

# Deregulation, Pricing, And Availability Issues In The Texas Homeowners' Insurance Market

A New Study By Patrick Brockett, Ph.D.

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## EXECUTIVE SUMMARY

Forces of hurricane intensity have been buffeting the homeowners' insurance market in Texas. The average premium for homeowners' insurance in Texas increased 112.8 percent from 1997 to the third quarter of 2002. This was the largest increase in the nation. Texas led the nation in the number of mold-related lawsuits in 2001, accounting for 70 percent of all mold claims filed nationally. The top five insurance companies in Texas saw mold claims rise over 500 percent in 2002, and, in spite of rate increases, insurers experienced loss ratios above 100 percent.

Consumers encountered higher prices, lowered coverages, and sometimes an inability to obtain insurance. Increasingly, there was pressure on legislators and insurance regulators to find a "fix."

"Fixing" price affordability and availability problems through legislative or regulatory actions, however, is fraught with difficulties. Insurance economics research shows that attempts to suppress insurance rates by regulatory intervention are counterproductive. Regulation generally drives prices up, rather than down, and exacerbates availability problems. Because they do not address the underlying causes of price increases, regulatory attempts to restrain the competitive market do not solve the problem.

Insurance economics scholars argue that if insurers were free to set rates, create forms, underwrite, and provide differentiated products, competitive market forces would tend to increase competition, increase availability,

allow more choices for consumers, and counter spiraling price increases. This result is illustrated by South Carolina, which, in the two years following its relaxation of insurance market regulatory constraints, saw the number of companies selling automobile insurance double and rates go down.

Senate Bill 14 (SB 14), passed by the 78th Texas Legislature, was a rational economic attempt to address these issues by creating a more competition-driven environment. This bill moves Texas from a "flexible-band" to a "file and use" regulatory environment, ostensibly more toward deregulation. However, SB 14 had other provisions that may sow the seeds for later problems, such as a "subsequent disapproval" provision by which the commissioner may disapprove rates implemented and force rebates. This "subsequent disapproval" provision could squelch the intended benefits of SB 14. If "subsequent disapproval" is invoked with great frequency or with too long a lag after implemented rates have been used, it would essentially make Texas a more regulated, "prior approval" environment.

Add to this the removal of the regulatory "safety valve," previously furnished by the Lloyd's insurance market (Lloyd's now being regulated by SB 14), and we have the explosive potential of significant market disruption, increased availability problems, and a much more stringent regulatory setting than currently exists. It all depends upon the commissioner's actions.

## RECOMMENDATIONS

- The commissioner of insurance should develop implementation guidelines for:
  - using "subsequent disapproval" as a last resort or for exceptional circumstances and
  - "file and use" in the least regulatory form.
- The Texas Legislature should enact a long-term plan for phasing out regulatory activities and should allow competitive pricing to determine homeowners' insurance rates.