

Study the relationship between insurance premiums and construction costs, especially as associated with recovery from natural disasters, to ensure that consumers are treated fairly

Comparison of Construction Costs and Insurance Data

The Texas Department of Insurance compared the average premium and average policy size for homeowners insurance in Texas to the Marshal & Swift/Boeckh (MSB) building cost index numbers.

MSB provides construction cost information to the property and casualty industry. They collect costs for labor and materials, which the industry uses to calculate the value of homes (cost to rebuild) and to estimate costs for remodeling, home repair, and restoration.

The graph below shows how average premium, average policy size, and construction costs have increased since 2000. In recent years they have moved in tandem, but that hasn't always been the case. In 2001, the average premiums increased much more than the Boeckh Index due to significant rate increases. From 2002 to 2006, average premiums were relatively flat, while the other values were increasing. This could be the result of deductions in coverage, increased deductibles, and the greater use of discounts, which would help offset increases in premiums due to increases in the amount of coverage purchased or rate increases.

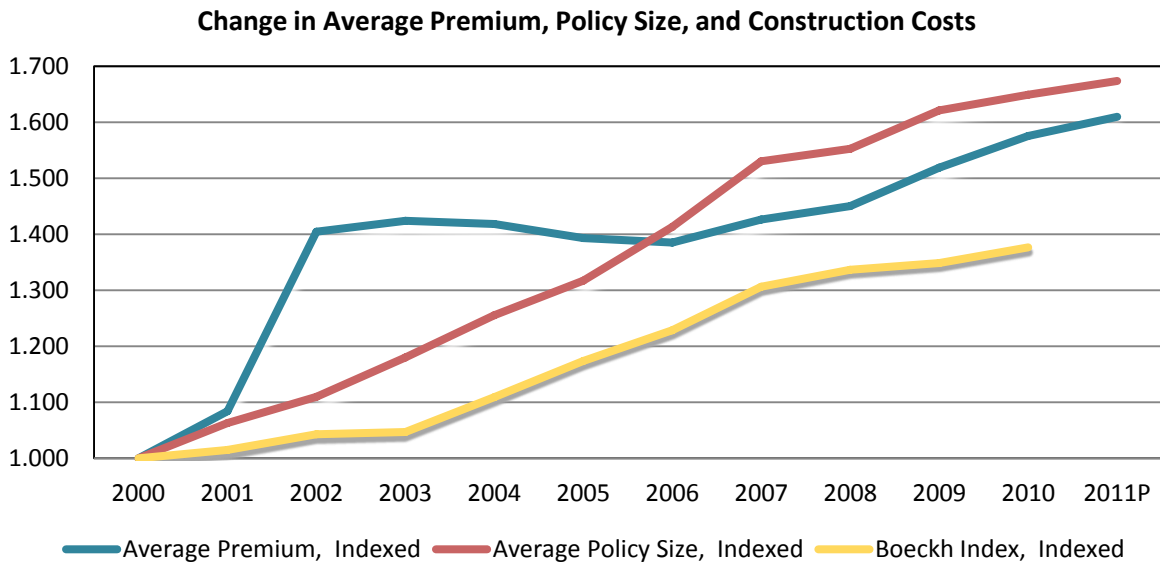


Figure 1: Change in average premium, policy size, and construction costs from 2000 to 2011. Numbers for 2011 are preliminary estimates.

Source: Residential Property Statistical Plan data and MSB data from TWIA.

Construction Costs Following a Catastrophic Event

Construction cost data can also be used as a claims adjusting tool for property. In addition to MSB, Xactware is another company that collects building cost information and provides tools for insurers and claims adjusters in calculating repair costs and settling property claims. These companies do extensive research to find timely cost information for labor and building materials for local areas.

However, after a catastrophe, insurers may find that the costs for labor and materials have increased above the local area costs reflected by the software. If the software estimates are inadequate because the insurer has to pay more for labor and materials due to supply shortages, then the insurer can revise the estimates to reflect current costs before the claim is settled.

Concerns

Critics have alleged that the insurance industry has used these tools for underestimating repair costs, which can result in underestimated claim offers. In 2007, Louisiana's State Attorney General Charles Foti filed a suit against numerous insurers, MSB, Xactware, ISO, and a consulting firm, McKinsey & Co., which advised many companies on practices to adopt in claims handling. In December 2008, a federal judge dismissed the lawsuit for lack of evidence.

Criticism also claims that the tools used to determine the replacement cost of policyholder's homes is overestimating home values, which would increase premiums. In early 2012, some Florida homeowners filed a class-action lawsuit against Citizens Property Insurance Corporation, claiming that the state-run insurer overestimated property values to increase premiums. Citizens uses 360Value, which is Xactware's software to estimate a home's replacement cost.