Why Texas Auto Insurance Consumers Have Not Benefited from "Tort Reform"

A Response to the Texas Department of Insurance

September 1999

Austin, TX -- Insurance Commissioner José Montemayor will soon announce his decision on "tort reform rate reductions". This announcement will be the last of five annual tort reform rate reduction decisions by the Texas Department of Insurance (TDI). As in the past, we expect TDI to claim hundreds of millions of dollars in savings to consumers from "tort reform." For private passenger automobile insurance, TDI has already claimed the following savings:

1996	$178.5 million
1997	$177.9 million
1998	$247.4 million
1999	$247.4 million

These claims are simply do not hold up under scrutiny. In fact, Texas auto insurance consumers have not seen reductions in premiums as a result of "tort reform." Rather, CEJ's August 1999 report on Texas auto insurers profitability shows the following overcharges to Texas auto insurance consumers

1996	$728.9 million
1997	$1,193.3 million
1998	$960.4 million

How can there be such a disparity in claims of "tort reform" impact? This memo supplements the August 1999 CEJ report to help sort through the various claims.

Fact versus Fiction: How did TDI come up with its estimate of "tort reform" savings?

TDI verifies and calculates "tort reform" savings by reviewing forms submitted by insurance companies. On these forms, insurance companies estimate what their losses and premiums would be without the "tort reform rate reduction" and then apply the "tort reform rate reduction" factors to these estimates. The resulting calculation is the estimate of "tort reform savings".

The first question that comes to mind is, why wouldn't the insurance companies simply inflate their estimates of pre-"tort reform" losses and premiums to avoid having to actually reduce rates by the appropriate amount? This appears to have actually been the case. Actual premiums charged to consumers did not decline. Rather, insurer profitability increased because of lower losses.

If insurers were actually lowering rates because of tort reform rate reductions, we would expect to see declines in premiums and constant loss ratios over time. Loss ratios – losses divided by premiums – should be constant over time because reductions in insurers' claim payments would be matched by reductions in premium.

What happened? As the CEJ report shows, despite "mandatory tort reform rate reductions," auto insurance premiums continued to increase, loss ratios fell dramatically and auto insurers reaped windfall profits from 1996 through 1998. Tables 1 and 6 of the CEJ report show increasing premiums and decreasing loss ratios following "tort reform." Tables 2, 4 and 5 of the CEJ report show the windfall profits of Texas auto insurers. For example, Table 4 shows that bodily injury liability rates for rate-regulated auto insurers were over 41% excessive in 1996 and 1997.

Which is the more credible evidence of "tort reform savings" – the TDI tabulation of numbers on tort reform forms submitted by insurers or the actual premium and loss experience of auto insurers over a three-year period? Despite the TDI claims to the contrary, the insurers' actual premium and loss experience shows, without doubt, that insurance companies, not consumers, have been the beneficiaries of "tort reform." In contrast to the absence of any facts or evidence to support the TDI claims of "savings," the insurers' actual premium and loss experience demonstrates conclusively that "tort reform savings" to consumers has yet to materialize.

1. "**It's not all due to tort reform"**

TDI staff have acknowledged the radical reduction in auto insurance losses and the record profits of Texas auto insurers. But, TDI staff argue that not all the reduction in losses is due to tort reform. Some of the loss reduction, they argue, is a result of other factors, such as safer cars and the aging of the driving population.

What TDI fails to mention is that, for rate-regulated auto insurers, TDI is responsible for ensuring that rates are fair, reasonable and not excessive. Thus, if an insurer submits a rate filing that is excessive, it is TDI's responsibility to challenge that filing and force the insurer to file lower rates. Whatever the cause of dramatically lower losses, it is TDI's responsibility to ensure that rates are not excessive – whether accomplished by mandatory tort reform rate reductions or by challenging insurers' rate filings. Thus, when TDI says that not all the loss reduction is a result of tort reform, they are simply admitting to failing to adequately review and challenge insurers' rate filings. Consumers do not benefit from "tort reform rate reductions" if the insurance companies lower rates on one piece of paper, but raise them on another.

2. **"Rates have come down**."

TDI staff have argued that rates *have* come down. They provide a chart showing the decline in rates compared to declines in average losses. TDI staff argue that, while rates may have been excessive, they are now reasonable. Once again, the facts contradict the TDI story.

In April 1998, TDI staff argued the exact same thing before an interim meeting of Texas state senate committees on economic development and civil justice – that rate reductions in early 1998 had lowered rates to reasonable levels. Yet, the actual 1998 premium and loss experience showed yet another year of windfall profits of Texas auto insurers in 1998 as in 1996 and 1997.

The TDI argument that rates have come down in 1999 is particularly shallow. Commissioner Elton Bomer lowered the benchmark rates by 5%, effective March 1999. Yet, few major insurers lowered their rates by even this 5% amount. Nationwide Mutual actually *increased* its rates by 1.3% in early 1999 before lowering them 2.4% effective October 1, 1999. Thus, even after the rate decrease, Nationwide's rates are only about 1% lower in 1999 than in 1998 – even though Nationwide's 1998 loss ratio was only 58%. This 58% loss ratio is about 15 percentage points below a loss ratio that will a reasonable profit. Similarly, the three biggest insurers – Allstate, State Farm and Farmers – lowered rates by less than half of the benchmark rate decrease, despite 1998 loss ratios of only 53%, 61% and 68%.

Once again, the facts contradict the TDI claims. Texas auto insurers have not significantly reduced rates in 1999 and, consequently, 1999 will be the fourth consecutive year of excessive overcharges to consumers and windfall profits for Texas auto insurers.