



File & Use In Texas:

Why It's Working – What Still Needs to Be Done

- **File and Use is still in its infancy in Texas.** SB 14, passed by the 78th Legislature, instituted market reform in Texas in stages. File and use rating for homeowners and auto insurance became effective December 1st, 2004, or just over four years ago. Though a significant time, four years is still a relatively short period in insurance economic cycles.
- **Partial implementation in Texas.** According to research by the Sunset Commission staff, and the subsequent adopted Sunset report, file and use has not been fully implemented for homeowners insurance in Texas. Because of the significant use of discretionary regulatory power by TDI, the Sunset Commission was unable to evaluate the true potential of file and use for the Texas market.
- **Texas is still reaping initial benefits, even from partial implementation.** Notwithstanding TDI's slow implementation of file and use in homeowners insurance, 29 new companies are writing in Texas on a we are establishing a competitive market. More than 20 additional companies have sought approval for new policies, but are not yet writing. This indicates interest in our market, but hesitance to commit capital to writing here until we show some commitment to competition and well-reasoned, properly targeted regulation. Auto, meanwhile, has been fully implemented. The result has been a healthy, well-capitalized, competitive marketplace that operates on the basis of economics rather than politics.
- **Other states.** According to academic studies presented to the Sunset Commission, 38 states now use file and use or better rating systems. The movement in the U.S. has been toward competitive rating models over the past several years, with notable turnarounds from disasters to better markets in several states, including South Carolina, New Jersey, and Massachusetts. Texas is counted among these states, but, as we know, it still hasn't fully implemented file and use.
- **The stakes, always high, are now higher in the aftermath of 2008 losses.** In 2004, 2006, and 2007, homeowners companies were very profitable, chiefly because of unusually good weather. As a result, many companies were able to incrementally lower rates while building surplus. However, Texas hailstorms and hurricanes finally caught up with us in 2008. There were eight weather-related catastrophes in the first quarter alone. This was followed by the fourth most costly hurricane season on record. Hurricane Ike was Texas' most costly storm and fifth among all hurricanes in the United States with over \$8 billion in insured losses.

- **Companies are even now paying billions in both their own claims and TWIA assessments.** Had Texas fully implemented file and use, we would likely have had an even better prepared marketplace to deal with the serious losses. As it is, our market is under significant strain, but has been able to fulfill its obligations with only a small number of insolvencies and limited disruptions. However, companies were forced to spend significant surplus built over the last few years, and face higher costs in everything from building materials to reinsurance costs. We need a continued commitment to a healthy market with more predictable market based regulation to allow companies to retool for the 2009 insurance year.
- **Two critical dangers.** Our infant market faces two critical dangers in the coming legislative session. If we are not precise and rational in our approach to insurance regulation, we could lose all of the public policy gains achieved since insurance reform in 2003.

TWIA reform. The legislature must reform TWIA. Currently, TWIA is broke, and almost wholly reliant on marketplace assessments to meet its obligations. Its assessments are already costing both the marketplace and the state general fund (in the form of premium tax offsets) in excess of \$1 billion as a result of hurricanes Dolly and Ike. We need to reform TWIA to put it in a more self-capitalized position and decrease (and ultimately eliminate) the exposure of the marketplace and the general fund to unfunded TWIA liabilities.

Calls for return to failed regulatory systems. We must not heed politically motivated calls for a return to the failed regulatory systems of the past. Bills have already been filed that would return Texas to one-size-fits-all policy forms, inhibit risk-based rating, and reestablish a non-competitive prior approval rating system. Serious consideration of such policies will discourage crucial investment of insurance capital in Texas. Adoption of such policies will cripple our market even as we struggle to recover from Ike and ensure coverage of risk in the 2009 insurance year. Think of this; had we been under prior approval during the profitable years since reform, and had rates been suppressed at the demand of politically motivated activist groups, Ike may well have destroyed our marketplace.

- **Conclusion. Texas' approach to insurance regulation must be rational.** If we want a marketplace that is competitive, with real opportunities for both consumers and companies, and without ultimate reliance on government money to underwrite risk, we must resist gratuitous, politically-motivated calls for continued subsidies and a return to the failed regulatory systems of the past (that delivered, for example, the mold crisis at the turn of the century). We must instead focus on right regulation that ensures solvency, good claims handling, fair business practices, consumer education, and real competition in the marketplace.