SUBJECT: Setting benchmark rates for certain lines of insurance

COMMITTEE: Insurance — committee substitute recommended

VOTE: 9 ayes — Smithee, Eiland, Averitt, Burnam, G. Lewis, J. Moreno, Olivo, Seaman, Thompson,

0 nays

WITNESSES: For — Richard S. Geiger, Texas Automobile Insurance Plan Association; Bob Huxel, Farmers Insurance Group; Jay Thompson, Association of Fire and Casualty Companies in Texas

Against — None

On — Rod Bordelon, Office of Public Insurance Counsel

BACKGROUND: In an effort to stabilize rates for automobile and homeowner's insurance, the 72nd Legislature in 1991 enacted the Omnibus Insurance Reform Act, which contained major insurance reforms, including the flexible rating program for motor vehicle and personal property insurance. The 73rd Legislature in 1993 placed the flexible rating procedure for setting a benchmark rate under the Administrative Procedures Act. The State Office of Administrative Hearings (SOAH), through the 1993 provisions, can make rate recommendations with final approval by the insurance commissioner.

The 1991 statute included provisions under which the Texas Department of Insurance (TDI) staff could participate in rate proceedings. This language was amended in 1993 and again in 1997. The 76th Legislature in 1999 placed an expiration date of September 1, 2001, on the authority of TDI staff to participate in a proceeding before the commissioner.

DIGEST: CSHB 2102 would require the insurance commissioner to promulgate by rule a benchmark rate for each insurance line subject to the flexible rating program after a notice and hearing. In promulgating the benchmark rate, the commissioner could give due consideration to expenses and operation of all insurers, allocated to each line of insurance in proportion to the amount the

net direct premiums of the benchmark line would bear to the aggregate of net direct premiums for all lines assessed, and could exclude only expenses that were disallowed under the flexible rating program.

Disallowed expenses would include, among other items, any unreasonably incurred expense as determined by the commissioner after notice and hearing in a proceeding apart from the benchmark hearings by lines. In the case of such a hearing, the commissioner would have to notify each insurer or group of affiliated insurers of this separate proceeding. The commissioner could not exclude any part of the expenses of an individual insurer or group of affiliated insurers unless this bill specifically disallowed those expenses.

Hearing procedures. The commissioner would have to request recommendations regarding changes to the benchmark rates before each annual hearing. Notice of each hearing involving benchmark rates would have to be published in the *Texas Register*, after which the commissioner would have to receive public comment for at least 30 days or at the hearing.

The public insurance counsel and any insurer, trade association, or other interested person or entity that had submitted proposed changes or actuarial analyses could ask questions of any person testifying at the hearing. The bill would remove provisions related to discovery and evidence presented at a benchmark rate hearing. After the hearing, the commissioner would have to adopt a rule promulgating the benchmark rate.

Judicial review. Judicial review of an order promulgating benchmark rates would be under the substantial evidence rule. A person aggrieved by the commissioner's action in the benchmark rate process could file a petition for judicial review in district court in Travis County not later than the 30th day after the date on which the commissioner adopted a final order on a benchmark rate.

Texas Automobile Insurance Plan Association (TAIPA). The insurance commissioner would have to determine and prescribe appropriate rates to be charged for insurance provided through TAIPA. The bill would remove the requirement for a SOAH hearing on rates for insurance provided through TAIPA. The association would have to file its rates with TDI for approval

by the commissioner. It could not file more than once in any 12-month period.

TAIPA, the public insurance counsel, and any other interested person or entity that submitted proposed changes or actuarial analyses could ask questions of any person testifying at the hearing. Before approving, disapproving, or modifying a filing, the commissioner would have to provide all interested people a reasonable opportunity to review and comment on the TAIPA filing.

The commissioner would have to schedule a hearing on the TAIPA filing not later than the 45th day after the date on which TDI received the filing. TDI would have to put a notice in the *Texas Register* no later than the seventh day after the date TDI received the filing that a filing had been made. The bill would specify the content of the notification.

After the hearing, the commissioner would have to approve, disapprove, or modify the filing in writing. If a filing were disapproved, the commissioner would have to state in writing the reasons for the disapproval and the criteria to be met by the association to obtain approval. TAIPA would have to file any amended filing with the commissioner not later than the 10th day after the date on which TAIPA received the commissioner's disapproval. The bill would set forth provisions relating to an amended filing.

The bill would take effect September 1, 2001. It would apply only to premium rates for an insurance policy delivered, issued for delivery, or renewed on or after January 1, 2002.

SUPPORTERS SAY:

Administrative hearings required by the flexible rating program for auto and homeowner's insurance are cumbersome and inefficient. CSHB 2102 would streamline this process by allowing the insurance commissioner to set the rate on the basis of open hearings. The resulting rates would better reflect the market at the time the rates became effective.

A major part of the 1991 insurance reforms was establishing a flexible rating system for auto and homeowner's insurance. At the time, this portion of the legislation was considered a radical change to bring down excessive rates and protect consumers. The benchmark method for setting rates was enacted

on a trial basis with a sunset date of 1995. When the Legislature enacted the TDI sunset bill in 1993, it made some changes to the rating law, including moving the rate hearings to SOAH. In 1995, the Legislature recognized that the flexible rating system was working and repealed the sunset date, making flexible rating the permanent rating system for certain lines of insurance in Texas.

SOAH must handle benchmark rate hearings for personal property and automobile insurance, including TAIPA, as contested cases. The average time between the initial notice of hearing until a rate is set often is a year. Since rates are based on data from years before the hearing, the resulting rates may not reflect current market conditions. Allowing the commissioner to exercise rulemaking authority in setting benchmark and TAIPA rates would reduce the number of steps involved in the benchmark process and would lower the costs. This change would not reduce the commissioner's authority in setting benchmark and TAIPA rates, as the commissioner now has the right to revise SOAH's recommendation based on evidence in the record. Also, the bill still would allow for judicial review of the rate process.

A rulemaking procedure before the commissioner could increase the public's ability to participate in the rate proceeding. Since the hearing no longer would be a contested case, interested parties might be more inclined to participate, since they would not necessarily have to hire an attorney for representation.

The insurance industry in Texas makes no secret that it would like to deregulate, especially private-passenger auto insurance rates and forms. At the least, auto insurers advocate moving toward a file-and-use system. Problems with the benchmark process form the industry's primary argument for abandoning the current system. Enactment of CSHB 2102 would deflate insurers' most compelling argument for deregulation.

OPPONENTS SAY:

CSHB 2102 would lead to higher auto insurance rates in Texas. Under the current benchmark rate process, insurers can select a rate within the flexibility band, plus or minus 30 percent — a 60 percent differential. Since insurers already can charge up to 30 percent above the benchmark rate without TDI approval, insurers likely would seek permission under this bill to raise rates higher, sooner. Insurers do not want to wait for an

administrative hearing, followed by a commissioner's ruling in, for example, October, when they could have a ruling by the previous March under this bill.

The focus should be less on the administrative hearings process and more on the bill's likely results. Currently, the auto insurance market alone in Texas is more than $8 billion. In the past, insurance companies have recommended more than a 10 percent increase in the benchmark rate. Using that figure, this legislation could cost Texans almost $1 billion, if there were fewer opportunities to examine evidence or confront witnesses through an administrative hearing.

For at least six years, TDI has considered Farmers Insurance Group's management fee an improper expense and has rejected it from consideration in setting the benchmark rate for auto insurance. CSHB 2102 would allow the commissioner to include this management fee, previously excluded as profit, in the base for determining the benchmark rate. Since Farmers has such a large portion of the auto insurance market in Texas, including this "expense" after six years of excluding it automatically would cause auto rates to go up.

As part of the flexible rating program, the commissioner would have to request recommendations from insurers, trade associations, the public insurance counsel, and other interested parties and would state that these recommendations include any supporting actuarial analyses. However, the bill would not allow discovery among the parties. In addition, the bill would permit a party to present analyses either before or at the hearing. This could put a party, such as the public insurance counsel, in the difficult position of having to ask questions of an insurer about complicated actuarial data that the counsel had not received in advance of the hearing.

Another provision in the bill would permit an advisory organization, such as the Insurance Services Organization, which collects ratemaking data, to be a party at the hearing. This could raise liability implications under the state's antitrust laws.

CSHB 2102 would establish that judicial review, in district court in Travis County, of an order promulgating a benchmark rate was under the substantial

evidence rule. Since this bill would do away with a formal evidentiary hearing, the provision that judicial review would fall under the substantial evidence rule is confusing.

The benchmark rating process was one aspect of major insurance reforms enacted by the 72nd Legislature. Insurers did not like the flexible rate program then, nor do they like it now. CSHB 2102 would bring them closer to their stated goal of complete deregulation.

OTHER OPPONENTS SAY:

CSHB 2102 would not address the TDI staff's ability to appear as a matter of right as a party, to present evidence, or to question a witness in a proceeding before the commissioner or the designated hearing officer in which rates were set. This provision still would expire September 1, 2001.

The bill would allow the commissioner to give due consideration to, among other things, expenses of operation of all insurers allocated to each line of insurance in a proportionate amount. By referring to expenses of operation of all insurers, not simply to those in this article, this bill could include expenses of county mutuals, Lloyd's plans, fraternal benefit societies, and other insurers that do not fall under the flexible rating program.

NOTES:

A proposed floor amendment by the author would continue the authority of TDI staff to participate in rate proceedings.

The committee substitute modified the filed version by authorizing the commissioner, in promulgating the benchmark rate, to consider expenses and operation of all insurers. It also would provide that disallowed expenses under the flexible rating program would include unreasonably incurred expenses determined by the commissioner after notice and hearing separate from the benchmark hearing.

Under the substitute, before each hearing, the commissioner would have to request recommendations from interested parties that would include any supporting actuarial analyses. Interested parties or other entities could present views, analyses, and arguments in response to the commissioner's request for recommendations, either before or at the hearing. The substitute would authorize the public insurance counsel and any insurer, trade association, or other interested person or entity that had submitted proposed

changes or actuarial analyses to ask questions of those testifying at the annual benchmark rate hearings.

The companion bill, SB 993 by Sibley, has been referred to the Senate Business and Commerce Committee.