SUBMITTED STATEMENT OF

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HEARING ON

PERSPECTIVES ON CHALLENGES IN THE PROPERTY INSURANCE MARKET AND THE IMPACT ON CONSUMERS

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PERSPECTIVES ON CHALLENGES IN THE PROPERTY INSURANCE MARKET AND THE IMPACT ON CONSUMERS

Chairman Brown, Ranking Member Scott and members of the Committee:

Thank you for holding today's hearing, titled "Perspectives on Challenges in the Property Insurance Market and the Impact on Consumers," and for the invitation to testify. My name is Jerry Theodorou. I am the director of the R Street Institute's (R Street) Finance, Insurance and Trade program. I have worked as an analyst of the property and casualty insurance industry for the past 15 years in my current position at R Street and at Conning, a Connecticut-based asset management and insurance research firm. My research, publications, public presentations and congressional testimonies focus on the impact of market forces and external drivers on insurers, policyholders and the economy.

Today's hearing is timely because ill-advised government intervention in some insurance markets has contributed to unhealthy disruption of the markets. Intervention in the form of price controls and monopolistic markets has led to reduced availability of coverage and higher costs for insurance buyers and has weakened competitive forces, a principle underscored in a quote by noted economist Thomas Sowell: "Competition does a much more effective job than government at protecting consumers."[1]

The competition imperative holds for the insurance industry, as it does for other industries. Competition in the property and casualty (P&C) insurance industry is a force that contributes to insurance coverage being more available and affordable for insurance buyers. The U.S. P&C insurance industry is highly competitive, with 2,651 P&C insurers operating in the country.[2] Because insurance is regulated at the state level rather than the federal level, the degree of competitiveness varies from state to state. Close to 900 insurers provide personal auto

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[1] Maddox Locher, "30 Priceless Quotes from the Great Thomas Sowell," *Fee Stories*, Feb. 28, 2023. https://fee.org/articles/30-priceless-quotes-from-the-great-thomas-sowell/?gclid=Cj0KCQjw9MCnBhCYARIsAB1WQVXBVNnAmsnQH4jPkP7WlkwQVbC3bdDenOqddL-Y4TPnIuMAXpsrsawaAndiEALw_wcB.

[2] Federal Insurance Office, *Annual Report on the Insurance Industry*, U.S. Dept. of the Treasury, September 2022. https://home.treasury.gov/system/files/311/2022%20Federal%20Insurance%20Office%20Annual%20Report%20on%20the%20Insurance%20Industry%20%281%29.pdf.

insurance—the largest line of business. There is no state with fewer than 50 auto insurers operating within its borders. Fully, 45 states have at least 100 insurers offering coverage for private vehicles.[3]

Measuring Competitiveness

The Herfindahl-Hirschman index (HHI) is commonly used to measure the competitiveness of an industry. It is calculated by adding the squares of the market shares of all sellers in the market. For example, if a market has only one seller, its market share is 100 percent and the HHI is 10,000 (100 x 100). If a market has 20 sellers, each with 5 percent of the market, the HHI is 500 (20 x 25). If the HHI is higher than 1,800, the market is considered by the Department of Justice—in accordance with longstanding policy—to be highly concentrated. If it is between 1,000 and 1,800, it is moderately concentrated. If the HHI is below 1,000, the market is considered competitive, not concentrated.[4] The lower the HHI, the more competitive the market.

Overall, the P&C insurance industry is not concentrated. On the contrary, it is highly competitive, with an HHI of 297.[5] For homeowners insurance, the average HHI is 621. There are 30 states where the HHI for homeowners insurance is less than 1,000, and 20 states where the HHI is greater than 1,000. The 10 largest P&C insurers have 50.2 percent market share, and the top 25 have 70.2 percent market share.

Analysis of homeowners insurance performance on a state-by-state basis supports the finding that markets are healthier where there is more competition. The data shown below reveals that the 10 states with the poorest financial performance in the past 10 years were more concentrated than the 10 states with the best performance in the past decade. The 10 states with the poorest performance had an average HHI of 1,074. The top four insurers had a 54.3 percent market share of homeowners insurance business in those states. By contrast, the 10 states with the best

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[3] Ibid.

[4] Chris Adams, "What is the Herfindahl-Hirschman Index and why would you use it?," Modern Analyst, last accessed Sept. 3, 2023. https://www.modernanalyst.com/Careers/InterviewQuestions/tabid/128/ID/1003/What-is-the-Herfindahl-Hirschman-Index-HHI-and-why-would-you-use-it.aspx.

[5] "2021 Competition Database Report," NAIC, January 2023. https://content.naic.org/sites/default/files/publication-cdr-im-competition-database-report.pdf.

performance in the past 10 years had an average HHI of 772. The four insurers with the largest market share in those states had a collective market share of 44.8 percent.

	HHI for Homeowners Insurance	Top 4 Market Share	Return*
Colorado	1,066	55.4%	-12.7%
Louisiana	1,001	50.1%	-11.3%
Nebraska	1,042	52.4%	-9.6%
South Dakota	836	46.4%	-7.6%
Iowa	1,056	54.2%	-7.0%
Montana	1,206	61.0%	-6.9%
Wyoming	1,230	63.5%	-2.8%
Illinois	1,511	61.4%	0.5%
California	862	47.0%	0.8%
Idaho	932	51.2%	3.3%
Oregon	1,119	58.3%	3.7%
Georgia	1,116	56.8%	3.8%
Texas	829	51.0%	4.6%
Minnesota	1,144	55.5%	4.9%
Puerto Rico	3,833	96.5%	5.1%
Maryland	966	51.9%	6.5%
National	621	40.3%	7.0%
Kentucky	1,282	62.2%	7.2%
Oklahoma	1,381	63.4%	7.3%
Arkansas	1,168	55.6%	7.8%
New Mexico	1,117	59.5%	8.0%
Utah	800	46.4%	8.3%
Tennessee	1,136	56.8%	8.7%
Indiana	965	49.5%	8.9%
Florida	451	32.5%	9.1%
West Virginia	1,307	61.4%	9.2%
Alabama	1,243	61.4%	9.4%
North Carolina	723	46.3%	10.2%
Michigan	930	53.6%	10.3%
New Jersey	608	40.0%	10.5%
Pennsylvania	923	53.8%	10.7%
Missouri	1,136	55.7%	11.2%

Mississippi	1,109	54.6%	11.7%
Ohio	858	46.9%	11.7%
Washington	961	53.1%	11.8%
Arizona	854	48.4%	12.1%
New York	769	49.0%	12.8%
Virginia	968	54.7%	13.2%
Nevada	909	50.8%	13.6%
Connecticut	494	33.4%	14.8%
Delaware	1,084	54.3%	15.2%
Wisconsin	957	48.8%	15.4%
Rhode Island	689	42.5%	15.6%
Kansas	994	52.4%	16.4%
North Dakota	790	46.9%	16.7%
Massachusetts	523	34.0%	16.9%
Vermont	686	43.0%	17.2%
Alaska	1,983	80.0%	17.8%
South Carolina	741	46.0%	18.7%
New Hampshire	625	40.9%	18.9%
Maine	632	39.4%	20.8%
Hawaii	1,672	63.3%	27.2%

*"Return" is "return on net worth," defined by the NAIC as an approximation of total profit after taxes divided by allocated capital and surplus, adjusted to place it on a generally accepted accounting principles basis.

Source: "2021 Competition Database Report," NAIC, January 2023. https://content.naic.org/sites/default/files/publication-cdr-im-competition-database-report.pdf.

Residual Markets

Another way to evaluate the competitiveness of insurance markets is to examine the size of the residual market compared to the size of the total insurance market in the state. A residual market is a state-sponsored insurance association for customers who seek to buy insurance but are unable to obtain it in the standard market. Reasons why customers may not be able to obtain coverage in the standard market include poor loss history or because their property may have unusually large risk exposure, such as being located next to a dynamite factory. Such residual market vehicles are known as "FAIR" plans, where FAIR stands for Fair Access to Insurance Requirements. The median amount of business in FAIR plans as a percentage of overall premium across states is 0.24 percent, which means that less than a quarter of 1 percent of homeowners insurance premium in individual states is placed in FAIR plans.[6] There are, however, some extreme outliers like Massachusetts, where FAIR plans account for as much as 6 percent of the state's premium.[7] The Massachusetts FAIR Plan has shrunk significantly over the past decade after accounting for close to 15 percent of the state's automobile and homeowners insurance in 2010. One of the reasons Massachusetts' FAIR plan is so large is because its coverages and rates are competitive with the admitted market.[8]

	FAIR plan earned premium as % of total market, property lines, average past 5 years
California	1.17
Florida	4.50
Louisiana	1.32
Massachusetts	6.11
North Carolina	2.78
Rhode Island	3.17

Source: "2023 PIPSO Products," Property Insurance Plans Service Office, last accessed Sept. 3, 2023. https://pipso.com/publications.

Although the P&C insurance market is generally highly competitive, restrictive regulations reduce competitiveness in some states, such as California and North Carolina.

California

California's insurance landscape exemplifies a market with restrictive price controls so disruptive that many insurers are curtailing their business operations in the Golden State or outright leaving the state.[9] California is one of six states that prohibits insurance companies from changing their rates unless the state's insurance regulatory body first approves the requested rate

[6] "2023 PIPSO Products," Property Insurance Plans Service Office, last accessed Sept. 3, 2023. https://pipso.com/publications.
[7] Joseph G. Murphy, *2010 Annual Report*, Commonwealth of Massachusetts Division of Insurance, last accessed Sept. 3, 2023. https://www.mass.gov/doc/2010-doi-annual-report/download.
[8] Ibid.
[9] Don Thompson and the Associated Press, "California to auto insurers: No rate increases, it's still a pandemic. Business claims a 'market crisis looming.'," *Fortune*, Sept. 17, 2022. https://fortune.com/2022/09/27/california-auto-insurance-no-rate-increases-geico-all-state-kemper-liberty-mutual-state-farm-ricardo-lara.

change.[10] These restrictive price controls prevent goods and services from reaching the free-market price and introduce costs through government bureaucracy and inefficient allocation of goods and services.[11]

California's burdensome insurance price controls have led to contraction in competition and have catalyzed the exodus of insurers operating in the state. California's P&C insurance market is the nation's largest, with the state's $104.9 billion in direct premium written representing 12.0 percent of the country's $876.2 billion.[12] In the past year, several insurance companies have announced that they will not write new California homeowners insurance.[13] Others have taken more drastic steps and are not renewing existing policies upon expiration.

The exodus of insurers from California has been driven by policies that have prevented insurers from operating their business in the state soundly. Most of the handicapping measures originated with the passage of Proposition 103 in 1988. Proposition 103 was introduced by consumer advocate Harvey Rosenfield. Mr. Rosenfield employed some flamboyant tactics to campaign for the passage of Proposition 103, including a 1987 publicity stunt where he "attempted to deliver a truckload of cow manure" to the Los Angeles headquarters of State Farm Insurance.[14] The proposition passed. Among its provisions are:[15]

1. An administrative requirement for insurance rate changes to be approved by the Department of Insurance (DOI) prior to implementation and for decisions to be made within 60 days of the filing. But prior to 60 days, the DOI requires the time limit to be

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[10] Jerry Theodorou, "2022 Insurance Regulation Report Card," *R Street Policy Study* No. 272, December 2022. https://www.rstreet.org/wp-content/uploads/2023/01/r-street-policy-study-no-272-REVD.pdf.
[11] Christopher J. Neely, "Why Price Controls Should Stay in the History Books," Federal Reserve Bank of St. Louis, March 24, 2022. https://www.stlouisfed.org/publications/regional-economist/2022/mar/why-price-controls-should-stay-history-books#:~:text=Prices%20allocate%20scarce%20resources.,costs%20imposed%20by%20price%20controls.
[12] S&P Global Capital IQ Pro. https://www.capitaliq.spglobal.com/web/client?auth=inherit#statIndustry/pcIndustry?KeyStatEntity=E61858CD-F1F9-42BD-8848-8CB6B42ED2FE.
[13] Steve Hallo, "More insurers exiting California's home insurance market," *Insurance Journal*, Aug. 16, 2023. https://www.propertycasualty360.com/2023/08/16/more-insurers-exiting-californias-insurance-market.
[14] Frederick M. Muir, "Prop. 103 Author, Nader disciple: Rosenfield: Hero to Some, Troublemaker to Others," *Los Angeles Times*, Dec. 3, 1988. https://www.latimes.com/archives/la-xpm-1988-12-03-mn-931-story.html.
[15] Steven Greenhut, "California's Insurance Market Is Burning Down," *The American Spectator*, May 31, 2023. https://spectator.org/californias-insurance-market-is-burning-down.

waived, so action on the filing can be delayed indefinitely. If the insurer refuses to waive the 60-day provision, there must be a hearing, which can take a year.[16]

2. A 20 percent rebate on automobile insurance premiums.
3. The introduction of public "intervenors" to challenge requests for rate increases greater than 7 percent.[17] It is noted that the intervenor used most often is Consumer Watchdog, an organization founded by Mr. Rosenfield.[18] California's intervenor process introduces consumer participation in the administrative process for setting insurance rates if they are deemed excessive or inadequate.[19]

Additional ways the California Insurance Department has straitjacketed insurers include prohibiting them from incorporating reinsurance cost into ratemaking and preventing them from taking into account recent climate and weather patterns in their risk modeling.[20] As a result of these restrictive regulations, many national insurers have curtailed their California business writing.[21] Even Farmers Insurance, founded and headquartered in California, announced in July 2023 that it would no longer write new homeowners business in the state.[22]

Florida and Louisiana

In contrast to California's restrictive price controls, current conditions in homeowners insurance markets in Florida and Louisiana are driven by litigation and natural catastrophes. Prior to March 24, 2023, when comprehensive tort reform was signed into law in Florida, the homeowners

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[16] Brett Horoff, "California PPA Rate Filing Moratorium: What Should Insurers Do?," Perr & Knight, June 30, 2022. https://www.perrknight.com/2022/06/30/ca-ppa-rate-filing-moratorium.

[17] Ibid.

[18] "Our Team," Consumer Watchdog, last accessed Sept. 3, 2023. https://consumerwatchdog.org/our-team.

[19] Tom Jacobs and Kris Elaine Figuracion, "California has hit brakes on private auto rate hikes since start of pandemic," S&P Global Market Intelligence, Nov. 3, 2021. https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/california-has-hit-brakes-on-private-auto-rate-hikes-since-start-of-pandemic-67299444.

[20] Thomas Frank, "Calif. scared off its biggest insurer. More could follow.," *E&E News*, May 31, 2023. https://www.eenews.net/articles/calif-scared-off-its-biggest-insurer-more-could-follow.

[21] Breanne Deppisch, "Home insurers pull out of California thanks to wildfires and state regulations," *Washington Examiner*, June 1, 2023. https://www.washingtonexaminer.com/policy/energy-environment/insurers-pull-out-california-wildfires-regulations.

[22] Matthew Kupfer, "After State Farm's and Allstate's Exits, Farmers Insurance Sets Limits in California," *The San Francisco Standard*, July 7, 2023. https://sfstandard.com/2023/07/07/farmers-insurance-state-farm-allstate-california.

insurance market was plagued by out-of-control meritless litigation.[23] The magnitude of the litigation abuse problem is starkly visible in the statistic that Florida accounts for 9 percent of the nation's homeowners insurance policies, but is responsible for 79 percent of the entire country's homeowner insurance litigation.[24] The tort reform measures are expected to restore the Florida market to a healthier position. However, the improvements will take time to materialize into rate reductions because in the days prior to Florida Governor Ron DeSantis signing tort reform into law, Florida plaintiff attorneys filed approximately 280,000 property insurance lawsuits—an action that will cause severe delays in normal court functioning.[25]

Although Louisiana's insurance market is often compared to Florida's, the homeowners markets in the two states differ structurally. In Florida, the largest homeowners insurers are single-state Florida-only insurers. The top five Florida homeowners insurers in decreasing size (by premium) order are Citizens Property Insurance Co. of Florida, Universal, State Farm, Florida Peninsula and Tower Hill.[26] By contrast, four of the five largest homeowners insurers in Louisiana (State Farm, Allstate, Liberty Mutual, USAA) are national carriers, which means that heavy Louisiana losses may not cripple the state's largest insurers. At a large national insurer, geographical diversification means poor results in one state can be offset by favorable results in other states, whereas a single-state insurer's financial health is more vulnerable to adverse loss trends in its state.

Rate Bureaus

Until the mid-20th century, insurers were members of statistical rating bureaus that required them to use the bureau's rates and policy wordings. The rating bureaus were responsible for

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23 "Tort Reform Overhauls Florida's Litigation Landscape," Greenberg Traurig, April 20, 2023. https://www.gtlaw.com/en/insights/2023/4/tort-reform-overhauls-floridas-litigation-landscape#:~:text=Florida%20Governor%20Ron%20DeSantis%20signed,law%20on%20March%2024%2C%202023.

24 "What They Are Saying: Florida Property Insurance Reforms," Florida Office of Insurance Regulation, May 24, 2022. https://floir.com/home/2022/05/24/what-they-are-saying-florida-property-insurance-reforms.

25 Katherine Kallergis, "More sticker shock ahead as Florida's property insurance crisis worsens," *The Real Deal*, July 26, 2023. https://therealdeal.com/miami/2023/07/26/more-sticker-shock-ahead-as-floridas-property-insurance-crisis-worsens.

26 S&P Global Capital IQ Pro. https://www.capitaliq.spglobal.com/web/client?auth=inherit#statIndustry/pcIndustry?KeyStatEntity=E61858CD-F1F9-42BD-8848-8CB6B42ED2FE.

developing the wording of insurance policy forms and for filing rates and forms at state insurance regulators on behalf of their member insurers. North Carolina is the only remaining state with a rating bureau that continues to provide these services for insurers writing homeowners business in the state.[27] All insurance companies licensed in the state to provide residential property coverage in North Carolina must subscribe to and be members of the North Carolina Rating Bureau (NCRB). Insurers support the NCRB financially by paying the bureau according to their market share in the state.

Monopolistic Markets

Workers' compensation insurance, a required line of business employers must provide for their employees, is highly competitive, with over 200 insurers offering the product in most states.[28] However, in four states—Ohio, North Dakota, Washington and Wyoming—the workers' compensation market is a monopoly, where a state-run insurance company is the only source of workers' compensation insurance.[29] Monopolistic markets for workers' compensation insurance introduce the same drawbacks of monopolies everywhere: There is no consumer choice or competitive pressure for companies to improve their products and services.

Homeowners Premium

The impact of price controls on homeowners insurance rates can also be discerned in data on average homeowners insurance premium by state.[30] The table below shows the average price of a homeowners insurance policy in California as $1,241, about the same as $1,222 for South Dakota or $1,296 for Tennessee. However, the cost to build or rebuild a home in California is higher than these other states. In California, homebuilding or rebuilding costs $173 per square

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[27] J. Bradley Karl et al., "Consent to Rate Laws: A Case Study of the North Carolina Homeowners Insurance Marketplace," *Journal of Insurance Regulation* 39:3 (June 25, 2020). https://content.naic.org/sites/default/files/jir-za-39-03-el-consent-rate-nc-homeowners.pdf.
[28] "List of Workers Compensation Insurance Companies," Class Codes, last accessed Sept. 3, 2023. https://classcodes.net/list-workers-compensation-insurance-companies/index.html.
[29] "Monopolistic state funds," International Risk Management Institute, Inc., last accessed July 11, 2023. https://www.irmi.com/term/insurance-definitions/monopolistic-state-funds.
[30] "Facts + Statistics: Homeowners and renters insurance," Insurance Information Institute, last accessed Sept. 3, 2023. https://www.iii.org/fact-statistic/facts-statistics-homeowners-and-renters-insurance.

foot—17 percent higher than $144 per square foot in South Dakota or Tennessee.[31] California is also more prone to natural catastrophes like wildfires. These comparisons suggest that homeowners' insurance in California is underpriced because of the price controls, a factor contributing to the exodus of insurers from the market.

Average Homeowners Insurance Premium in $ by State, 2020

Alabama	1,501	Montana	1,347
Alaska	989	Nebraska	1,586
Arizona	866	Nevada	824
Arkansas	1,498	New Hampshire	1,048
California	1,241	New Jersey	1,277
Colorado	1,667	New Mexico	1,151
Connecticut	1,582	New York	1,356
Delaware	907	North Carolina	1,119
Florida	4,200*	North Dakota	1,230
Georgia	1,403	Ohio	871
Hawaii	1,245	Oklahoma	2,040
Idaho	810	Oregon	735
Illinois	1,144	Pennsylvania	967
Indiana	1,021	Rhode Island	1,788
Iowa	998	South Carolina	1,327
Kansas	1,478	South Dakota	1,222
Kentucky	1,174	Tennessee	1,296
Louisiana	2,038	Texas	2,000
Maine	956	Utah	764
Maryland	1,169	Vermont	984
Massachusetts	1,667	Virginia	1,107
Michigan	1,002	Washington	937
Minnesota	1,481	West Virginia	974
Mississippi	1,674	Wisconsin	762
Missouri	1,301	Wyoming	1,308

[31] Jordan Rosenfeld, "Most (and Least) Expensive States to Build a Home," Go Banking Rates, June 16, 2023. https://www.gobankingrates.com/investing/real-estate/most-expensive-cheapest-states-to-build-house.

U.S. Average	1,331

*Data for Florida is from 2022, provided by Insurance Information Institute correspondence.

Source: "Facts + Statistics: Homeowners and renters insurance," Insurance Information Institute, last accessed Sept. 3, 2023. https://www.iii.org/fact-statistic/facts-statistics-homeowners-and-renters-insurance.

Conclusion

A free and competitive insurance market positively impacts customer choice and undergirds sound risk-adjusted pricing. However well-intentioned they may be, government-imposed price controls and other interventions lead to disruption and can, in extreme instances, result in crisis conditions where choice is limited and prices rise unmanageably.

Thank you for holding today's hearing, and thank you for your consideration of my views. I look forward to any questions you may have.