



PAYING MORE FOR LESS

A BRIEF HISTORY OF HOMEOWNERS INSURANCE RATES IN TEXAS (2001-2006)

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www.TexasWatch.org

EXECUTIVE SUMMARY

Despite the political rhetoric from lawmakers, regulators, and industry lobbyists, Texas homeowners have been suffering for years from a continuing crisis in our insurance market: Rates remain too high, insurance providers continue to use unfair underwriting practices, and Texans are left with insurance policies that do not provide the protection and security they need.

Politicians have promised meaningful action for the past two legislative sessions, but the so-called reforms passed by our elected leaders have only benefited one party: the insurance industry. Lax oversight, ineffective enforcement, historically low losses, and a lack of legislative will have all combined to produce a perfect storm, and hardworking Texas families are caught in the middle.

In this report, we give a brief history of homeowners insurance rates in Texas and how recent changes in the law have failed to meaningfully improve the market for Texas policyholders. Additionally, we will provide an outline for restoring some balance so that hardworking Texas families are paying a fair price for a product that will protect them during their time of need.

While many promises have been made to Texas homeowners over the last several years, they have amounted to little more than empty rhetoric and have not translated into real action or meaningful savings. Instead, the powerful insurance industry and its well-connected, influential lobby have successfully pushed favorable measures that have not benefited policyholders.

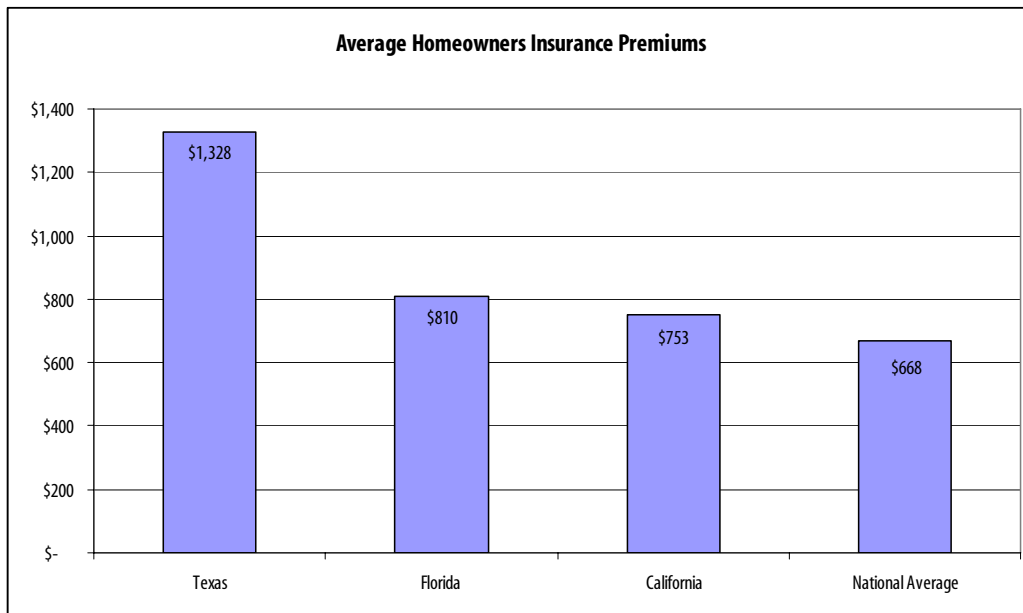
Today, as premiums remain inflated and coverage options continue to be whittled away, Texas homeowners are getting less and less for their insurance premium dollar. In short, we are paying more for less and Texas families deserve better.

While we believe that a new regulatory framework would benefit consumers best, modest reforms that work within the existing “file and use” system would greatly improve the market for Texas policyholders. At the end of this report we enumerate a series of policy recommendations that we hope lawmakers will enact in the next legislative session. If taken together, these reforms will begin to bring much needed accountability to the marketplace by giving homeowners a fairer and more balanced insurance market.

RECORD INSURANCE OVERCHARGES

Texans pay the highest insurance premiums in the nation.¹ According to the most recent national study by the National Association of Insurance Commissioners (NAIC) of our country's insurance market, Texans pay an average premium for their homeowners insurance that is \$1328 per year, an astonishing figure that is roughly twice the national average.²

It is remarkable to view the premiums for other large states experiencing significant weather-related losses against the premiums we pay in Texas. For example, homeowners in Florida pay an average annual premium of \$810 for their homeowners insurance, while Californians pay just \$753.³



While homeowners insurance premiums in Texas have skyrocketed and never returned to Earth, losses experienced by insurance companies have reached historical lows, resulting in massive overcharges and price gouging for policyholders. Since passage of Senate Bill 14 in 2003, a clear trend has developed. Homeowners continue to pay inflated premiums while insurance losses have dropped dramatically:

- In 2003, the top homeowners insurance companies in our state reported a loss ratio⁴ of 58%, according to TDI.⁵ TDI also noted that this 58% figure is “within a percentage point

¹ National Association of Insurance Commissioners, *2003 Homeowners Insurance Report*, January 5, 2006; see http://www.naic.org/documents/research_2003_homeowners_prem_by_state.pdf.

² *Id.*

³ *Id.*; see also

<http://www.consumerwatchdog.org/insurance/fs/?postId=5389&pageTitle=Remarks+of+Harvey+Rosenfield+On+Insurance+Reform+in+California>.

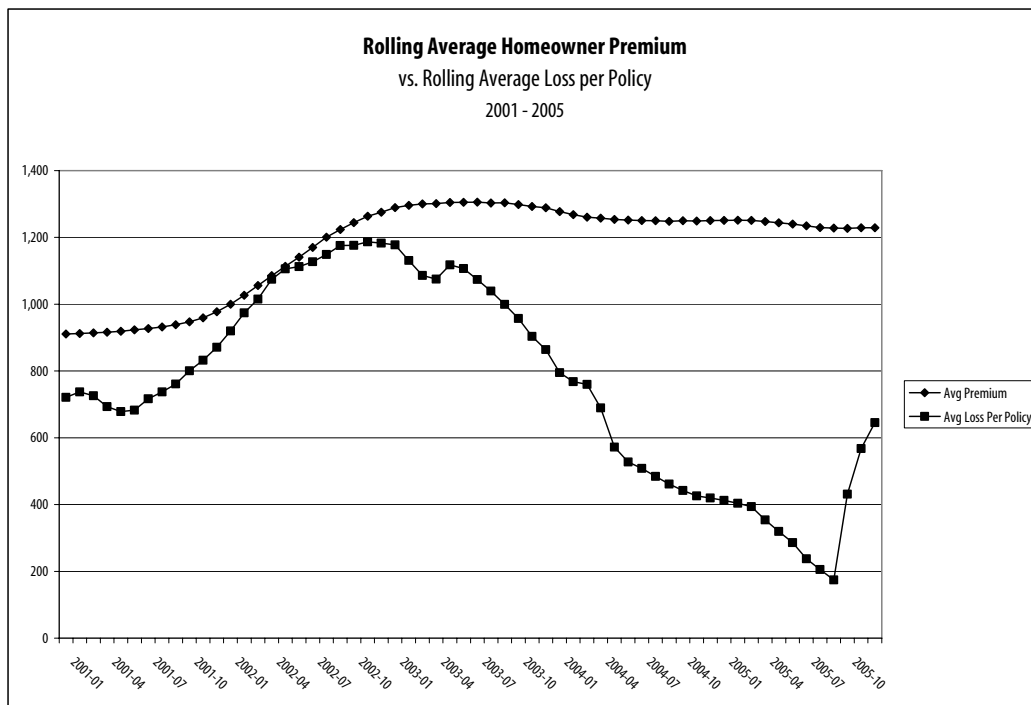
⁴ *Merriam-Webster* defines an insurance loss ratio as “the ratio between insurance losses incurred and premiums earned during a given period.” See <http://www.m-w.com/dictionary/loss%20ratio>.

⁵ Texas Department of Insurance, *New Data Shows Improvement in Homeowners Insurance Market*, NEWS RELEASE, March 15, 2004; see <https://wwwapps.tdi.state.tx.us/inter/asproot/commish/news/clips2004.asp?id=1347>.

of the figure the Texas Department of Insurance has used in setting the benchmark rates in the past,”⁶ meaning that these carriers had what was effectively an ideal year.

- In 2004, insurance carriers enjoyed what TDI described as “[r]ecord low loss ratios”⁷ with an average loss ratio of just 27.6%.⁸ This means that for every dollar of premium collected from Texas homeowners, insurance companies only had to pay out approximately 28 cents in losses, an incredibly miniscule amount.
- In 2005, Texas took a direct hit from Hurricane Rita. Despite having a catastrophic Category 3 hurricane devastate part the Texas coast, homeowners insurance companies posted just a 56.9% loss ratio, which is their second most profitable year of the decade.⁹

Data compiled by the Office of Public Insurance Counsel (OPIC) graphically illustrates the troubling phenomenon of excessive premiums during a time of falling losses (*see chart below*). **According to OPIC’s most recent data, premiums dropped by a paltry 4.8% between January 2003 and September 2005.¹⁰ Meanwhile industry losses have fallen by a whopping 85.2% over the same time period.¹¹**



⁶ *Id.*

⁷ Texas Department of Insurance, *TDI Orders Homeowners Insurers to File Rates with Department*, NEWS RELEASE, March 16, 2005; *see* <https://wwwapps.tdi.state.tx.us/inter/asproot/commish/news/clips2005.asp?id=19>.

⁸ *Id.*

⁹ Terry Stutz, *'05 Good for Texas Insurers*, DALLAS MORNING NEWS, March 22, 2006.

¹⁰ Office of Public Insurance Counsel, *Rolling Average Homeowner Premium vs. Rolling Average Loss per Policy, 2001-2005*.

¹¹ *Id.*

In real dollars, premiums have essentially remained flat, only moving slightly from \$1,290 per policyholder in January 2003 to \$1,228 in September 2005. During that same period, losses plummeted from an average of \$1,177 to just \$174.¹²

OPIC's data shows an increase in losses after Hurricane Rita, which is to be expected. However, note that this increase still results in a low loss ratio for insurers. We expect the overall trend to continue with premiums remaining high and losses falling until our lawmakers and regulators force the insurance companies to change their ways.

An analysis of state insurance data showed that Texas insurers overcharged homeowners and drivers by nearly \$4 billion in 2004 alone.¹³ Comparing annual statement data provided by insurance carriers to the benchmark figures used by TDI in the past to set rates, Texas Watch and the Center for Economic Justice (CEJ) found that Texans in 2004 overpaid for their homeowners insurance to the tune of \$2.1 billion, which amounts to an overcharge of 90% and translates into an average overpayment of \$600 per home insured.¹⁴ Additionally, Texas drivers paid 1.8 billion in overcharges, equating to \$200 per driver.¹⁵

LAX OVERSIGHT & DWINDLING COVERAGE

The ongoing overcharges have occurred as TDI has been soft with most of the major insurance carriers, including the top three companies, State Farm, Allstate, and Farmers, which together make up 55% of the current market.

- State Farm has refused to reduce their rates after a years-long court dispute. Meanwhile, the company's policyholders have been forced to endure overcharges that grow by \$1.29 million every month.¹⁶ State Farm's recent attempt to increase its premiums in Texas prompted the *Dallas Morning News* editorial board to describe the company's behavior as "bewildering" and "not in the spirit of market competition."¹⁷
- Allstate struck an agreement with TDI that has allowed the company to continue charging excessive premiums by ordering a one-time refund rather than an overall rate reduction.¹⁸
- Farmers negotiated a deal with TDI that has allowed the company to pocket \$101 million in overcharges and interest.¹⁹

¹² *Id.*

¹³ Center for Economic Justice and Texas Watch, *Insurers Price Gouge Texas Policyholders by \$4 Billion in 2004*, March 31, 2005; see <http://www.texaswatch.org/documents/CEJ-TW%20Overcharge%20Report%202005-31-05%20Final.pdf>.

¹⁴ *Id.* at page 1.

¹⁵ *Id.*

¹⁶ Calculated by dividing 10 percent (the interest penalty sought by TDI) by 12 months, giving a monthly interest rate of 0.8333%. Multiply this interest rate by \$155 million (the amount by which State Farm was ordered to reduce its rates in August 2003), and you get \$1.2916 million per month.

¹⁷ *Not in the Insurance Spirit*, DALLAS MORNING NEWS, June 5, 2006.

¹⁸ *Homeowners Insured by Allstate to Get Policy Refunds*, THE ASSOCIATED PRESS, August 17, 2004; Purva Patel, *Firm Lowers Cost to Insure Homes*, HOUSTON CHRONICLE, August 17, 2004, also see Texas Watch materials on this settlement: <http://www.texaswatch.org/media/allstatesettlement.htm>.

¹⁹ For more information on TDI's deal with Farmers, please see Texas Watch's memorandum to the Legislature of December 8, 2004: <http://www.texaswatch.org/media/farmerssettlement.htm>.

Couple the excessive prices that Texas homeowners have been paying and the industry's sweetheart deals with declining levels of coverage provided in their policies and the picture becomes even starker. While homeowners insurance premiums for Texans remain the highest in the nation, policies have been whittled away through new exclusions, providing nearly 45% less coverage than before as companies moved away from comprehensive coverage to "national" policy forms, which typically cover fewer perils.²⁰

In addition, many policyholders are shouldering more of the burden as they are forced to assume higher and higher deductibles.²¹ In fact, the insurance industry itself has been directing its policyholders to assume more and more risk by doubling deductibles on auto policies, which would cost an average driver hundreds of dollars if they are forced to use their policy.²²

UNFAIR INSURANCE PRACTICES: CREDIT SCORING AND REDLINING

Given that our lending practices require every homeowner to purchase insurance, homeowners rightfully expect the state to ensure a fair insurance market. Even in the face of clear evidence that insurance credit scoring and the overuse of rating territories are inherently unfair, lawmakers and regulators have not acted to effectively curb their use by insurers.

In January 2005, TDI published an extensive study of insurance credit scoring that brought a number of striking findings to light.²³ The study showed that middle class Texans and minorities are disproportionately harmed by the practice.²⁴

Couple this new data with existing studies that show that 79% of all credit reports contain errors²⁵ and that insurers use credit scores inconsistently,²⁶ and it begs the question: Why use an inherently flawed measurement that is arguably discriminatory?

The TDI report also showed us that rates may vary by as much as 400% as a result of your credit score.²⁷ Texans understand that it just does not make sense for companies to value this factor so highly.²⁸

²⁰ Texas Department of Insurance, *SB 310: Summary Report for the 78th Legislature, Final Report*, March 28, 2003, at pages 7 and 21; see <http://www.tdi.state.tx.us/reports/pdf/sb310rpt.pdf>.

²¹ See, e.g., Texas Department of Insurance, *Homeowners Insurance Price Comparisons: How to Find the Best Rate*, February 2005, <http://www.tdi.state.tx.us/consumer/rghome.html>; Insurance Information Institute, *Twelve Ways to Lower Your Homeowners Insurance Costs: Raise Your Deductible*, http://www.pueblo.gsa.gov/cic_text/housing/12ways/12ways.htm; and Insure.com, *Home Insurance Basics: Higher Deductibles, Lower Premiums*, <http://info.insure.com/home/basics.html>.

²² See <http://www.texaswatch.org/media/release022706.htm> and <http://www.texaswatch.org/documents/TCAIS%20Email.pdf>.

²³ Texas Department of Insurance, *Use of Credit Information by Insurers*, December 30, 2004, see <http://www.tdi.state.tx.us/reports/pdf/creditrpt04.pdf>; Texas Department of Insurance, *Use of Credit Information by Insurers: The Multivariate Analysis*, January 31, 2005, see <http://www.tdi.state.tx.us/reports/pdf/credit05sup.pdf>.

²⁴ Texas Department of Insurance, *Use of Credit Information by Insurers*, December 30, 2004, pp. 3-4, see <http://www.tdi.state.tx.us/reports/pdf/creditrpt04.pdf>.

²⁵ U.S. PIRG, *Mistakes Do Happen: A Look at Errors in Consumer Credit Reports*, June 2004; see <http://uspirg.org/uspirg.asp?id2=13649&id3=USPIRG&>.

²⁶ Texas Department of Insurance, *Use of Credit Information by Insurers*, December 30, 2004, p. 7; see <http://www.tdi.state.tx.us/reports/pdf/creditrpt04.pdf>.

Prior to 2003, a rating territory for both homeowners and auto insurance could for the most part be no smaller than a county, ensuring that companies could not single out “undesirable” areas and charge them sky high rates. The Legislature repealed longstanding protections for policyholders and opened this area up in SB 14 (78R),²⁹ allowing the Insurance Commissioner to enact a rule that lets insurers vary their rates widely within a single county.³⁰

Evidence was presented to the House Insurance Committee in 2005 that demonstrated how insurers were carving up counties and charging different rates according to one’s ZIP Code.³¹ Some insurers were charging some residents of Harris County *more than twice* the amount others were paying. How does it serve public policy to charge one person twice as much because they live one ZIP Code, one block, or even one street away from another part of town?

Perhaps not surprisingly, inner-city, lower income, and minority neighborhoods are bearing the brunt of the highest rate increases with the new rating territories. Faced with this knowledge, HB 792 (by Coleman) was never brought to a vote in the House Insurance Committee. A similar bill, SB 677 (by West), suffered the same fate in the state Senate.³²

Texas policyholders are getting hit with both ends of the stick. Stated plainly, Texans are paying much more for far less.³³

POLICY RECOMMENDATIONS FOR THE FUTURE

The insurance crisis began in 2001 and yet much work remains to be done in order to bring balance to our state’s insurance marketplace. Insurance was an emergency issue leading up to the 78th Session and it continues to be an emergency for millions of Texans as we approach the 80th Session.

While state leaders and members of the Legislature may hope that this issue fades quietly into the background, the renewal notices that carriers send to their policyholders -- and the exorbitant premiums they demand -- ensure that this issue will remain a hot button and will only get worse until our lawmakers and regulators finally act to make it better. Below, we include several policy reforms that would bring substantial improvements to our homeowners insurance market:

- 1. Rate Reductions:** Massive overcharges in our homeowners market continue to plague policyholders to this day. The legislature should mandate a comprehensive marketwide

²⁷ Texas Department of Insurance, *Use of Credit Information by Insurers*, December 30, 2004, pp. 4-5, *see* <http://www.tdi.state.tx.us/reports/pdf/creditp04.pdf>.

²⁸ *Homeowners’ Insurance*, Scripps Howard Texas Poll (Spring 2003), May 16, 2003 at question 4.

²⁹ Article 5.171, TEXAS INSURANCE CODE.

³⁰ 28 TAC §5.9960; *see* <http://www.tdi.state.tx.us/rules/1110d-059.html>

³¹ House Insurance Committee hearing, February 21, 2005; *see* <http://www.house.state.tx.us/fx/av/committee79/50221p22.ram> at 22:25.

³² SB 677, 79(R) (by West); *see* <http://www.capitol.state.tx.us/cgi-bin/db2www/tlo/billhist/billhist.d2w/report?LEG=79&SESS=R&CHAMBER=S&BILLTYPE=B&BILLSUFFIX=00677>.

³³ For a more detailed look at this disturbing development, please see the following Texas Watch consumer handbook: <http://www.texaswatch.org/documents/Texas%20Homeowners%20Policy%20Coverage.pdf>.

review of our rates by TDI. Lawmakers should require that any identified overcharges be promptly returned to policyholders, and companies who refuse to comply should be subject to the penalties outlined in SB 14, 79(R).

2. **One-Stop Shop:** An information vacuum has occurred since the Legislature and TDI allowed carriers to offer different homeowners insurance policies. Insurance policies are complicated documents. Policyholders today are being asked to compare apples-to-oranges. Because coverage levels vary so greatly between the different policies, policyholders can not shop on price alone. TDI should develop a “one-stop shop” where policyholders can easily make side-by-side comparisons of different policies, as well as companies’ complaint data, enforcement actions, penalties, financial ratings, and other relevant information. Information already published by TDI and OPIC should be gathered into one convenient place and publicized widely in order to help consumers shop the market.
3. **Guarantee Living Expenses for Victims of Catastrophes:** When disaster strikes, insurance companies must be made to pay the temporary living expenses of displaced policyholders. Mandatory policy endorsements should be in place for all carriers writing homeowners insurance in our state, so that victims can count on assistance from their carrier during trying times, regardless of whether they have suffered direct damage to their property, been ordered from the area by civil authorities, are prevented from returning to their area because of continuing threats, such as downed power lines or impassable roads, or are without utilities or other essential services as a result of a catastrophe.
4. **Regular Reporting:** The Legislature should direct TDI to regularly report the most current data regarding homeowners and private passenger automobile rates. Although TDI produces some reports currently, they typically lag years behind. The Legislature should have the timeliest information available in order to make intelligent policy decisions. It should be packaged in a manner that allows lawmakers – and their constituents – to quickly and easily see how much rates have gone up (or down) over the last 6, 12, 24, and 36 months.
5. **End Insurance Credit Scoring:** Insurance credit scoring is flawed and potentially discriminatory. The time to end it has come. This is a position favored by a majority of Texas homeowners. If the Legislature can not find the will to end this practice, it must at a minimum fix the loopholes in its current statutory regime concerning the treatment of those who have “thin” credit files (i.e., those without much credit history), as well as the time period during which those who have suffered extraordinary events can qualify for exceptions to a carrier’s insurance credit scoring practices.
6. **Rating Territories and Redlining:** Insurance carriers are carving up our state and rating different areas (also known as “territories”) by ZIP Code. It is bad public policy to allow insurance companies to charge houses on one block twice as much as they charge houses a block over. Insurance companies should not be able to vary homeowners or private auto rates by more than 15% within a county, except for legitimate weather-related reasons (such as charging residents directly along the coastline more than those living 20 miles inland).

Taken together, these modest reforms will represent a real improvement for policyholders. Without a dedication to meaningful insurance reforms that provide homeowners with the significant rate relief they need and the protections they deserve, we will continue to suffer under a system that favors powerful insurance companies over Texas citizens.

It has been nearly five years since homeowners began seeing their insurance premiums skyrocket. In the meantime, insurers have posted record profits, enjoyed lax oversight, and turned their backs on policyholders in their time of need. Homeowners, meanwhile, have been forced to endure an out-of-balance insurance market that does not serve their interests. It is time for the Legislature to finish the job of insurance reform by lowering rates and protecting policyholders.