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Friday, April 04, 2008

Missing the big picture in insurance debate

By Drew Thornley

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Consumers groups are again crying foul about recent statistics from the Texas Department of Insurance, showing Texas homeowners' insurance companies paid out only 36.5 percent of the premiums collected to pay claims in 2008. These consumer advocates level the predictable charge that insurers are simply reaping profits by gouging consumers with inflated rates and paying out little in claims.

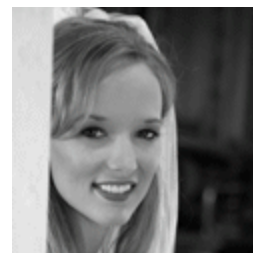
Although the populist rhetoric sounds persuasive enough, the profits many protest are the means by which insurers will be able to cover large future losses. Prudent, actuarially-sound insurance companies maintain a proper long-term focus and save for the inevitable rainy day.

Markets with the most efficient and competitive prices are ones with prices determined by two parties: those who supply and those who demand. However, Texas law stands in the way of a truly competitive marketplace, where the interactions of insurers and policyholders determine prices.

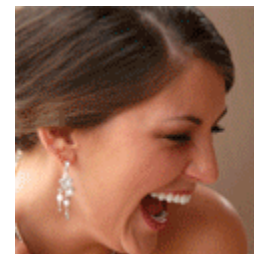
Legislators have given the Texas Department of Insurance the authority to reject insurance rates for being "excessive" if they are "likely to produce a long-term profit that is unreasonably high in relation to the insurance coverage provided."

Of course, both "unreasonably high" and "excessive" require a subjective judgment that is best left to the values and judgments of consumers, not a small army of regulators.

Furthermore, the requirement for TDI to determine what is "unreasonable" leads to rates that are not adequately focused on risk, which overexposes insurers and puts them at risk of insolvency. Without the ability



to price their products according to risk, insurers may be forced out of business altogether when a major storm or catastrophe occurs. Particularly while recovering from losses caused by recent major hurricanes, insurers should be able to price their products according to risk, so they can stay in business should another major storm or catastrophe occur.



Ultimately, letting subjective notions of affordability guide rate regulation is not the proper path to insurance competition and insurer solvency. A perfect example is the Texas Windstorm Insurance Association (TWIA).



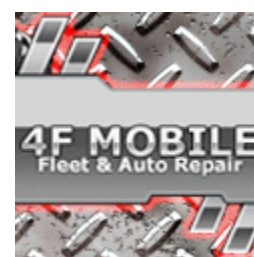
While TWIA is supposed to be a provider of last resort (i.e., a market for those unable to obtain insurance in the private marketplace), its below-market rates, which must be approved by TDI, have resulted in a dramatic increase in the number of policyholders and, thus, its exposure to potential claims. The number of TWIA policyholders increased from 68,756 in 2001 to 217,374 at the end of January 2008; and TWIA's total exposure to potential claims is currently \$64.9 billion.



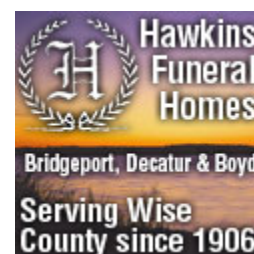
TWIA recently requested an increase in the value of commercial and government properties for which it may write coverage. If granted, this coverage increase will move the Texas insurance market in the wrong direction, as more higher-value properties will be eligible for TWIA, thus further increasing TWIA's exposure and the number of TWIA policyholders.



TWIA member assessments and the Catastrophe Reserve Trust Fund can only cover about \$1.7 billion of losses, much less than the potential losses from major hurricanes. Any additional losses would be paid from general state revenue funds. Thus, the state's windstorm "insurer of last resort" has been turned into a massive liability for Texas taxpayers and consumers. The last thing Texas needs to do now is further increase this multibillion-dollar liability.



Consumer groups want the Legislature to intervene, further regulating the prices and business practices of insurers. While this notion may play well initially, the consequences will be dire for Texas consumers. Companies suffering under heavy-handed regulation will pull out of Texas rather than assume the risk of paying claims on damages their rates cannot cover. Indeed, most consumers will not worry about who is making a profit on the so-called "excessive" rates but rather about the mere availability and quality of coverage.



In a free market, producers' and consumers' interests and preferences bring about mutually agreeable prices



for products and services. As policymakers review the Texas homeowners' insurance market, they should keep in mind that Texas insurers and Texas consumers are the proper parties to determine homeowners' and windstorm insurance rates. Markets, not governments, will ultimately find the proper balance.

Drew Thornley is an economic freedom policy analyst at the Texas Public Policy Foundation, a non-profit, free-market research institute in Austin.



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