HOUSE RESEARCH ORGANIZATION bill analysis | 5/21/2003 | SB 14 Jackson, et al. (Smithee, et al.) (CSSB 14 by Smithee)

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| SUBJECT: | Regulating certain insurance rates, forms, and practices |
| COMMITTEE: | Insurance — committee substitute recommended |
| VOTE: | 6 ayes — Smithee, Seaman, Gallego, B. Keffer, Taylor, Van Arsdale<br><br>0 nays<br><br>3 absent — Eiland, Bonnen, Thompson |
| SENATE VOTE: | On final passage, April 2 — 28-3 (Barrientos, Gallegos, Shapleigh) |
| WITNESSES: | For — None<br><br>Against — Donald Ahrens, Texas Association of Mutual Insurance Companies; Ron Cobb, American Insurance Association; Beaman Floyd, Allstate, Nationwide, State Farm, American Insurance Association, USAA, and Texas Coalition for Affordable Insurance Solutions; Dan Lambe, Texas Watch; John Miletti, Travelers Property Casualty; Jo Betsy Norton, Allstate Insurance; Denise Ruggiero, State Farm Insurance; Rob Schneider, Consumers Union; John P. Smith, AARP; Joe Woods, Alliance of American Insurers; Cyndi Taylor Krier and Will Davis, United Services Automobile Association; Robert Earley, State National Companies; Richard Geiger, Association of Fire and Casualty Companies of Texas; Mike McMahan, Farmers Mutual Protective Association of Texas; Jim Shawn, Texas Surplus Lines Association, Texas Windstorm Insurance Association, and FAIR Plan Association; Bill Stinson, Texas Association of Realtors; Jay Thompson, Association of Fire and Casualty Companies of Texas and Farm Bureau Insurance Companies<br><br>On — Rod Bordelon, Office of Public Insurance Counsel; Robert A. Gilbert, Independent Insurance Agents of Texas; Brian Davis, Ranchers and Farmers Mutual Insurance Companies; Jonathan Klein, Progressive County Mutual Insurance Company; *(On committee substitute:)* David Durden and Philip Presley, Texas Department of Insurance |

BACKGROUND: Before 1991, the state only allowed insurers to deviate downward from a state-promulgated benchmark rate. In an effort to loosen regulatory constraints and stimulate price competition, the 72nd Legislature in 1991 set up a benchmark system for flexible rate-setting, allowing insurers to charge up to 30 percent more or less than the state benchmark. Insurers must justify rates outside the benchmark "flexibility band" to the insurance commissioner (Insurance Code, art. 5.101). Lawmakers imposed a sunset date of 1995, but the 74th Legislature in 1995 repealed the sunset date, and flexible rating became permanent for homeowners and other insurance lines in Texas.

In recent years, homeowners insurance companies, seeking to avoid rate regulation, have shifted more and more of their business toward unregulated branches called Lloyd's companies. The 72nd Legislature exempted Lloyd's plans from the benchmark rating system because, in 1991, they comprised only 20 percent of the market and generally covered specialty risks at rates lower than the standard rates. The Texas Department of Insurance (TDI) estimates that Lloyd's companies now write about 95 percent of Texas homeowners policies. A parallel situation exists in auto insurance, with about 30 percent of the market having shifted to unregulated county mutual companies. Although exempt from rate regulation, Lloyd's homeowners plans remain subject to state regulation of forms that dictate the content and coverage of insurance policies.

**Benchmark rate setting.** Effective September 1, 2001, HB 2102 by Eiland and Seaman changed the procedure for setting benchmark rates for homeowners and other insurance lines. Previously, rates were set in a contested hearing before the State Office of Administrative Hearings (SOAH), with final approval by the insurance commissioner. The process took an average of 14 months, resulting in complaints by insurers that the benchmark did not reflect current market conditions. The benchmark is a prospective (forward-looking) rate, but it relies on retrospective data, much of which is at least 18 months old by the time the rate is set.

Benchmark rates for homeowners insurance were set last in June 2002 in an uncontested rulemaking proceeding before the insurance commissioner, using the new procedures in HB 2102. An uncontested hearing is more informal than a contested one, and participants need not be represented by legal counsel. The commissioner considers many factors when setting the benchmark rate, including loss ratios, profit margins, operational expenses, competition, investment and underwriting experience, and consumer complaints. After the benchmark is set, insurers must file their rates with TDI within 30 days of the benchmark's effective date and must implement the new rates within 60 days.

**Policy forms.** Also at issue in the rate regulation debate is the use of forms that establish the content and coverage of policies. Until recently, the state has required all auto and homeowners insurers to use state-promulgated forms. Three standard policies are available — the HO-A, HO-B, and HO-C — but 96 percent of all homeowners buy a HO-B policy, which covers replacement costs for most kinds of damage. In 2001, in response to a rate spike following an increase in mold and water damage claims, TDI approved a mandatory endorsement to the HO-A and HO-B forms that capped coverage for mold remediation at $5,000, while enabling policyholders to buy additional levels of mold and water coverage through riders. In 2002, on a case-by-case basis, TDI also began to approve the use of certain national policy forms for large insurers only.

**File and use.** A file-and-use system applies to general liability and commercial property insurance in Texas, including farm and ranch policies, all commercial casualty, and medical professional liability insurance rates and forms (Insurance Code, art. 5.13-2). Under this system, an insurer sets a rate that it believes to be actuarially sound on the basis of its internal performance data, with no reference to a state benchmark. The company justifies the rate with internal data and loss ratios and files it with the commissioner. The rate takes effect immediately without prior approval, but the commissioner may disapprove a rate within 60 days if it is found to be excessive, inadequate, unfairly discriminatory, or unreasonable. The benchmark rating system for homeowners insurance carriers also resembles a file-and-use system to the extent that a carrier files a rate within the flexibility band.

**SB 310.** The 78th Legislature enacted SB 310 by Fraser, effective February 25, 2003, requiring certain insurers writing residential property insurance in Texas to file current and projected rates and supporting data with the commissioner. On March 28, TDI submitted a final summary report to the governor, lieutenant governor, House speaker, and members of the Legislature. The report provided a review of current and six-month prospective rates to inform the Legislature whether rates are just, adequate, and reasonable and not excessive or unfairly discriminatory, and to help the Legislature determine the most effective and efficient regulatory system for residential property insurance.

**The Texas FAIR Plan Association** operates as a safety-net provider for consumers who have been turned down at least twice for residential property insurance (Insurance Code, art. 21.49A). The association began operation in December 2002, and by March 2003, about 1,300 agencies were authorized to write FAIR plan policies. Consumers may buy only a HO-A policy, the least comprehensive level of coverage available, under the FAIR plan. FAIR policies do not cover certain items such as water damage or mold remediation. If the association experiences a deficit, it must assess participating insurers, which, in turn, may charge premium surcharges on every property insurance policy issued by the insurers in Texas.

DIGEST:

Effective June 1, 2003, CSSB 14 would make the following changes:

- Within 35 days, residential property insurers (including Lloyd's plans) would have to file and begin using rates that complied with new rate standards. The commissioner would have 120 days to review and act on those rates and could order refunds if they were found to be excessive.
- Personal automobile and residential property insurance companies would have to file withdrawal plans before leaving the Texas market or substantially reducing their market share in Texas.

On the bill's effective date or on September 1, 2003, CSSB 14 would make the following changes:

- Credit scoring models would have to be filed with the commissioner. Insurers would have to disclose to consumers the use of credit scoring (setting premiums on the basis of a consumer's credit history) and would have to notify consumers when and why credit scoring caused an action resulting in denial, cancellation, or nonrenewal of a policy.
- Commercial auto insurance would be moved to a file-and-use system.
- All policy forms would be moved from a promulgated system to a file-and-use system.

- Insurers would have to file underwriting guidelines with the commissioner, who could reject unfair or discriminatory guidelines.
- Many premium discounts for homeowners and auto insurance would be repealed, such as discounts for antitheft devices or security systems.
- A $75 million tax-exempt revenue bond program would be created to finance the FAIR plan (residential property insurer of last resort); bond payments would be made from service fees assessed on participating insurers and the Texas FAIR Plan Association.
- It would become a state jail felony (punishable by 180 days to two years in a state jail and an optional fine of up to $10,000) for certain insurance companies to discriminate on the basis of race, color, religion, ethnicity, or national origin.

Beginning September 1, 2004, a file-and-use system would take effect for all residential and commercial property insurance, personal and commercial auto insurance, and commercial inland marine insurance.

## *RATE REGULATION*

Rates for residential property insurance and personal auto insurance would be regulated to ensure availability and price competition and to prohibit price-fixing and other anticompetitive behavior. Insurers would be prohibited from including certain expenses in their rate structure, including administrative expenses; lobbying expenses and contributions to legislative advocacy organizations; certain advertising expenses; criminal and civil fees, fines, penalties, or exemplary damages; charitable contributions; or advisory organization fees.

**Affected insurers.** Insurers brought under the bill’s prior-approval regulation umbrella in June 2003 would include all insurance companies authorized to write residential property insurance or personal automobile insurance in the state, including Lloyd’s plans and county mutuals. Rate regulation would not apply to the Texas Windstorm Insurance Association, the FAIR Plan Association, the Texas Automobile Insurance Plan Association, or to any insurer that was not engaged in the business of residential property insurance or personal automobile insurance in Texas before the bill’s effective date. Farm mutuals and surplus lines insurers would be exempt.

**Rating criteria.** In setting rates, an insurer would have to consider past and prospective loss experience; hazards and risks inside and outside the state; actuarially credible premiums, exposures, losses and expenses; operating expenses (excluding disallowed expenses); investment income; a reasonable profit margin; and other relevant factors. An insurer could group risks by classification and could modify classification rates to produce rates for individual risks. The commissioner could require an audit of the insurer's historical premium and loss data and could establish requirements for reporting historical premium and loss data.

**Rate filings.** Insurers would have to file annually with TDI all rates, rating manuals, supplementary rating information, and other information required by the commissioner. The commissioner would determine by rule the categories of information and statistics required, including information to ensure that rates did not include disallowed expenses. Insurers would have to certify that rate filings were based on reasonably sound and verifiable actuarial principles and that no classifications were unfairly discriminatory as to race, color, religion, ethnicity, or national origin.

The commissioner could require additional rate filings when an insurer used a new policy form or changed underwriting guidelines, if TDI received a substantial number of consumer complaints, if there was a significant difference between an insurer's current and prospective loss trends, or if the commissioner by rule established good cause for a filing.

**Prior approval required.** Within 30 days of a rate filing, the commissioner would have to act upon a rate or it would be deemed approved, unless the new rate exceeded the previous rate by 12.5 percent or more. For good cause, the commissioner could extend the approval period another 30 days, and no later than 10 days after the rate was filed, the commissioner could ask for additional information. The commissioner would have to approve the rate filing if it were found to be adequate, not excessive, and not unfairly discriminatory. After a rate initially was approved, an insurer could use any subsequent rate without prior approval, so long as it did not exceed the lesser of 107.5 percent of the prior approved rate or 110 percent of any rate used by the insurer in the previous year.

A rate disapproval order by the commissioner would have to specify how the rate failed to meet rating standards and could specify an approved rate. Not later than 20 days after a disapproval order was issued, an insurer could request either a rate hearing by SOAH or binding arbitration. A SOAH administrative law judge would hear the case and remand a proposal to the commissioner. An insurer that requested binding arbitration would waive its right to appeal and would have to pay the entire cost of the arbitration. If an insurer did not comply with a rate filing deadline or file all required information and the commissioner did not act within 30 days, the rate filing would be denied. The commissioner also could require supervision of an insurer's rates if warranted by its financial condition or rating practices.

The commissioner would act upon a rate based on whether the rate complied with the rate standards set forth by the bill, the underwriting guidelines were fair and not discriminatory, the insurer had properly applied credit scoring, and whether any management fees charged by the insurer were not unreasonable or excessive. Management fees would have to be itemized, including an analysis of the component of each fee and an itemization of the fee's profit load.

**Public information and use of filed information.** Rate filings and supporting information would be public information, subject to the "trade secret" exceptions in the Local Government Code. Information filed by an insurer could be shared with the legislative and executive branches of state government. The Office of Public Insurance Counsel (OPIC) could review all rate filings and other filed information and could object in writing to an insurer's rate filing within 30 days of the filing. Confidential information disclosed to these parties would remain confidential.

**Rate hearings; appeal.** Rate hearings would be conducted according to the administrative procedure and practices set forth in the Government Code, subject to the duties of SOAH and the commissioner in rate-setting proceedings. An insurer or OPIC could appeal an order of the commissioner within 30 days in accordance with the statutory guidelines for judicial review. An insurer would have to pay the costs of an appeal if the insurer did not prevail. The burden of proof would be on the insurer to establish that the commissioner's order was an abuse of discretion.

**Notice to policyholder.** An insurer would have to notify policy holders in writing of any rate increase greater than 10 percent immediately before renewal.

## *EXCEPTIONS TO RATE FILING AND APPROVAL*

At an insurer's request, the commissioner could exempt the insurer partially or wholly from certain data filing and rate approval for a specific time period. However, an exemption would not apply to the requirement to file rates and information about market capacity with TDI. The commissioner could not require an insurer to file information that was not contained in its books and records during the normal course of business.

To be eligible for a reduction in the amount of data required for rate filing, a residential property insurer would have to execute an enforceable contract with TDI agreeing not to leave the residential property insurance market or to reduce its market share substantially in the first year of the agreement without first obtaining commissioner approval or filing a withdrawal plan. The insurer would have to certify that its average filed rates did not exceed the previous year's rates by the greater of 7.5 percent or 2.5 percent plus an established cost-of-living increase. The insurer also would have to be current with all data filings and not be subject to any contested disciplinary action by TDI.

**Insurer market share.** A residential property insurer with market share of 5 percent or more that acquired an interest in an insurer with a smaller market share or that split into smaller entities would have to continue to file rates for all affected entities. A rate otherwise exempted from regulation could not be excessive, inadequate, unreasonable, or unfairly discriminatory for the risks to which it applied.

An insurer with a market share of 5 percent or more would be subject to rate approval. However, the commissioner could grant a partial reduction in the amount of filed data required if the filed rate represented an increase of less than 7.5 percent and the reduced filing would not affect consumers or the market adversely.

An insurer with a market share of 5 percent or less would be subject to rate filings, but the commissioner could grant a partial or total reduction in the amount of supporting information required if it would not affect consumers or the market adversely and if the insurer agreed not to leave the market or substantially reduce its business without first filing a withdrawal plan.

An insurer with a market share of less than one-half of 1 percent would be subject to rate filings but could request an exemption from any other specific filings for up to three years if it would not affect consumers or the market adversely.

A surplus lines insurer would be exempt from rate filing and approval requirements unless its total market share exceeded 5 percent or unless the commissioner found, after notice and opportunity for hearing, that the insurer was using the surplus lines affiliate to avoid rate regulation.

## *CREDIT SCORING*

Upon enactment of CSSB 14, credit scoring would be regulated for personal auto insurance, residential property, fire and allied lines insurance, and noncommercial insurance for boats, personal watercraft, snowmobiles, or recreational vehicles. Insurers that used credit reports for underwriting or rating coverage would have to disclose to consumers in writing that they were using credit scoring, and they could not deny, cancel, or refuse to renew a policy based solely on credit information. Violation of any credit scoring rule promulgated by TDI would constitute a violation of the Deceptive Trade Practices Act and would create liability for a personal cause of action.

**Adverse effect.** If an adverse effect — denial of coverage, cancellation or nonrenewal of coverage, or the offer to and acceptance by a consumer of a policy form, premium, rate, or deductible other than the one for which the consumer specifically applied — resulted from the use of credit scoring, within 30 days the insurer would have to describe in writing the primary reasons for it and advise the consumer of his or her right to get a free credit report and dispute the information with the credit reporting agency.

An absence of credit information would have to be treated neutrally by the insurer unless the insurer had statistical underwriting information about the consumer that was reasonably related to actual or anticipated loss experience. An insurer could not take an action that resulted in an adverse effect because a consumer did not have a credit card account unless the insurer considered other applicable factors.

**Negative factors.** An insurer could not count against a consumer a credit inquiry not initiated by the consumer, an inquiry for insurance coverage, a collection account with a medical industry code, or multiple lender inquiries made by the home mortgage or motor-vehicle lending industries. On written request, an insurer would have to provide reasonable accommodation for a consumer who had been affected negatively by catastrophic illness, a family death, temporary unemployment, or identity theft. An insurer could ask for written confirmation of the negative event before granting an exception.

If a consumer's credit information was found to be inaccurate, incomplete, or unverifiable, the insurer would have to re-underwrite and re-rate the insured within 30 days of receiving notice of the problem. If an insured had overpaid because of a credit reporting error, the insurer would have to credit the amount of the overpayment.

**Mandated filing; indemnification.** An insurer that used credit scoring would have to file its credit scoring model with TDI within 90 days of the bill's effective date. The filing could include loss experience justifying the use of credit scoring. An insurer would have to indemnify and hold its agents harmless from liability, fees, and costs arising from an agent's use of credit scoring, so long as the agent followed the insurer's procedures and complied with applicable laws or rules.

**Sale of information prohibited.** The credit reporting agency could not sell data or lists that included any information connected with an insurer's inquiry about a consumer's credit, including the expiration date of the policy or any other terms and conditions of the consumer's insurance coverage. An insurer still could obtain a claims history report or a report regarding a motor vehicle.

**Report.** The commissioner would have to submit a report on credit scoring to the Legislature and the governor by January 1, 2005. The report would have to include a summary statement, a description of insurer practices and credit models, the number of consumer complaints, favorable and unfavorable effects on consumers, disproportionate impact on any class of individuals, recommendations from the department, and any other necessary information. The report also would have to be posted on TDI's website, along with updated insurer profiles providing information to consumers on whether an insurer was using credit scoring or not.

## *UNDERWRITING GUIDELINES*

CSSB 14 would require all insurance companies authorized to write auto and residential property insurance, farm and ranch insurance, and residential fire and allied lines insurance, including reciprocals or interinsurance exchanges, county mutuals, and Lloyd's plans, to submit actuarially justified underwriting guidelines to the commissioner and to OPIC. OPIC could file an objection to the use of an underwriting guideline.

Changes in underwriting guidelines would have to be filed within 10 days after an insurer began to use them. If a new underwriting guideline resulted in the re-underwriting and nonrenewal of more than 10 percent of the insurer's policyholders, the proposed change would have to be filed with TDI. If the commissioner did not reject it within 10 days, the insurer could begin using it on the 11th day after filing.

An insurer could ask the attorney general to classify its underwriting guidelines as proprietary information, thus making them confidential under the trade secrets exemption of the Public Information Act. Unless the attorney general classified the guidelines as proprietary, they would be considered public information.

## *INITIAL RATE FILING FOR HOMEOWNERS INSURANCE*

Within five days of the bill's effective date, the commissioner would have to adopt rating criteria for the review of initial rate filings, post them on the Internet, and distribute them by bulletin. Twenty days later, each residential property insurer in Texas would have to file rates and all required supporting information with the insurance commissioner. The insurer could reference a rate already filed in response to SB 310, so long as the information was updated as necessary. Ten days after the commissioner received the initial rate filings, the rates would take effect.

No later than 120 days after an insurer filed its rates, TDI would have to review all rate filings, and the commissioner could disapprove or reduce a rate found to be excessive without a hearing. The commissioner could approve a rate increase if it was found to be inadequate or confiscatory. Ten days after receiving notice that a rate was disapproved, an insurer could request a hearing by SOAH on the basis that the reduced rate would be inadequate or confiscatory. An insurer could appeal the decision of the administrative law judge to the Travis County district court, or it could request binding arbitration. During the hearing or appeals process, an insurer could use its rate in effect or a rate approved by the commissioner.

If a rate was found to be too high, the commissioner could order an insurer to reduce its rate and refund policyholders the overpayment plus interest. A rate found to be excessive by less than 3.5 percent would be *de minimus,* and a direct refund would not have to be issued if the insurer agreed to reduce future rates by the amount of the overcharge plus interest. The initial rate filing provision would expire September 1, 2004, and would not affect a related hearing or proceeding in progress.

### *FILE-AND-USE SYSTEM*

As of the bill's effective date, commercial auto insurance, including commercial policies written by county mutuals, would be subject to file-and-use rating under Insurance Code, art. 5.13-2. Beginning September 1, 2004, all residential and commercial property (including Lloyd's plans), personal and commercial auto (including county mutuals), and commercial inland marine insurance also would be subject to file-and-use rating. In reviewing rates under file-and-use, the commissioner would have to consider any state or federal legislation that could affect rates for liability coverage. An insurer would have to notify a policyholder in writing 30 days in advance if rates were going to increase 10 percent or more.

**Rules for insurance companies new to Texas.** An insurer authorized to write personal auto or residential property insurance in Texas after the bill's effective date, including a reciprocal or interinsurance exchange, mutual insurance company, capital stock company, county mutual, or a Lloyd's plan, would be subject to rate standards and filings, public information, and disapproval of rates under a file-and use system.

**Standard rate index for personal automobile.** With regard to county mutuals writing personal auto insurance only, the commissioner would have to compute and publish annually a statewide standard rate index that reflected accurately the average statewide rates for classifications for the following coverages: bodily injury liability, property damage liability, personal injury protection, medical payments, uninsured and underinsured motorists, and physical damage for collision and other than collision. The rate index would be computed using the benchmark rate in effect as of the bill's effective date. The index would be adjusted annually thereafter to reflect average changes in claims costs in the personal auto market in Texas.

**County mutuals that write for the nonstandard market.** A county mutual insurance company that wrote personal auto policies at nonstandard rates (at least 130 percent of the standard rate index) would not be subject to rate filing requirements, if the insurer and its affiliated companies had a market share of less than 3.5 percent. If a county mutual writing for the nonstandard market increased its rates by 10 percent or more during a 12-month period, it would have to file its rates. By rule, the commissioner could grant exceptions from rate filing for other insurers that served the high-risk market.

**Market share.** When promulgating filing rules for insurers with less than 5 percent of the market, the commissioner would have to take into account certain characteristics specific to insurers and markets, such as the size of their business, loss experience, targeted markets, coverage limits, and any potential barriers to market entry or growth.

## ***POLICY FORMS***

Policy forms and endorsements for all personal auto and homeowners insurance companies would be subject to file-and-use as set forth in

Insurance Code, art. 5.13-2, sec. 8. Policy forms regulation would not apply to the Texas Windstorm Insurance Association, the FAIR Plan Association, and the Texas Automobile Insurance Plan.

### *WITHDRAWAL REQUIREMENTS*

CSSB 14 would make insurance companies and other legal entities authorized to engage in the insurance business, including reciprocals or interinsurance exchanges, Lloyd's plans, and county mutuals, subject to withdrawal and restriction plans beginning June 1, 2003.

### *INSURANCE DISCRIMINATION*

CSSB 14 would make it a state-jail felony to offer insurance coverage to a person at a different premium rate from that offered to another person because of race, color, religion, ethnicity, or national origin. It also would be a state jail felony to collect an insurance premium based on rates that differed because of race, color, religion, ethnicity, or national origin. The penalty would apply to capital stock companies, mutual companies, local mutual aid associations, statewide mutual assessment companies, and stipulated premium insurance companies.

### *FAIR PLAN REVENUE BONDS*

CSSB 14 would establish a tax-exempt revenue bond program to raise funds for residential property insurance through the Texas FAIR Plan Association. The Texas Public Finance Authority could issue up to $75 million in revenue bonds for the association to establish and maintain reserves for paying claims, pay operating expenses, buy reinsurance, or finance deficits. Public securities could be issued at public or private sale and could not mature more than 10 years after the issuance date.

**Service fees.** Public securities for the Texas FAIR Plan Association would not create a pledging, giving, or lending of the state's faith, credit, or taxing authority. Securities would be payable only from a service fee assessed against each insurer required to participate in the FAIR plan (including a Lloyd's plan or a reciprocal or interinsurance exchange) and against the association itself. The service fee would be set by the commissioner and collected by the comptroller. As a condition of leaving the property insurance market, an insurer would have to pay its share of any remaining obligations on the association's securities.

**Agreements; enforcement.** The state could not limit, alter, or impair the rights of the Texas FAIR Plan Association to honor agreements with the owners of the public securities. A writ of mandamus would be available as an enforcement mechanism.

**Retention of profits.** The association's profits would be retained and applied for the purpose of the association and not distributed to insurers.

## *REPEALS*

CSSB 14 would repeal the following provisions:

- premium discounts on personal auto insurance for antitheft devices, academic achievement, attendance at drug and alcohol driving awareness programs, and membership in certain youth groups;
- exemptions for Lloyd's plans and county mutuals from the maximum rate cap for fire insurance;
- reductions in homeowners insurance premiums for meeting certain home security standards;
- reductions in homeowners property and fire insurance premiums for approved fire suppression devices;
- reductions in homeowners premiums for approved sprinkler systems;
- certain exceptions for farm mutual companies offering fire insurance;
- the current system for flexible (benchmark) rating;
- the current system for conducting flexible rating hearings;
- requirements that county mutuals file a schedule of charges with TDI;
- a prohibition against insurers sharing prospective loss costs with advisory organizations;
- regulations for filing of rates and fees by county mutual insurance companies; and

- application of certain rules for rates for motor vehicle insurance written by Lloyd's plans and reciprocals or interinsurance exchanges.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2003.

SUPPORTERS SAY:

CSSB 14 could provide much-needed rate relief to Texas homeowners within 35 days by requiring an initial rate filing upon the bill's enactment. Texans pay the highest homeowners insurance rates in the nation, and a consumer who paid $1,000 per year for a comprehensive HO-B policy in 2000, now pays $1,446 per year for a new policy that limits coverage for mold or water damage. Data gathered in response to SB 310 showed that homeowners rates have increased by an average of 45 percent statewide since 2000, and that part of the increase would have occurred in the absence of mold claims. TDI estimated that individual company rates could be reduced by as much as 25 percent from their current levels.

CSSB 14 would be an acceptable compromise between the extremes of tighter regulation and total deregulation. Requiring an initial rate filing and then moving companies to file-and-use after the first year would bring rates down initially, then create a competitive environment in which companies could file rates based on their actual costs, not on an artificial benchmark. Rate regulation may keep premiums down, but it does not reduce the insurer's underlying costs. No product can be sold for long when prices do not recover costs. In the long run, freeing companies from benchmark rating would create more availability of insurance while promoting price competition.

Bringing all Lloyd's plans and county mutuals under regulatory oversight would provide an ongoing source of insurance data to aid state decision makers in determining whether rates are unfair or discriminatory. Until the enactment of SB 310, limited data were available on how many Lloyd's plans were setting rates outside the flexibility band, and while TDI knew the rates for county mutuals, it did not know what factors made up the rates. CSSB 14 would allow the commissioner to monitor insurance rates and underwriting guidelines through annual rate filings and thus be able to avert another insurance crisis before it developed.

CSSB 14 rightly would include personal auto insurance under the regulation umbrella. Texas currently has a dual system of rate regulation, resulting in some insurers being regulated and others being exempt. In TDI's 2003 Biennial Report to the Legislature, the commissioner recommended that a rate oversight system be established for both personal automobile and residential property insurance. About $3.2 billion of the $10 billion annual auto insurance market is being written by unregulated county mutuals, and each year a growing percentage of consumers are being shifted to the unregulated market. Loss ratios in the auto insurance market have deteriorated in recent years due to medical inflation and an increasing number of personal injury claims, as well as an increase in the cost of repairing vehicle damage at auto body shops. If loss trends continue as they have, the auto market will need a rate regulation mechanism in place to provide a shock absorber against potential rate spikes.

The bill would grant freedom of forms to Texas insurers. For years, national companies have used national forms in every state except Texas. This practice has distorted economies of scale and has resulted in higher costs to Texas consumers. If insurers could have adopted national forms four years ago, a mold coverage crisis would not have arisen, because insurers already would have excluded major cost drivers such as mold and water damage from the standard form. Freedom of forms allows insurers to respond quickly to vulnerabilities in the marketplace, thus averting potential crises before they happen. Forms freedom ultimately would benefit all consumers by giving them greater choice and lower costs.

CSSB 14 would regulate the use of credit scoring, creating a transparent process that would protect consumers and prevent discrimination. A number of safeguards would be built into the law to ensure that consumers with little or no credit would not be discriminated against. Medical bills would not be counted against a consumer, nor would certain other situations, such as temporary unemployment or identity theft. A study by Fair Isaac, a company that develops credit scoring models, found that policyholders with credit accounts in delinquency filed more insurance claims, resulting in higher losses for insurers. Using reliable predictors such as credit scoring to assign risk helps insurers to price their policies more accurately, ultimately creating more equitable insurance rates for all consumers. The majority of consumers stand to benefit from credit scoring, and consumers with poor credit could be motivated to pay their bills on time if it were going to save them money on insurance.

The bill would repeal state-mandated premium discounts, restoring discretion to insurers in this area. Since insurers would be developing their own rates independent of a state benchmark, they would need to be able to offer only discounts that are actuarially sound, according to each individual company's loss ratios.

CSSB 14 would exempt surplus lines from regulation, thus preserving an important insurance market of last resort. Surplus lines provide a temporary "home" for consumers who cannot find immediate coverage in the voluntary market. These insurers are barred by law from competing with voluntary markets in Texas, so they never will grow to be a significant competitive factor. Many of the unregulated surplus lines offer broader coverage to homeowners than does the FAIR plan. If subject to regulation, surplus lines would stop writing residential property insurance in Texas. These companies provide a valuable outlet for temporary problems and should be allowed to continue doing so.

The bill would allow insurers to capitalize on economies of scale by including management fees in their rate structures. In certain cases, a parent company centralizes a number of administrative duties for its subsidiaries — such as generating computerized renewal notices to consumers — then charges the service back to the subsidiary. Because all rates are prospective, an insurer might overestimate the cost of a prospective fee and overcharge a consumer, but since this practice would be regulated and the profit load on all such fees would be itemized, TDI could reject a fee that it determined to be excessive.

CSSB 14 would protect consumers in the rate-setting process by allowing OPIC to object to an insurer's rate structure or underwriting guidelines. OPIC is the more appropriate party to object to rate structure or underwriting issues, while consumers still could complain to the commissioner about individual premiums or issues with their own policies. As history with the file-and-use system for commercial insurance has shown, consumer complaints are the most common trigger for a special rate review. CSSB 14 would represent a major improvement over current law, under which consumers have no access to information about 96 percent of the homeowners market. Rate hearings are public, so nothing would prevent a consumer from commenting at the hearings. Consumers could shop around and "vote with their pocketbooks" if they had a concern about an insurance company's rate.

The bill would lift barriers to entry in the Texas market by repealing a current prohibition against reporting prospective loss costs to advisory organizations. Smaller insurance companies lack the sales volume to self-generate the data about losses in certain markets needed to set accurate rates. By allowing smaller companies to obtain prospective loss-cost data from advisory organizations, the bill would give them important information they needed in order to set rates and compete in the Texas market, thus encouraging small companies to enter the market or expand their businesses in Texas. The bill would prohibit advisory organizations from publishing rates based on the data, thus banning anticompetitive uses of the information.

OPPONENTS SAY:

CSSB 14 would move insurance regulation in the wrong direction. The state should return to the more restrictive "prior approval" system in use before 1991, so that TDI would play a role in reviewing every rate filing from now on. The recent data gathered by TDI in response to SB 310 showed steep rate hikes among homeowners insurance companies, including the unregulated Lloyd's companies, proving that insurance companies cannot regulate themselves. Oversight of personal lines of insurance should be stricter than that of commercial lines, because the average person does not have a lawyer or other analyst to evaluate the myriad of confusing choices in an unregulated marketplace.

The bill would provide no guarantees of a rate rollback, thus failing to meet the primary promise of insurance reform. Since January 2001, homeowners insurance rates have exploded in response to the mold and water damage crisis. The SB 310 data call confirmed that rates have risen faster than could be justified by insurers, especially since all but $5,000 in mold and water coverage was stripped from the HO-B policy. CSSB 14 would grant freedom of forms to insurers, allowing them to eliminate mold and water coverage altogether, yet consumers would not receive a mandatory rate rollback in return. Consumers voted the 78th Legislature into office on the promise that consumer-friendly insurance reform would take place this session, and they are counting on rate rollbacks.

The recent insurance crisis ought to have taught the state that a level playing field is not possible when some companies are excluded from regulation. Leaving Lloyd's plans and county mutuals out of the benchmark system in 1991 led to the writing of millions of unregulated policies and unprecedented rate shock for consumers. CSSB 14 would exempt surplus lines, farm mutuals, and certain county mutuals writing for nonstandard markets from rate standards, while giving the commissioner discretion to exempt nearly all insurance companies from some amount of regulation. Loopholes and exceptions would leave room for insurers to game the system. All companies that write personal auto or residential property insurance should be subject to the same regulatory standards, without exception.

The state should ban the practice of credit scoring altogether. Tornadoes do not strike homeowners on the basis of their credit scores, and no independent studies have proven any statistical relationship between a consumer's credit history and his or her ability to drive or maintain an automobile. The SB 310 data call showed that credit scoring has a significant impact on the rates charged individual policyholders, causing some rates to be reduced by as much as 27 percent or increased by as much as 75 percent. Credit scoring is discriminatory, especially against women, minorities, low-income consumers, and consumers who conduct all of their personal business on a cash basis. Also, credit reports often are filled with errors that can take months to fix, while consumers are left to pay higher insurance rates.

CSSB 14 would not give consumers the information or rights they need to monitor and protest insurance rating practices. Much of the information filed by insurers with regard to rates, rating manuals, underwriting guidelines, and credit scoring would be subject to the trade secrets exemption of the open records act, thus allowing insurers to keep individual policyholders and consumer advocacy groups in the dark. Also, the bill would allow only OPIC to object to rates on consumers' behalf. Although OPIC is charged with representing consumers as a whole, it may not represent certain classes of consumers over others. Because of this, certain classes of consumers could be left without legal standing to protest insurance company practices.

The bill wrongly would allow insurance companies to include management fees when setting their homeowners insurance rates. In November 2002, TDI and the attorney general reached a $117 million settlement agreement with

Farmers Insurance Group in an effort to end a lawsuit that alleged deceptive trade practices and discrimination against some groups of homeowners. In addition to a rate reduction of 6.8 percent and $30 million in refunds for credit scoring, Farmers agreed to make restitution to customers for $35 million in management fees charged to homeowners policies written in 2002. A state district judge will rule soon on whether the settlement agreement holds. Charging undisclosed management fees to the policyholder is an unfair practice that creates hidden profits for insurance companies. If the stated purpose of insurance reform is to protect consumers and reduce rates, allowing insurance companies to charge management fees to policyholders is not the way to meet that goal.

CSSB 14 would repeal antitrust protections in current law that prohibit the reporting of prospective loss costs to advisory organizations. Prospective loss costs are one component of the data that insurers use in devising rate filings. In the 1980s, advisory organizations hosted forums wherein actuaries from competing insurance companies could exchange competitively sensitive information about prospective loss costs. Antitrust protections were added to current law in response to a lawsuit filed by the attorney general, alleging that the publication of prospective loss costs by advisory organizations led to anticompetitive behavior. Insurers' access to a component of rates from a single source creates a potential for collusion, leading to less variation in rates. It is important not to repeal the law in this area, because under a looser regulatory environment of file-and-use, the state must maintain antitrust protections to protect vigorous competition.

The bill would repeal mandatory premium discounts, thus taking away some of the few insurance benefits over which consumers have control. Many consumers have worked hard and spent extra money to improve security measures in their homes or in their cars in order to qualify for insurance premium discounts. However, CSSB 14 would repeal savings on premium discounts, leaving insurance companies as the sole beneficiaries of consumer investments in these areas. Furthermore, if initial rates were approved by the commissioner this summer and premium discounts then were repealed in September, the net effect could be a back-door rate increase for some consumers that essentially would be sanctioned by the state.

**OTHER OPPONENTS SAY:**

CSSB 14 would grant too much discretionary authority to the commissioner under the prior-approval plan in effect until September 1, 2004. For the first year of the plan, the commissioner essentially would have total control over insurance rates, thus creating barriers to entry in the insurance marketplace. Vesting that much power over rates in the commissioner could lead to differences of opinion on actuarial models, which could damage the marketplace. Commissioner authority is best directed toward regulation of solvency, market conduct, and consumer complaints, not toward rate review, in which consumers can protect themselves. Also, it would be unfair to require insurers to bear the burden of proof on whether the commissioner had abused his discretion.

CSSB 14 should go directly to a file-and-use system without an initial rate filing. Texas insurers already must worry about hurricanes, hailstorms, and demographics, so the one area in which the Legislature can provide certainty is in the regulatory environment. If lawmakers would create a predictable, consistent environment more in line with successful models in other states, more companies would be willing to write policies in Texas. Improving availability of coverage is a function of regulatory certainty and lifting barriers to entry, neither of which would be accomplished by changing horses in midstream. Instituting a prior-approval system up front, then switching to a file-and-use system in 2004, only would delay true insurance reform until next year.

CSSB 14 should stick to its initial charge and only regulate homeowners insurance. Including the auto insurance market in the bill would get off track from the original purpose of insurance reform. Only 30 percent of the auto insurance market is in unregulated county mutuals, compared to 96 percent of the homeowners insurance market in unregulated Lloyd's plans. Voters in the last election demanded rate rollbacks in the homeowners insurance market, but virtually no one complained about the availability or price of auto insurance. The $10 billion auto insurance market is more than three times larger than the $3 billion homeowners insurance market, and it affects nearly every single Texan. The Legislature should address homeowners insurance first, see how the reforms play out over the interim, then revisit auto insurance in the next session. Meanwhile, there is nothing preventing lawmakers from putting a freeze on the migration of auto insurers into county mutuals, thus stemming the tide of backdoor deregulation by auto insurers until the issue can be explored in more depth.

CSSB 14 could give rise to new private causes of action under the bill's credit scoring provisions by potentially placing the enforcement mechanism in the hands of plaintiffs' lawyers. Inconsistent interpretations of the law by different judges could result in an inconsistent enforcement mechanism. Even though damages in such cases might be nominal, this provision could lead to an excess of litigation, at odds with the tort-reform goals that the Legislature is pursuing this session. The commissioner should be the gatekeeper on credit scoring, as on other issues.

NOTES:

The Senate engrossed version of SB 14 would have created a prior-approval system with a 30-day deemer (a clause that allows rates to be deemed approved if the commissioner does not act within 30 days of a rate filing) for both homeowners and auto insurance beginning September 1, 2003. County mutuals would have been exempt, unless they increased their rates by 10 percent or more in a calendar year. The commissioner could have simplified filing requirements for insurers that wrote less than 2 percent of the total homeowners premiums in the state.

An initial rate filing would have had to take place within 10 days of the bill's effective date. The commissioner would have had 20 days to act on rates for insurers with more than $10 million in premiums, and 80 days to act on rates for insurers with $10 million or less in premiums. After that, annual rate reviews would have been required for insurers with market share of greater than 5 percent in either the auto or homeowners market. Biennial rate review would have been required for insurers with a market share of 5 percent or less. A schedule of mandatory reviews would have been published no later than September 1 of each year for the upcoming 12-month period, and TDI could have conducted reviews more often.

Insurers would have had to file a withdrawal plan if leaving the market or reducing premium volume by 75 percent or more. The commissioner could have ordered the date a withdrawal could begin as well as modifying, restricting, or limiting the withdrawal in any manner. The insurer would have had to notify insurance agents six months before withdrawing.

Rating manuals and underwriting guidelines would have had to be filed with TDI. No territory in a rating manual could have been smaller than the boundary of a county. All rate filings, supporting information, rating manuals, and underwriting guidelines would have been subject to the Public Information Act. TDI or OPIC could have published a summary of underwriting guidelines in a manner that did not identify insurers.

The Senate engrossed version would not have allowed binding arbitration as an alternative to an administrative hearing with SOAH.

Policy forms and endorsements for auto and homeowners insurance would have been subject to prior approval with a 60-day deemer (a clause that allows rates to be deemed approved if the commissioner does not act within 60 days of a rate filing). Insurers could have continued to use promulgated or national forms. The commissioner would have been authorized to withdraw an approved form.

Credit scoring models would have been deemed public information and would not have been subject to exemptions from disclosure under any law. The commissioner would have had to promulgate allowable differences in rates due solely to credit scoring.

Premium discounts would not have been repealed, and insurers would have had to provide discounts for policyholders with more motor vehicles than operators in the household.

The Senate engrossed version also would have created a seven-member Property and Casualty Legislative Oversight Committee, comprising three senators, three House members, and the public insurance counsel. The committee would have had to monitor the progress of insurance reform and report its findings and recommendations to the Legislature.

Rep. Wolens, whose HB 600 died in the House Insurance Committee, plans to offer a number of floor amendments, including but not limited to amendments that would:

- roll back homeowners insurance rates to where they were in January 2001;

- create greater transparency in filings of rates, underwriting guidelines, and credit scoring models, by disallowing exceptions from the Public Information Act;
- create a prior approval system that would require the commissioner to act on each and every rate, rather than allowing rates to be deemed approved after 30 or 60 days;
- eliminate all exceptions to rate filing;
- prohibit insurance companies from discriminating unfairly;
- disallow management fees from being included in the rate structure;
- reinstate antitrust provisions that prohibit the sharing of prospective loss-cost information with advisory organizations;
- take auto insurance regulation out of the bill; and
- freeze the migration of business from standard auto carriers to unregulated county mutuals.