Texas Homeowners Insurance: Why Is It So Expensive?

Texas has long had some of the highest homeowners insurance premiums in the country. In 2011, according to the National Association of Insurance Commissioners (NAIC), Texas had the third highest average premiums in the United States.[1] For a home valued between $175,000 and $200,000, Texas homeowners premiums were 76% higher than the national average.

Average Premium on a Home Insured for $175,000 - $200,000

Top Ten States	
Louisiana	$1,648
Mississippi	$1,468
Texas	$1,440
Oklahoma	$1,433
Florida	$1,431
Alabama	$1,165
Kansas	$1,112
Arkansas	$1,015
North Dakota	$1,003
Missouri	$958
U.S. Average	**$819**

Why are Texas homeowners paying so much? And what is driving the increase in premiums? While greater catastrophe losses give us a high national ranking, recent premium increases have more to do with increasing company expenses and profits.

Catastrophic Weather Losses

The insurance industry frequently highlights our high level of historical losses due to bad weather. Industry analysts point out how large Texas cities are exposed to hurricanes, tornados and hail storms. According to data from Insurance Services Office (ISO), from 2008-2013, Texas catastrophe losses per insured house were 88% higher than the countrywide average even excluding losses due to Hurricane Ike.[2]

<u>While catastrophe losses explain why premiums are high relative to other states, evidence suggests they are not the primary driver of recent premium increases</u>.

[1] NAIC Dwelling Fire, Homeowners Owner-Occupied, and Homeowners Tenant and Condominium/Cooperative Unit Owners Insurance: Data for 2011. Comparison based on Insurance Range $175,000-$199,999, Form HO-3.
[2] ISO Fast Track Data 2008-2013 excluding 4Q 2008.

Higher Insurance Company Expenses

Insurer expenses, just for writing homeowners policies, are higher in Texas than countrywide. According to a 2012 report by The Texas Department of Insurance (TDI), acquisition costs (which reflect agent commissions), advertising, and underwriting are 65% higher in Texas than the U.S. average. Overhead costs such as building, equipment and salaries are 43% higher.[3]

Agent commissions are higher because they are set as a percentage of premium. As a result, the high Texas premiums generate high commissions for agents. A number of companies address this by selling direct, which can reduce expenses, but some policyholders prefer the services of an agent. The higher overhead costs may partially be a function of Texas's large geographic area. However, some national insurers appear to allocate central overhead costs to states in proportion to the state's premium volume. In some key respects, high Texas premiums contribute to high expenses rather than the other way around.

Increasing Target Profit Margins

According to TDI, the average target profit margin in insurer rate filings rose from 5% in the early 2000's to 11% in 2012.[4] A target profit margin is what insurers include in their rate filings and hope to earn if all goes as planned. Actual profitability varies from year to year depending on losses and other expenses. More recent insurer rate filings have included target profit margins exceeding 20%.

Part of the increase is the result of low investment returns earned by insurance companies. Insurers typically invest the vast majority of reserve and surplus funds in highly secure investments such as government bonds. Returns on these investments have become extremely low in recent years. This results in insurance companies seeking greater returns through underwriting profits paid by policyholders.

In addition to lower investment returns, insurance companies also claim the risk of writing homeowners insurance in Texas is higher than previously thought. As a result, they are now demanding much higher overall profit margins.

Increasing Reinsurance Costs

When an insurance company purchases insurance to cover a portion of its risk, it is commonly referred to as buying "reinsurance". Reinsurance cost provisions in rate filings more than doubled between 2003 and 2012 according to TDI.[5] These increases are largely felt in coastal areas where reinsurance costs can account for half the premium paid.

[3] TDI Report to the Senate Business and Commerce Committee: Homeowners' Premiums and Rates in Texas, 2012
[4] See above
[5] See above

Primary insurers are typically granted wide latitude over the amount of reinsurance they purchase. In addition, reinsurance companies are subject to much less regulation than primary insurers. In fact, the rates they charge aren't regulated at all. Reinsurance profit margins can be two to four times higher than primary insurance. In addition, reinsurance is commonly purchased from affiliates of the primary insurer. This generates higher profits for the insurance group as a whole.

Cost Component Changes – Summary

According to industry rate filings from 2003 to 2012, the majority of the average cost increase is due to higher expenses and expected profit rather than increases in expected losses. If reinsurance is included as an expense, the percentage climbs even higher. The table below indicates the average dollars of increase seen by cost component from 2003 to 2012 according to insurer rate filings.

Average Dollars of Increase Per Homeowners Policy
By Cost Component
Insurer Rate Filings 2003–2012

Cost Component[6]	**Dollars of Increase**
Non-Hurricane Loss and Loss Adjustment Expense	$212
Target Underwriting Profit and Other Risk Charges	$187
Underwriting Expenses	$144
Reinsurance	$66
Hurricane Loss and Loss Adjustment Expense	$31
Total	**$640**
% Related to Underwriting Expense + Profit[7]	**52%**
% Related to Losses + Loss Adjustment Expense	**38%**

An Inefficient Market

Consumers benefit when markets are efficient. Efficient markets provide consumers with options from many companies at very competitive prices. The most efficient markets require competitors to offer their products and services at the lowest possible price to maintain market share. According to 2012 NAIC data, there are 103 companies writing over $1 million of homeowners insurance in Texas.[8] On the surface, this would tend to reflect a market that is

[6] See previous note for source. Cost components reflect rate indications rather than rates actually charged. Table is shown for comparative purposes only.
[7] For purposes of this comparison, reinsurance is not included as a loss or expense although insurers generally consider it an expense.
[8] National Association of Insurance Commissioners (NAIC) Annual Statement State Page Data, 2012

competitive. Also, market reports show companies increasing market share and others losing ground. However, the eight largest insurance groups by market share in 1996 remain the eight largest today. And those eight groups control 76% of the market.[9] This tends to suggest the market is less efficient than it appears on the surface.

Other factors reflect market inefficiency as well. According to a 2010 report by Deloitte Research, 60% of policyholders rarely or never shop their policy. Insurance company pricing systems are designed to maximize profit. Frequently this means overcharging long-term policyholders while offering attractive rates for new business. The Deloittte survey found that 42% of homeowners policyholders were with the same company over 10 years. Many of these consumers could get better deals (and make the market more efficient and competitive) by shopping their policies.

A report by the Office of Public Insurance Counsel (OPIC), found that auto policyholders who stayed with the same company for more than eight years could save an average of 19% on their premiums by switching carriers. Many could save even more. We believe similar savings are likely in the homeowners insurance market.

We know there are many reasons why consumers don't routinely shop for insurance. OPIC remains committed to increasing the percentage of policyholders who do shop through our web site tools and educational outreach efforts.

Other OPIC Efforts

OPIC reviews all homeowners insurance rate filings. Problems we find are reported to TDI, and if warranted, OPIC requests TDI to take regulatory action. Under Texas law, insurance companies can be subject to TDI's regulatory authority if they use rates that are excessive. With TDI and on our own, OPIC has sought reduced rates and refunds for consumers. These efforts have resulted in some rates being lowered and some consumers receiving refunds, but these cases can take a long time to resolve. Consumers are still waiting for refunds originally ordered by the Commissioner in 2003. There are no shortcuts. The cases are always technical and complex.

Conclusion

For the reasons explained in this article, policyholders should always shop for the best deal. Use OPIC's policy comparison tool to compare coverage at www.opic.state.tx.us. Also check out HelpInsure.com to find insurance companies in your area and compare their rates. Regardless of the regulatory system, there will always be some pricing excess when markets aren't efficient. Shopping your policy will help you make sure you aren't overcharged.

[9] TDI Quarterly Report on Legislative Market Conditions, 4th Quarter 1996 and 2nd Quarter 2013