



Texas Public Policy Foundation  
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# THE COST OF CONSUMER REGULATION IN THE HOMEOWNERS' INSURANCE MARKET

Bill Peacock  
Center for Economic Freedom

# Harvard Conference Questions Adherents to Free Markets

- “If the current state of the U.S. economy makes clear that former Federal Reserve Chairman Alan Greenspan's faith in free markets was misplaced, the question remains: what was it about free markets that proved — and still continues to prove — so alluring to economists, scholars, and policy-makers alike?”
- Conference “brings together leading scholars to discuss their research regarding the historical origins, psychological antecedents, and policy consequences of the free market mindset. Their work illustrates that the magic of the marketplace is partially an illusion based on faulty assumptions and outmoded approaches.”

## Mandated Forms Created Mold Crisis and Cost Consumers \$900 Million

- ❑ Overregulation of insurance forms, combined with some overreaching courts, forced insurers to pay for mold claims that weren't actually covered under the policies that were sold
- ❑ With companies unable to use national forms, mold claims under the state-mandated form grew from 1,050 in the first quarter of 2000 to 14,706 in the fourth quarter of 2001.
- ❑ The average cost of mold claims per policyholder per year increased from \$24.32 in 1999 to \$300.50 at the end of 2001.

# File and Use Today is Not Really File and Use

- Texas Sunset Advisory Commission found:
  - TDI uses statutory pre-market regulatory tools without defined practices, making aspects of rate regulation unpredictable
  - The processes for placing insurers under prior approval and releasing insurers from prior approval are not defined, creating uncertainty in the system
  - The Legislature cannot judge the success of the shift to file-and-use rate regulation because the system has not been fully implemented

# File and Use Today is Not Really File and Use

- ❑ Commissioner can reject filed rates that have not been used
- ❑ Commissioner can place companies under prior approval based on a subjective determination of rating practices or of a statewide emergency
- ❑ Rates covering almost 50% of the market have been routinely challenged
- ❑ “File and haggle” impacting capital investment in Texas: 29 new companies writing insurance, but comprised only 3.7 percent of the market in 2006.

# Rate Regulation Today

- ❑ The Insurance Code says rates may not be “excessive, inadequate, or unfairly discriminatory”
- ❑ Code says, “A rate is excessive if the rate is likely to produce a long-term profit that is unreasonably high in relation to the insurance coverage provided”
- ❑ In a competitive market, profits are determined by consumers voluntarily paying for products and services they value

# Rate Regulation Today

- Statutory emphasis on excessive rates conflicts with other statutory provisions that 1) prohibit “inadequate” rates, 2) “promote the availability of insurance,” and 3) “promote price competition among insurers.”
- Excessive regulation leads to rate volatility
  - Electricity prices
  - TWIA prices
  - Mold premium increases
- Markets allow prices to find lowest rates in both near-term and long-term

# TPPF Recommendations

- Shift the focus of homeowners' insurance rate regulation to rates that are inadequate or discriminatory
- Make the insurance system a true file-and-use system so the commissioner would be able to disapprove only those rates that are already in use, and
- Allow the insurance commissioner to place under prior approval only companies whose financial positions warrant increased supervision for the purposes of maintaining solvency.

# Reality Check

- ❑ The call for a move to prior approval because of the failure of file-and-use misrepresents reality because file-and-use hasn't yet been fully implemented in Texas. Instead, it condemns a watered-down version of prior approval.
- ❑ Recommendations are not based on theory, but on fact. Illinois, South Carolina, and Washington, D.C. are three states who have put these principles into practice in either the homeowners' or auto insurance market and seen excellent results for consumers.

# Reality Check: Reduced Regulation has Led to More Competition in Texas

Year	Herfindahl Index	Regulatory Situation/Events
1998	1662	Heavy regulation: flexible-band rates and form regulation in place
1999	1661	Lawsuit filed claiming standard form covers mold damage
2000	1636	TDI fails to implement 1997 forms changes; mold crisis underway
2001	1611	TDI fails to implement 1997 forms changes; jury awards \$32 million in mold lawsuit; mold crisis increasing
2002	1458	Form regulation relaxed: mold crisis peaks and begins to decline
2003	1388	Flex-band replaced with prior approval; mold crises ends
2005	1258	File-and-use in operation

# Reality Check

- ❑ In a competitive market consumers don't need the government to protect them because if they don't like the prices they are paying, they can protect themselves and regulate profits by switching to a new provider.
- ❑ The Texas homeowners' insurance market is competitive enough to allow the market to protect consumers and ensure profits are not excessive



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