

TDI SUNSET & HOMEOWNERS' INSURANCE REGULATION

THE ISSUE

Reform of the Texas homeowners' insurance market in 2003 called for a file-and-use regulatory system. However, five years into the reforms, the Sunset Review Commission's Staff Report on the Texas Department of Insurance (TDI) rightly concludes that the "Legislature cannot judge the success of the shift to file-and-use rate regulation because the system has not been fully implemented."

One reason for the incomplete implementation is TDI's use of pre-market and post-market regulatory tools. (The Insurance Code grants TDI authority to reject rates before and after being used in the marketplace.) Failure to implement file-and-use is a major problem facing the Texas homeowners' insurance market, because pre-market regulation hinders timely entry of rates into the marketplace and disrupts market pricing.

Another problem is TDI's focus on affordability. Ultimately, a regulatory stance focused on affordability reduces investment, hinders competition, and puts insurers at risk of insolvency. An example of the danger of focusing on affordability—rather than solvency—is the failure of Texas Select Lloyds in 2006, at a time when TDI was committing significant resources to pursuing legal actions against two major insurance companies for excessive rates.

Furthermore, statutory calls for rates neither "excessive" nor "inadequate" are at odds with each other, creating regulatory uncertainty. This conflicting statutory guidance stands in the way of true file-and-use rate regulation in the Texas homeowners' insurance market.

The sunset review process of TDI presents an excellent opportunity to address today's problems with the regulation of homeowners' insurance and to bring a consumer-friendly regulatory system to the Texas homeowners' insurance marketplace.

THE FACTS

- ★ Senate Bill 14 (2003) called for a transition to a file-and-use regulatory system for homeowners' insurance, with the intention of having a file-and-use system in place as of December 1, 2004.
- ★ Texas' system of rate regulation for homeowners' insurance includes pre-market and post-market regulatory tools, where rates can be rejected before or after they are first used in the marketplace.
- ★ TDI's belated implementation of a 1997 provision allowing insurers to use national

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forms, along with lawsuit abuse, caused premiums to rise dramatically. This delay ultimately cost consumers almost \$900 million.

- ★ After TDI allowed insurers to use non-standard forms in 2002, mold claims plummeted and rates stabilized. TDI acknowledged that, without the deregulation of forms, rates could have increased at least 20 percent more than they did.

RECOMMENDATIONS

- ★ Mandate a full and timely transition to a true file-and-use system, thus allowing the Commissioner to disapprove only rates in use.
- ★ Shift the focus from blocking “excessive” rates to guarding against inadequate or discriminatory rates.
- ★ Implement a true file-and-use system for policy forms, and focus policy-form regulation on the wording and clarity of an insurance form rather than the content of a form, in order to save time and money for consumers.
- ★ Allow the Commissioner to place under prior approval only those companies whose financial positions warrant increased supervision, in order to maintain solvency.
- ★ Limit the supplementary information insurers may be required to submit to TDI in a rate filing.
- ★ Eliminate OPIC and its functions, along with TDI’s pre-market regulatory functions, so consumer protection is handled through complaint-and-enforcement channels at TDI. As opposed to having a consumer representative within TDI, a better approach is to craft a regulatory process that is inherently consumer friendly.

RESOURCES

- *Modernizing the Texas Insurance Marketplace* by Bill Peacock and Machir Stull, Texas Public Policy Foundation (Aug. 2007) <http://www.texaspolicy.com/pdf/2007-08-PP21-insurance-bp-ms.pdf>.
- *Q&A on Homeowners’ Insurance Regulation in Texas* by Drew Thornley and Bill Peacock, Texas Public Policy Foundation (Feb. 2008) <http://www.texaspolicy.com/pdf/2008-02-PP05-Q&A-Sunset-dt-bp.pdf>.
- *Insurance Regulation 101—Higher Risks Generally Mean Higher Rates* by Bill Peacock, Texas Public Policy Foundation (July 2007) http://www.texaspolicy.com/commentaries_single.php?report_id=1575.
- *Consumer Sovereignty: Time to Bring Consumer Regulation into the 21st Century* by Bill Peacock, Texas Public Policy Foundation (Sept. 2007) http://www.texaspolicy.com/commentaries_single.php?report_id=1609.
- *Missing the Big Picture in Homeowners’ Insurance Debate* by Drew Thornley, Texas Public Policy Foundation (Mar. 2008) http://www.texaspolicy.com/commentaries_single.php?report_id=1833.
- *A Better Homeowners’ Insurance Market Awaits* by Drew Thornley, Texas Public Policy Foundation (June 2008) http://www.texaspolicy.com/commentaries_single.php?report_id=1997.
- Sunset Advisory Commission Hearing Material (June 2008) http://www.sunset.state.tx.us/81streports/tdi/tdi_hm.pdf.
- *Consumers, Competition, and Homeowners’ Insurance: A Sunset Report on the Texas Department of Insurance and the Office of Public Insurance Counsel* by Drew Thornley and Bill Peacock, Texas Public Policy Foundation (Aug. 2008) <http://www.texaspolicy.com/pdf/2008-08-RR06-TDISunset-dt-bp.pdf>.
- *Consumers Lose with Texas’ Burdensome Insurance Regulations* by Drew Thornley, Texas Public Policy Foundation (Sept. 2008) http://www.texaspolicy.com/commentaries_single.php?report_id=2177.

