SUBJECT: Continuing the Texas Department of Insurance

COMMITTEE: Insurance — favorable, without amendment

VOTE: 6 ayes — Smithee, Hancock, Nash, Sheets, L. Taylor, Torres

3 nays — Eiland, Vo, Walle

WITNESSES: For — Stacey Pogue, Center for Public Policy Priorities; Jay Thompson, AFACT, TALHI; (*Registered, but did not testify:* Robert Gilbert, USAA; Patricia Kolodzey, Texas Medical Association; Lee Loftis, Independent Insurance Agents of Texas; Kandice Sanaie, Texas Association of Business; Jared Wolfe, Texas Association of Health Plans)

Against — None

On — Beaman Floyd, Texas Coalition for Affordable Insurance Solutions; Chloe Lieberknecht, Sunset Advisory Commission; Bill Peacock, Texas Public Policy Foundation; Ware Wendell, Texas Watch; (*Registered, but did not testify:* Deeia Beck, Office of Public Insurance Counsel)

BACKGROUND: The Texas Department of Insurance (TDI) regulates the business of the insurance industry to ensure that consumers have access to competitive and fair insurance products. TDI regulates insurance companies' solvency, rates, forms, and market conduct. Besides licensing individuals and entities involved in selling insurance policies, the department investigates insurance law violations. The department's consumer-related functions include educating the public about insurance and helping consumers resolve complaints. TDI also provides fire prevention services.

The commissioner of insurance, appointed by the governor and confirmed by the Senate, directs department policy and operations. There is no policymaking body for TDI. At the end of fiscal 2009, TDI had 1,572 staff, 875 of whom were dedicated to insurance-related activities, while the rest performed functions relation to workers' compensation. TDI's fiscal 2010-11 budget was approximately $251 million.

TDI regulates all major insurance lines sold in Texas, including life, accident, health, and property and casualty insurance. The department has

15 statutorily created advisory committees and councils that provide input on many of these insurance lines and other issues.

Texas currently regulates homeowners insurance rates through a file-and-use system, in which insurers must file rate changes with TDI but are not required to wait for TDI approval to put new rates in effect. File-and-use is one of several rate regulation schemes common among the states. Prior approval systems require insurers to receive approval from regulators before they may change rates. Flexible rating systems allow insurers to implement new rates as long as the rates do not exceed or fall below an acceptable range set by regulators.

Under the Texas file-and-use system, insurers must file rates with TDI and may implement the rates immediately or whenever they choose. TDI may disapprove administratively a rate deemed excessive, inadequate, or unfairly discriminatory before the rate has been implemented or may disapprove a rate-in-effect through a contested case hearing at the State Office of Administrative Hearings. TDI may subject certain insurers to a prior approval process if the insurer's financial condition or rating practices require supervision or if there is a statewide insurance emergency. Insurers subject to prior approval must file rates with TDI, then await approval before using the rates. If a rate is not approved or disapproved within 30 days, the insurer may deem the rate approved.

TDI last underwent Sunset review in 2009. The agency's Sunset bill, SB 1007 by Hegar, was not enacted during the 2009 regular session. During the first called session of the 81st Legislature in 2009, SB 2 by Hegar extended OPIC until September 1, 2011. The department then underwent a special-purpose Sunset review to be considered by the current Legislature. If not continued by the 82nd Legislature, TDI will be abolished September 1, 2011.

DIGEST:

HB 1951 would continue TDI until September 1, 2023. The bill would add standard Sunset provisions governing conflicts of interest of the commissioner of insurance and agency staff, maintaining information about complaints, use of technology to increase public access, and alternative rulemaking and dispute resolution procedures.

HB 1951 would add to the duties and purpose of TDI the responsibilities to protect and ensure the fair treatment of consumers and to ensure fair competition in the insurance industry in order to foster a competitive

market.

Property and casualty insurance rate regulation. HB 1951 would specify rate regulation for certain property and casualty insurance lines. The bill would require the commissioner to specify department procedures for supplementary requests for rating information to include the number of times the department could request information and the kind of information the department could request.

The commissioner would have until the earlier of the rate's effective date or the 30th day after the rate filing to disapprove of a rate. If the commissioner had not disapproved of a rate within that time period, the rate would be considered approved. Extensions could be granted for good cause, but the commissioner and insurer would be prohibited from extending the 30-day period by agreement.

The bill would require the department to regularly track and analyze factors contributing to rate disapproval.

If it determined that an insurer's rate filing was inadequate or incomplete, TDI could request additional information from the insurer. A request for additional information during the rating review period would not be included in the computation of the 30-day period. TDI would have to track and analyze requests for additional information to ensure the process remained fair and reasonable.

HB 1951 would require the department to make its procedures for rate reviews available to the public and to include factors that would lead to rate disapprovals. The information would have to be general and could not reveal the propriety or trade-secret information of an insurer.

If the commissioner required an insurer to file rates for prior approval, the commissioner would have to assess periodically whether conditions requiring prior approval filing continued to exist. If the conditions no longer existed, the commissioner would have to issue an order excusing an insurer from prior approval requirements. In any orders requiring an insurer to file under prior approval laws, the commissioner would have to explain the requirements the insurer needed to meet in order to be excused.

The commissioner would be required to issue rules defining the financial conditions and rating practices that would cause an insurer to be subject to prior approval filing, including how a statewide insurance emergency

would be determined. HB 1951 would also require the department to track precedents regarding rate disapprovals to ensure that rate standards were applied uniformly to insurers. The current provision governing department requests for additional information for prior approval filings would be repealed by HB 1951.

Residential property insurance in underserved areas. The commissioner would have to consider whether access to the full range of coverage for residential property insurance existed as a factor in determining whether an area was underserved. The commissioner would be required to evaluate areas and make underserved designations no less than once every six years. At least once every six years, the commissioner would also have to conduct a study to determine if current designations were accurate so that access to insurance in those areas would continue to both increase and improve.

The commissioner would have to conduct a study that examined the impact of increasing the percentage of premiums collected by residential property insurers that qualified for an exemption to the rate filing and approval (or file-and-use) system under sec. 2251.252 and would have to include the findings in TDI's biennial report to the Legislature. This requirement would expire September 1, 2013.

Data collection for personal auto and residential property insurance. Auto and residential property insurers that conducted business in Texas would have to file with the commissioner aggregate claims information, including the specific number of claims that:

- were filed during the reporting period;
- remained pending on the final day of the reporting period, as well as any pending litigation;
- closed with payment during the reporting period;
- closed without payment during the reporting period; and
- were carried over from the reporting period immediately preceding the current reporting period.

The information would have to be filed annually, broken down by quarter. TDI would be required to post the information relating to claims on its website without revealing any insurer's proprietary or trade-secret information. The commissioner would have to establish a method for posting the information and would have to describe how the information

would be posted.

Assessments. HB 1951 would revise the conditions for which a health maintenance organization (HMO) could be assessed by the commissioner. Instead of being "impaired," an HMO would have to be placed under supervision or conservatorship under ch. 441, Insurance Code, or be party to a ch. 443 delinquency proceeding. The commissioner would have to determine that the HMO had insufficient funds to pay all health care claims and administrative expenses incurred by the commissioner relating to its rehabilitation, liquidation, supervision, conservatorship, or seizure. Under the bill, the commissioner would be required to calculate an assessment using the requirements currently in law.

The bill would change the basis on which abatements or deferrals would be calculated. Instead of using the basis for assessments provided by the approved plan of operation, the bill would allow the commissioner to use calculations made to assess the HMO when placed under supervision, in conservatorship, or other similar situations.

HB 1951 would limit the window of time to 180 consecutive days for the use of funds obtained from an assessment of an HMO whose surplus was impaired and that was under supervision or a conservatorship.

State fire marshal's office. HB 1951 would require the commissioner to prescribe a reasonable fee for an inspection by the state fire marshal that could be charged to the property owner or occupant who requested the inspection, as the commissioner considered appropriate.

The state fire marshal would have to periodically inspect state-leased, not just state-owned, buildings. The commissioner would have to adopt guidelines for assigning potential fire-safety risk to state-owned and state-leased buildings. By January 1 every year, the state fire marshal would have to report inspection findings to the governor, the lieutenant governor, the speaker, and relevant standing committees.

Under HB 1951, the commissioner would have to delegate power to the state fire marshal to take disciplinary and enforcement actions, including applying administrative penalties, toward anyone who violated a law within the marshal's authority. The commissioner would have to specify actions to be delegated to the state fire marshal and detail the procedures by which to employ the enforcement actions.

The commissioner also would have to adopt a schedule of administrative penalties for violations and make it available to the public upon request. Administrative penalties would have to be based on such issues as the severity of the violation, economic harm to the public, history of previous violations, and deterrence needed for future violations. The state fire marshal would be able to impose administrative penalties in lieu of canceling, revoking, or suspending licenses or certificates.

HB 1951 would allow the state fire marshal to impose an administrative penalty without involving the commissioner. The bill would specify the method to dispute a penalty or its amount.

Electronic transactions. HB 1951 would authorize entities regulated by TDI to conduct business electronically if each party to a transaction agreed to do so. The commissioner would have to implement minimum standards of compliance for regulated entities conducting business electronically.

Advisory committees. HB 1951 would abolish 15 boards, committees, councils, and task forces upon the bill's effective date. It would specify the relationship among remaining advisory committees and TDI. The commissioner would have to adopt rules addressing the use of advisory committees, including rules governing an advisory committee's:

- purpose, role, responsibility, and goals;
- requirements regarding size and quorum;
- membership qualifications;
- procedures for appointments;
- terms of service;
- requirements for training; and
- duration.

Advisory committees would be prohibited from creating rules or policies and would be structured and used to advise the commissioner, the state fire marshal, and TDI staff.

The commissioner would have to create rules to govern the department's periodic review of advisory committees to confirm their necessity. The department would have discretion to keep or develop committees as needed. Advisory committees would be required to comply with ch. 551 of the Government Code, the Open Meetings Act.

Effective date. The bill would take effect September 1, 2011. Unless otherwise specified, the provisions of this bill would apply to insurance policies, contracts, or evidences of coverage delivered or renewed on or after January 1, 2012.

SUPPORTERS SAY:

HB 1951 would implement revisions, including a number of recommendations of the Sunset Advisory Commission, that would improve the operations of TDI. The bill would clarify the regulation of property and casualty rates under the file-and-use system, providing insurers more certainty about the acceptance of rate filings and the conditions under which rates could be denied. Unnecessary advisory committees would be abolished, and the commissioner would be granted the flexibility to establish advisory committees as needed by rule.

The continuance of TDI is necessary due to the insurance markets' ongoing need for oversight. The bill would better define the agency's overall duties in statute by clearly charging the agency with the duties of protecting consumers, ensuring fair competition in the market, and fostering a competitive market. TDI currently regulates the insurance industry properly by ensuring the availability of fair products and a competitive market, and HB 1951 would implement some changes to make the department's regulatory actions run more efficiently.

Regulation of property and casualty rates. The bill would bring clarity to the file-and-use system. Currently, insurers rarely immediately implement rates that they have filed, because they are afraid of the possible legal and administrative costs if rates are later disapproved. Contested case hearings are costly to conduct, and insurers must justify their rates against the findings of actuaries from both TDI and the Office of the Public Insurance Counsel. Costs increase further if an insurer must appeal a rate ruling to a district court.

HB 1951 would bring predictability and transparency to the department's use of property and casualty insurance regulatory tools. The bill would strengthen the existing prior approval processes by giving TDI rulemaking authority to establish the processes and standards by which an insurer could be placed under prior approval. HB 1951 would require the commissioner to establish the financial conditions and rating practices that could subject an insurer to prior approval, and to provide disclosures to insurers on how they could be freed from prior approval. Insurers would

be able to avoid costly mistakes under HB 1951 because of the department's duty to specifically outline its supplemental request process in rate regulation. By making legal requirements much clearer to insurers, the bill would help ensure that Texas promoted a competitive insurance market.

The file-and-use system proposed in this bill would be better for consumers than a full prior approval regulatory system because it would enhance market competition. A healthy, competitive insurance market with many participating insurers is the best way to ensure that companies strive for efficiencies to keep costs down and to keep rates low enough to attract a large consumer base. File-and-use allows insurers to assess risks and immediately begin use of an actuarially justified rate. Prior approval systems allow the state regulatory agency to interfere in an insurer's implementation of rates, which the insurer has already deemed necessary to keep itself solvent and guard against annual fluctuations in claims filings.

The insurance industry is based on assessment of risk, and insurers must assess a variety of consumer, environmental, and regulatory standards, as well as the performance of the financial market, when setting rates. A prior approval system would introduce yet another risk to an insurer because the insurer would not know if insurance regulators would approve the rates. This could worsen outcomes for consumers because insurers would try to set higher rates to account for the higher risk and also could decide to exit the market or reduce the number of policies they wrote to avoid losses. The regulatory history of the Texas insurance market demonstrates the trend of significant declines in insurer participation when regulation is increased, and reduced competition leads to higher rates for consumers. While efforts to increase regulation are well intended, they lead to worse consumer outcomes.

The biggest risk to consumers would be to regulate insurer rates such that insurers became insolvent and could not pay consumer claims following a catastrophe because state regulators had prevented the insurer from establishing an adequate reserve. Although insurer profits were very high in 2006 and 2007, the reserves generated from business during those years allowed many insurers to stay in business despite the extreme losses related to natural disasters that they paid in consumer claims for 2008. HB 1951 would work to protect the solvency of companies.

Commissioner of insurance. The insurance commissioner should be an impartial regulator, not an elected official. If the insurance commissioner were elected, candidates could simply campaign on the promise of lowering rates. The market does not always safely allow this goal. An insurance commissioner elected with the mandate to lower rates could implement policies that could jeopardize insurer solvency.

Credit scoring. Those who seek to abolish the use of credit ratings in establishing premiums make the inaccurate assumption that the industry is indicating that a low credit score increases the likelihood of poor driving. Credit scoring has proven an accurate way to measure risk, because studies consistently have demonstrated that people with low credit ratings are less likely to make a claim. Whatever the factor that drives the risk association between credit and claim rates, insurers should be able to measure this indicator of risk.

Insurers already provide disclosure when notifying consumers with information that their credit score provided a basis for adverse action. These companies should not have to bear additional burdens of providing individual notice to consumers on issues such as how to improve credit scores. Any increased burden on insurance companies would result in higher premiums for consumers.

OPPONENTS SAY:

Although HB 1951 would continue the existence of TDI, it would not ensure that Texas consumers were protected and that the insurance industry was fair.

Regulation of property and casualty rates. HB 1951 would support a continuing shift toward a pro-industry approach to insurance regulation that has left consumers without sufficient protection from companies poised to take advantage of a deregulated system. By adding provisions to the Insurance Code that would move the insurance industry toward a more complete file-and-use system, the bill would not ensure any protections for consumers by regulating rates on the front end before companies would be able to collect unfair premiums from policyholders.

Insurers should not be allowed to deem whether their own rates are fair. This bill would continue the file-and-use system that allows insurers to file notice of a rate change with TDI and begin to use that rate immediately. TDI cannot disapprove a rate-in-effect, even if deemed unfair or

excessive, without an administrative hearing and possible appeal to a district court. The file-and-use system was supposed to decrease Texas' insurance rates, which are the highest in the nation, yet this system has not lived up to this expectation, and HB 1951 would provide no additional incentive for insurers to lower rates.

HB 1951 would not work to fulfill TDI's goals to protect consumers and ensure a fair marketplace because it would only perpetuate the current file-and-use system for property and casualty insurance rates. Implementing a prior approval system would allow TDI to review and approve all rates before they were passed along to policyholders. Insurers could not enact steep rate increases and engage in price gouging to recoup losses too rapidly. Prior approval places the burden of proof on the insurer to justify that its rate filings were necessary and justified.

Instituting a disapproval period for rate filings would place pressure on the department's staff and resources to review rates in a timely manner to ensure fair rates for consumers and the marketplace. Taxpayers should be assured that state agencies are actively doing their jobs and not allowing insurers to slip through the system due to inaction. This concern is especially important due to the state's current fiscal conditions.

The insurance market is not a standard competitive marketplace because consumers in some instances are mandated to obtain coverage or may greatly need the benefits of coverage. This environment necessitates prior rate review so that insurers do not take advantage of consumer vulnerability.

Regulatory interventions do not influence the amount of market participation to the extent that some file-and-use proponents claim. Before 2003, when there were benchmark rates, insurers were not allowed to have different rating tiers. Because of this, insurers spun off affiliates so that each affiliate could act as a surrogate for a rating tier. These affiliates no longer were needed when regulatory changes were made in 2003, and many affiliate operations ceased. The actual decline in insurer group participation was negligible, even if the total number of companies seemed to decrease significantly.

Commissioner of insurance. While the commissioner directs policy that influences homeowners, patients, and other consumers, the commissioner only is accountable to the governor. Many more Texans are affected by the

actions of the insurance commissioner than by the actions of the elected agriculture and railroad commissioners, yet Texans do not have a say in choosing their insurance commissioner. At least 10 other states allow their citizens to have a say in whom would best govern a fair insurance market through election of their insurance commissioners, and Texans should have this ability too.

Credit scoring. Texas should not allow the use of credit scores in setting rates. Credit scores are determined based on a person's payment history, amounts owed, length of credit history, new credit, and types of credit. None of these criteria reflects the measure of risk associated with a consumer's driving behavior. Many consumers unfairly have faced rate increases solely based on their credit scores, when they never have filed a claim.

If insurers will not be prohibited from using credit scores in setting rates, they should be required to do more to inform consumers of their standing and how they can improve their credit scores and, ultimately, their premiums. Consumers would be more informed and better enabled to make decisions about purchasing insurance products.

NOTES:

The companion bill, SB 644 by Hegar, was reported favorably, as substituted, by the Senate Government Organization Committee on March 28.