Texas Conservative Coalition Research Institute

House Committee on Insurance

June 11, 2024

[Note: the testimony below addresses only the fifth topic listed in the notice for this hearing]

Subject to be heard by the Committee: *Study current factors affecting the property and casualty insurance market in Texas. Compare the Texas insurance market to other states with respect to affordability in homeowners' insurance.*

Property and casualty (P&C)[1] insurance rates nationwide have soared since 2021, with some states- particularly Florida and California- seeing dramatic increases. According to a November 2023 release by the Congressional Research Service (CRS), auto insurance rates increased by an average of 18.9 percent year-over-year.[i] From January 2023 to February 2024, homeowners insurance premiums rose by 23 percent on average.[ii] Commercial property insurance premiums have seen a relentless rise: the second quarter in 2023 marked the 23rd consecutive quarter in which they rose.[iii]

Texas has felt the force of these rising rates more than most states. Auto insurance rates increased by an average of almost 24 percent in Texas in 2022.[iv] From May 2021 to May 2023, homeowners insurance premiums increased by an average of 46 percent in Texas.[v]

The soaring cost of homeowners insurance is regrettably offsetting the property tax relief that the Legislature has recently provided to Texans. Texas now ranks in the top few states in the country in terms of average annual homeowners insurance premiums. The precise ranking and the estimated annual premium (based on $300,000 in dwelling coverage) depend on the source, as illustrated below:

- 2024 Bankrate survey: Ranked Texas 6th highest ($3,726);[vi]
- 2024 Insurance.com survey: Ranked Texas 7th highest ($3,851);[vii]
- 2024 survey by NerdWallet: Ranked Texas 2nd highest ($4,400).[viii]

Soaring P&C insurance rates are the result of a near "perfect storm" of various and sometimes related factors in recent years, including poor industry performance; an increase in the number of especially damaging storms and disasters; rising reinsurance rates; pronounced inflation, especially with respect to building materials and construction labor; and interest rates that rose significantly and rapidly after reaching historical lows in 2020 (and being low for most of the 2010s). These factors often overlap with

[1] P&C insurance is a term used to describe certain types of insurance coverage, including homeowners insurance and auto insurance.

one another; for example, the rising cost of building materials means that, all else being equal, storms cause more financial damage. Similarly, rising interest rates increase reinsurance costs. The above factors are discussed in the numbered points below.

1. Poor Industry Performance in Recent Years

Insurers are raising rates due in part to poor industry performance in recent years. In the first half of 2023, the P&C industry suffered an underwriting loss of more than $22 billion nationally, with the corresponding losses for the first halves of 2021 and 2022 totaling $21.5 billion and $26.5 billion, respectively.[ix] For every dollar in home and auto premiums P&C insurers collected in 2023, they paid an average of $1.10 in claims and expenses.[x] Several factors account for this poor performance, including inflation (particularly in the price of building materials), higher reinsurance costs, supply chain disruptions, increasing property values, and growing losses from natural disasters.[xi] [xii]

2. Increase in the Number of Events Causing Severe Property Damage

CRS has pointed out that "The National Oceanic and Atmospheric Administration (NOAA) tracks 'weather and climate disasters' causing more than a billion dollars (in inflation-adjusted dollars) in overall damages/costs since 1980. Such events have increased in number from 33 in the 1980s to 131 in the 2010s and 84 in the 2020s so far."[xiii] Some of this is attributable to more people living in high-risk areas; for example, Texas's population has increased by approximately 8 million people (~35 percent) over the last two decades.[xiv] With more people and property in a high-risk area, a bad storm or disaster will cause greater losses, all else being equal.

Unfortunately, Texas experiences a disproportionate amount of "heavy weather" events such as strong winds, hailstorms, and tornados. The National Weather Service reports that, as of late May, Texas leads the nation in heavy weather events thus far in 2024 with 1,332 (Missouri was second with 871).[xv] Although the public understandably focuses on highly visible disasters such as powerful hurricanes that make landfall, much smaller events in the aggregate can be more damaging, at least in some years. In August 2023, *The Wall Street Journal* reported that, according to the prominent reinsurance company Swiss Re, widespread thunderstorms (which often involve strong winds and hail) in the United States accounted for almost 70 percent of global insured natural catastrophe losses in the first half of 2023.[xvi]

3. Skyrocketing Cost of Reinsurance

Insurers purchase reinsurance to protect themselves from catastrophic losses. Reinsurers often operate globally and do not have the same geographically concentrated risks that "regular" insurers often have. To a considerable extent, the factors that are driving the rising costs of insurance are the same ones that are driving up reinsurance premiums; if insurers are suffering heavy losses, reinsurers need to price those heavier losses into the premiums they charge insurers.[xvii]

But reinsurance costs are also substantially affected by rising interest rates. Interest rates rose rapidly in recent years, due in large part to the need to combat rising inflation. With significantly higher interest rates across the market, investing in reinsurance companies became less attractive relative to more conservative investments, such as U.S. Treasury obligations. With less interest from investors and a growing need for capital, reinsurers increased the premiums they charge to insurers. Fortunately, there are recent signs that capital is flowing back into the reinsurance market.[xviii]

4. Inflation

American consumers are well aware of how punishing inflation has been the last few years. From April 2020 to April 2024, inflation was 22 percent.[xix] But some sectors of the economy suffered inflation to a greater extent than others, and the construction and automobile industries were two of them. With today's automobiles being more technologically sophisticated, supply chain disruptions attributable to the COVID-19 pandemic sent their prices soaring. The construction industry experienced inflation both with materials and labor. According to the National Association of Home Builders, inflation in the costs of building materials was approximately 14.6 percent in 2021, followed by 15 percent in 2022, meaning that cumulative inflation for those two years was just under 32 percent.[xx] Fortunately, the figure for 2023 was just 1.3 percent.[xxi]

Moreover, the construction industry is experiencing difficulty finding qualified workers. According to the National Center for Construction Education and Research (NCCER), more people are leaving the construction industry than entering it.[xxii] An analysis by an industry trade group in January 2024 found that there were more than 450,000 job opening available in construction.[xxiii] One spokesperson for a trade group bluntly explained the shortage of workers: "The biggest challenge that the construction industry is facing . . . is that people don't want their babies to grow up to be construction workers."[xxiv]

Recommendations

1. Homeowners Insurance

Unfortunately, there is little policymakers can do to bring P&C insurance rates back down to 2021 levels (although see the recommendation below relating to county mutual insurers and auto insurance policies). As inflation cools from its recent peak, the hope is that premiums will decline. As evidenced by the significant underwriting losses P&C insurers have suffered in recent years, the rapid increase in premiums since 2021 is not the result of bad actors, market failure, or gouging.

It should be emphasized that Texas has a deep and competitive P&C insurance market. TDI reports that there were 79 companies[2] offering homeowners insurance in Texas in 2023.[xxv] Moreover, while insurance is a heavily regulated industry in all 50 states, Texas does not burden insurers with excessive regulation. Texas is a "file and use state," which means that once an insurer files its rates, it can use them on their effective date,[xxvi] subject to TDI later disapproving of any rate that does not comply with the guidelines in place. The Texas Department of Insurance approved 2,663 filings (or allowed them to stand) in 2023 out of 2,923 filed, with the remaining filings either being withdrawn or being rejected for procedural/compliance reasons (e.g., the insurer did not provide enough information in the filing).[xxvii]

The best approach for policymakers is to resist the call to intervene in the P&C market. California is an instructive case of what can happen when there well-meaning attempts to find relief from rising premiums. Although insurers' average loss ratio on homeowners policies in that state were better than the national average in the decade leading up to 2022, wildfires in the state have become a major concern to insurers.[xxviii] Due to Proposition 3, which was approved by voters in 1988, insurers must obtain "prior approval" from regulators before increasing rates.[xxix] Requests for premium increases

[2] The actual number of companies was 161, but many of the companies are affiliated with each other. The figure of 79 reflects the sum of unaffiliated companies and affiliated groups.

greater than 6.9 percent require a public hearing, which can take 18 months or longer to complete.[xxx] California also restricts insurers from taking the cost of reinsurance into account in their rate requests,[xxxi] or from using modeling as opposed to historical claims experiences;[xxxii] this latter restriction limits insurers' ability to take into account threats that have increased in seriousness (or are about to), such as wildfires.[xxxiii] Because of the difficulty in appropriately pricing their insurance coverage, State Farm, Allstate, and Farmers announced in 2023 that they will no longer offer new home insurance policies in California, and AIG and Chubb intend to adjust their offerings.[xxxiv] The exit of insurers from the market will result in less competition, ultimately harming consumers. Additionally, it will put pressure on the state to expand its insurer of last resort, an arrangement which is sure to burden taxpayers. Tellingly, the California Commissioner of Insurance plans to implement changes in December 2024 in response to industry's complaints about over-regulation,[xxxv] which Allstate has indicated may lead it to re-consider its decision.[xxxvi]

Some insurers have similarly stopped offering new policies in Florida[xxxvii] and at least six insurers in Florida became insolvent in 2022.[xxxviii] But Florida is a unique case due its combination of hurricane risk and a broken tort system that was not addressed by litigation until 2021, the effects of which are still playing out. More than 116,000 lawsuits were filed against Florida insurance companies in 2021; remarkably, no other state had more than 900 in that same year.[xxxix]

It should be emphasized that P&C insurance is a volatile industry. CRS has pointed out that:

> Cycles in insurance prices and availability are not uncommon, particularly for property and casualty insurance. Periods of high prices and reduced availability are termed hard markets, with soft markets referring to periods of relatively low prices and wider availability. Hard markets can occur when particularly unexpected events occur in claims payouts or in an insurer's asset/investment portfolio or when both sides of an insurer's balance sheet are affected.[xl]

It appears that the P&C insurance industry is still undergoing an overhaul of pricing and assessment of risk in the wake of the pandemic, more volatile weather, high inflation, and rising interest rates. Some industry observers predict a 6 percent increase in homeowners insurance rates in 2024.[xli] But rates in Texas may remain flat.[xlii] Falling inflation and lower reinsurance costs are possibilities and would offer relief. But there is a good chance that today's premiums are simply the new normal. Consumers must focus on what they can control; for example, having a high credit score can significantly reduce homeowners insurance premiums.[xliii]

2. Auto Insurance

Although the Legislature may have few options when it comes to addressing high homeowners insurance premiums, it can make at least incremental improvement regarding auto insurance premiums: changing the law that favors government county mutual insurers (CMIs).

CMIs were authorized by the Legislature in 1937.[xliv] Initially, they provided property and casualty coverage for "barns and other farm, dairy, hennery and ranch buildings and improvements, on vehicles, harness, implements, tools and machinery used on farms, dairies, henneries or ranches, and on fowls, domestic animals and livestock."[xlv]

In the first half of the 1950s, a number of CMIs failed; in 1955, the Legislature forbade the creation of new CMIs but gave existing CMIs the authority to issue automobile insurance.[xlvi] According to the Texas Department of Insurance (TDI), in 1979 (or perhaps even earlier), the Legislature made a crucial change to the law that remains in place today: it prohibited traditional insurers- but not CMIs- from increasing insurance rates on consumers due to certain moving violations.[xlvii] This prohibition on non-CMI insurers is in place despite the fact that drivers with these moving violations are statistically a higher risk to insurers.[xlviii] In short, CMIs can price drivers accurately; non-CMIs cannot.

This uneven application of the law grants an unwarranted competitive advantage to CMIs. Non-CMI insurers have three obvious options when doing in business in Texas, each of which leaves them at a disadvantage relative to CMIs.

First, they can charge their entire pool of customers a rate which reflects the actuarial risk of those drivers in the pool with moving violations. But this results in the safer drivers (i.e., those without moving violations on their record) being charged higher premiums than their actuarial risk warrants. These safe drivers can simply purchase insurance from CMIs, who can offer them the lower rates they deserve. This option can be thought of as the "overcharging" option.

Second, non-CMI insurers can charge their entire pool of customers a rate which reflects the actuarial risk of those drivers in the pool with *no* moving violations. This option is also undesirable, because it prevents these insurers from pricing high-risk drivers appropriately, leading to premium revenue that may be inadequate to cover anticipated damages or to profits that deter investment from prospective shareholders. This option can be termed the "undercharging" option.

Third, the non-CMI insurers can simply decline to do business with drivers with a history of moving violations, in which case they are limiting their pool of prospective customers relative to CMIs. This option might be termed the "limited market" option.

Faced with these unpalatable options, many non-CMI insurers pursue a more sophisticated fourth or fifth option. Fourth, they purchase a CMI and operate their Texas business through this new CMI subsidiary. This option can cost many millions of dollars. Or fifth, they can rent a CMI's license, which can easily cost several million dollars.[xlix] In either of these last two cases, costs to recoup expenses are passed on to consumers. Many national insurers (e.g., Progressive) have pursued one of these last two options.

In its December 2022 interim report, the Committee noted the testimony it had heard from a representative of the Texas Department of Insurance (TDI), who stated that there were 23 CMIs in Texas (of which 22 were active in 2021), and that Texas was the only state with CMIs.[l] Notably, the Committee stated in the report that it had invited representatives of CMIs to testify to the Committee, but they had declined.[li]

Because of the unwarranted competitive advantage they enjoy, CMIs as of 2021 have accumulated 50 percent of the personal auto insurance market and 30 percent of the commercial auto insurance market (by premium amounts written).[lii]

House Bill 3365 (88R; Harris, Caroline) would have reformed the status quo by allowing non-CMI insurers to take into account moving violations in pricing policies, just as CMIs are currently allowed to do. The bill passed out of committee on a party-line 5-4 vote and was placed on the General State Calendar, but proceeded no further. The Legislature should pursue a similar bill next legislative session. Such a bill would not lower auto insurance premiums drastically- perhaps by 5 percent; however, that is" low-hanging fruit" in terms of pushing down auto insurance rates.

Any person or entity opposing a measure like HB 3365 should be asked to provide a specific response to the following question: *Why do CMIs deserve the exclusive right to price consumers in accordance with the respective actuarial risks they pose?* Any answer claiming that CMIs should retain this unique privilege because the Texas auto insurance market has worked well over the years (excluding the recent dramatic rise in premiums) should be rejected as non-responsive; it is a logical possibility that the market has worked well despite CMIs' unwarranted advantage, not because of it.

ENDNOTES

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[xvii] See https://www.wsj.com/finance/the-insurance-market-is-flirting-with-natural-disasters-2a4ca930.
[xviii] Id.
[xix] See https://data.bls.gov/cgi-bin/cpicalc.pl?cost1=1.00&year1=202004&year2=202404.
[xx] https://www.nahb.org/blog/2024/01/building-materials-prices-plummet-in-2023
[xxi] Id.
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[xxiii] https://stateline.org/2024/01/24/the-us-needs-homes-but-first-it-needs-the-workers-to-build-them/.
[xxiv] Id.
[xxv] See https://www.tdi.texas.gov/reports/pc/documents/pcalr2023.pdf (p. 33).
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