2012

Report to the Senate Business and Commerce Committee

Homeowners' Premiums and Rates in Texas

A comparison of Texas' homeowners' insurance premiums with those of other states to identify the factors underlying Texas' premium levels and recent rate increases. Recommendations for the legislature to reduce homeowners' rates.

Texas Department of Insurance

July 10, 2012

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Executive Summary

Key Findings

- A state-by-state analysis of numerous variables shows that the primary driver of high premiums is high losses, both actual ordinary losses (See Figure 1) and potential catastrophe losses. No other factor appears to be correlated with premium levels.

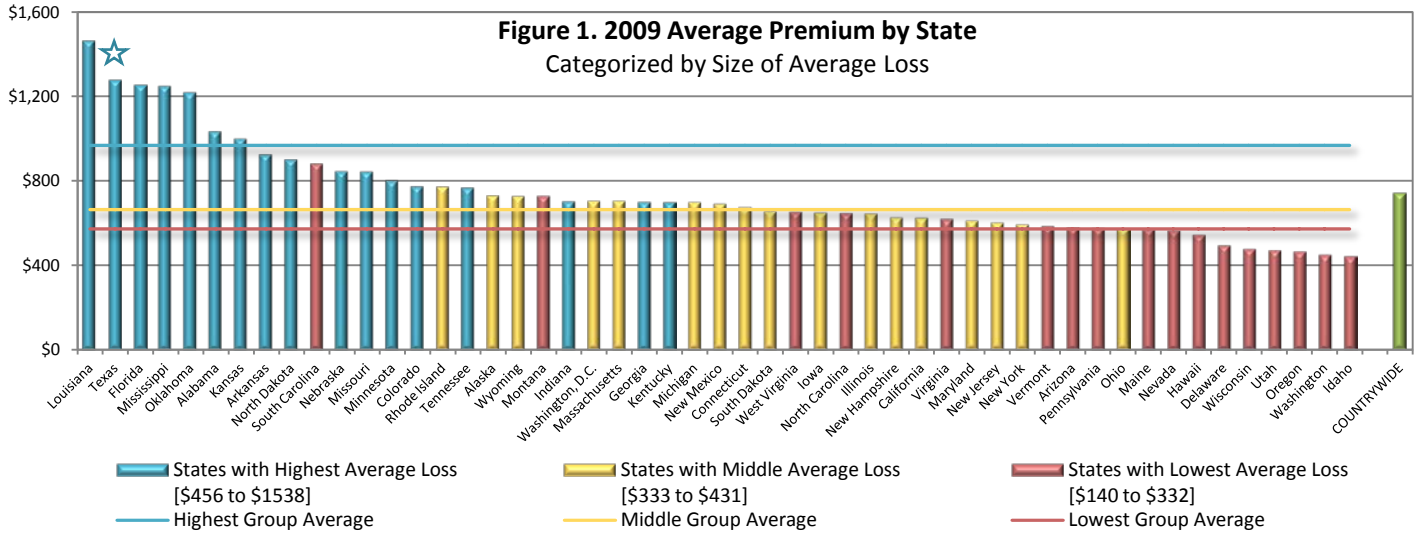


Figure 1. 2009 Average Premium by State
Categorized by Size of Average Loss

- Rates in Texas have gone up 21 percent since the beginning of 2009, but are increasing at a slower rate than countrywide and in many other states, based on a sample of 34 states (See Figure 2).

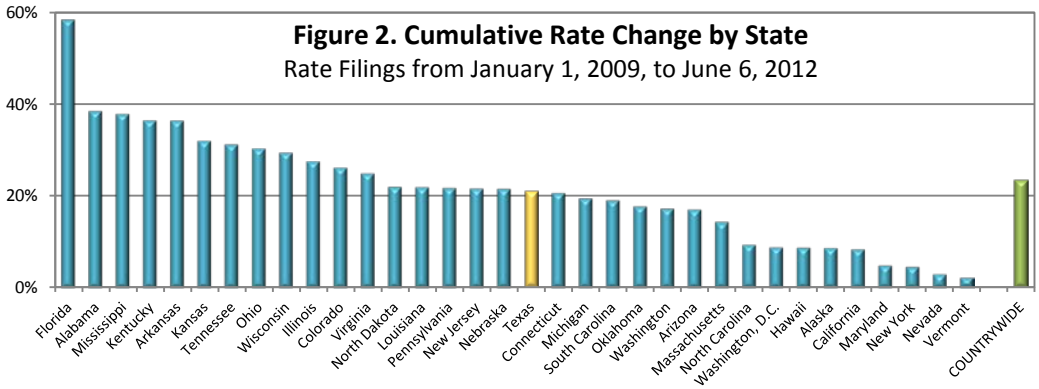


Figure 2. Cumulative Rate Change by State
Rate Filings from January 1, 2009, to June 6, 2012

- The main drivers of recent rate increases in Texas and some factors underlying these drivers are:
  - **Non-Catastrophe Claim Costs**: increases in underlying repair costs, expanded coverage, changes in the features of new homes.
  - **Catastrophe Claim Costs**: changes to hurricane models and to the underlying assumptions used in the models; movement in recent years toward catastrophe models for non-hurricane catastrophes.
  - **Additional Risk Charges to Finance Catastrophe Risk**: changes to hurricane models and an increased awareness of exposure; insurers' demands for the same return for assuming the risk that a reinsurer would.
  - **Underwriting Expenses**: percentage expenses increasing with average premium increases.
  - **Underwriting Profit and Contingencies**: recent decline in interest rates.

Recommendations

- Reducing loss costs will be the most effective way to reduce rates.
  - **Licensing or other credentialing management of roofing contractors** would eliminate disreputable "fly-by-night" contractors, ensure contractors have the needed qualifications and training, and ensure that repairs are made to better withstand the next event.
  - **Premium credits for use of impact-resistant building materials** would reduce hail losses.
  - **Reducing fraudulent activity** would reduce costs to both consumers and insurers.
  - **Stronger building codes** and rigorous enforcement of those building codes have been shown to decrease loss costs.

Introduction

According to the National Association of Insurance Commissioners' (NAIC) report on 2009 average homeowners' insurance premiums (the latest data available), Texas has one of the highest average premiums in the country. Additionally, many insurers in Texas filed to increase their homeowners' rates in the last two years. The Texas Department of Insurance (TDI) has been tasked with answering some difficult questions: Why are premiums so high? Why are rates going up? What can TDI or the legislature do about it?

To answer these questions, TDI compared Texas homeowners' premiums with those of other states across a broad range of factors. We have identified the factors underlying premium levels in Texas (and other states) and have provided suggestions for steps the legislature can take that are likely to reduce homeowners' rates.

Limitations on the Data

National comparisons are problematic because of variations in property values, coverage provided, policy forms, and the influence of residual markets. The NAIC report includes data for the Texas Windstorm Insurance Association (TWIA) in Texas, but not for Louisiana's and Florida's insurers of last resort, Citizens Property Insurance Corporation (Citizens), which write wind-only coverage and full homeowners' coverage. Other states have wind pools, as well as hurricane-only writers in the voluntary market that may not be included in this report. These exclusions may significantly underestimate the total cost of homeowners' insurance in these states.

Even though these limitations on the data may significantly underestimate the average premium in other states, it is the only basis for comparison available, so our analysis relies on the average premiums provided by the NAIC report. Additionally, Texas would still be in the top three states with high average premiums.

Comparing Premium Levels in Texas with Other States

In this section, we compare the average premium in Texas to the average premium in other states and show how the factors correlate to premium levels. We compare the 2009 average premium in Texas to that of every other state for all coverage amounts combined and for coverage amounts in the range of $175,000 to $199,999 to establish a baseline for comparison. We looked at different iterations of the regulatory system, the average loss per policy, and exposure to catastrophes as potential factors having a correlation to premium levels.

Average Premium Comparison: All States

Although Texas has one of the highest average premiums in the nation, the cumulative growth in average premium from 2005 to 2009 is lower in Texas than the corresponding growth in many other states (See Figure 1).

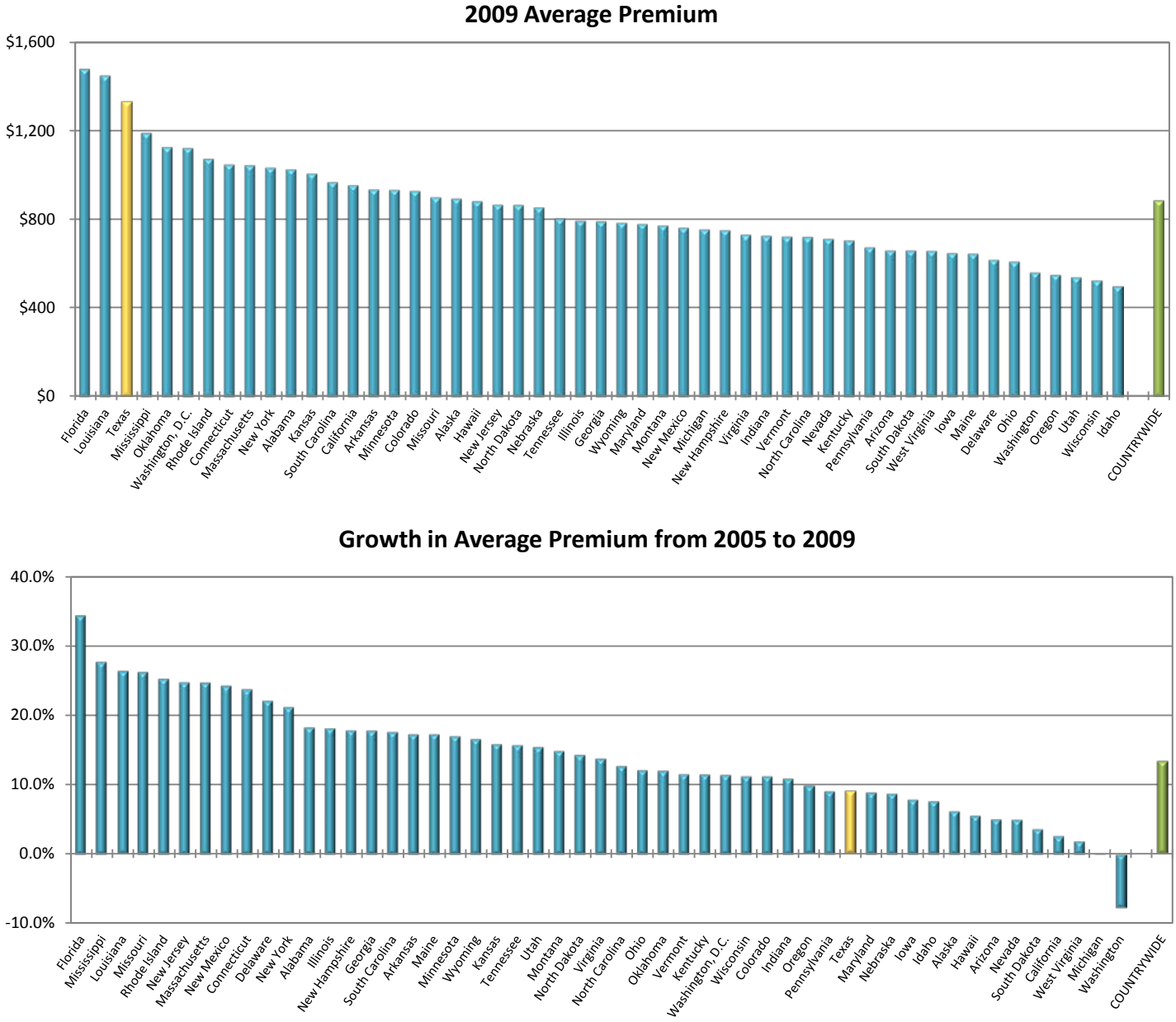


Figure 1. 2009 average premium by state and cumulative growth in average premium by state from 2005 to 2009 for all owner-occupied homeowners' policy forms combined for all coverage amounts.
Source: 2005 through 2009 NAIC reports on average premium.

Average premium is most impacted by changes in the amount of insurance and changes in the rate levels, so it is important to consider the average amount of insurance when comparing average premium growth. If the average amount of insurance increases over time, the average premium will also increase since insureds are buying more coverage. The distribution of policies in certain ranges of amounts of insurance varies greatly between states (See Figure 2).

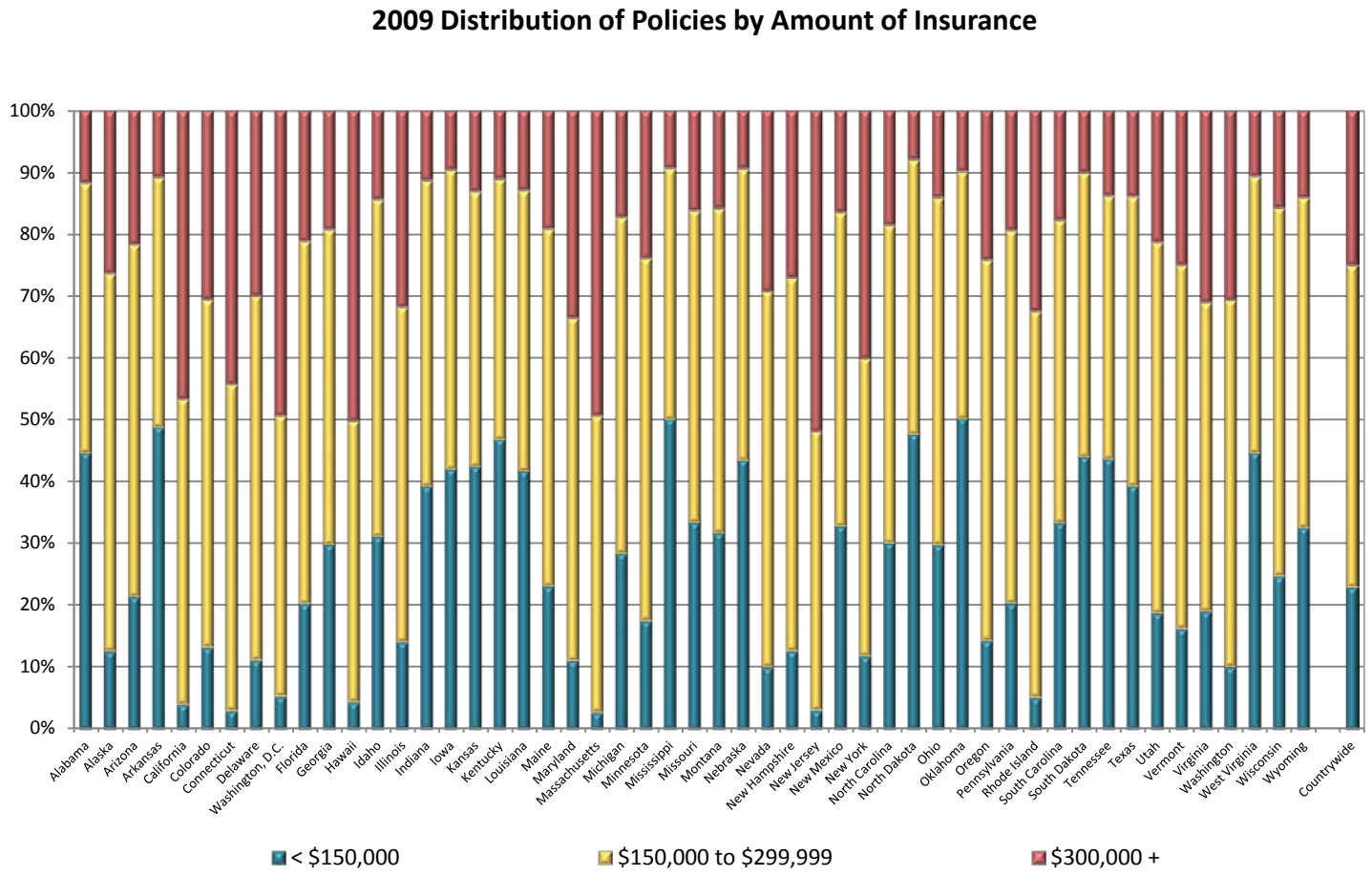


Figure 2. 2009 distribution of policies by amount of insurance for all owner-occupied homeowners' policy forms for certain ranges of coverage amounts.
Source: 2009 NAIC report on average premium.

Since the average amount of insurance in each state affects the average premium for that state, the average premium per $1,000 of coverage is a better basis for comparison as it measures, to a greater extent, how much of the change in average premium is due to changes in rate levels.

However, we could not easily obtain the average premium per $1,000 of coverage for other states. As an alternative, we analyzed the average premiums for coverage amounts in the range of $175,000 to $199,999. This reduces the effect of increasing coverage amounts on the average premium, but doesn't eliminate it. The remaining analyses of premium levels were performed using this range of coverage amounts.

Texas still has one of the highest average premiums in this coverage amount range for 2009, but the growth in average premium from 2005 to 2009 is lower in Texas than the corresponding growth in many other states. Texas' increase in average premium is less than the countrywide increase and the increase in 35 other states (See Figure 3).

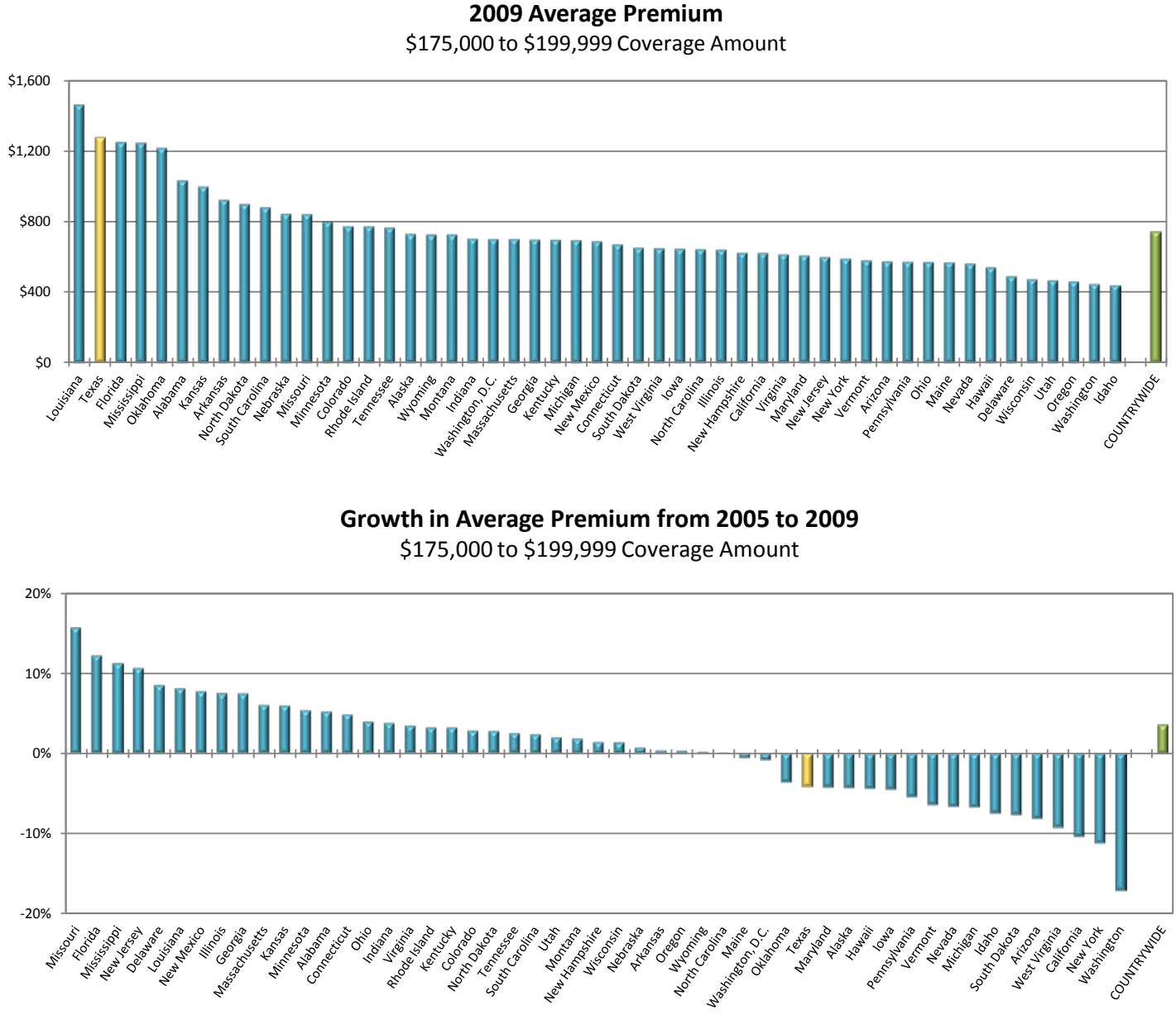


Figure 3. 2009 average premium by state and cumulative growth in average premium by state from 2005 to 2009 for all owner-occupied homeowners' policy forms combined for coverage amounts in the range $175,000 to $199,999.
Source: 2005 through 2009 NAIC reports on average premium.

Factors Correlated with Premium Levels

Even though the cumulative growth in average premium from 2005 to 2009 is less than the majority of other states, the fact remains that Texas consistently has one of the highest average premiums in the country. To determine which factors have the greatest impact on a state's average premium level, and in an attempt to find a direct link to Texas' high premiums, we tested the hypotheses that the regulatory system, the size of the state, the average loss per policy, and exposure to catastrophes have an effect on premium levels.

We obtained the information for each of these factors for all 50 states and the District of Columbia and compared the premium levels between states for each factor. We produced graphs that rank the states by their average premium and color-coded the states' premium bars based on the characteristic of that state. If the factor is a good predictor of average premium levels, we should see clusters of the same colors on both ends of the graph. This clustering of colors represents states with a similar characteristic in a similar range of average premium. If the factor is not a good predictor of average premium levels, we should see the colors randomly dispersed throughout the graph. We also calculated the averages for each group, which represents the average of states with similar characteristics. We performed a visual analysis on each graph and made observations based on the analysis.

To validate our visual analysis and to test the statistical significance of each factor, we also performed a multivariate analysis. A multivariate analysis is a statistical analysis, which considers all the factors simultaneously and determines which are the best predictors. The analysis is performed across multiple dimensions while taking into account the effects of all the factors.

Regulatory Environment

We reviewed the regulatory environment governing the insurance industry in each state. We considered the possibilities that the method of selecting the commissioner, the type of rate filing laws, restrictions on underwriting, and the ease of nonrenewal or cancellation of a policy, may contribute to high premiums. If we could isolate a factor with a clear correlation to high premiums, a direct solution would be to adopt the laws and practices of a low premium state.

Commissioner Type

Eleven states have an elected commissioner; in all other states, the commissioner is appointed by the governor or by a person or agency appointed by the governor.

The average premium for states with an elected commissioner is higher than for states with an appointed commissioner (See Figure 4), but the multivariate analysis indicates that the type of commissioner is not a predictor of premium levels.

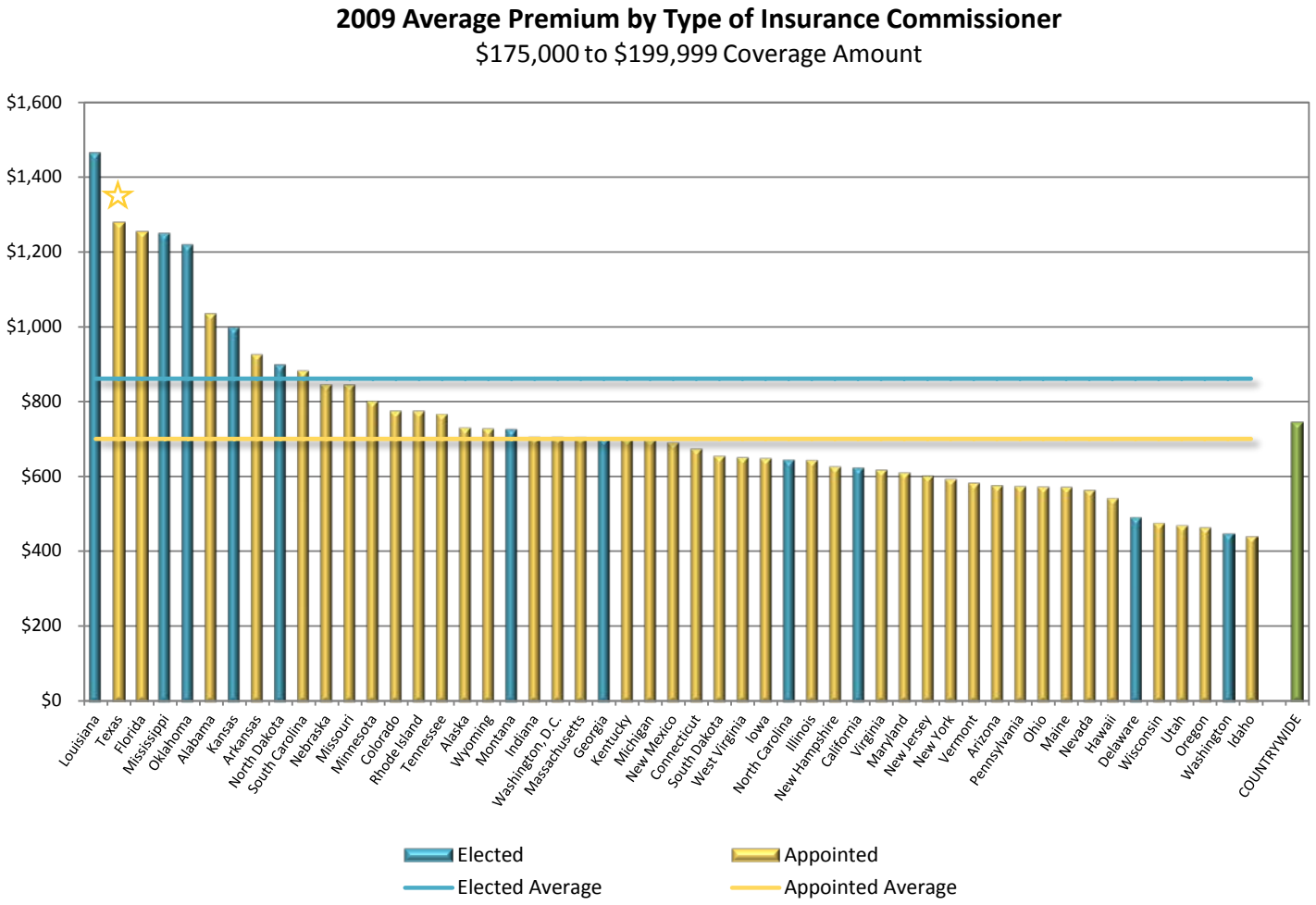


Figure 4. 2009 average premium by state for all owner-occupied homeowners' policy forms combined for coverage amounts between $175,000 and $199,999, grouped by type of insurance commissioner.
Source: 2009 NAIC report on average premium and 2011 NAIC Insurance Department Resources Report.

Rating Law

States have four basic types of laws regarding the way rates are filed and reviewed: a prior approval system requires that rates be approved before they can be used; a flex rating system requires prior approval for rate changes above a set value and file-and-use for rate changes below that value; a file-and-use system requires insurers to file their rates before they can use them, but the rates are not approved; a use-and-file system requires insurers to file their rates, but they can use them before they are filed, and they are not approved. In most file-and-use and use-and-file systems, rates can be disapproved.

To determine if the type of rating law is a strong predictor of premium levels, we split the states into three groups: prior approval and flex rating; file-and-use; and use-and file and no file.

The average premiums for all three types of rating laws are very similar (See Figure 5), and the multivariate analysis confirms that the type of rating law is not a predictor of premium levels.

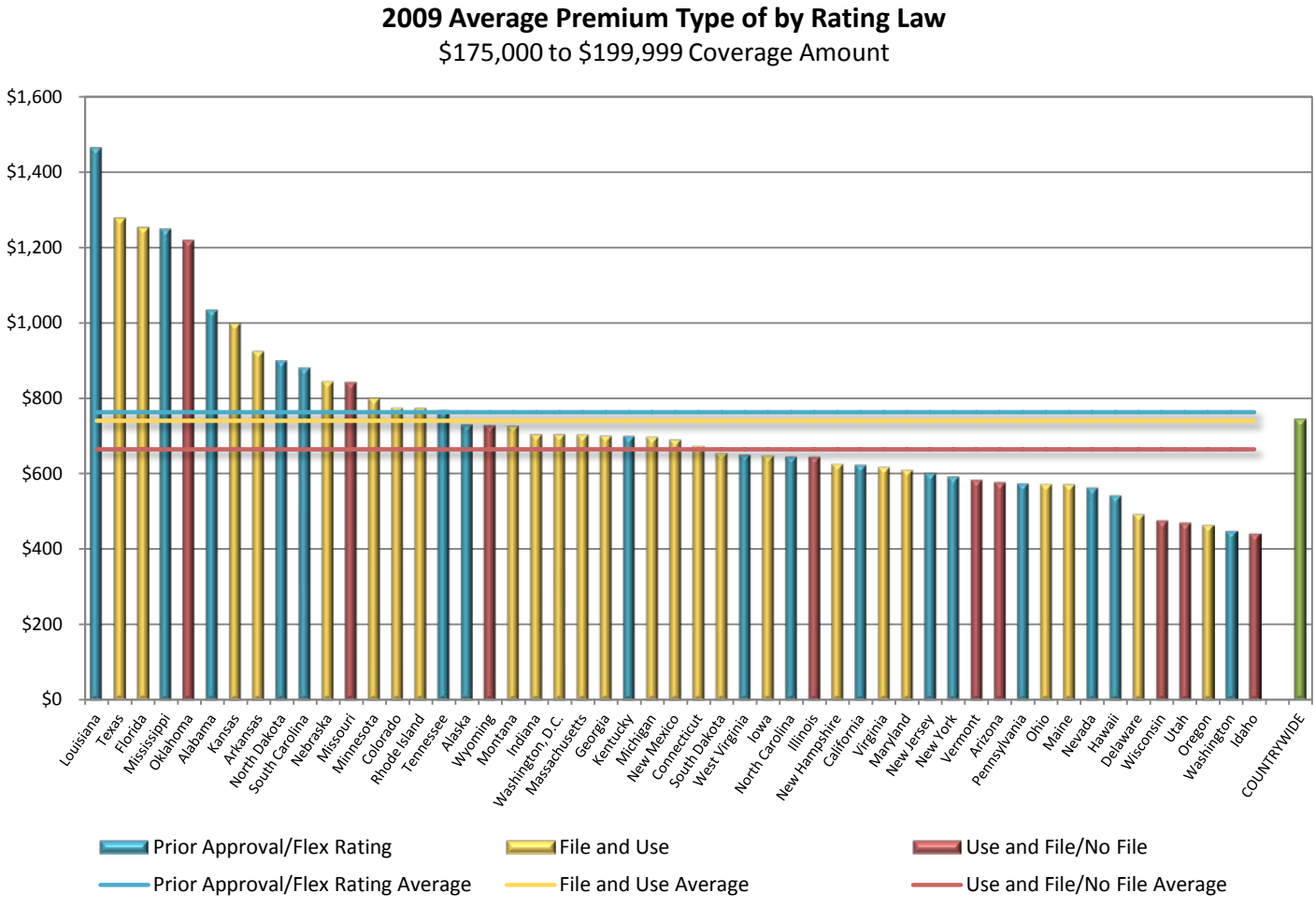


Figure 5. 2009 average premium by state for all owner-occupied homeowners' policy forms combined for coverage amounts between $175,000 and $199,999, grouped by type of rating law.
Source: 2009 NAIC report on average premium and ISO report of filing laws.

Underwriting Restrictions

States have varying restrictions on insurers' underwriting practices. All states prohibit unfair discrimination, such as refusing to insure a person because of the person's race, color, religion, or national origin. Some states allow insurers to decline to write a policy for any reason, some states allow insurers to decline to write a policy except for certain reasons, and other states allow insurers to decline to write a policy only for specified reasons. For example, Texas places limits on insurers' abilities to decline to issue a policy based solely on an applicant's credit history.

To determine if the level of underwriting restrictions is a strong predictor of premium levels, we examined the statutes in each state that relate to underwriting and scored the restrictions based on the importance in determining losses. We split the states into three groups: most restrictive, middle restrictive, and least restrictive, based on their total score.

The average premium for states with the least restrictive underwriting is less than states with the most restrictive underwriting (See Figure 6), but the multivariate analysis indicates that the level of underwriting restrictions is not a predictor of premium levels.

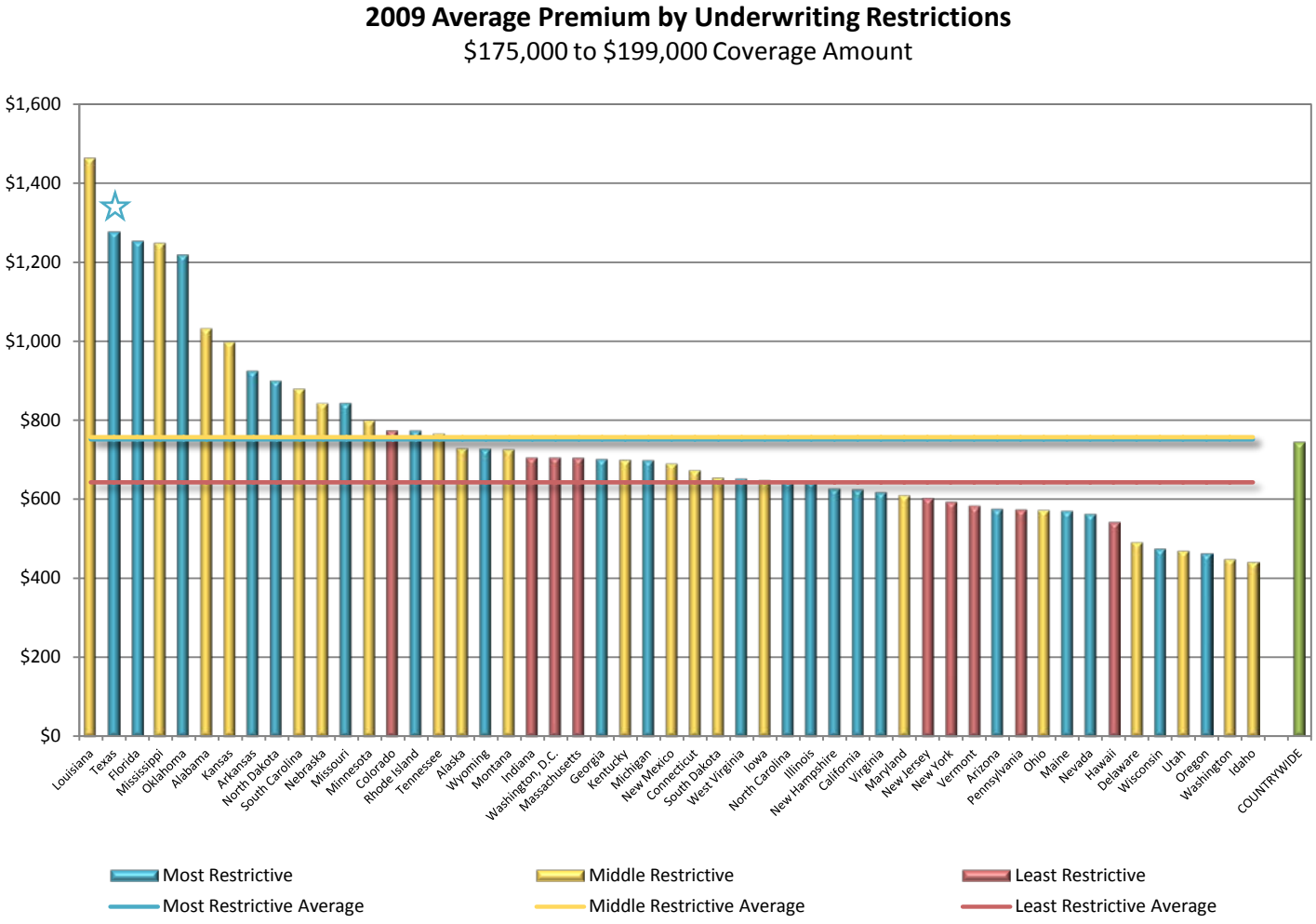


Figure 6. 2009 average premium by state for all owner-occupied homeowners' policy forms combined for coverage amounts between $175,000 and $199,999, grouped by underwriting restriction group. The restrictions in each state were scored based on the importance in determining losses and the states were split into three equally-sized groups based on their total score.
Source: 2009 NAIC report on average premium and underwriting statutes from each state.

Ease of Nonrenewal and Cancellation of a Policy

States have varying restrictions on their nonrenewal and cancellation practices. Some states allow insurers to nonrenew or cancel a policy for any reason, while other states have restrictions on when insurers may nonrenew or cancel a policy. For example, Texas insurers can nonrenew for any reason, as long as a notice is given, but can cancel only for specified reasons, which include nonpayment of premium and discovery of fraud or misrepresentation.

To determine if the ease of nonrenewal and cancellation of a policy is a strong predictor of premium levels, we examined the statutes in each state that relate to nonrenewal and cancellation and scored the restrictions based on the severity of the restriction. We split the states into three groups: most restrictive, middle restrictive, and least restrictive, based on their total score.

The average premiums for all three groups of nonrenewal and cancellation restrictions are very similar (See Figure 7), and the multivariate analysis confirms that the ease of nonrenewal and cancellation of a policy is not a predictor of premium levels.

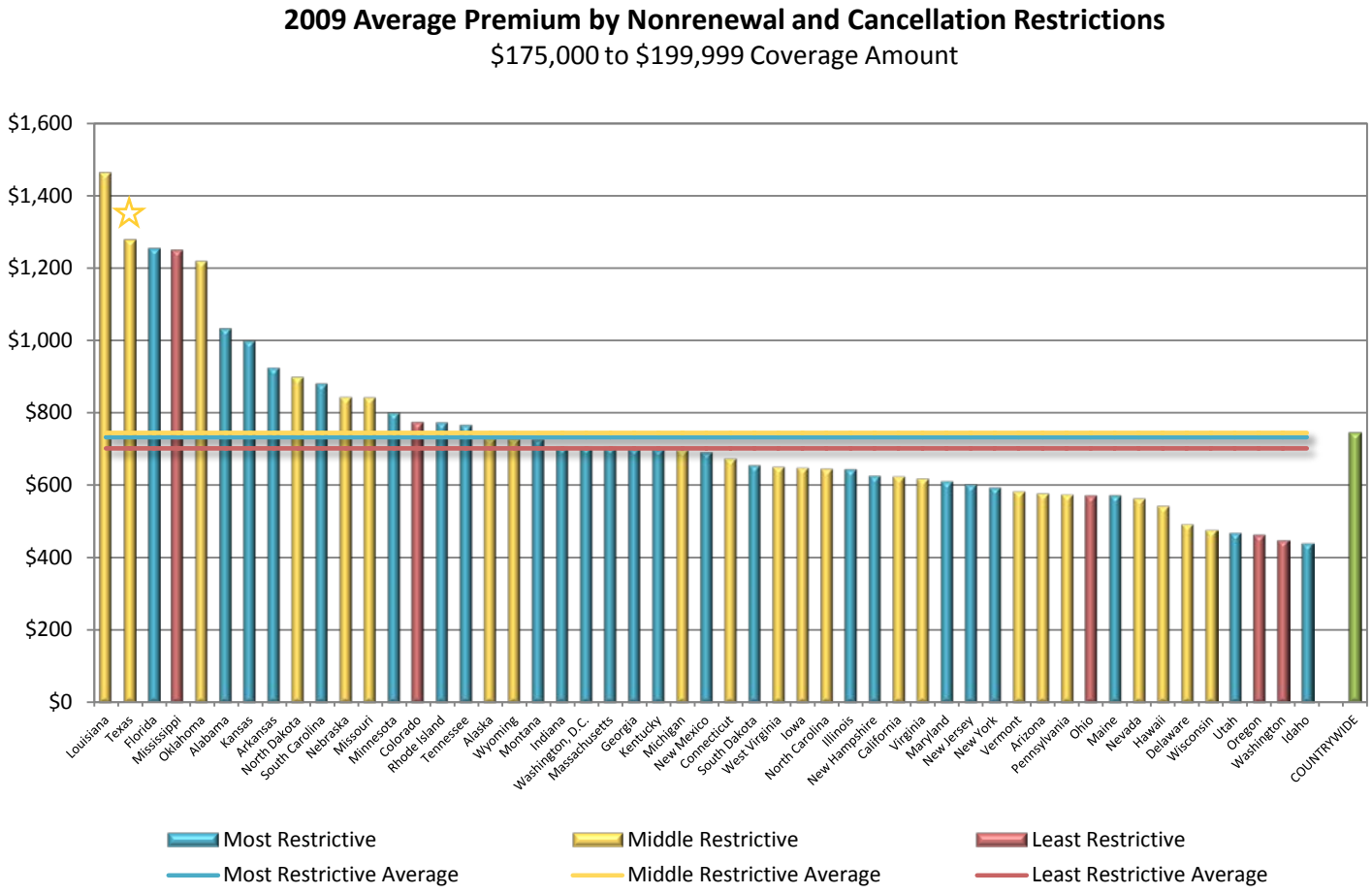


Figure 7. 2009 average premium by state for all owner-occupied homeowners' policy forms combined for coverage amounts between $175,000 and $199,999, grouped by the cancellation or nonrenewal restriction group. The restrictions in each state were scored based on the severity of the restriction and the states were split into three equally-sized groups based on their total score.

Source: 2009 NAIC report on average premium and 2012 Cancellation & Nonrenewal For The 50 States and District of Columbia.

Size of State

Texas has a large population, so we tested the hypothesis that there is a correlation between the size of the state based on the number of policies and the size of the premium.

To determine if the size of the state is a strong predictor of premium levels, we ranked each state based on the total number of policies written in 2009 and split the states into three equally-sized groups: high, middle, and low, based on their rank.

The average premium for the states with the middle number of policies is higher than for states with the lowest and highest number of policies (See Figure 8). The multivariate analysis indicates that the size of state is not a predictor of premium levels.

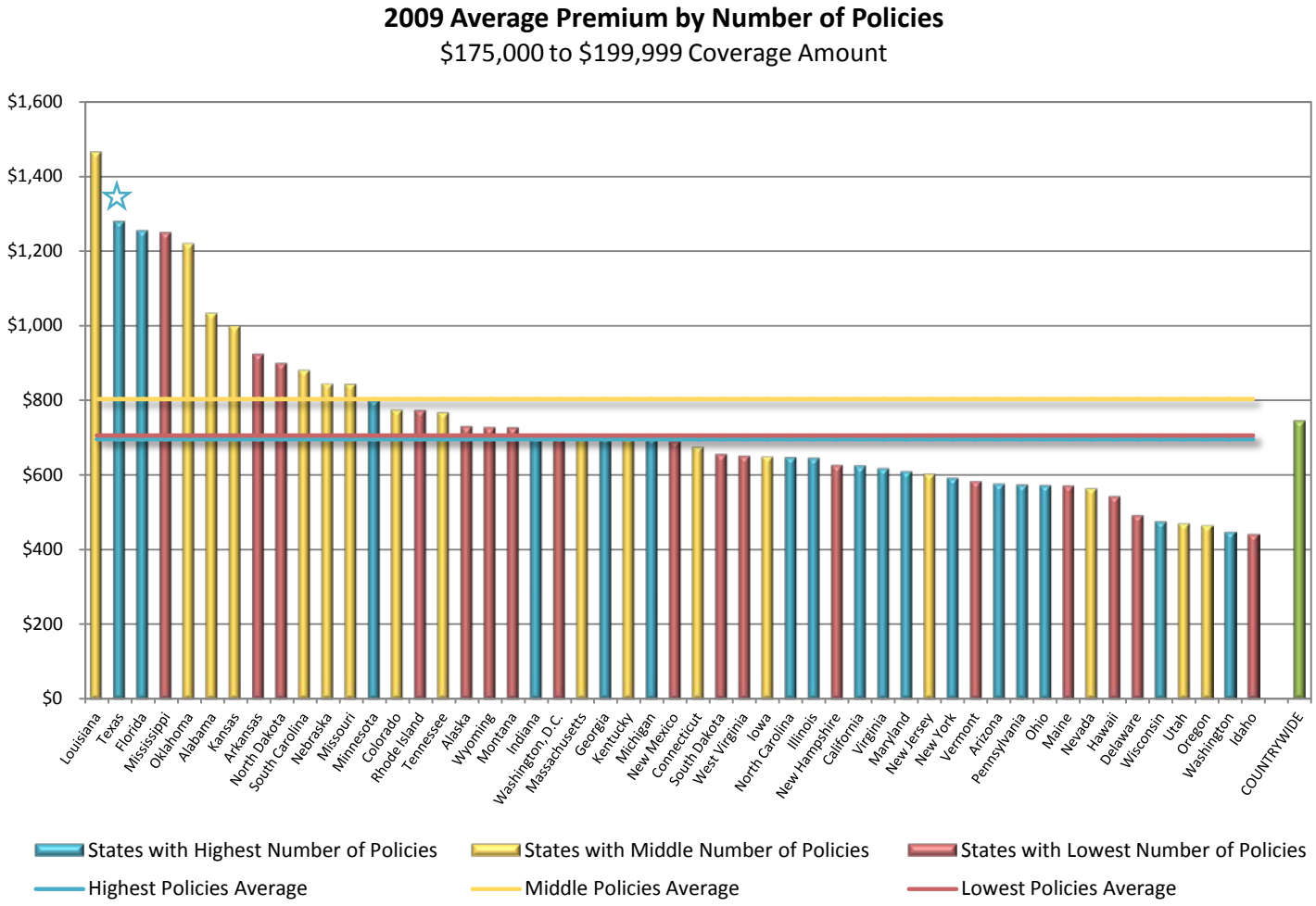


Figure 8. 2009 average premium by state for all owner-occupied homeowners' policy forms combined for coverage amounts between $175,000 and $199,999, grouped by the number of policies. Each state is ranked based on the total number of written policies in 2009 and the states were split into three equally-sized groups.
Source: 2009 NAIC report on average premium.

Average Loss per Policy

In Texas, losses make up a significant portion of the premium.

To determine if the size of the average loss per policy is a strong predictor of premium levels, we ranked each state based on the average loss per policy from 2000 to 2009 and split the states into three equally-sized groups: high, middle, and low, based on their rank.

The average premium for states with the highest average losses is substantially higher than the average for the rest of the states and there appears to be a strong correlation between the average loss per policy and the premium levels (See Figure 9). The multivariate analysis confirms that the average loss per policy is a strong predictor of premium levels.

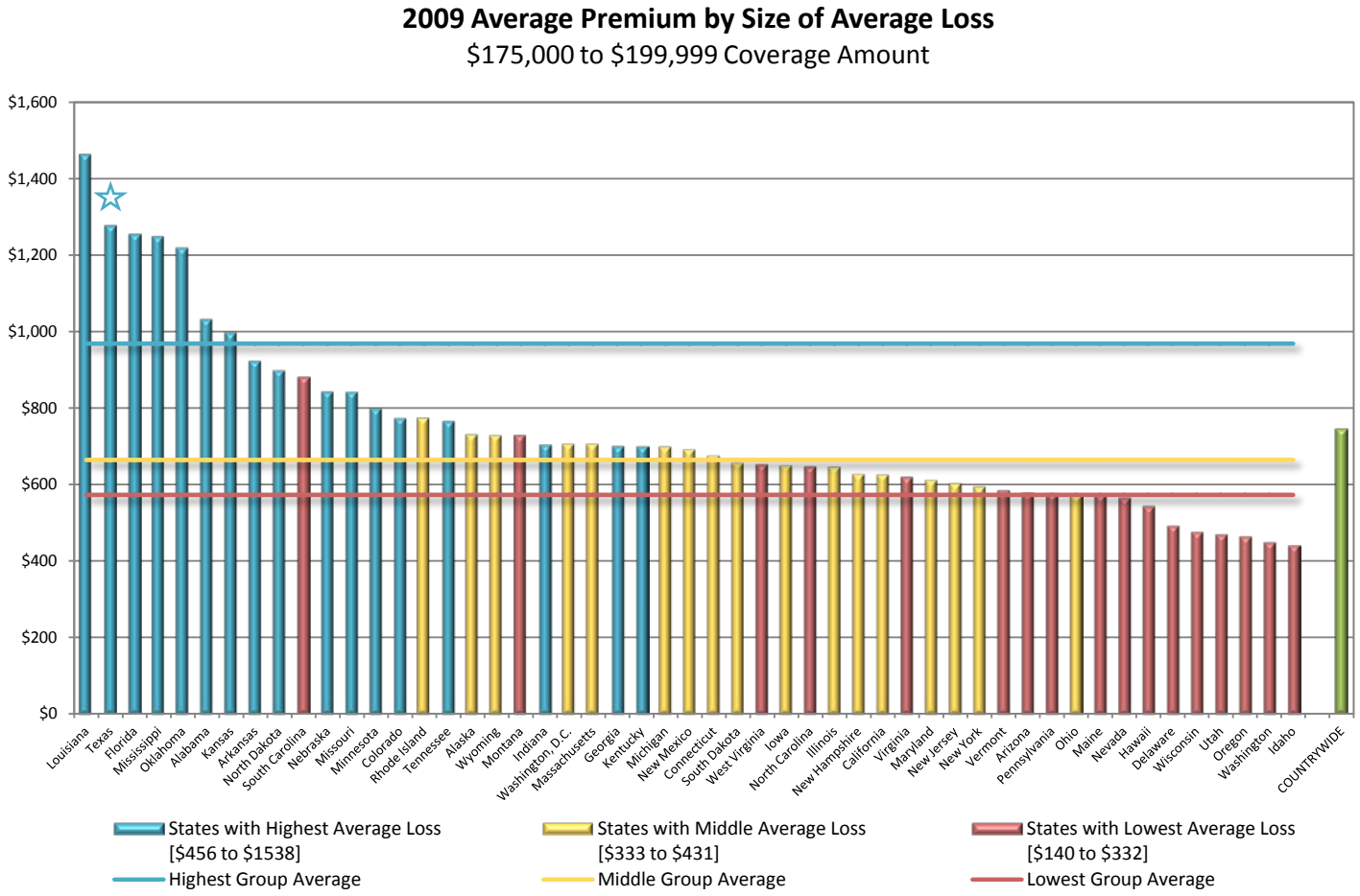


Figure 9. 2009 average premium by state for all owner-occupied homeowners' policy forms combined for coverage amounts between $175,000 and $199,999, grouped by the average loss per policy. Each state was ranked based on the average loss per policy from 2000 to 2009, and the states were split into three equally-sized groups.
Source: 2009 NAIC report on average premium and 2000 though 2009 NAIC profitability reports.

Average Combined Ratio

The combined ratio is the ratio of the total amount of losses, loss adjustment expenses, and underwriting expense to the total premium. It is a common measure of profitability.

To determine if there is a relationship between combined ratio and premium levels, we ranked each state based on the average combined ratio from 2000 to 2009 and split the states into three equally-sized groups: high, middle, and low, based on their rank.

Based on this analysis, there appears to be a relationship between combined ratios and premiums (See Figure 10). States with high premiums tend to have high 10-year combined ratios. However, the multivariate analysis indicates that the combined ratio is not a predictor of premium levels.

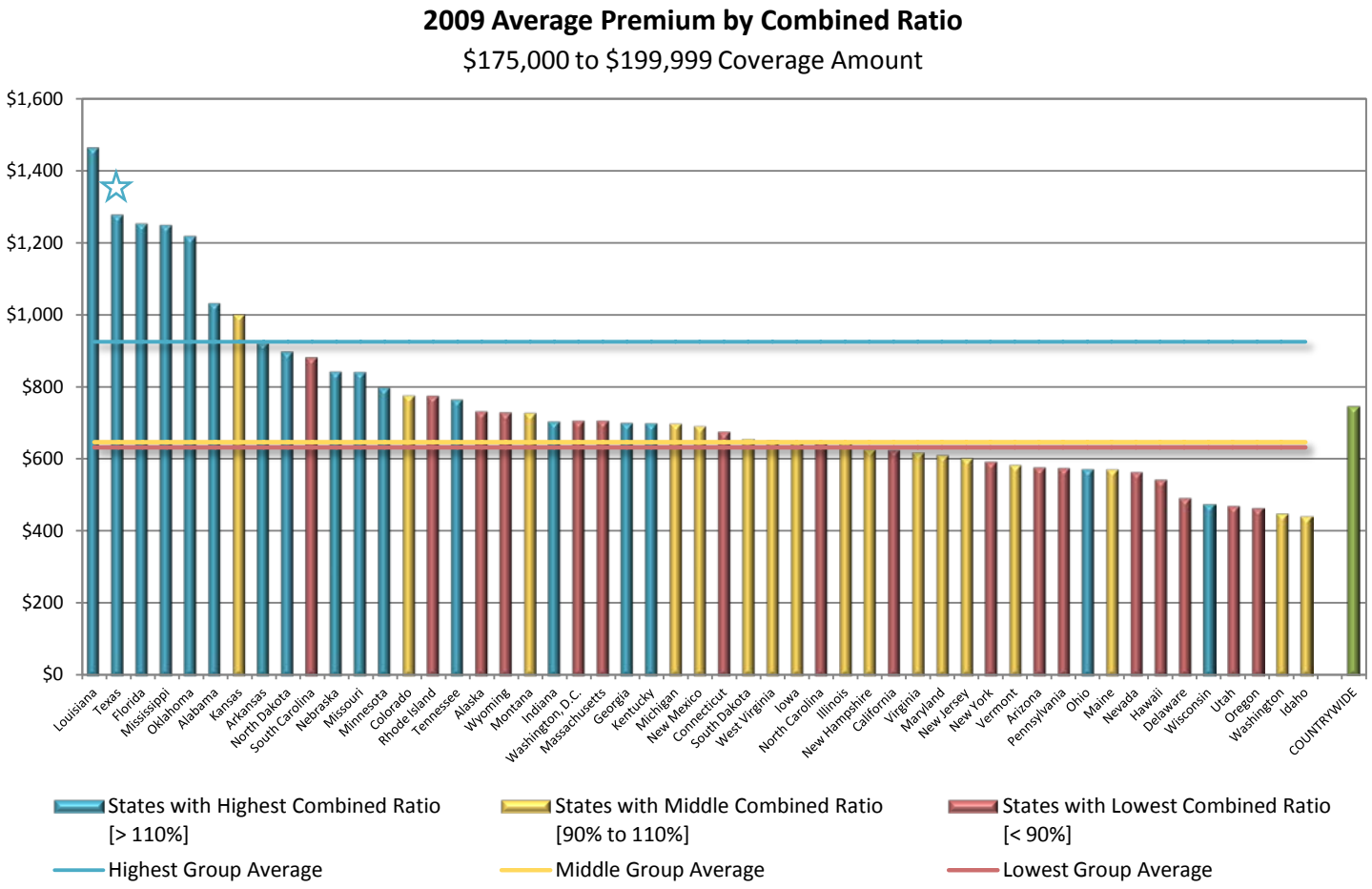


Figure 10. 2009 average premium by state for all owner-occupied homeowners' policy forms combined for coverage amounts between $175,000 and $199,999, grouped by the combined ratio. Each state was ranked based on the average combined ratio from 2000 to 2009, and the states were split into three equally-sized groups.
Source: 2009 NAIC report on average premium and 2000 though 2009 NAIC profitability reports.

Exposure to Number of Catastrophe-Type Perils

Texas is exposed not only to hurricanes, but to hail, tornadoes, and other thunderstorm-related perils as well. These perils cause a significant portion of the losses in Texas. While homes may be exposed to other catastrophe-type perils, such as earthquakes or wildfires, hurricanes, hail, tornadoes, and other thunderstorm-related perils represent the greatest risks faced by an insurer issuing homeowners' policies[1].

We categorized the states by the number of catastrophe-type perils they are exposed to, based on each state's exposure to hurricanes, hailstorms, and tornadoes. We considered Gulf Coast and Southeast Atlantic states to be exposed to hurricanes. We considered states with an annual average of three or more hail reports per 100 square miles covering a significant portion of the state from 2000 to 2009 to be exposed to hailstorms. Lastly, we considered states with an annual average of six or more tornado reports per 10,000 square miles from 1991 to 2010 to be exposed to tornadoes.

The average premium for states exposed to two or more catastrophe-type perils is substantially higher than for states with zero or one catastrophe-type perils, and the number of catastrophe-type perils appears to be a strong predictor of premium levels (See Figure 11). The multivariate analysis confirms that exposure to catastrophe-type perils is a strong predictor of premium levels.

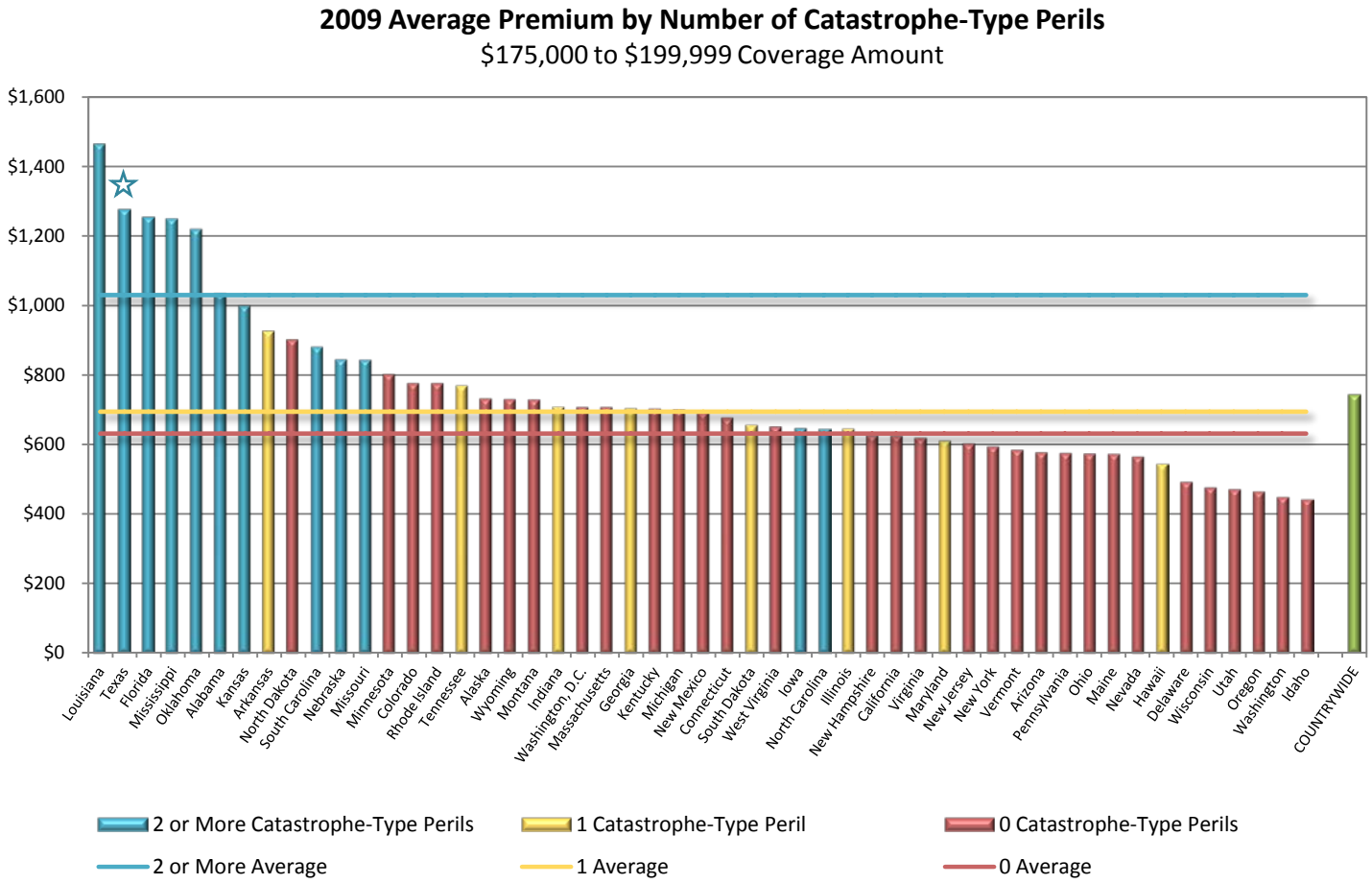


Figure 11. 2009 average premium by state for all owner-occupied homeowners policy forms combined for coverage amounts between $175,000 and $199,999, categorized by number of catastrophe-type perils. Hurricane, hail, and tornado were assigned to states with that exposure. Earthquake and wildfire perils were not included in this analysis.
Source: 2009 NAIC report on average premium and Institute for Business and Home Safety report on tornados and hail.

[1] Earthquakes are typically covered under a separate policy and wildfires are less frequent and do not represent a statistically significant risk long-term.

Average Premium and Cost Comparison: Texas vs. Countrywide

Based on the previous analysis, we determined that the primary driver of high premiums is high losses. The losses, together with the loss adjustment expenses and underwriting expenses, make up the actual amounts paid by an insurer, on a direct basis[2]. If the losses, loss adjustment expenses, and underwriting expenses add up to less than the premium, there is an underwriting profit. If the losses, loss adjustment expenses, and underwriting expenses add up to more than the premium, there is an underwriting loss.

The actual amounts paid per policy in Texas for each of these costs is higher than the corresponding countrywide cost, on average. In fact, the average loss per policy alone in Texas is greater than the entire average premium countrywide. And even with an average premium substantially higher than countrywide, the homeowners' insurance industry as a whole has been less profitable in Texas than countrywide (See Figure 12).

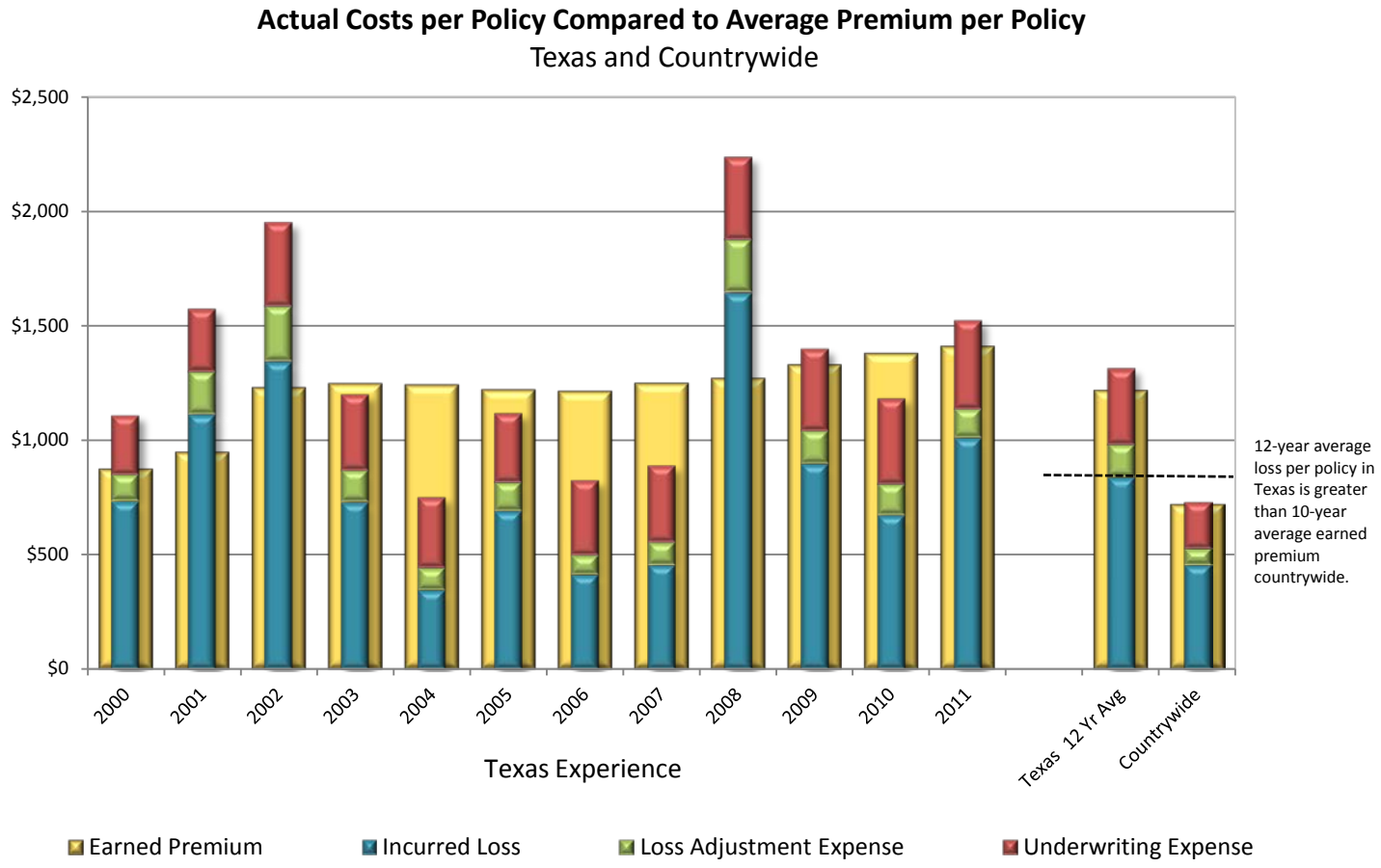


Figure 12. Average costs per policy in Texas for all owner-occupied homeowners' policy forms from 2000 to 2011. Countrywide average from 2000 to 2009.
Source: Texas compilation of Annual Statement Page 14 data from 2000 to 2011; 2000 to 2009 NAIC profitability reports.

[2] Premiums and losses are on a direct basis. This means that amounts insurers paid for reinsurance are not subtracted from the premiums, and amounts insurers collected from reinsurers are not subtracted from the losses.

Conclusions: Comparing Premium Levels in Texas with Other States

The average premium in Texas is higher than in many other states, but is increasing at a slower rate. This is true for all coverage amounts combined, as well as for coverage amounts in the range of $175,000 to $199,999.

A state-by-state analysis does not indicate a strong correlation between premium levels and the type of insurance commissioner, the type of rate filing law, restrictions on underwriting, or the ease of nonrenewal and cancellation of a policy.

The primary driver of high premiums is high losses, both actual ordinary losses and potential catastrophe losses. Texas has a high average loss per policy and a high exposure to catastrophes.

A look at the actual amounts paid per policy since 2000 on a direct basis shows that the average loss, loss adjustment expense, and underwriting expense are all higher in Texas than the corresponding countrywide cost. The average loss per policy alone is greater in Texas than the total average premium countrywide.

We now focus on further investigating the factors that are correlated with premium and identifying the reasons for the recent rate increases. In this section, we compare the recent rate changes in Texas with the rate changes in other states and we examine each component of the supporting information used to justify rates in order to identify the driving factors of the rate increases. We find that there are a number of factors putting upward pressure on rates for homeowners' insurance in Texas. Some of these factors are directly related to the costs that insurers have to pay. Others involve the market's perceptions of economic conditions and appetite for risk, as well as behavior and decisions of policyholders.

Rate Change Comparison: Texas vs. Countrywide and Other States

Rates in Texas increased 21 percent since the beginning of 2009, compared to a 9 percent increase for the period from 2006 to 2008. To determine if the acceleration of rate increases in the last few years was specific to Texas only or instead was a countrywide phenomenon, we requested rate filings made by the top five insurers in the top 40 states by premium volume from January 1, 2009, to June 6, 2012. Additionally, if the State Farm, Allstate, and Farmers groups were not represented in the top five insurers, we requested rate filings from the top insurer in each of those groups.

All the major states responded to our request; we received rate filings from 33 other states and estimated a cumulative rate change for this time period for each state and overall, based on the information we received. We determined that the cumulative rate change in Texas over the last three and a half years is less than the estimated countrywide cumulative change and less than 17 of the other states (See Figure 13).

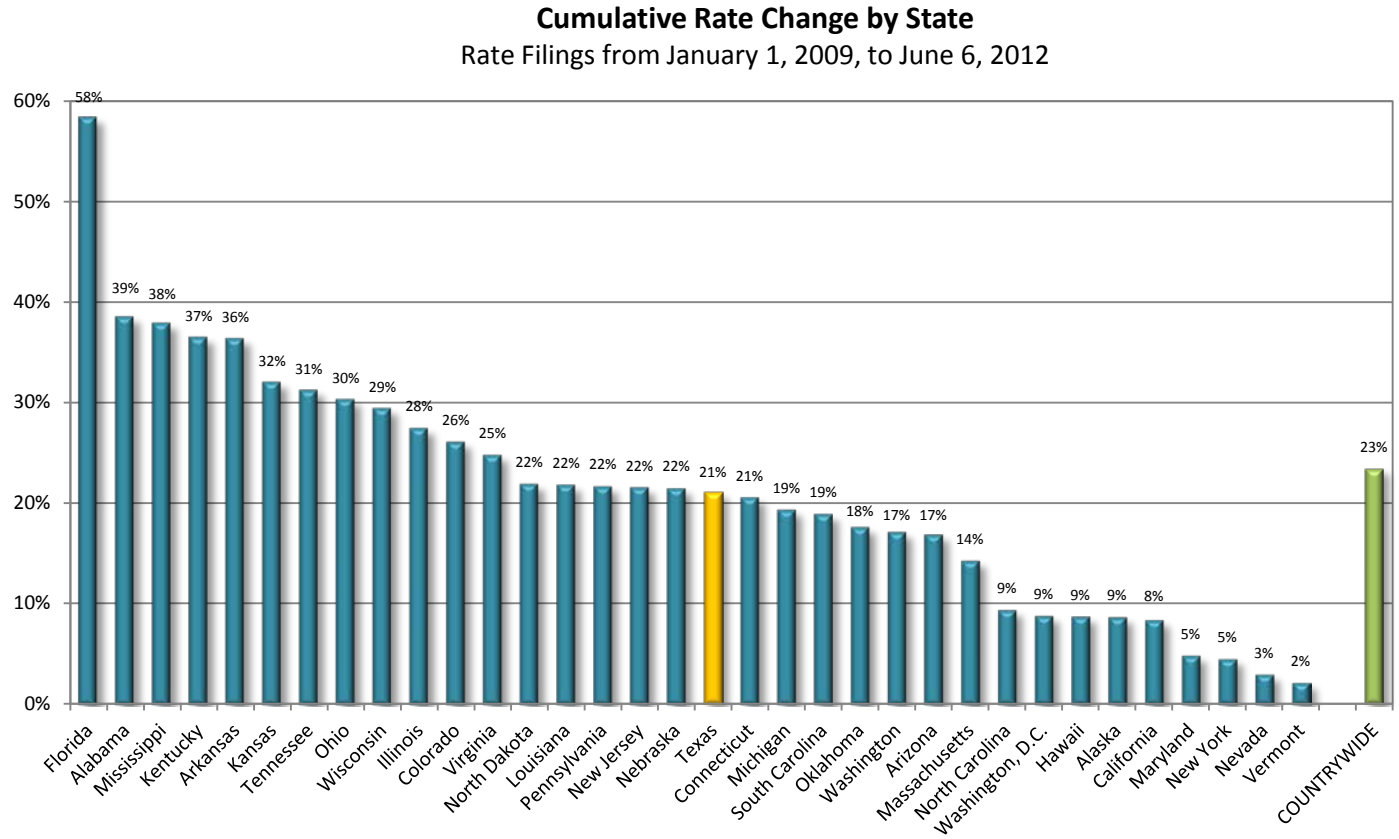


Figure 13. Average rate change by state based on filings received for the top five insurers in each state, including the top company in the State Farm, Allstate, and Farmers groups if they were not represented in the top five insurers, from January 1, 2009, to June 6, 2012.
Source: Rate filings requested from each state.

We determined previously that the primary driver of high premiums is high losses. In order to determine if high losses are also a primary driver of rate increases, we performed an analysis on the rate changes by state, similar to the one we did on the average premiums. We ranked the 34 states that we received rate filings from based on the average loss per policy from 2000 to 2009, and split the states into three groups: high middle, and low.

The average rate change for states with the highest average losses is higher than the average for the rest of the states and there appears to be a correlation between the average loss per policy and the cumulative rate change (See Figure 14).

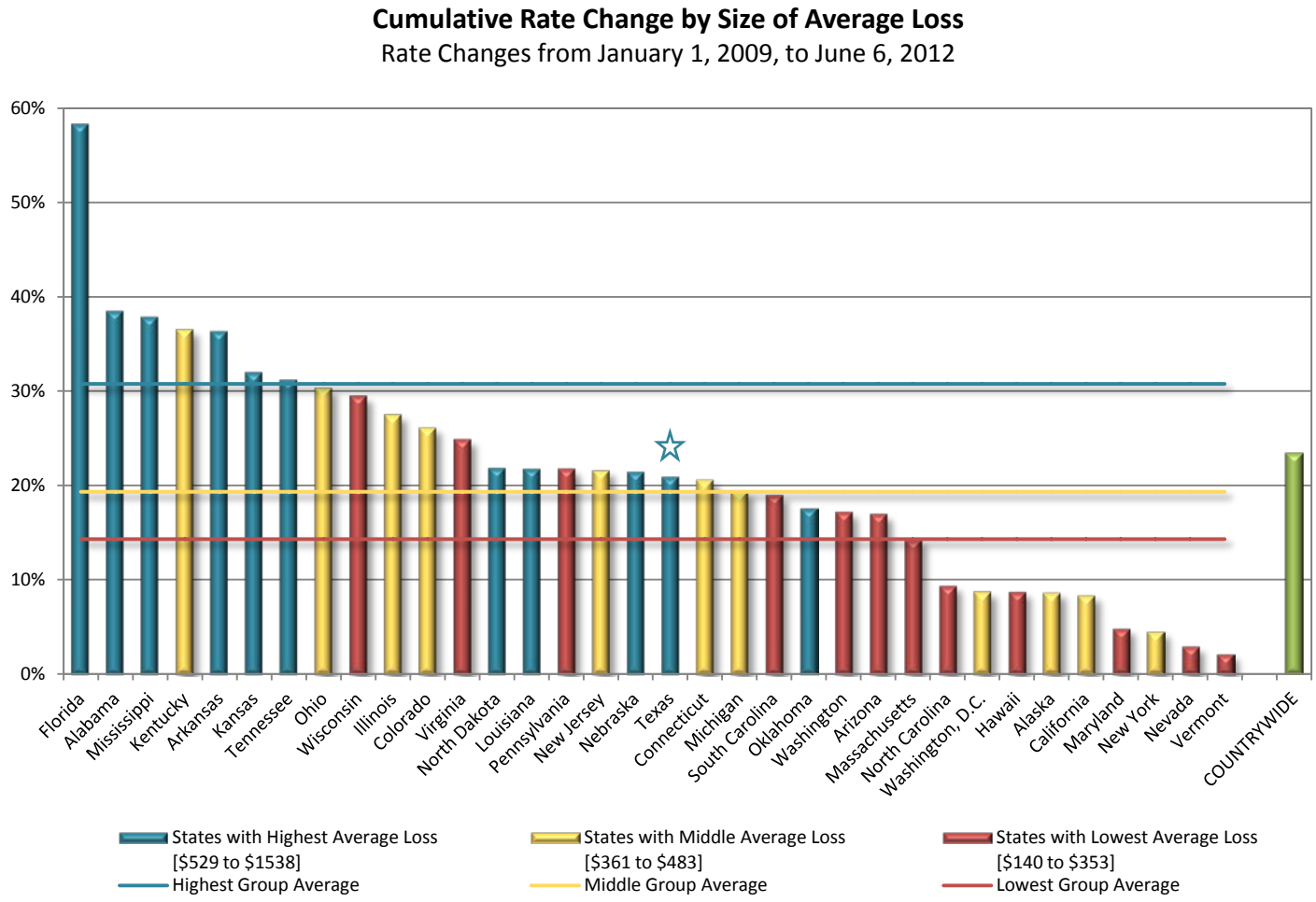


Figure 14. Cumulative rate change by state from January 1, 2009, to June 6, 2012, for all owner-occupied homeowners' policy forms combined, grouped by the size of the average loss per policy. Each state was ranked based on the average loss per policy from 2000 to 2009, and the states were split into three equally-sized groups.
Source: 2000 through 2009 NAIC profitability reports and rate change filings requested from each state.

Even though we determined that the type of rating law is not a predictor of premium levels, we wondered if there was a relationship between the type of rating law and the rate changes. We performed the same analysis on rate changes that we did previously on premium levels. We split the 34 states that we obtained rate change information for into three groups: prior approval or flex rating; file and use; and use and file or no file; and compared the rate changes in each group.

The average cumulative rate change for states with prior approval or flex rating is less than that for states with other rating laws (See Figure 15).

Cumulative Rate Change by Type of Rating Law

Rate Changes from January 1, 2009, to June 6, 2012

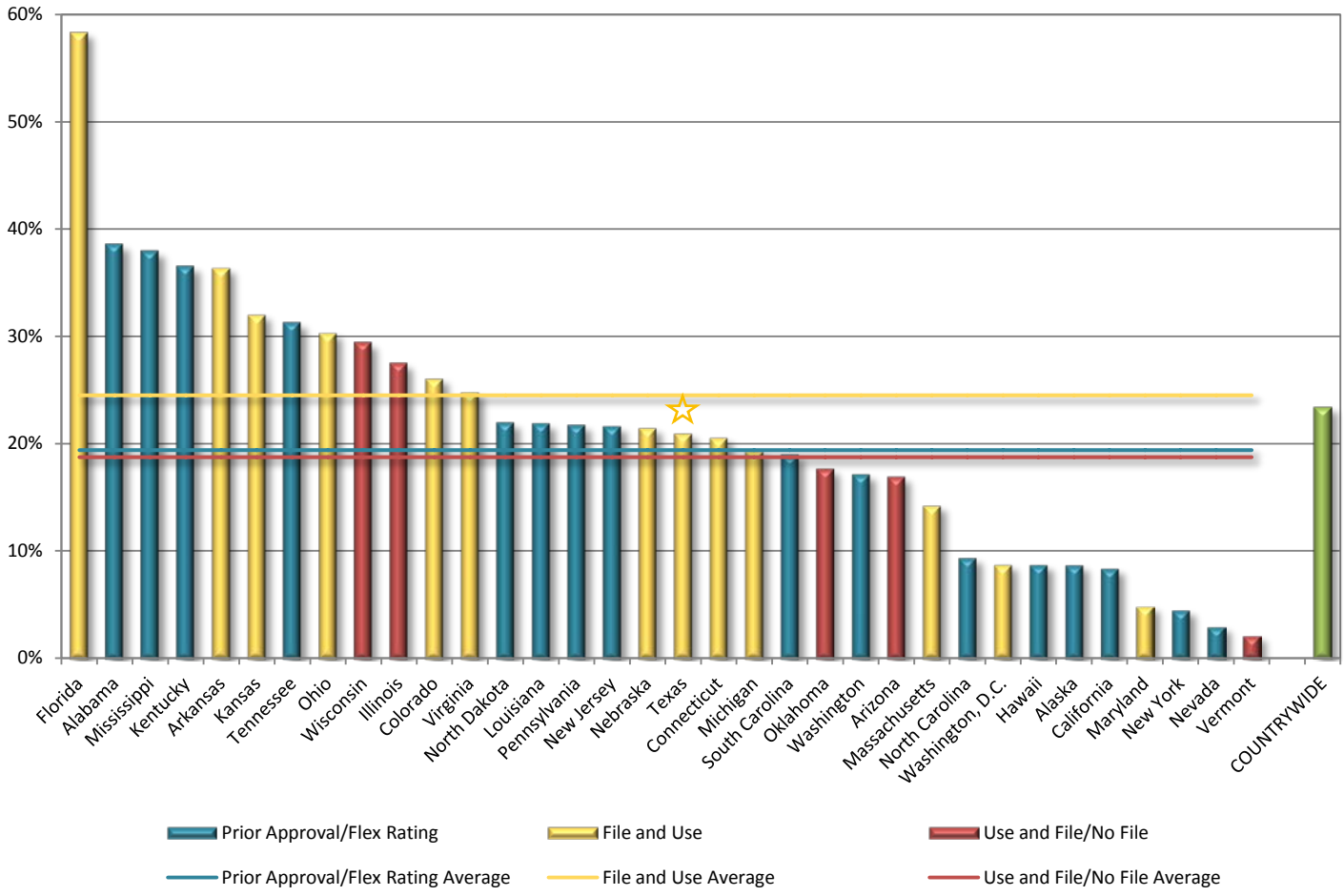


Figure 15. Cumulative rate change by state from January 1, 2009, to June 6, 2012, for all owner-occupied homeowners' policy forms combined, grouped by the type of rating law.
Source: 2000 through 2009 NAIC profitability reports and rate change filings requested from each state.

Average Premium Levels and Rate Levels in Texas

So far, we have concluded that although Texas had one of the highest average premiums in the country in 2009, but that the cumulative growth in average premium from 2005 to 2009 is lower in Texas than the corresponding growth countrywide and in many other states. We also determined that the cumulative rate change in Texas since 2009 is less than the estimated countrywide rate change and less than that in many other states.

Since we have access to more current data in our own state than in other states, we looked at the changes in the average premium and the average amount of insurance through 2011 and compared that to the changes in the rates.

Average Premium

Average premium tells us the actual dollar amounts paid by policyholders on average. It is affected by rate changes, deductible shifts, coverage changes, and the movement of policyholders between companies. It is difficult to determine the effect of each of these factors on the average premium, but later we will show the average premium per $1,000 of coverage, which removes the effect of changing amounts of insurance. In Texas, the average premium increased dramatically in 2002, decreased slightly from 2003 to 2006, and then increased from 2006 to 2011 (See Figure 16). The increase in 2002 was mostly due to the rate increases following the mold crisis. The overall increase from 2000 to 2011 is 61 percent.

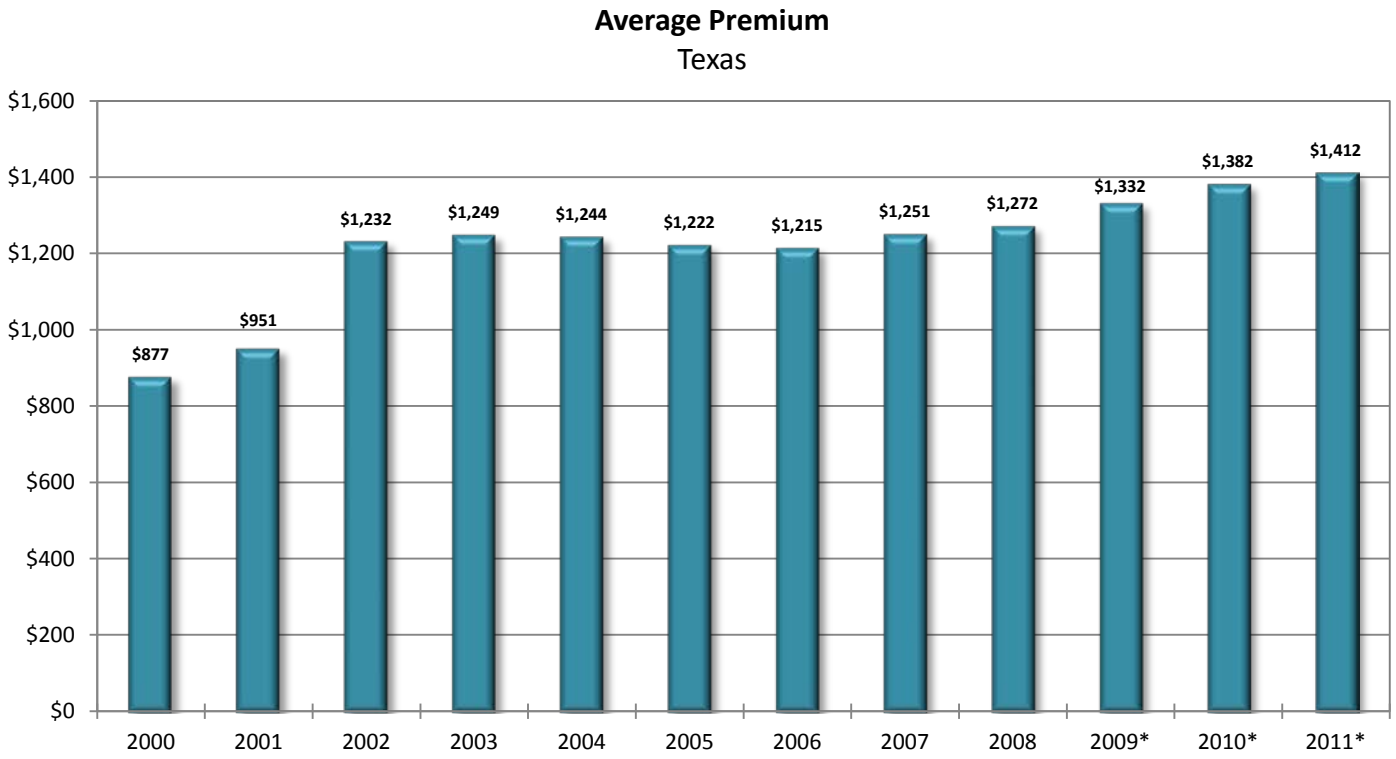


Figure 16. Average premium in Texas from 2000 to 2011 for all owner-occupied homeowners' policy forms combined for all coverage amounts.
**Figures may change slightly as data is updated.*
Source: Residential Property Statistical Plan data.

Average Amount of Insurance

The amount of insurance is the coverage amount for dwelling structures on a policy, and is the amount it would cost to completely rebuild the structure. It is different from the sale price of a home, because the amount of insurance excludes the value of the land. The average premium is largely affected by changes in the amount of insurance. If the average amount of insurance increases over time, the average premium will also increase since insureds are buying more coverage.

The experience in Texas indicates that even though the average amount of insurance purchased by policyholders has increased every year since 2000, there was a slowing in the rate of increase in recent years as compared to previous years (See Figure 17).

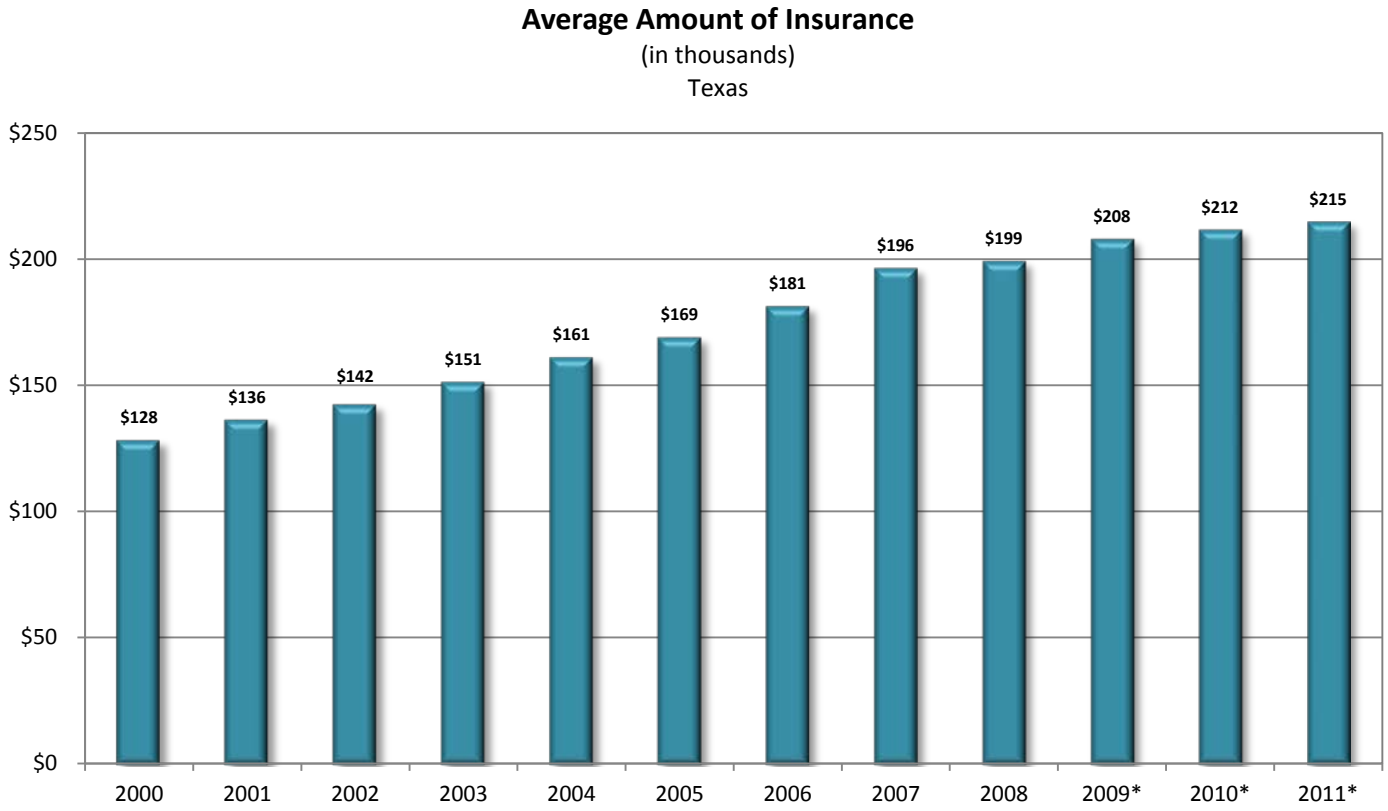


Figure 17. Average amount of insurance in Texas from 2000 to 2011 for all owner-occupied homeowners' policy forms combined.
**Figures may change slightly as data is updated.*
Source: Residential Property Statistical Plan data.

Change in Average Premium per $1,000 of Coverage vs. Change in Rate

To eliminate the effect that the increasing coverage has on average premium, we analyzed the average premium per $1,000 of coverage, which better reflects the impact of changes in rate levels. The average premium per $1,000 of coverage is the ratio of the total premium written to the total amount of insurance provided on the building, and can be thought of as a rate. This rate tends to decrease as the amount of insurance increases. If policyholders decide to increase their amount of insurance less than before, which we saw happen in recent years, the decrease in the rate per $1,000 of coverage will slow down.

The combination of policyholders increasing their amount of insurance less than they have previously and insurers increasing rates compounds the increase in the average premium per $1,000 of coverage. The actual rate change taken by the industry however, is greater than the increase in average premium per $1,000 of coverage (See Figure 18). The average premium per $1,000 of coverage has decreased 4 percent overall from 2000 to 2011, whereas rates have increased approximately 5 percent annually on average. This difference in the average premium per $1,000 of coverage and that which is implied by the cumulative rate changes is due to various factors, such as changing coverage, increasing deductibles, and insurers' greater use of discounts. Additionally, the rate change estimated by an insurer is usually based on the assumption that the insurer will retain all policyholders. In reality, policyholders receiving a rate increase upon renewal are more likely to reduce coverage or to shop for coverage with another company, and as a result, the estimated rate change is usually never fully realized.

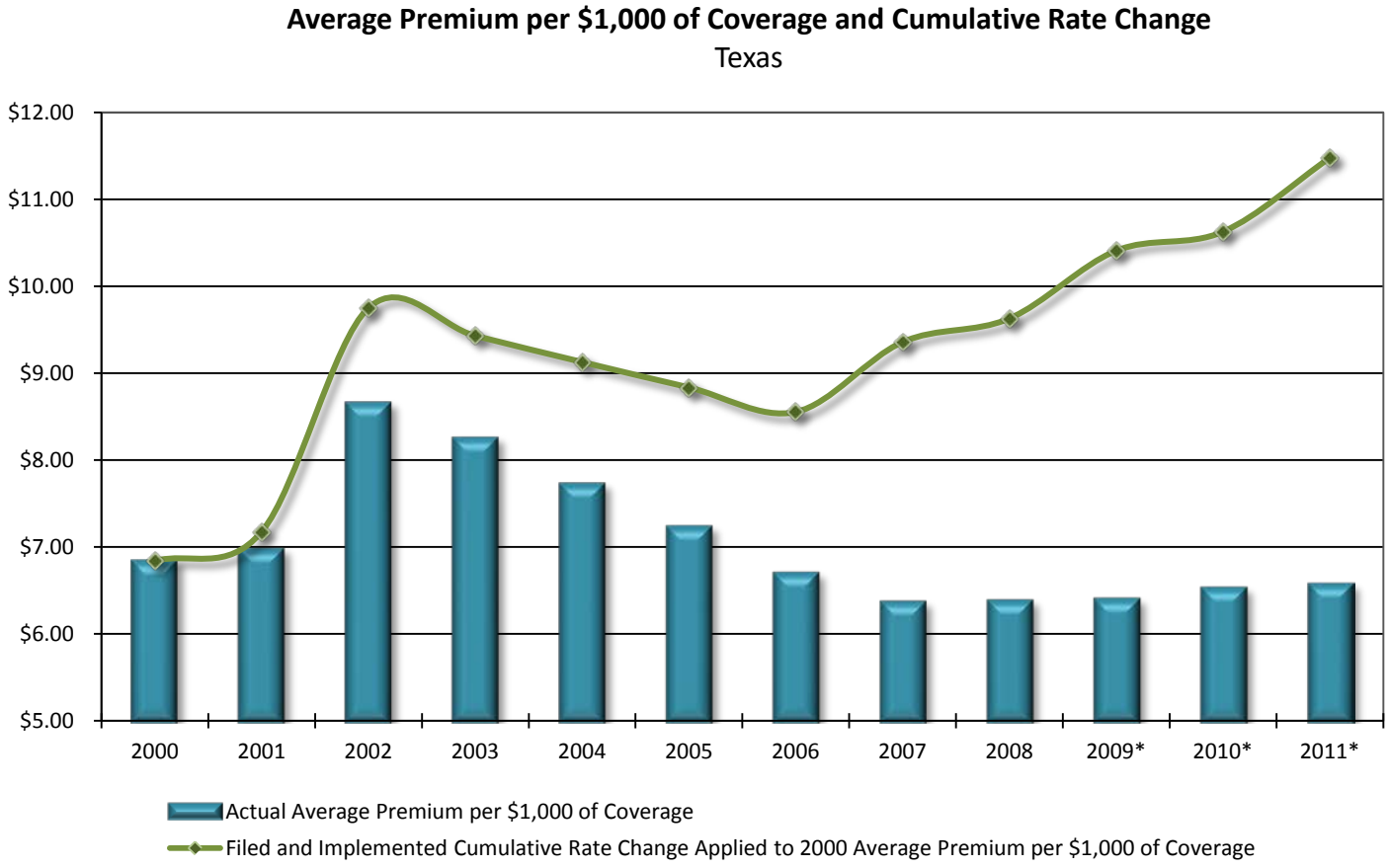


Figure 18. Actual average premium per $1,000 of coverage from 2000 to 2011, and filed/implemented cumulative rate changes taken by the industry applied to the 2000 average premium per $1,000 in coverage in Texas for all owner-occupied homeowners policy forms combined for all coverage amounts.

**Figures may change slightly as data is updated.*

Source: Residential Property Statistical Plan data and rate changes filed with TDI.

Regional Differences in Premiums and Losses

When it comes to both average premiums and average losses, there is a lot of regional variation across Texas. To study this variation, we separated Texas into six regions (See Figures 19) and compared the average loss per policy and the average premium per $1,000 of coverage. (See Figure 20).

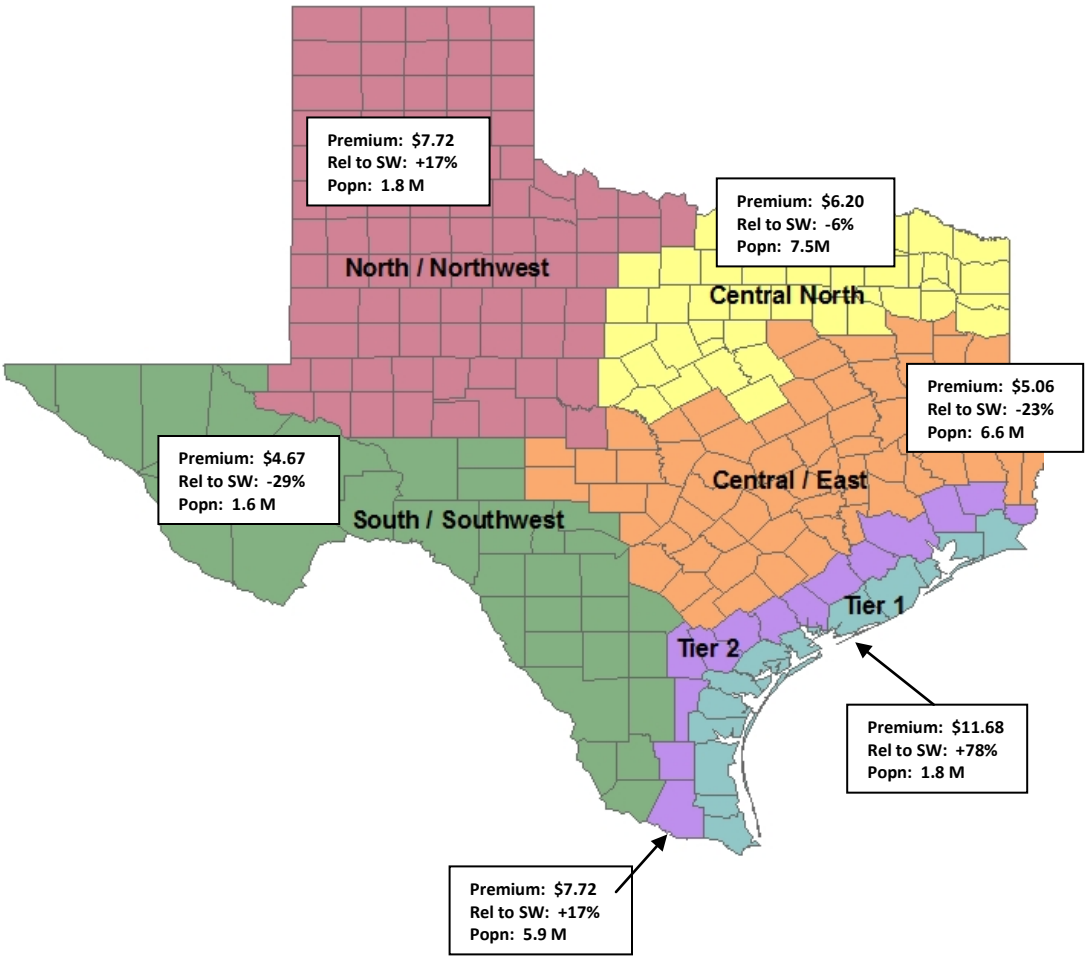


Figure 19. Map of Texas separated into six regions. Average premium per $1,000 of coverage, premium relative to statewide, 2010 population for each region.

The highest loss per policy is in the first tier coastal counties ("Tier 1"), followed closely by the second tier coastal counties ("Tier 2"), because of the exposure to hurricanes.

Second to the coast is the Texas panhandle ("North / Northwest") and north Texas ("Central North"), where the most significant peril is severe thunderstorms, tornadoes, and hail. This area includes the cities of Dallas and Fort Worth, as well as Lubbock and Amarillo.

North of the seacoast and south of the hail belt, is a large area that has a lower exposure to hurricanes, severe thunderstorms, hail, and tornadoes ("South / Southwest" and "Central / East"). This area includes the cities of El Paso, San Antonio, and Austin. The lowest losses in Texas are in these areas.

The average premium per $1,000 of coverage tracks closely with the average paid loss per policy across the regions. The regions with higher losses have a higher rate than regions with lower losses. Losses are not the only driver of rate levels, however. There are other factors that may vary by region that may also have an impact on the differences in rates between regions, such as reinsurance costs, which are affected by loss costs.

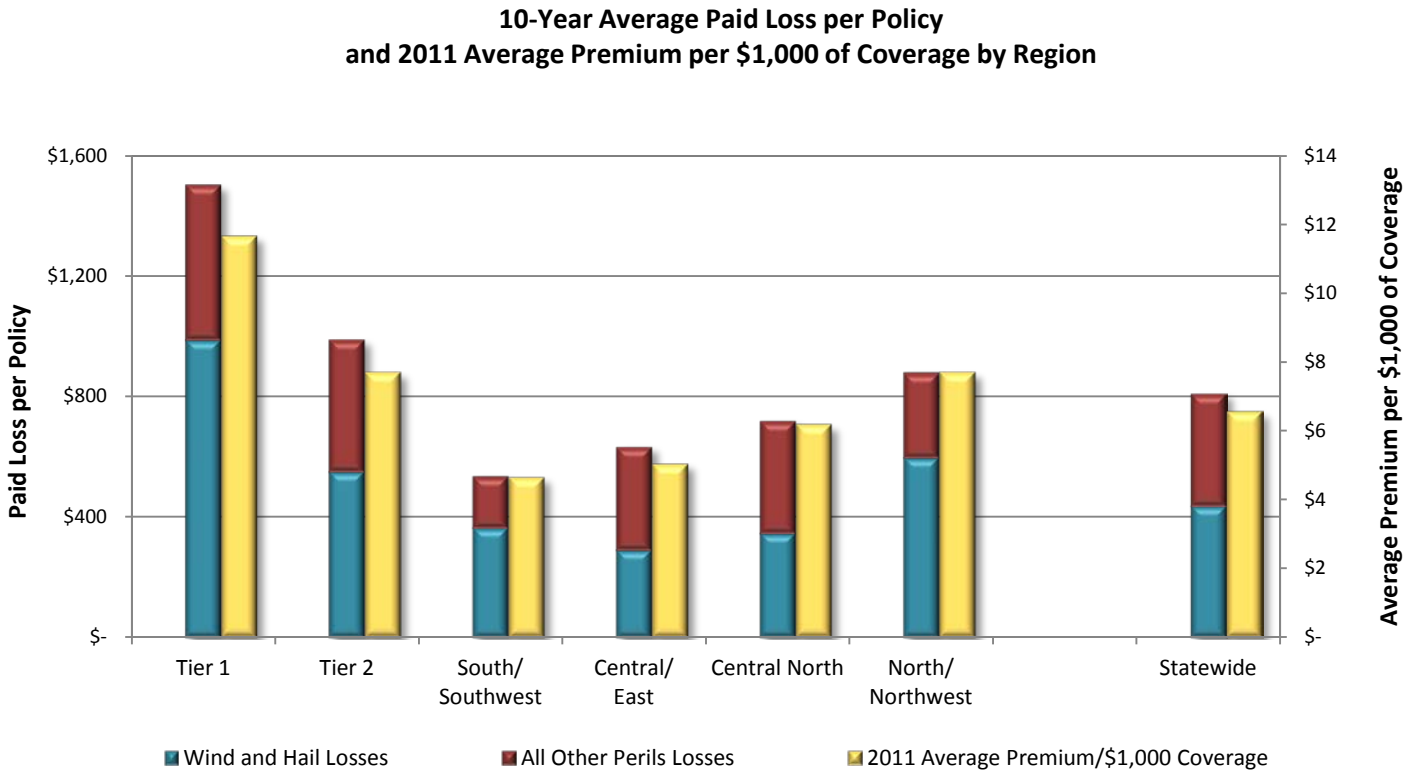


Figure 20. 10-year average paid loss per policy by region from 2001 to 2010; 2011 average premium per $1,000 of coverage by region.
Source: Residential Property Statistical Plan data.

Cost Component Provisions in Rate Filings

Even though the average premium per $1,000 of coverage has not increased as sharply as the cumulative rate change in recent years, the policyholders of Texas are still impacted by the recent rate increases, either with a higher premium or with a reduction in coverage.

One source of information that may help to explain the recent rate increases is the supporting information that insurers file with TDI. An insurer determines the appropriate rate to charge based on several cost components, such as losses, expenses, and profit. If the cost components add up to an amount that is different than what the insurer expects to collect in premium, the insurer needs to adjust its rates to bring the expected premium to an appropriate level. Insurers make filings with TDI that contain these estimates of the individual costs components used to adjust their rates.

We reviewed the cost components underlying top insurers' 2011 and 2012 rate filings, and compared these cost components to similar cost components provided in 2003, which for 95 percent of insurers, was the first year they were required to file support for their rates[3]. We translated these components into dollar amounts to provide an easy basis for comparison. Although each cost component increased since 2003, the cost components that increased by the highest dollar amount are the non-hurricane loss and loss adjustment expenses (LAE); underwriting expenses; and underwriting profit and contingencies (See Figure 21). While the hurricane loss component did not increase as much, the reinsurance, other risk charges to finance catastrophe risk, and underwriting profit and contingencies are all affected by the risk that hurricane exposure presents. For example, the other risk charges are used to provide an extra return to the insurer to provide access to additional capital for retaining catastrophic risks.

Average Cost Components

Component	2003 Provision[4]	Current Provision[5]	Reason for Change
Non-Hurricane Loss and LAE	$749	$961	Repair costs, coverage levels, nature of risk
Hurricane Loss and LAE	$75	$106	Changes to hurricane models
Reinsurance	$62	$128	Catastrophe risk, cost of reinsurance
Other Risk Charges	$0	$49	Catastrophe risk
Underwriting Expenses	$300	$444	Increases with average premium
Underwriting Profit and Contingencies	$62	$200	Investment income
Total	$1,249	$1,693	

Figure 21. Summary of cost component provisions in rate filings for all owner-occupied homeowners' policy forms in 2003 compared to current.
Source: Rate changes filed with TDI.

[3] Prior to the enactment of SB 14 (78th Regular Session, 2003), Lloyds companies and reciprocal exchanges, which accounted for 95 percent of the homeowners' market, were exempt from rate filing requirements and rate regulation.
[4] The 2003 provisions are the average percentages that were expected to go toward each cost component at that time, multiplied by the 2003 average premium.
[5] The current provisions are the average percentages expected to go toward each cost component during the projected period, based on the current projected premium. For the purpose of this analysis, the current projected premium is calculated by multiplying the 2003 average premium by the overall cumulative rate change from 2003 up until the most recent filings, and then by the most recent overall indicated rate change.

It is important to note that the current provisions are based on insurers' projections for these cost components, which are not necessarily the amounts underlying the actual rates proposed by the insurers. For example, in the latest rate change filings for eleven leading insurers in Texas, the average rate change was an 8.5 percent increase, while the average rate change indicated by their own analyses was 29.7 percent. In other words, insurers implemented an 8.5 percent increase, but their analyses implied that greater rate increases were warranted. Therefore, the total of the current provisions, $1,889, is not representative of the estimated 2012 average premium.

We cannot estimate how much of each cost component is underlying the actual rates proposed by the insurers because we cannot assume which portions of the total rate they chose not to take. In practical terms, insurers pay for losses and expenses, and only then, if any amount remains, do they realize an underwriting profit. On average from 2000 to 2011, the homeowners' insurance industry has not achieved the underwriting profit provisions proposed in the recent rate filings (See Figures 12 and 26).

Since each cost component used to justify the recent rate changes has increased, we studied each component in further detail and attempt to find reasons for the increase. Since the projected amounts used to justify rates are based, at least in part, on historical amounts, we looked at the actual historical amounts paid over the last several years.

Non-Hurricane Claim Costs

The paid loss per policy increased for most perils from 2003 to 2011 (See Figure 22).

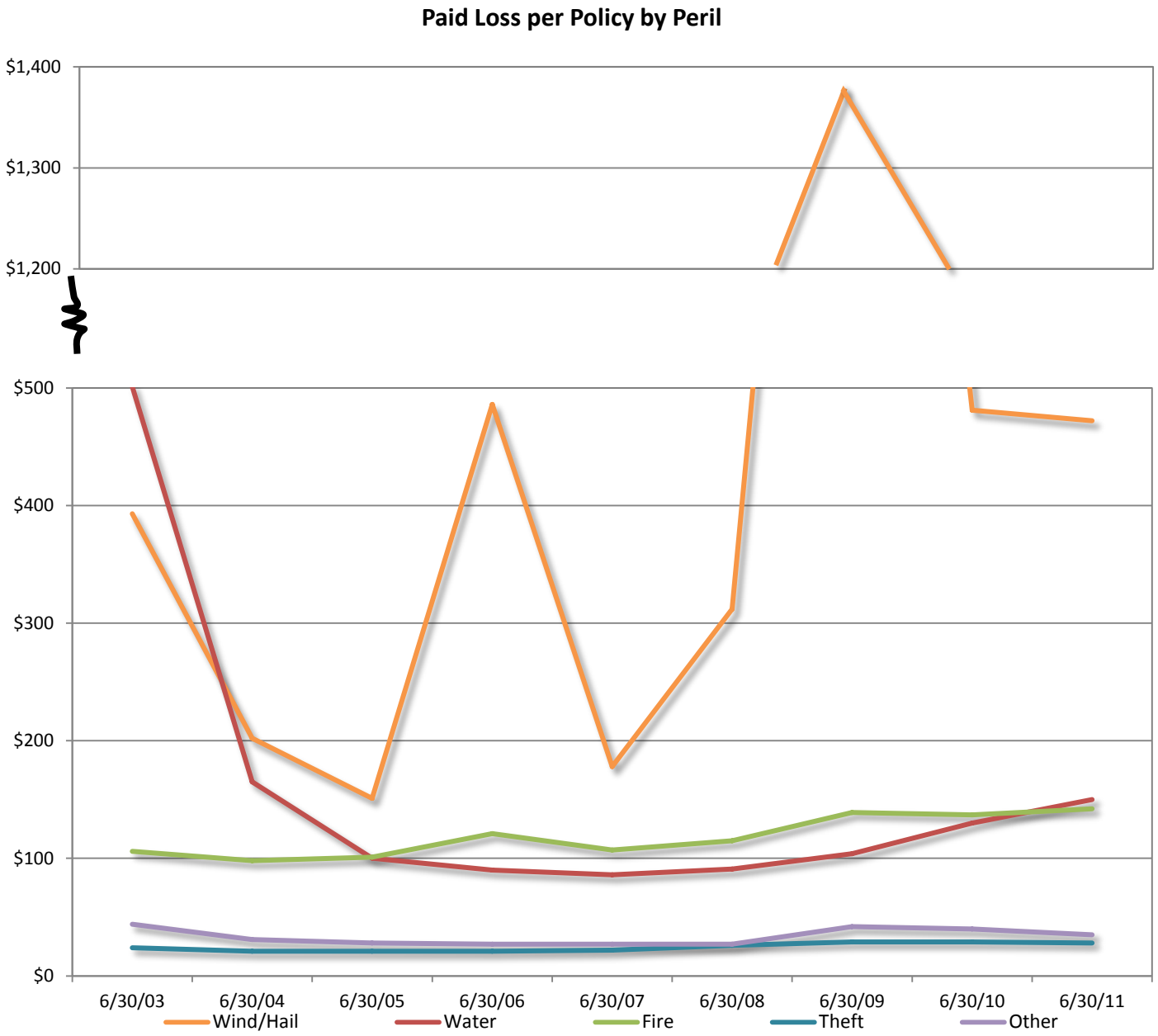


Figure 22. Average paid loss per policy in Texas for all owner-occupied homeowners' policy forms combined for all coverage amounts, categorized by peril.
Source: Residential Property Statistical Plan data as of 06/30/2011.

Wind/hail losses are very volatile, as the previous chart demonstrates, due to the inherent nature of catastrophes. In ratemaking, catastrophe losses are removed from the experience data and considered separately. We did a similar exercise with the industry-wide data to exclude major catastrophes. The wind/hail losses for years with large hurricanes were excluded and the remaining wind/hail losses were smoothed over many years in order to average unusually good or unusually poor wind/hail experience.

When we remove the big events from the industry-wide loss data, there is an underlying trend in the paid loss per policy for every peril (See Figure 23). Insurers typically use five years of historical data to select a loss trend to project losses into the future. Between mid-2007 and mid-2009, the non-hurricane loss ratio increased from 46 percent to 53 percent and then remained at that level. This occurred because claim costs per policy increased by 19 percent while premium per policy increased by 4 percent.

Since claims costs account for a large part of the premium dollar, the deterioration in claims experience is a major factor in insurers' recent rate increases. The actuarial analyses extrapolate the deterioration in costs into the future, and so the rates are based on the presumption that this increase will continue.

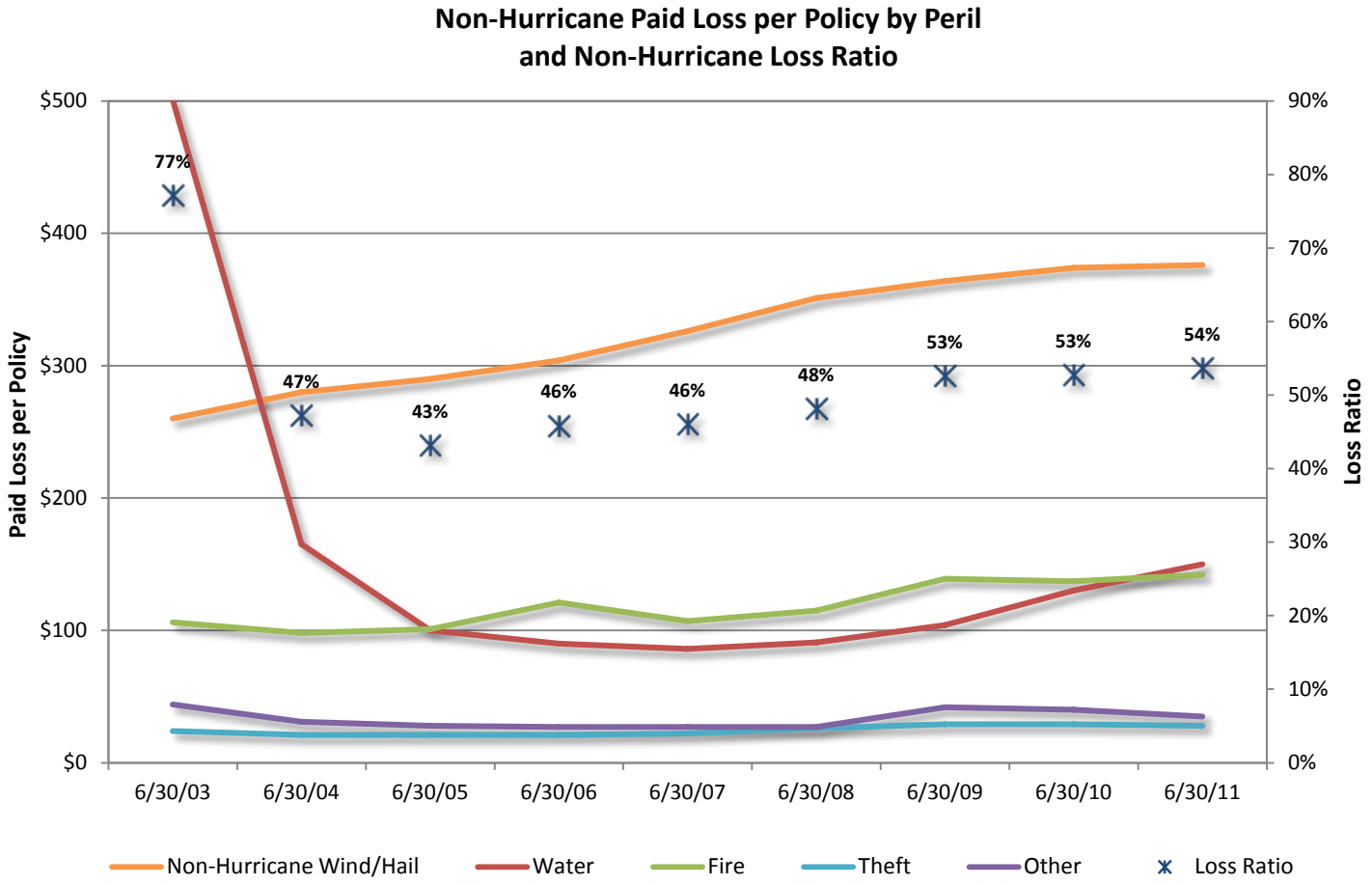


Figure 23. Average paid loss per policy and average paid loss ratio per policy in Texas for all owner-occupied homeowners' policy forms combined for all coverage amounts, categorized by peril, smoothed in the wind peril to estimate non-hurricane wind losses; 2003 and 2004 wind/hail points estimated.
Source: Residential Property Statistical Plan data as of 06/30/2011.

Drivers of Non-Catastrophe Claim Costs

When asked for the factors driving deteriorating non-catastrophe claims experience, the industry provided us with their theories. We did not validate any of these items with independent studies, but some of the factors may include:

- Increases in underlying repair costs. There was a sharp increase in material costs in recent years for some types of building materials that are based on oil products, such as asphalt shingles (See Figure 24).

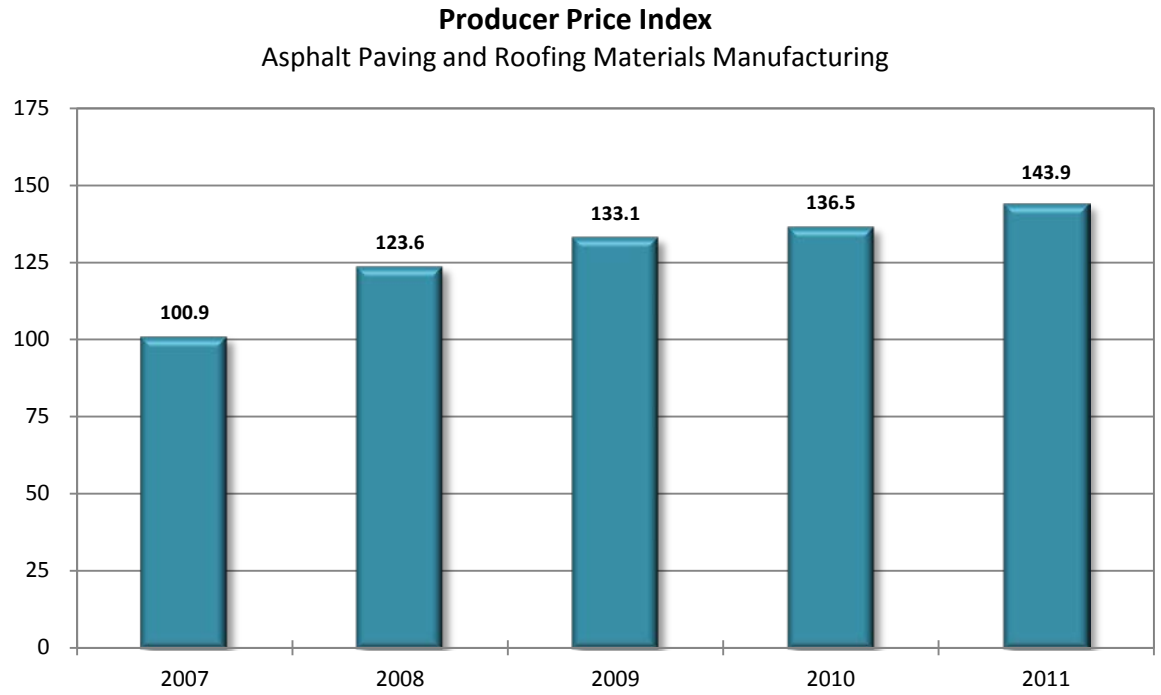


Figure 24. Countrywide asphalt paving and roofing materials manufacturing producer price index, relative to December 2006. Source: Bureau of Labor Statistics

- Changes in level of coverage. Following the mold crisis in the early 2000s, most insurers implemented procedures to strictly limit their exposure to water damage. Since that time, some insurers have begun expanding their coverage again, which may explain the growth in claim costs for water damage.
- Changes in the nature of the risk. Features that are common with new homes, such as upstairs laundry rooms, wooden floors, and open floor plans, increased the potential for expensive water damage and other claims.

Catastrophe Claim Costs

Texas is subject to infrequent, but very costly, catastrophic events, such as hurricanes, hailstorms, tornadoes, and other thunderstorm-related perils. In their rate filings, many insurers have increased their projections of future claim costs associated with hurricanes and other catastrophes.

Hurricane Claim Costs

Unlike hailstorms and tornados, which tend to be relatively frequent, and therefore much easier to price, hurricanes involve rare and extreme events. Insurers cannot rely on historical loss experience to include the cost of hurricanes in their rates. Instead, insurers rely on computer models that simulate thousands of hurricanes. Some insurers will use one vendor's model, other insurers may combine the model results from two or three vendors. Reinsurers also use these computer models, as well as their own internal computer models, when they determine the price they will charge insurers for reinsurance.

The increase in projected hurricane claim costs is due in part to changes that vendors have made to their hurricane computer models and to changes that individual insurers have made to the underlying assumptions used in the hurricane models. These changes are based on information gained and lessons learned by the model vendors after evaluating damage from each new hurricane.

As an example of the impact of changes made by vendors to the hurricane models, RMS' hurricane model version 11.0 produces 76 percent higher estimates overall for hurricane costs in residential property than the previous version. One particular insurer's indication would increase about nine percentage points if they were to use RMS' version 11.0, assuming a 76 percent higher estimate overall for hurricane losses.

The impact on overall rate levels due to the RMS version 11.0 hurricane model will vary by insurer depending on the insurer's distribution of business over the state and the extent to which the insurer relies on the RMS model as compared to other models. Additionally, there may be a further impact of the model revision on the reinsurance costs and additional risk loads used to justify rate levels.

Non-Hurricane Catastrophe Claim Costs

The increase in projected non-hurricane catastrophe claim costs is due in part to a change in the non-hurricane catastrophe analyses in recent years. In the past, most insurers projected non-hurricane catastrophe costs based on actual historical data. However, it is becoming more common to extend the computer modeling approach from just hurricanes to other weather events, such as thunderstorms and winter storms. This usually increases the estimates of future non-hurricane catastrophe losses. This change in methodology is most likely driven by the recent occurrence of large loss events in Texas and other states, such as tornadoes and hailstorms, and the perceptions by the insurers that the older analyses produced inadequate estimates of potential catastrophe losses.

Out of the top 20 homeowners' insurance writers in Texas in 2011, which account for 79 percent of the state's market share, four use a computer modeling approach to estimate losses for catastrophes other than hurricanes, based on the most recent rate change filings made with TDI.

Additional Risk Charges to Finance Catastrophe Risk

Additional risk charges reflect additional costs related to the risk of hurricanes and other catastrophes. The potential costs of extreme-case events are so large that even leading insurers believe they cannot absorb them using funds generated from their regular business. Instead, insurers make special provisions to have access to additional funds should such a catastrophic event occur. The proceeds from these risk charges are either used to purchase reinsurance or catastrophe bonds for ceding catastrophic risks, or else to provide an extra return to the insurer to provide access to additional capital for retaining catastrophic risks.

Reinsurance

Some insurers have purchased greater amounts of reinsurance than they did in the past. This may be in response to large hurricanes that produced financial losses that were significantly greater than many in the industry previously expected. In addition, recent catastrophes and their impact on solvency have caused regulators and rating agencies to sharpen their focus on the adequacy of an insurer's planning for catastrophic events.

Many of the same factors that cause the primary insurers to increase their projection of catastrophe losses, such as changes to catastrophe models and an increased awareness of exposure, apply equally to their reinsurers.

Retained Risk

In the past, insurers that were part of a large group often could obtain reinsurance from their parent at below-market costs. Insurers that essentially reinsure their operations within an affiliated group of insurers have become more aggressive in demanding the same return for retaining the risk that a reinsurer would for assuming the risk.

Underwriting Expenses

While losses have the most significant impact on premium levels, another driver of high premiums is the higher-than-average underwriting expenses. Underwriting expenses consist of general expenses; policy acquisition expenses, which consists of commissions and other acquisition expenses; and premium taxes, licenses, and fees.

The actual historical average underwriting expense components since 2000 shows that Texas' average policy acquisition expense is 65 percent higher than countrywide; the average general expense is 43 percent higher than countrywide; and the average premium taxes, licenses, and fees expense is 47 percent higher than countrywide.

In addition to being higher than the countrywide average, the amounts paid for underwriting expenses in Texas have increased over time. From 2000 to 2011, the average commission expense increased 61 percent; the average other acquisition expense increased 41 percent; the average general expense increased 21 percent; and the average premium taxes, licenses, and fees expense increased 75 percent (See Figure 25). This is compared to a 61 percent increase in average premium over the same period. Part of the increase in the expenses is due to certain expenses being a percent of premium, such as agents' commission. As the average premium increases, expenses that are a percent of premium will automatically increase by the same amount.

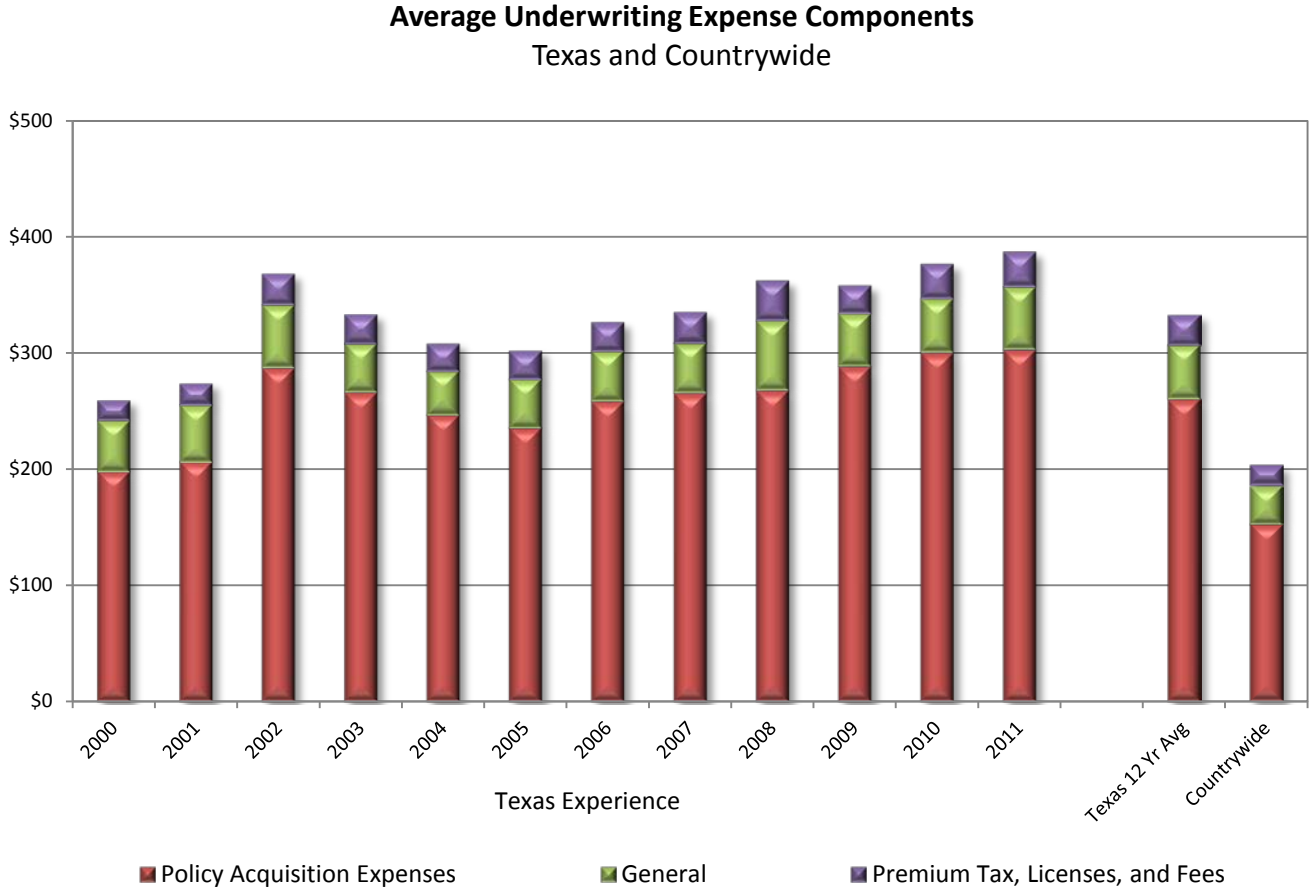


Figure 25. Average underwriting expenses per policy in Texas from 2000 to 2011 for all owner-occupied homeowners' policy forms. Countrywide average from 2000 to 2009.
Source: Texas compilation of Annual Statement Page 14 data from 2000 to 2011; 2000 to 2009 NAIC profitability reports.

Policy acquisition expenses consist of agents' commissions and other acquisition expenses, such as advertising and policy issuance. The average premium in Texas is approximately 50 percent higher than the countrywide average, and some expenses, such as agents' commissions, are a percentage of the premium.

In order to determine if the average policy acquisition expense paid in Texas is out of line with what is paid in other states, we plotted the average policy acquisition expense for each state. The states are ordered based on their 2009 average premium for coverage amounts in the range $175,000 to $299,999, which is consistent with the rankings we used in the previous analysis on premium levels. The downward slope to the graph indicates that as the average premium decreases, the average policy acquisition expense decreases as well. There are a few outliers that do not follow this pattern, and that is most likely due to a high average amount of insurance in those states (See Figure 26).

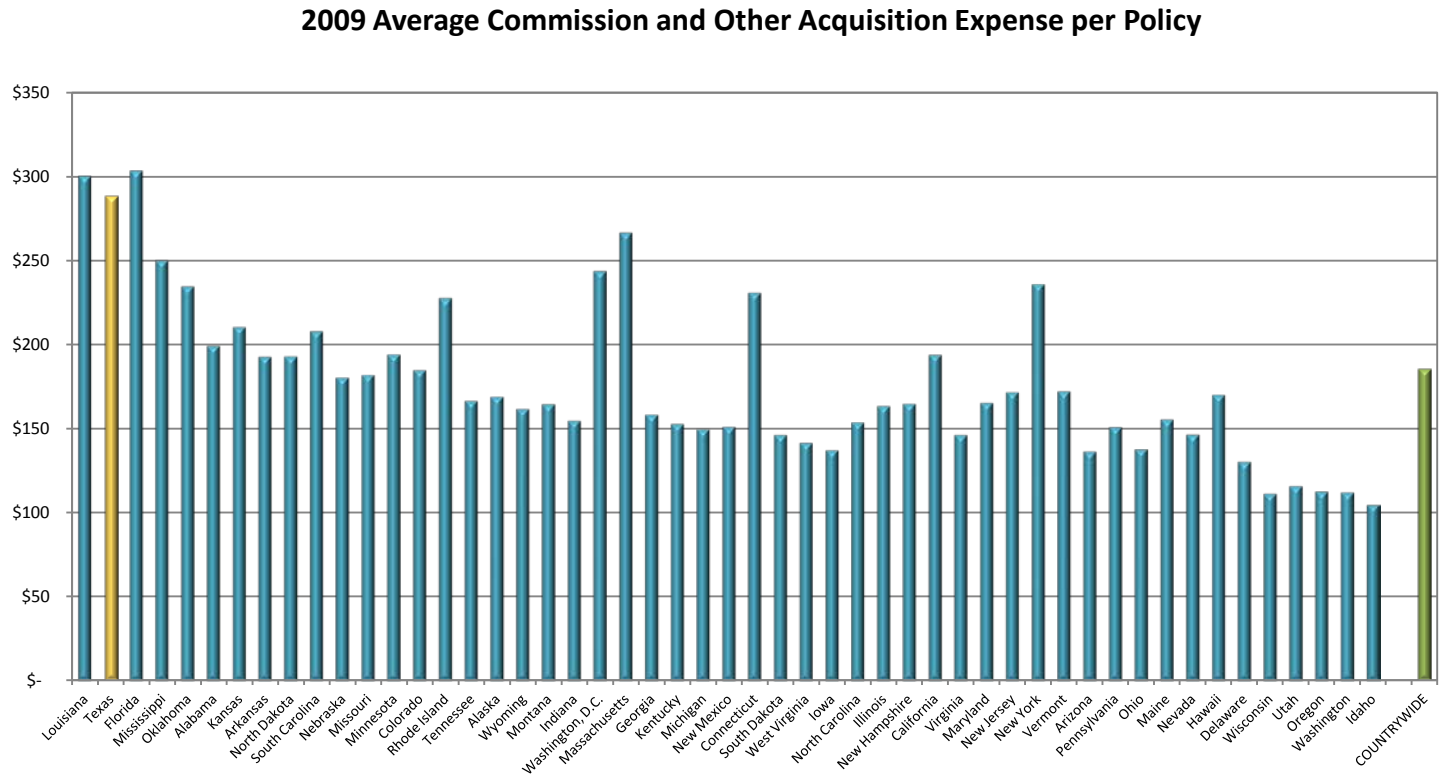


Figure 26. 2009 average homeowners commission and other acquisition expense per policy for all policy forms combined for all coverage amounts. States are sorted based on the 2009 average homeowner premium per policy for coverage amounts in the range $175,000 to $199,999.
Source: 2009 NAIC report on average premium and 2009 NAIC profitability report.

Underwriting Profit

The underwriting profit and contingencies provision reflects a margin in the rate that, together with the investment income, insurers are able to earn, which provides a reasonable return to the insurer considering the risks involved. In recent years, insurers have increased the underwriting profit provision used to justify rates in their rate filings. Previously, a typical underwriting profit provision was 5 percent; the average underwriting profit provision used to justify rates in the most recent rate filings was 11 percent.

Texas' actual underwriting profit results have varied greatly over time, depending mostly on the existence or absence of catastrophes. Although the underwriting profit provision used to justify rates has increased in recent rate filings, the actual underwriting profits since 2000 indicate that the provisions proposed in the filings are generally much higher than the industry has achieved (See Figure 27). On average, the underwriting profit in Texas from 2000 to 2011 was -8 percent.

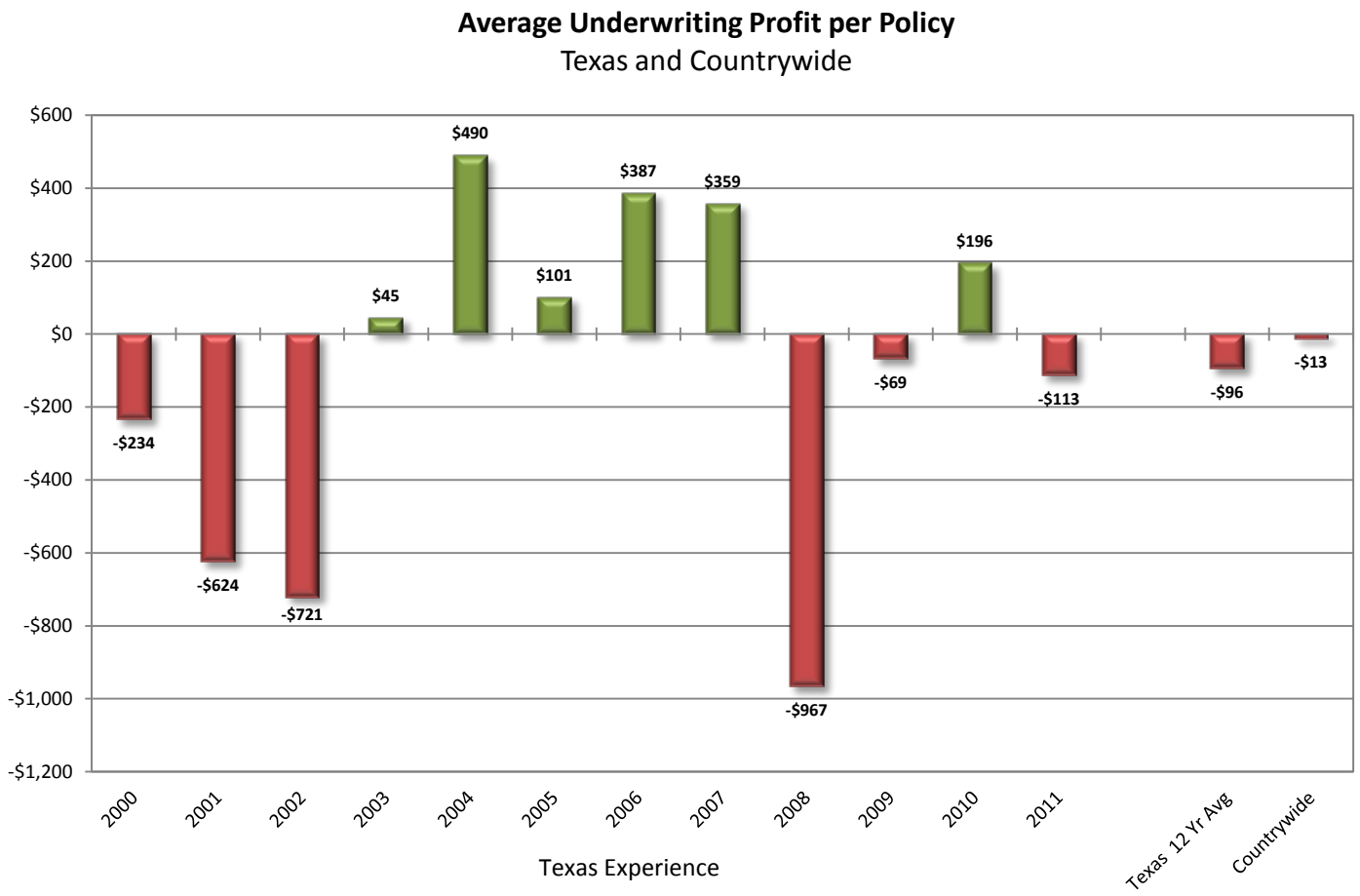


Figure 27. Average underwriting profit per policy in Texas from 2000 to 2011 for all owner-occupied homeowners' policy forms. Countrywide average from 2000 to 2009.
Source: Texas compilation of Annual Statement Page 14 data from 2000 to 2011; 2000 to 2009 NAIC profitability reports.

Drivers of Underwriting Profit Provisions

Part of the increase in the underwriting profit and contingencies provision is driven by the recent decline in interest rates. Although the decrease in interest rates does not have a proportional effect on the profit provision, it does affect an insurer's underwriting profit calculation. As interest rates decline, insurers have less opportunity to earn a return from investing premium dollars and are more inclined to seek a larger underwriting profit.

The return on U.S. Treasury Securities, at a three-year constant maturity, has decreased 82 percent from 2007 to 2011 (See Figure 28).

Figure 28. Return on US Treasury Securities at a three-year constant maturity.
Source: Federal Reserve Board.

Conclusions: Factors Underlying Texas' Premium Levels

Rates in Texas have increased 21 percent since the beginning of 2009, but are increasing at a slower rate than in many other states, based on a sample of 34 states. High losses appear to be a driver of not only premium levels, but of cumulative rate changes as well.

The average premium per $1,000 of coverage has not increased as sharply as the cumulative rate change in Texas, however. This is due to many factors, such as changing coverage, increasing deductibles, insurers' greater use of discounts, and rating plan changes. The rate changes estimated by insurers may not be fully realized if policyholders reduce coverage or shop for coverage with another company upon renewal.

Insurers determine the appropriate rate to charge based on several cost components: non-catastrophe losses and LAE; catastrophe losses and LAE; additional risk charges to finance catastrophe risk; underwriting expenses; and underwriting profit and contingencies. A review of current rate filings made by top insurers revealed that each cost component that is used to justify rates has increased since 2003. The factors underlying the increase in each of the cost components, based on information given to us by the industry, may include the following:

- **Non-Catastrophe Claim Costs**: increases in underlying repair costs, expanded coverage, and changes in the nature of risks.
- **Catastrophe Claim Costs**: changes to hurricane models and to the underlying assumptions used in the models; movement in recent years toward catastrophe models for non-hurricane catastrophes.
- **Additional Risk Charges to Finance Catastrophe Risk**: changes to catastrophe models and an increased awareness of exposure; insurers' demands for the same return for assuming the risk that a reinsurer would.
- **Underwriting Expenses**: percentage expenses increasing with average premium increases.
- **Underwriting Profit and Contingencies**: recent decline in interest rates.

Legislative Recommendations to Lower Homeowners' Insurance Rates

There are three main components of homeowners' rates: losses and loss adjusting expenses (~60 percent); underwriting expenses, such as agents' commissions and overhead (~20 percent); and underwriting profits and reinsurance costs (~20 percent). In the past, when the legislature was successful in passing legislation that reduced rates (for example, medical liability and workers' compensation), the legislation addressed the cost drivers. Based on our analysis, our recommendations to lower homeowners' insurance rates are aimed at the loss cost drivers.

About half of the total losses paid by insurers in Texas over the last 10 years have been weather-related losses from wind and hail. Of these weather-related losses, insurers paid more than $7.6 billion in hail losses in Texas. This is more than insurers paid for any other cause of loss, including hurricanes, over the same period (See Figure 29).

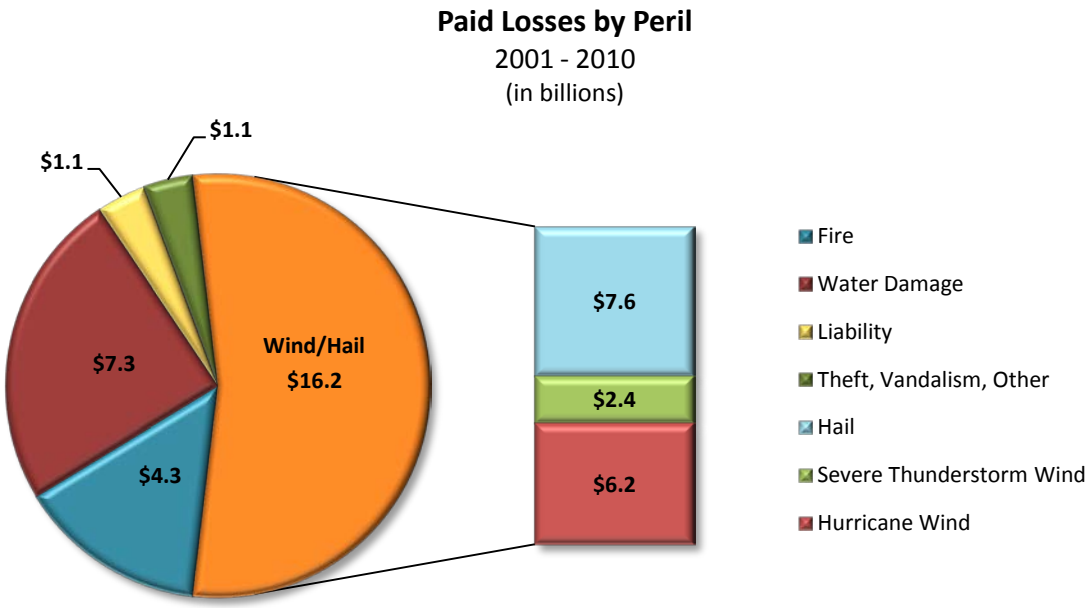
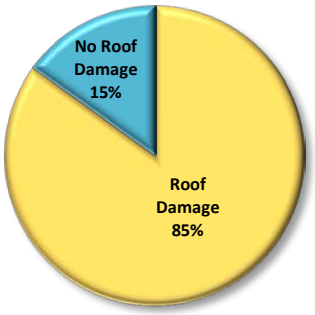


Figure 29. Total paid losses in Texas by peril from 2001 to 2010.
Source: Residential Property Statistical Plan data.

Although no legislation can change the weather, there are legislative solutions that can reduce wind and hail losses in Texas, such as improving the quality of roofs and improving building codes.

Improve Roof Quality

The Texas Windstorm Insurance Association reviewed 1,605 claims received between July 1, 2011, and December 31, 2011, and found that 85 percent of these claims involved roof damage. The amount paid on these roof damage claims averaged $6,394. The roof is an important part of a home because it protects the structure. If it deteriorates or leaks, homeowners may incur additional damage to the structure's interior or to personal property within it. Legislative solutions that address roof damage and roofing costs and will be the most effective at reducing wind and hail losses.



TWIA Claims between July 1, 2011, and December 31, 2011

Credentialing of Roofing Contractors

With the severe weather in Texas, it is common for insurers to repair or replace their policyholders' roofs before they wear out due to normal wear and tear. After a catastrophe, such as Hurricane Ike or the recent Dallas-area hailstorms and tornado, "roofing contractors" flock to areas in need of repairs. These contractors are unlicensed and some are from out of state. Unlicensed "roofing contractors" may not install or repair roofs properly, and may not even complete the jobs they start. An inadequately repaired roof can lead to higher and more frequent losses in the future for homeowners. In addition, if a roofer is not bonded, a homeowner may not have any recourse if the promised work is not finished or completed to quality standards.

While many states have license requirements for roofers to install or repair roofs, Texas does not. Most licensing arrangements require training, bonding, passage of a licensing exam, and continuing education. This would provide a base line assurance that the roofer is knowledgeable about the trade and bonded in case the contractor fails to complete the job. Moreover, licensees are subject to regulatory action including loss of license, for misbehavior, etc.

Absent legislative action, there are actions insurers may be able to take that can help to achieve similar goals. For example, insurers could establish "preferred contractor" relationships with roofing contractors who are knowledgeable, experienced, reliable, and have a proven record of making proper repairs, and provide incentives to policyholders who use "preferred contractors." As part of their underwriting and rating, insurers could also require proof of satisfactory roof installation.

Require Premium Credits for Consumers Using Impact-Resistant Roofing Materials

A recent study by the Institute for Business and Home Safety concluded that impact-resistant roofing materials had a substantial impact in reducing hail losses. Under the promulgated benchmark system, insurers were required to offer premium credits for roofing materials that met certain standards for impact resistance. Although many insurers do offer impact-resistant roofing credits, such credits are not required. Credits would encourage consumers to use impact-resistant roofing materials in hailstorm-prone parts of the state.

In 2010, less than 2 percent of policyholders in Texas were eligible to receive premium credits for impact-resistant roofs. In the Texas Panhandle, where hailstorms are prevalent, less than 10 percent of policyholders were eligible to receive premium credits for impact-resistant roofs.

Reduce Fraudulent Activities

Insurance fraud increases the costs to both insurers and consumers. Insurers, the National Insurance Crime Bureau (NICB), and others have observed increased contractor fraud in catastrophe-related claims. NICB notes that Texas has a higher incidence of questionable hail claims than any other state. TDI has funded a special prosecutor in the Dallas County District Attorney's office for several years, and recently added special prosecutors in Harris and Bexar counties. These prosecutors have the specialized expertise needed for successful prosecution of insurance fraud cases, which should result in increased fines, restitution and deterrence.

Other states have recently acted laws addressing contractor fraud:

In Tennessee, roofing contractors must provide a property owner with detailed company information and a detailed description of all damage repairs. All contracts must contain a form notifying property owners of their right to cancel a contract within three days after receiving a statement from the insurer that the damage is not a covered claim.

Iowa prohibits residential contractors from offering to pay part or all of an insurance deductible as part of an agreement to perform repairs after storm damage. The law also requires the contractor to provide the homeowner with information about cancelling the contract and their rights.

TDI is surveying other states and exploring other legislative proposals for combating fraud related to property insurance claims, and may have additional recommendations for legislation.

Improve Building Codes

Improving building codes may decrease loss costs, including building codes that deal with wind- and hail-resistant roofing construction in wind- and hail-prone parts of Texas. Stronger structures can better withstand high-speed winds, flying debris, and hail. This reduces property damage and results in lower insurance costs.

Additionally, occupants of existing homes can take measures to mitigate their exposure to risk, whether it is the risk of hail, severe storms, hurricanes, or wild fires. Such mitigation efforts, while they may come at a cost, should lower premiums for homeowners insurance.

Studies have shown that structures built to stronger building codes have fewer claims and lower average loss amounts than structures built to an inferior code or not built to a code at all. For example, an analysis by TWIA of 128,627 of their residential property policies in force on August 31, 2008, in Jefferson, Chambers, Galveston, and Brazoria counties, reveals that 13.7 percent of the policies were built to the International Residential Code (IRC). Of these, 45.8 percent had filed a Hurricane Ike claim. In contrast, 79.3 percent of the policies were built to the pre-1998 code or to no code at all, and of these, 71.1 percent had filed a Hurricane Ike claim. Additionally, the Hurricane Ike claims for policies with structures built to the IRC had an average loss of $12,307, compared to claims for policies with structures not built to the IRC that had an average loss of $19,767. This translates to an average loss cost of $5,637 for policies with structures built to the IRC and $14,054 for policies with structures not built to the IRC, which is a substantial difference (See Figure 30).

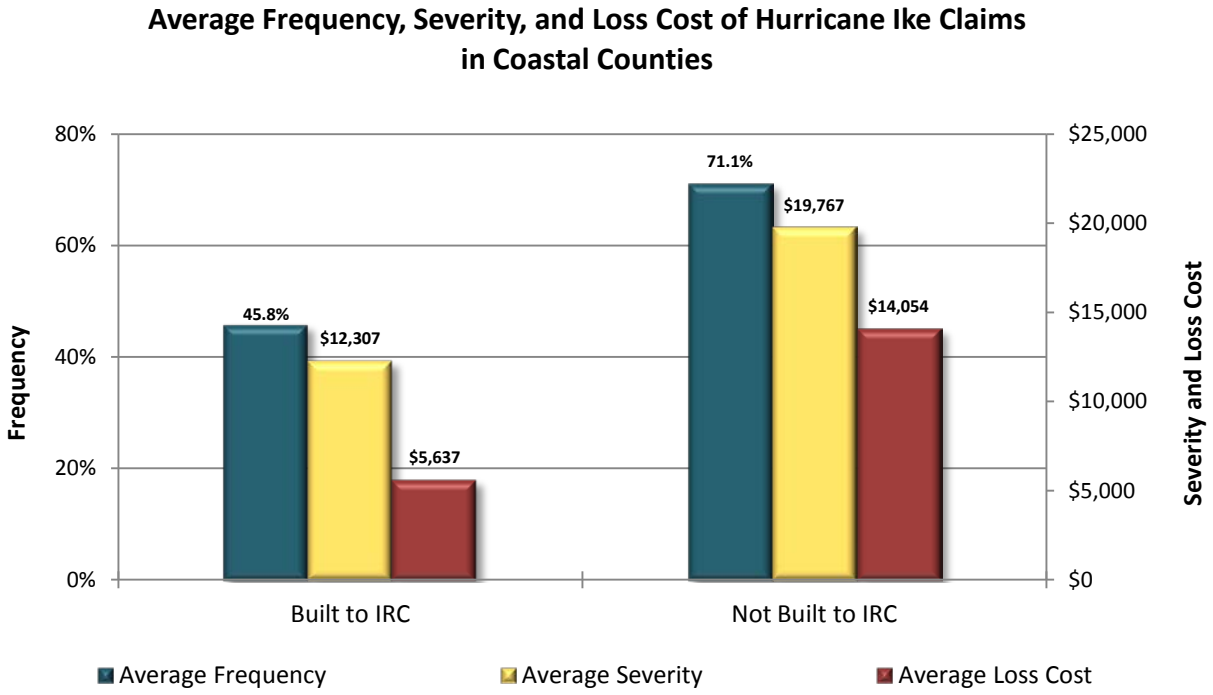


Figure 30. The average frequency, severity, and loss cost of Hurricane Ike claims, based on an analysis of TWIA's in-force policies on August 31, 2008, in Jefferson, Chambers, Galveston, and Brazoria counties, grouped by whether the structure on the policy was built to the International Building Code.
Source: Texas Windstorm Insurance Association.

Improving the building codes would not reduce losses immediately, however, because it could take 50 years or more to replace existing housing stock with homes built to the new building code. Even though the premium levels may not be fully impacted by reduced losses, we wanted to see if a relationship existed between the strength of building codes and the average premium levels. We split the coastal states into three groups based on the strength of their building code, determined by the Institute for Business and Home Safety (IBHS) ratings, and compared the average premium among states in these three groups, similar to the analysis we performed previously on average premiums.

Coastal states with the strongest building codes have a lower average premium than states with the middle and weakest building codes (See Figure 31). We did not confirm this result using a multivariate analysis, however, because statistical significance cannot be accurately determined based on only a few data points. More importantly, improving building codes is a very long-term solution to high losses and the impact may not yet be present in the data.

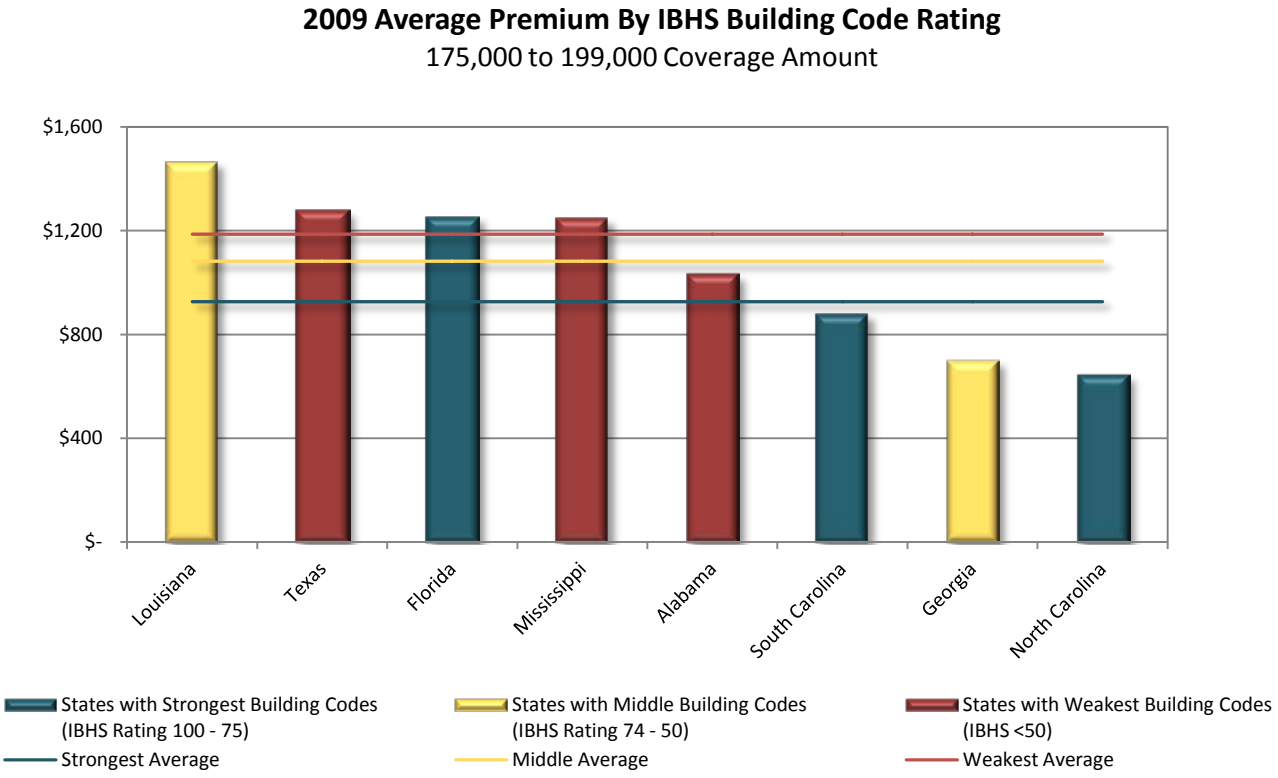


Figure 31. 2009 average premium by state for all owner-occupied homeowners' policy forms combined for coverage amounts between $175,000 and $199,999, grouped by IBHS Building Code Rating. Highest ratings mean strongest building codes, lowest rating mean weakest building codes.
Source: 2009 NAIC report on average premium, Institute for Business and Home Safety January 2012 report, "Rating the States."

Even though improving building codes may not reduce losses immediately, insurers and reinsurers see coastal states with strong building codes as a more attractive place to do business than coastal states with weak building codes. This could increase the supply of capital to the insurance market of states with better building codes, which could affect prices.

We recommend that the legislature consider requiring all residential properties be built to the IRC or to stronger building codes, and encourage mitigation efforts to fortify existing structures. We also recommend that all residential property insurers be required to offer premium credits to policyholders whose homes are built to the IRC or to a stronger code.

Absent legislative action, there are actions insurers can take that may help to achieve similar goals. For example, more insurers can develop and use building code "grades" for communities. These grading schedules, such as ISO's Building Code Effectiveness Grading System (BCEGS), would grade communities on how strict their building codes are, and how strictly they enforce their building codes. Insurers could then use a community's building code grade when determining the premium to charge for homeowners in those communities. Homeowner insurers extensively use a similar system that grades fire departments, called the public protection class (PPC) system.