



Southwestern Insurance Information Service

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## insurance news

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### **Agency faults reinsurance purchases Consumers needlessly pay extra, office says**

Texas homeowners covered by the state's three largest home insurers could save an average of 8 to 14 percent a year on premiums if they didn't bear the cost of coverage that companies buy for themselves, a state consumer agency says.

Allstate, State Farm and Farmers all buy policies, known as reinsurance, to help pay claims after a major disaster and say what they spend is necessary. They usually pass on part of that cost to policyholders.

“But they don't need it,” said Deeia Beck, head of the Office of Insurance Counsel, which represents consumers before regulators. “Some smaller companies that only sell in Texas or are highly concentrated on the coast might need it, but for the larger diversified companies, it doesn't make sense.”

The agency is pointing to reinsurance as regulators review recent rate increase filings by the big insurers, sending letters in protest. If companies do buy reinsurance, they should lower rates because their risk drops when they buy re- insurance, the insurance counsel argues.

The Texas Department of Insurance considers reinsurance a legitimate expense but examines whether companies bought the right amount and at what cost. It can also determine whether insurers are passing along too much of those costs to consumers.

“We do think it's a necessary expense for companies to adequately cover their risk, but we do want to make sure they have the right amount,” department spokesman Jerry Hagins said.

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State Farm policyholders could save an average 9 percent statewide if reinsurance costs were factored out, according to the insurance counsel. For Allstate customers, the savings would average 8 percent, for Farmers customers, an average 14 percent. The savings could be even greater for coastal and Harris County residents because the reinsurance costs fall predominantly on those with property at risk of hurricane damage, Beck said.

State Farm and Farmers declined to say how much coverage they buy or how much they pay for it. Allstate declined to say how much it pays for the \$250 million in reinsurance for Texas it has, but it noted that it kicks in after the company pays out \$1 billion in losses.

Allstate, State Farm and Farmers notified regulators of home insurance rate increases this year. All three work reinsurance costs into their rates.

The insurance department is still reviewing the companies' increases and can force those that have implemented hikes to pay refunds with interest if it considers them unjustified.

### Standard practice

Buying reinsurance is a standard practice nationwide. Companies normally buy reinsurance to offset hits to surplus funds — money various states require they set aside for unexpected or surprisingly large claims. If a company's surplus declines, it also limits how much insurance it can sell.

“It is an important and long-recognized clear expense of doing business,” said Beaman Floyd, director of the Texas Coalition for Affordable Insurance Solutions, an industry trade group. “I find it curious that reinsurance costs would be challenged in this way. It's a clear cost.”

The Office of Insurance Counsel's argument that buying reinsurance should lead to rate reductions may be reasonable given that companies are reducing their risks, said Dan Jones, who teaches risk management at the University of Houston.

But companies don't really know by how much, he said, adding that losses can end up larger than the funds and the reinsurance coverage that a company has available.

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**“In view of what we've been through in the last four years, they would be carted off in white coats in a big vehicle should they choose not to buy reinsurance,” he said. “And their stockholders and policyholders would not look upon it kindly.”**

**The insurance counsel also argues reinsurance is unnecessary if companies limit the policies they sell in the state, as both Allstate Texas Lloyds and State Farm Lloyds have done in recent years.**

### **Risk-management tool**

**State Farm, Farmers and Allstate each say they use reinsurance to manage risk.**

**“The result of effectively managing risk is that State Farm Lloyds is better positioned to fulfill its obligations to policyholders in their time of need,” State Farm spokesman Kevin Davis said.**

**Spokesman Bill Mellander said Allstate considers buying reinsurance a responsible move that costs money.**

**“There are costs associated with prudent responsible business decisions, and unfortunately some of those costs need to get passed on to the consumer,” he said.**

**Since the consumer is not paying the second company or reinsurer, Farmers must, noted Larry Pratt, executive director of South Texas for Farmers. “Without reinsurance, we would be able to insure less property in Texas because the aggregate exposure would threaten our solvency,” he said.**

**It's not just the major players that the insurance counsel takes issue with. Beck also opposes a \$28 million re-insurance purchase by the non-profit Texas FAIR Plan, which sells home insurance to those Texans — except those directly along the coast — who can't find it elsewhere.**

**Beck took issue with the size of the purchase, given that the company's exposure to potential claims payouts has dropped.**

**The company's projected exposure dropped 21 percent from last year but its re-insurance premium increased 39 percent, Beck said.**

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### Already having trouble

Alex Winslow, head of Austin-based Texas Watch, noted the cost is being passed on to consumers who are already having trouble finding insurance.

“Is it appropriate for FAIR Plan to be raising rates to purchase additional reinsurance when they don't have a history of needing the level or reinsurance they're asking for?” Winslow said. “It raises questions in my mind about the appropriateness of the rate hike.”

Jim Oliver, executive director of the FAIR Plan, said the company decided to buy the coverage because it has less than \$10 million in surplus funds, but more than \$8 billion in exposure in Harris and Fort Bend counties alone. It also projects that a Category 3 hurricane through the Houston area could cause up to \$300 million in losses.

Once the company runs out of money, state law lets it assess private companies statewide, which in turn can pass on the costs to policyholders.

Hurricane Ike will cost the company \$220 million, and reinsurance helped it avoid assessing private insurers, Oliver said.

“Obviously, those on the outside are concerned about the impact of reinsurance on the overall rates,” he said. “This is a reasonable concern, but the governing committee has to look at all possible issues and cannot just focus on rates.”

### REDUCING RATES

If companies factored out the cost of reinsurance from rates, this is the average statewide drop in premium policyholders would see.

- State Farm: 9%
- Allstate: 8%
- Farmers: 14%

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- **FAIR Plan: 33%**

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