Windstorm insurance woes continue

By BILL PEACOCK
HOUSTON CHRONICLE

Nov. 29, 2009, 9:28PM

People buy insurance because they are unwilling to bear certain risks on their own.

A homeowner might not want to risk a lifetime of accumulated wealth to a fire burning down his home. Or a small-business owner might not want to risk her livelihood and those of her employee's because of a hurricane that attacks the Gulf Coast.

Insurance provides protection to these people by allowing them to share risk. However, in Texas, insurance regulation generally makes it more difficult and expensive to do this. And the recent denial by the Texas Department of Insurance (TDI) of the Texas Windstorm Insurance Association's (TWIA) rate increase request shows that the situation won't improve anytime soon.

Risk-based insurance regulation is an afterthought in Texas. A focus on consumer protection, fairness and eliminating the excess profits of insurance companies dominates the process. Yet regulations based on these principles do anything but protect consumers. Instead, they take decision-making about sharing risks out of the hands of consumers and insurers and put it in the hands of regulators in Austin, greatly increasing the cost of insurance in the process.

Most consumer advocates don't care about this as long as they think shareholders and taxpayers are picking up the bill. But consumers ought to care: The regulatory focus on keeping rates low has actually led to higher insurance costs. There are several reasons for this.

The most basic reason is supply and demand. Attempts to suppress rates actually increase risk and keep companies from investing capital in Texas to expand supply. Less supply combined with growing demand mean higher prices, shortages or quite often both. No amount of regulatory maneuvering can defeat this basic law of economics.

Applied to windstorm insurance, Texas has essentially driven private insurers out of the highest-risk areas. With zero private-sector supply, the state has become the sole supplier. Yet when they switched to their new, highly subsidized TWIA policies, many coastal residents complained that they were actually paying more than before.

This may not make intuitive sense, but it is actually easy to explain. TWIA can't spread its risk and lower its costs. Unlike private insurers, it can't insure for hurricanes in South Carolina, snow storms in Minnesota, or tsunamis in Bangladesh. It can't insure cars. Or insure homes in other parts of Texas. So it has no multiline discounts or other means by which insurers pass on savings to consumers.

We wind up with the paradox that Texas is forcing coastal residents to buy the most expensive windstorm insurance that could possibly be designed while forcing the rest of us to subsidize these policies, yet there still isn't enough money to pay off claims in the case of a major storm.

This becomes even clearer when we discover that one of the major reforms of the recent legislative session was to put in a financing mechanism that will only cover TWIA's windstorm claims up to $2.5 billion. This got insurance companies and the state budget off the hook, but homeowners across the state will still have to foot the bill in the case of a major storm.

Consumers, taxpayers and businesses all win when voluntary, market-based relationships work out complex problems like windstorm and homeowners' insurance. However, when government steps in to fix the problem, it becomes a zero-sum game that pits one side against the other.

When this happens, nobody wins.

Peacock is the director for the Center for Economic Freedom with the Texas Public Policy Foundation, a nonprofit, free-market research institute based in Austin. He may be reached at ***bpeacock@texaspolicy.com***.