected as normal and what's expected as a new initiative.

And let's say it's defined as another Monroe County. Let's say Plackman's Parish comes up and they want to do the same thing. What's that cost? What percentage is the FIA then going to give each

Write Your Own company for that? And I think it becomes too subjective to try and do that every time another project pops up.

Sure, we'd love to do it, and yes, when you start seeing the fees coming down and the project going up, we start screaming. But I think if you start identifying exact costs for what it is, you're going to have screaming from 95 different Write Your Own companies. But make sure if you do go that way, document it, so when you have this meeting four years later, you can tell people what that number is.

MR. LEIKIN: Working off of a theoretical full actuarial premium I think would be difficult. In addition, there is some -- I think it throws things in odd ways. The missing premium and where the full actuarial premium would be the highest is probably associated with the policies where your expenses are perhaps a lot lower. They don't require the elevation certificates. And your expenses are really associated with the lower premium policies, to a large extent.

But along -- what was suggested here was that our flood premium, in general, is lower than the average premium we're calculating the industry-wide expense ratio against. I think that holds some promise of making an appropriate adjustment in looking at what the actual expenses are and the dollars for the companies. We'd have to convert it to some percentage, but that is some hope for making it more realistic.

AUDIENCE MEMBER: What if you had a minimum? In other words, the percent expense allowance subject to a minimum so that these premiums are at least earning at the break-even point so they are not returning less.

MR. LEIKIN: I'm not sure I follow it.

AUDIENCE MEMBER: But I know on other lines of business where we have percentages and we have to produce at least a certain result, we have either a dollar minimum for that or a flat fee for that so that you're at least getting that.

MR. LEIKIN: Per policy.

AUDIENCE MEMBER: Whatever policy you're using it for. That's why I say a minimum might fit there.

AUDIENCE MEMBER: I also want to mention that our number does include all of the costs associated with these additional initiatives. It's not outside of that.

So the other thing is, in talking about

justification to Congress or whoever, our insurance and expenses, as well as any company's, are public information. So that certainly can be utilized if Congress needs some support about what our costs are. We're comfortable with it. It follows, again, regulation is what we use for all lines of business. And I'll stop making my pitch. But that number does include all fees and additional things that we're asked to do that's reflected in there.

AUDIENCE MEMBER: I want to make a comment because I feel real strongly on this one. Even with an expense adjustment, the initiatives can't go to infinity. Resources are set. You have to make your priorities. You have to put your budget together. You have to plan accordingly.

It sounds like you have a system for planning that looks into multiple years and so forth. I think that's got to be the guide so that we're all pulling on the right oar and keeping the boat in the right direction. You set goals well, use the planning techniques accurately, you share that, we communicate on the specifics so we come up with the best approach. I think we can make this thing work.

MR. LEIKIN: And we haven't had as good a tool of doing that ourselves until really this past year. So we should be able to do a better job for you and with you now that we have laid out the blueprint that all the senior managers in FIA have crafted as to where we see things are going and using that and establishing the projects for the year. We need to get that into your processes earlier.

AUDIENCE MEMBER: And I think one of the things that we would ask you to recognize is that essentially you have capped your expenses. And that there's a saying that nothing is impossible for the person that doesn't have to do it or pay for it.

You've already decided what you're going to pay for this year. And so when you come up with additional ideas or additional things that need to be done, you don't have to do any cost analysis as to what those things, what the ultimate impact of those will be because you have fixed expenses for the most part.

MR. TROITTIER: Our particular group, we were ready to go at noontime, and after lunch we decided that we should stay because Frank came into the room. And we thought that he was policing us, and we got into a discussion about Regulation 30. But in all essence, we feel we should keep it short and sweet right now.

We actually took our discussion of graphs, and this looks like a silent bid auction, and I'm not sure which one I want to bid on, but I'll buy it without being framed.

Ours is the 8 and a half by 11 on the pillar over there. And when we actually took our various larger sheets and tried to condense them, the unilateral or the -- the group thoughts were almost unilateral in that we just needed more money for participating in this program.

And Jim is passing out this 8 and a half by 11 sheet.

And we had kind of a unique discussion because we had four companies geographically scattered throughout the country, and Richard Cody and I had a philosophical conversation about his selling flood in Vermont and Maine as against my selling flood in the state of Florida. And there's a real difference. But there was basically no difference in the fact that we both need more dollars to continue on in this program.

So the base allowance basically is very simple. We concluded that we should use the direct method of weighted average for the five lines of business. And not an incentive, but additional compensation added to the base now would be 2 to

5 percent. We figured there should be some latitude there. And they should be for things like the compensation for the inability to realize an underwriting investment profit or compensation for business risk created for other lines of business and compensated for lost opportunities.

And FIA helped us with some of that language. Compensation for extraordinary mandated measures such as, but not limited to -- this is where the 2 and 5 comes in -- the PRP reunderwriting, the address standardization, CBRS monitoring, the elevation certificate changes, the rewriting, the ICC implementation. And, of course, the upcoming Monroe County reinspection, which is in my back yard, so that's going to be interesting and fun from knowing what's down there.

The condo reinspections, that's another issue. Loss of repetitive loss business. And map revisions and the incentive program, we felt that basically whether you leave it as is or lower it down, as Larry's group showed, to the 10 where it first started, that it should be redefined for different company sizes. And I don't see this on here, but we brought it up. They should be redefined for companies in different parts of the United States.

We think that if you took all of the coastal states out of the United States, that those states, inland states, should be looked at differently, and the incentives should probably be different. Because I would imagine in those states we have losses coming up from flooding from excessive rains that are being paid and probably not as much premium volume coming out of those states, and they should probably be looked at differently.

And a suggestion in closing was to use the categories currently in place for the Administrative Cup Award and the Quill Award.

So basically, in essence, we seem to be all on the same wave. Incentives should probably be changed. Certain additional compensation should be exercised with due diligence and dispatch. I think the cost of doing business in the last five years has escalated by far at a very rapid rate. And it's as expensive to administer a program, I think, in New England as it is in the state of Florida.

So with that, I'm looking forward to a good healthy discussion after the break. And we enjoyed the program. Thank you.

MR. CONNOR: Let's make it short today, a 15-minute break, and then we'll reconvene and start on the discussion of the long term.

(WHEREUPON, a brief recess was taken from 9:41 to 10:01 a.m.)

MR. LEIKIN: If we can get conversations winding down.

I think the groups that we had get together yesterday and the resulting discussions that we've had this morning really, I think, are surpassing our expectations for this meeting.

I think I've talked with a few people outside, and certainly the opportunities we've had at Write Your Own conferences or at the IBHS flood committee meetings haven't really given us this kind of opportunity to exchange our thoughts about what the problems are and come up with some concrete suggestions on how we could improve things. So I hope -- I'm very encouraged by this.

We wanted to try and wrap up the short-term concerns before we move into the long term. Although, of course, we realize that the discussions inevitably kind of go back and forth. To the extent we can, we wanted to finish and then be able to focus on some longer-term issues.

In listening to what was going on so far this morning, I think there are at least three major things that I gathered. First, that regardless of what influences there were in the early days of Write Your Own regarding companies joining the program, what were the incentives for the companies to join and what were the companies trying to get out of their participation in the program, we do have a different climate now with regard to how everyone is viewing costs, and there's a different consciousness about that. And because of a different time and with regard to other initiatives on the part of the industry with regard to other natural hazards and such, that we do need to look at flood differently than we were looking at it back in the early '80s.

We certainly have required and initiated an abundance of projects in the last couple of years. And our expectations for companies to respond, when you see it all put together, in red, it does make a good point. That we need to be aware of and improve the way we're -- when I say "we," I mean the FIA is looking at how much we're expecting of the companies at once.

And, of course, some of what we discussed this morning will lead into our discussion of long-term issues, and I think we have much better tools now, as I mentioned earlier, to be able to communicate with you earlier about what our concerns are, what our goals are for the next few years.

We do have somewhat of a question mark, of course, with the new administration coming in. But I think that the FIA executives who worked on the blueprint, I think we agree that there's a lot of solid material in that blueprint that really should keep us on track on those objectives and not be steered too far off base on what a new administration would want to do. I think we -- a lot of thought went into that, and it does represent the true long-term direction.

There are, I think, a couple of things that can be done in the short run to deal with the short-term issue. Without getting into exactly what the numbers will be this morning, because we do need to go back and look at this, NFIA, and then have some further discussions through the IBHS flood committee, but we will look at some way of justifying at least some short-term boost in the expense allowance that we can get into the rule-making process.

We don't have much time to spare, but we will work on how we can have discussions with the -- leading up to the March meeting of the IBHS flood committee. That may be -- correct me if I'm wrong.

We need to actually have a proposed rule out in the register by April?

MR. CONNOR: By April 1st.

MR. LEIKIN: So that meeting comes early March, so we still have some tail-end meaningful discussion. We need to work together leading up to that. We'll look for some reasonable justification, whether it's -- we certainly had a lot of ideas here on how we can come at it different ways, whether it's going part way back to net or if it's looking at actuarial premiums or looking at some real industry average of what the premiums are that the expense allowance is being calculated against. We'll work on some justification.

And I think we have some opportunity now to make a significant reduction in what your expenses have been recently with regard to PRPs. We've been -- I guess we don't have the report to be able to hand out. We just got it done a little bit before this meeting, but it seems that we can provide some relief on the PRP reunderwriting on renewals that we've gone through. We have gone through a cycle. We've cleaned up a lot of that business. And at the very least, we can work on something where the bureau is providing information to you-all on which policies don't qualify for based on the zone change as we do right now with the repetitive loss on the front end before the renewal. So we're not in a mode of checking it after the renewal and then working on some mid-term correction. So if we provide that information to you, and accept that whether it's -- however accurate it is, of course, there will be some appeal process still in there, but we'll accept that we're using the Q3 as opposed to requiring something more definitive than that. And we'll provide that to you, whether it's 90 days ahead of time or whatever before the renewal, and we'll use that as the information to make the call. I think -- I hope that that would make some meaningful reduction in what you're seeing here in your expenses that have risen in the last year or so. Those are two main things I think we can work on meaningfully in the short term.

Before we move off short-term solutions, are there any other --

AUDIENCE MEMBER: Regarding the retention component, every group mentioned the fact that the retention component, the goals are set way too high and it's really --

MR. LEIKIN: That's a good point. We'll take a look at the retention scheme. While we have by rule the idea of a marketing incentive, it is not part of the rule making as to what the exact schedule is for the incentives. So yes, we can work on that.

Ed, do we have a group lined up to start on the long term?

Unless there's something else someone wants to say on the short term.

MR. CONNOR: On your question about the retention, are you talking about for the adjustment made for the upcoming arrangement year?

AUDIENCE MEMBER: For the year we're in.

Unless you want to go retroactive to last year. If we don't see it as an attainable goal when the program is running in 82 to 85 and the incentive starts at 90, very few companies are going to be above 90. So what I'm asking is that we consider an adjustment to that scale, at least for the year we're currently in. I mean, it would be wonderful if you went back in time, but --

MR. LEIKIN: Larry, let's take that under advisement. Certainly we're talking about what do we need to do for the next arrangement year.

I guess I'm not -- we'd have to take a look at what we had envisioned -- was it two years ago when we came up with the latest scheme? And what was known at that time with what was going to be happening with retention.

AUDIENCE MEMBER: A question arose in our group, and I don't know whether you mentioned it in the first couple of minutes in the presentation while I was out. We had mentioned last summer in response to a question that came in or suggestion of making the arrangement a two-year arrangement, and we said we would do that. The question in our group is, Where is that? Is that going to be for the upcoming arrangement starting October 1st or sometime after that?

MR. LEIKIN: I guess at this point I don't think we want to open that discussion up right now. It would seem to me that if we have concerns of short-term and long-term expense allowance considerations, that this may not be the time to lock us into a two-year arrangement. Let's leave it one year and retain some flexibility. That would be my suggestion.

There are some advantages, of course, to making a longer term, but as long as we're in these discussions and trying to work on something that we're all more comfortable with, I would keep tilting it towards keeping it at one year.

MR. CONNOR: Let's start the short term on the long term. Why don't the spokespersons come forward.

MR. PALMER: The long term is building on the short-term goals that we had up before. But adding onto it, because we realized in the long term, a three- to five-year period may take time to implement these.

The first new point to add to the short term would be on the growth incentive. And we recognize that the larger companies certainly would have even a challenge if they couldn't get 18 percent. Obviously, 10 percent is a challenge too. If you have a 700,000 policy base book, it's difficult. And to be meaningful for the larger companies, then we'd have to figure out what the tiers would be to handicap it. Just make some type of adjustment for the growth incentive that makes sense for large, medium and small companies.

For example, and I'm just throwing these out for the sake of discussion. Maybe the larger tier companies could max their bonus out at 2 percent. And maybe we could quantify that by maybe going back for the last three or four years of the growth cycle and see how that would have impact on the category of companies a certain size and above and see if it was attainable.

And then you move into the middle category, suggest maybe maximizing the bonus out there at 5 percent. And still keep in mind, this is genuine new business and not counting rollovers. And then for the smaller companies and the start-up companies, the 10 percent, because they would be coming in with a zero base or smaller base, and it would be more realistic to meet those goals.

The third point -- again, the first point is building off the short-term fixes, and then recategorize or rehandicap the growth.

And number three, and Doris gets credit for this, is maybe a team bonus for all the Write Your Own companies where we would all benefit a percentage, if, as a collective group, we all genuinely increased the policy base. And we would have to make sure that we're talking about dec sheets or contracts or policies in force, have a clear understanding what that means. But clearly an understanding that makes sense for the bottom line. Yes, we've increased the policy base.

It's kind of like each Write Your Own company would be a member of the board of directors of the National Flood Insurance Program and that company would share in the bonus pool for the performance of the whole group. So we step out of the parochial concerns we have and move into these.

Now, how could that work? Wouldn't it be nice to know that if in fiscal year 2002, if as a group the policy base increased genuinely with new policies 5 percent. We know from the statistics that we have now that it's creeping around 1 or 2 percent, if I'm remembering that correctly, Denny. But so there would be an additional bonus on top of the incentives that could maybe amount to a quarter point or so. That would come back as a reward for helping the whole program along. That way we're kind of tugging in the same direction, and everybody might feel that pressure for the good of the cause. So that's point three.

Point four would be an agent training bonus for the companies that are real proactive on going out and training their agents. Helping them not only write the business correctly, but also the training would be increasing their perception of the market and to make them maybe a little more aggressive to represent the product. Talk about the E&O and stuff like that.

Point number five on our chart up there, which is the third one from the left, we have a category that talks about incorporate bureau resources. And that Number 5, there is a reference to the models for discussion. And I'm not too sure. Maybe we -- we might have used the wrong number there, group. Did we mean to put in model for discussion number four?

The point with that is, and this is some of Wally's concerns that he expressed very well in the meeting. He should be up here talking and not me. Is that if there are these additional -- what was the term -- initiatives or projects that are imposed upon us into the term of the arrangement, that the bureau would be the safety valve to do that work at their expense or provide the service to us, so it's not an expense item out of our already-limited operating budget.

For example, if something was in place today for that concept, that the bureau would -- and they are already doing this, already providing more support on the zone determinations and the PRP. That may be of some help. But if you read that model for discussion number four, it's a little vague, and it can be interpreted in different ways. But it says, No change with the bureau doing some of the underwriting, slash, service functions for them, the Write Your Owns. For example, zone determinations, prescreening, PRP, check the zones, et cetera. So there's an idea to take into consideration.

Now, I interpret that a little more broadly. Wouldn't that be great if some determinations could be done by the bureau? I can imagine tea thrown into the harbor by the zone determining companies that have financed their operation to see to that. So we don't mean to rock the boat there, but on the other hand, they may be the ones that that service could be provided by. And they would have a bigger clientele and basically some type of contract to do it. So it could be a win/win.

Group, did I make that point? I was a little confused on that myself, but is that the idea behind it?

AUDIENCE MEMBER: The largeness of the numbers in terms of efficiencies, that could be provided by the bureau compared to what the individual companies could do. So there can be a win/win situation for the companies and the bureau and also the whole program to help reduce expenses.

MR. PALMER: And it could actually turn

out to be more business for the zone determining companies to do a good job. You could parse up the country to areas that they have the strength in and utilize the services and they would have the arrangement with the NFIP to do so.

The sixth point, we touched on this, is, you know, what is driving the cost up and reviewing the overly excessive commissions paid by the Write Your Owns. It's hard to reconcile what we're talking about knowing that there are exorbitant commissions being paid simply to buy existing books of agents' business. And we would be remiss if we didn't put that up on the radar.

Now, remember, we're a small-ish group of companies in our particular group, and I noticed the ones that followed us pretty much had to be a cluster of the larger Write Your Owns. So as I was listening to them talk, it was a neat blend of these ideas though that kind of made some sense.

I guess I have to ask the question of, why can't the larger Write Your Owns start benefiting from the economy of scales that the small Write Your Owns can't? Some of us are pushing towards the break-evens on our costs. Fair question to consider anyway.

Last point, number seven on our chart. And let me ask this. Does anybody know if the aggregate and averages that we're utilizing includes consideration for the premium taxes?

AUDIENCE MEMBER: I don't know for certain that's the one that's been used. I know Best averages and aggregates had a discrete column.

MR. PALMER: It seems to me that I've always worked off the premise that the expense allowance had consideration in there for an average a percent paid for premium taxes.

And I think Bruce Bender made an excellent comment at one of the FISCAA or marketing committee meetings where some companies have a strategic advantage. Nothing wrong with this. This is just for the numbers of that company. If they are domiciled in a state where a lot of flood business is written or any of the southeastern states because they are domiciled with their property and casualty chart, in that state they are given a break on the premium tax they pay.

For example, it costs Redland more to go into that state and write a flood policy because the premium tax is a little higher to us. And where the company that's headquartered there has an advantage on me because they may only pay a fraction of the premium tax, and they could fairly use that for their marketing efforts. That's a polite way of saying increasing the commissions paid.

But the suggestion in our group was -- and we don't mean to penalize anybody, but suppose that was a pass-through. We just get reimbursed exactly what the premium taxes are that we pay. And that would, first of all, save money. It may be a way to, if you're going to try to explain this to Congress, here's an area we found we can reduce this a little bit and make it a pass-through. It's on the edge right here. I wouldn't be representing my group fairly if I didn't bring it up and discuss it. But it's food for thought.

Is there any other type pass-throughs we can see on that? That is an area out there that can be leveraged to your advantage depending on where and how you do business.

MR. LEIKIN: Larry, it's also an expense category that is not within your control really.

MR. PALMER: But then we've also had some discussions too where they are talking about not making it a requirement to pay premium taxes because hiding behind the shield of the federal program like federal crop does. And that is just -- that's something new on the radar that's come up from a couple different angles. Jo Ann may be looking at it as a way to justify some reduction of the fee.

And then the lawyers now are talking about that is a tag back to the preemption of this program that's hard to explain when we're saying, Look now, under the new arrangement and the new policy form, it clearly says if you're going to sue under National Flood Insurance Program policy, it has to be in the federal courts. But an attorney on the other side can argue saying you're still touching the state governments by paying state premium taxes. You can't do it both ways. You're either totally a federal program exempt from all that stuff even through the Write Your Own mechanism where you're going to still pay it. It's a political decision, I recognize, but again, food for thought.

Any questions?

Before I get off the stage, I want to remind everybody, after this meeting at 1 o'clock is the FISCAA meeting, that's Flood Insurance Servicing Company Association of America. You're all invited. We'd love to have you there. If you're a new Write Your Own company or existing one that's interested, we'd love to have you come there.

Mr. Bender made the arrangements. It's in the Sonoran Room which is out the front lobby to the left of the building. You walk there. It's on the left there. It starts 1 o'clock until 5. We have an interesting agenda. We'll have pass-out items. But it's another opportunity to see it from the property and casualty companies' perspective.

MR. MOSER: Well, as you can see from our summary for our long term, we broke it into interim and then future, which is within five years.

On the interim basis, we see basically the same as what we came up to with short term was using the direct with a baseline expense adjustment. Then having an adjustable contingency. It would have to be determined based on what we're asked to do. The profit, the reasonable profit figure, and then an incentive piece.

For long term, as I mentioned for the short term, if every company reported the flood expenses in line with Regulation 30, that should become an accurate number. And we would use that with a contingency for additional things that we're asked to do. The profit amount and an incentive.

One thing we haven't touched on is the

claims side. One of the member companies of our group, which doesn't happen to be here any longer, has accurate statistical data to support the fact that the 3.3 is a very outdated number, and it really doesn't work for catastrophe-type losses. So we really need an analysis done to determine what should that number be.

On a short-term basis, we'd want to increase the ULAE to more accurately reflect the claim handling expenses, especially for the catastrophes. Let's face it, 90 percent of our losses are catastrophes.

Group, did I miss anything?

Any questions?

AUDIENCE MEMBER: There is one thing, just to remind everyone, the interim was just not for the upcoming arrangement year, but for the year following that, until such time as the future could be established.

MS. KLEINE: Well, we basically thought that our short-term objectives could very well be our long-term objectives so that those that we did come up with in the short term could be refined and moved to long term. And what we did was we kind of went through each of the models that were on the sheet that was passed out and kind of threw out 2 and 3.

But 1 was one that we had come up with, and this was one where maybe the FIA would reimburse us a fixed dollar amount for every policy that's processed. But our thought process here was that the average premium for flood is lower than other lines. So on a percentage basis, maybe that doesn't make sense, but it really -- it is more looking at what does it cost to process a flood policy and then reimburse companies based on that, using some averages, and Kathy was the one in our group that brought that point up. And I think it's a valid point, and it may be something worth really looking into the details. So when you're looking at a percentage, you're not hurting the smaller companies when you're looking at it on a percentage basis but really the dollar amount per processed policy. So I think that's something that hadn't come up before.

We really didn't spend a whole heck of a lot of time on this because we spent more of our time on the short term. But we did talk a little bit about this baseline activity and thought there was maybe some merit in considering maybe the Write Your Owns having a baseline activity that they are required to perform. And then if they go up and beyond or they choose to do trading as opposed to not do training, that we would be compensated based on that dollar amount.

And these are ideas that were brought up, and they are not necessarily -- there was not necessarily agreement in our group that this is the way they'd like to go. But other items that were brought up may be there is measurable items, each company must do X in underwriting, they must do X in claims and must do X in training. And then the FIA then, you know, on a report card type scenario evaluates the extent that they did, and then the reimbursement somehow is tied to that.

And again, these are long term kind of things, but what it does is it does not put all the emphasis on the growth or the sales in the marketing but really how well a customer is taking care of their existing business and looking toward the long-term future of the flood program. And that kind of incorporates these baseline activities. And really considering paying additional amounts based on additional activities and the extent the company wants to do that. I think that's really about all I've got.

Does anyone else have anything?

AUDIENCE MEMBER: One interesting

concept that I thought came up in the group in the seven hours of discussion that we had, dealt with paying a -- maybe you said that and maybe I missed it -- a per policy bounty. That way you get away from the size of the company and their base was so big, therefore, they are actually, quote, getting penalized. That way you figure out that, okay, a 2-percent incentive on average of a $300 policy is 6 bucks. I'm just using some example numbers. Therefore, you get paid 6 bucks. So whether you're a new company or a company that's been around for the past 20 years or so, you still get 6 bucks a new policy. And that way you get away from the percentage problems. So I thought, well, seven hours, we got something outside the box.

AUDIENCE MEMBER: Rhonda, I wouldn't say your group was involved in thought too long on that issue yesterday. Jim Pitts' group finished and he went and ran four miles, got back, and you guys were still talking.

AUDIENCE MEMBER: Did you want to mention Medicare?

MS. KLEINE: From an overall perspective, and this is my own personal opinion and maybe not so much of the group's, but I think that there's 100 ways to skin a cat. And I think that it's beneficial for the FIA to really look at all the various alternatives, and Medicare reimbursement being one of them because it is a program that's working. I'm not sure how well. And then figure out how well does it fit into the existing program we've got.

The other thing I think is important is we keep the program simple so that we really do understand what we're going to get paid and so we can manage our business based on what we believe we're going to get paid. But I think -- I definitely think it's worth looking into. Whether it pans out, I don't know.

MR. TROITTIER: By using the future direct model, the flood line only, times and of course adding an additional -- some additional compensation, probably 2 percent for the first bullet that's in the short term, which is the compensation for things like lost opportunities, especially for those with, say, large advertising budgets in the larger companies.

The incentives, basically have the incentives for all writers to increase their books similar to the current method but add additional incentives for the target areas, such as increased writings in the Midwest, the B, C and X zones. And this would address FIA's goals of increasing spread of risk and the audits with no material findings. And we weren't sure what the material findings were from the company that the FIA would like to improve.

We think that the short-term development by year end will certainly lead into the long-term aspects of the thinking so that we kind of kept it in a narrow margin. And as the year progresses, to develop the ideas from the short term. I think they will just flow into the long term.

MR. CONNOR: Could I ask a question on the audits? What kind of audits are you talking about? The financial audits, operation reviews or all?

AUDIENCE MEMBER: Whatever you all want. Whatever the FIA wants to do, where they want to focus. In other words, you put your incentives where you want them. You want us to do those particular things. That's where you put the incentives.

MR. CONNOR: So in other words, let's take PRP ineligibles. If we came out and did an operational review and we focused on how the companies were handling ineligible PRPs and identify these, and to the extent that they were done well by a company, because it is a program initiative there should be some consideration for incentive there.

Thank you.

AUDIENCE MEMBER: But then on the other hand, if we had the contingency fund, the companies would have the money to make sure it's done correctly to begin with, as opposed to how are we going to pay for this.

AUDIENCE MEMBER: Incentives should always be above the base.

AUDIENCE MEMBER: We don't want to turn you into big brother either.

MR. CONNOR: I know. So that if we paid you additional moneys to do that and I did an operational review and it wasn't done, what do we do? Do we take the money back?

AUDIENCE MEMBER: Then you don't pay the incentive.

MR. CONNOR: There's a reverse to that too.

AUDIENCE MEMBER: You haven't paid the incentive because you haven't done the review.

AUDIENCE MEMBER: You haven't received anything yet. But I have some issues with that whole concept because anybody that's had any experience in the auditing world, you know there's never an audit without something being found or else they are not doing their job. That's just the nature of that type of occupation. So I would be shocked if you will ever see an audit where everything is perfect.

AUDIENCE MEMBER: The thing deals with material findings. I think materiality is the issue.

AUDIENCE MEMBER: Isn't that subjective?

AUDIENCE MEMBER: No, not in terms of an audit.

AUDIENCE MEMBER: What is considered material?

AUDIENCE MEMBER: So the auditor makes the determination.

AUDIENCE MEMBER: So it's subjective to the auditor.

MR. CONNOR: It may be subjective with the auditor, but it's consistent wherever you go. In other words, the auditor will determine what's material or what isn't, but that's going to be applied straight across the board.

AUDIENCE MEMBER: But couldn't you -- why would you incent a company for doing something they are supposed to be doing? They are supposed to be doing it in the first place. The incentive is you get to stay in the program.

MR. CONNOR: Yes, sir.

AUDIENCE MEMBER: We weren't meaning you, Larry.

MR. CONNOR: I didn't mean to open up discussion on this. I'm just curious. We'll have further discussions on this anyway, but you kind of touched one of my areas.

AUDIENCE MEMBER: Just a comment on the geographic spread in our group. One of the discussions we hit upon, the problem you run into is those companies, that if you decide you want to grow in the Midwest and you're set only in Florida, you don't get to participate in that part of the incentive.

So I guess I'd be wary. I'm nationwide, so it really wouldn't affect me. The companies that are based in Puerto Rico, they have no way to grow in Iowa. But if you pick the PRPs as an area to grow, then that, I think, opens up the door for anybody and everybody. And one point it might be you want new policy growth. And if it's a PRP, it will be counted double or 50-percent extra. And therefore, it would be much easier to quantify, measure.

MR. CONNOR: Another example of that would be small business owners' attendant policies for whatever we may want to try to grow.

AUDIENCE MEMBER: One of the things we also brought up is if you do it, make sure it's for an extended period of time, not just, okay, this year's flavor is PRP, and next year we're going to do business owners. Because now you've geared up a campaign for PRPs and all of the sudden it stops and we have to -- so make an administration period or at least, like, three years so you start getting to reap the rewards.

MR. LEIKIN: Three years, no more policies in Florida, everywhere else.

Do we have enough folks back?

Well, again, with the discussions of the long-term issues and potential solutions, I think we've gotten a lot of good ideas. As opposed to some of what we discussed already for the short term where we need to quickly come up with something specific, the longer-term solutions really, what is our process going to be to explore them so we can make the adjustments that will be appropriate for future arrangements. And that's why I wanted to get together quickly with Corise and the FIA folks to talk about how we'll accomplish it.

We've come up with at least a beginning

schedule and a few assignments that would help get us started. First, we'll use the IBHS flood committee structure to help us puzzle this out. And along with a task force that Ed -- the task force has already been involved in looking at retention and such and it included members beyond just IBHS members. So the task force will work on this issue. We're aiming to have that task force meet in the March time frame along with the IBHS flood committee meeting as the first meeting to look at the long-term expense allowance considerations.

In getting ready for that meeting, of course, we're going to have this transcript of the proceedings of the last couple of days. We'd also like to ask each of the spokespersons for the groups, if they would write up specifically a report on what came out of their group so we can make the most sense of this that we can. And we'll make that available for the IBHS committee and also the task force. I guess if we have a time frame on that, we need it by the March meeting.

MS. MORRISON: March 6th is the meeting.

MR. LEIKIN: It really needs to be ready so that it can go out with the package of materials.

MR. CONNOR: I would like to get it by

mid February. Maybe February 14th. Do we have all spokespersons in here?

Is that a reasonable time? That would be a big help for us.

MR. LEIKIN: Send it to Ed Connor, yes.

One of the issues that I think we need to do a fair amount more exploration into is to really justify where we're going to head with this and to look at what are the activities of the companies that it's reasonable to expect that would already be included in whatever baseline expense provision we have.

We know that a certain amount of reunderwriting gets done, certain amount of systems changes get done, and those are embodied in the statistics we're looking at for expenses. So what are the reasonable -- what's the reasonable level of activity that can be expected in that baseline versus where we get into the unique flood expenses or timing of projects that are beyond the control of normal company control to meter out how you're using the resources.

To help us do that, of course, that's part of what the task force should be looking into, but we're also contemplating bringing in a Deloitte &

Touche type outfit to help us look at what those reasonable levels of activity should be. And that would work -- that contractor would work in tandem with the task force.

I think that -- am I missing something in the near-term schedule?

Any comments on the proposed course of action for dealing with the long term? Anything anybody wants to add?

AUDIENCE MEMBER: And then are you expecting out of that March 6th meeting to then have that task force come back to you with a final recommendation?

MR. LEIKIN: Yes. It's going to take probably some conference calls, and it will be more than one meeting. We're not expecting a one-day look at this because, as I said, I think there's something that needs to be prepared to help the task force review what should be done and make a recommendation. We'll know better about, I imagine, the schedule for that task force at the March meeting of what's a reasonable expectation for the recommendation to be coming out.

I would like to -- I'm going to walk a fine line here. I want to say that as far as short-term issues, we're definitely going to take a look at how we can justify some boost to recognize the pain that you're suffering. And we are also, as I said, particularly in the area of PRP, I think we have something right now to help in reducing your current level of expenses.

I don't want to raise -- because we're talking about a short term, and it's very short term, because we need to go to proposed rule-making by April 1st to be able to meet the dates. We're also in a period here where we have a change in administration, and rule making is not necessarily something that will flow as quickly as when you have an administration already in and comfortable with what might be going on. So we're going to -- we will do our best to do something.

I think it's reasonable to say that it's unlikely we're talking about three or four percentage points because I don't think that's something that would get through quickly in the time frame we're talking about. But we will take a look at what we can justify within those parameters, realizing that we have a new administration. And aside from the fact that we still need to deal with OMB and looking at what it really means in terms of levels and expenditures.

Any further thoughts? We do have some --

MS. MORRISON: On the short term, we had said that between now and March we'd like to -- IBHS would like to fine tune what that is exactly going to be. So I think you all were going to go back with the short-term proposals here today and come up with what you think is a realistic improvement from where we are today and send that to the IBHS committee. And then we'll have one of those teleconference calls between now and March, IBHS will with FIA, looking at that proposal for the short term.

So in the next, I don't know if it would be month or so, we would expect -- I would expect something probably from you all around the short term and then expect a --

MR. LEIKIN: We'll regroup next week. So the IBHS committee will get an opportunity to look at the short-term solution before our March meeting. Because our hope is, when we meet in March, we won't have to talk about short term. That will have been decided by then. We can focus the efforts and the task force efforts on the long term.

MR. CONNOR: Which is why it's important

that February 14th date I gave you in terms of when I need those reports. To the extent I can get it sooner -- that would be my drop-dead date, but if I could get it sooner, that gives me more time to put it all together. And we can work on it and get it out to -- on the short-term stuff particularly, get it out to the committee for review.

AUDIENCE MEMBER: Again, if in addition to information you're going to provide goes directly to this issue of activities and expenses, if somehow IBHS can also add to it information regarding uncompensated value, this enormous value that the companies bring to the program, and to address that.

We recognize it, but if you get that where others recognize it more completely, I think it helps the whole process of reviewing efforts. I think that's something that really should be made known as widely as possible.

MS. MORRISON: So in addition to the expense and establishing the baseline on expenses, it would be what value do we add in the Write Your Own program.

MR. LEIKIN: It's really maybe, once again, an attempt at expressing the Write Your Own advantage. Which, at one point, we had a very good paper that explained, at that time, the view of the Write Your Own advantage. And I think a few years later there was an attempt to get a re-expression of that, which didn't pan out as well as maybe we would have liked.

But I think it is important that we can and that you help us in crafting what are all the -- I think that's a good way of putting together the value-added aspects.

Well, once again, I think this exchange has been one of the best discussions that I think I've participated in with the Write Your Own program. And I'm very pleased that we were able to get so much out on the table. Helping us do that, of course, I want to particularly thank Frank Reilly for joining us and --

MR. REILLY: Thanks for inviting me.

MR. LEIKIN: I know Frank continues to have a real interest in how well we're doing and what we're doing, and his guidance continues to be something that is of real benefit to us.

And I want to thank you all for the energy that you put into it. And I think we had a good friendly partnership exchange here, which I really appreciate.

MS. MORRISON: And I want to also, I guess at least on behalf of IBHS companies, if not all the companies, extend our appreciation for having the opportunity for the last few days to go through this. It's probably at least -- we weren't sure what to expect. I think overall, at the end of the day now, we realize that this really was a good session.

We especially want to extend appreciation to Ed Connor because I know he was going out on a limb putting this together not really knowing what to expect and if he would be able to survive the meeting at the end. He's come to a few of our IBHS meetings and come out of it a little bit bruised, I think, after some of our discussions. But he continues to hang in there with us, and we appreciate that as well.

MR. LEIKIN: I also want to express the FIA's appreciation for what Ed did in putting the meeting together and in bearing the brunt of -- and Ed Pasterick and all the other division directors and Jo and Don and the CSC folks. There was a lot of effort put into this to make sure this meeting went well and was productive.

I think I'm going to hold off on that stuff. We'll get that material out to folks in another venue rather than getting us launched into some further detailed discussion at this point.

Any last comments for the good of the cause before we go, I don't know, explain to FISCAA or something?

MR. PALMER: Not explain, just sit down and have a nice meeting.

AUDIENCE MEMBER: Will the transcripts be supplied out to everybody or be on the website or --

MR. LEIKIN: What we planned on -- the transcripts for the, say, the E-commerce meeting and others, do we just put it on the web site?

AUDIENCE MEMBER: It would save on postage and printing.

MR. CONNOR: The thought that I had, and I think we did this with the other meeting, we can send it electronically because it's going to be hard copy and electronic. I can e-mail it to everybody.

AUDIENCE MEMBER: I think this is too sensitive to put it on the website to the general public.

MR. CONNOR: I prefer to e-mail it out.

AUDIENCE MEMBER: We also have some private website we could post it on, and I'll e-mail you the link to it.

MR. LEIKIN: The transcripts, if you've waded through transcripts, that's a tough way to discern. That's why I'm anxious to get these reports. That could be an addendum to where the spokespersons from the groups have made sense of the final.

MS. MORRISON: I would recommend that the spokespeople take these back with them to use.

MR. LEIKIN: We'll work on an appropriate time where we can get it all out to you. Maybe -- mid February is not that far away anyway.

MR. LEIKIN: Thank you all.

(WHEREUPON, the proceedings concluded at 11:26 a.m.)

C E R T I F I C A T E

STATE OF ARIZONA)
) ss.
COUNTY OF MARICOPA)

I, MICHAELA HERMAN DAVIS, a Certified Court Reporter, hereby certify that the foregoing pages, numbered 1 through 88, constitute a full, true and accurate transcription of all the proceedings had in the above matter, all done to the best of my skill and ability.

DATED at Phoenix, Arizona, this 8th day of February, 2001.

____
Michaela Herman Davis, RPR-CRR
Certified Court Reporter
Certificate #50574