

## Homeowners' Insurance: The Problem with Prior Approval

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### Prior Approval

A number of bills have been filed this session to establish a prior approval system in Texas. However, those who call for a move to prior approval because of the shortcomings of the current system ignore the fact that for much of the last five years Texas has been in large part operating a *de facto* prior approval system.

Until last year, State Farm and Allstate—the state's largest and second-largest writers of property and casualty (P&C) insurance, respectively—operated under a prior approval regime. Almost half of Texas' P&C market was directly subjected to this regulatory scheme.

In addition, many rates filed in Texas have been challenged by the Texas Department of Insurance (TDI) before they were used. This raises the percent of the market subject to actual or *de facto* prior approval to almost 60 percent.

Finally, TDI's internal process for prioritizing rate filing reviews guarantees that rates affecting the majority of the homeowners market—84 percent—will be reviewed.

Now that TDI, Allstate, and Farmers have ended their legal battles, no major insurers are operating in Texas under formal prior approval. But this doesn't change the fact that the market has been generally operating under a prior approval system for almost five years. Those who want to institute a full-blown prior approval system are simply recommending that Texas adopt the same system they have been criticizing.

The Texas Sunset Advisory Commission's Staff Report made several findings that support this. In these findings below, the reference to pre-market regulatory tools includes prior approval:

- In 2003, the Legislature established a system of rate regulation for homeowners' insurance that incorporated both pre-market and post-market regulatory tools.
- 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 high level of regulatory intervention and resulting uncertainty brought about by prior approval has become a major problem. One significant aspect to this is the lack of capital commitment to the Texas homeowners' market.

The Staff Report states, "Fifty-two new companies have had policy forms approved and approximately 29 companies have begun writing insurance. In 2006, these new companies combined to comprise 3.7 percent of the total homeowners' market."

While the reforms of 2003 have brought new entrants, only about half of the companies that have filed forms have actually offered rates, and of those that entered the market, they claimed only 3.7 percent of the market share in 2006.

One strong possibility for this is that these potential or actual new entrants are still hesitant to commit capital to Texas given the lack of full implementation of the file-and-use system they were promised.

The Foundation recommends that only those insurers at imminent risk of insolvency should be subject to prior approval, thus protecting to the extent possible these companies' ratepayers, while restoring a capital-friendly regulatory certainty to the marketplace.

Quite distinct from attempting to protect consumers whose insurers are at great risk of insolvency, placing an insurer under prior approval for how that insurer calculates rates—what factors the insurer considers and does not consider, how those factors are weighted, etc.—is the type of subjective pre-market response identified by Sunset Commission staff.

Additionally, it is difficult to see how “a statewide insurance emergency” justifies placing a company (or companies) under prior approval. Without a clear definition of what constitutes “a statewide insurance emergency,” this section of the Code provides the commissioner a catch-all provision to justify placing any insurer(s) under prior approval. This vague statutory language does not provide the commissioner or insurers with clear guidance on the implementation of prior approval and has the potential to be the exception that swallows the rule. ★

