Insurance 101:
Decoding Your Auto and Homeowners Insurance Costs

Insurance serves as a crucial financial protection tool, enabling consumers to mitigate the potential burden of a loss that might otherwise be financially crippling. The policyholder pays premiums, and in return, the insurer provides an insurance contract, or policy, outlining certain coverages against specified risks or losses (such as damage to a home caused by a natural disaster or an automobile accident).

Setting the price (more generally referred to as the rate) for insurance is like pricing any other product or service, but with a unique factor. Insurance is all about managing risk. When you buy insurance, you're preparing for potential future events, and the exact costs of those events aren't known upfront. Insurers must predict the likelihood of future claims and losses along with other costs that make up the business of insurance. Insurers rely on actuarial analysis of loss trends and other data to determine coverage pricing. They use past loss information to help predict potential future losses.

What goes into determining premiums and rates for auto and homeowners insurance?

Insurers use actuarial standards and rating classifications when determining rates.

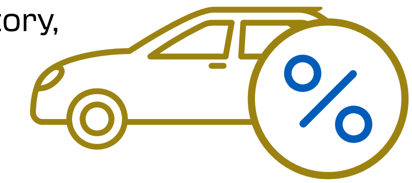
Actuarial standards follow three goals:

Insurance companies must have adequate reserves to pay claims

- Promoting fairness among different risks that may have different expected costs
- Permitting economic incentives to operate and encourage widespread availability of coverage
- Protecting the financial integrity of the insurance system

Insurers look at individual consumers using rating classifications, which are factors that help assess different risks and more accurately develop rates for pricing those risks. Texas law prohibits the use of classifications based on race, religion, and national origin.

Personal Auto insurance rate classifications include:



- Driver characteristics (age, sex, marital status, accident history, claims history, criminal history such as DWI, credit scoring)
- Type of vehicle and how much it will cost to replace it
- Where you live and how much your drive

Homeowners insurance classifications include:

- Type of construction of a home (brick, wood frame, stucco, etc.)
- Condition of home and type of roof structure
- Age of home (new construction or otherwise)
- Location of home
- Owner factors (examples: presence of burglar alarms, fire extinguishers, type of pets, gun ownership, pool ownership, factors to mitigate wind losses, previous theft losses, fire losses, and other types that might show a pattern)

Why have rates increased?

Factors affecting all claims and overall costs that are causing upward pressure on rates:

Inflation - Inflation significantly impacts the cost of goods and services that directly affect insurance. This includes the cost of new and used vehicles, car parts, and repairs; as well as building materials and construction labor.

- New and used vehicle prices increased 52.3% since January 2020, peaking in January 2022. As of December 2023, used car prices were still 38.1% above pre-COVID levels.
- The Bureau of Labor Statistics Consumer Price Index (CPI) showed a 42.4% increase in the CPI for motor vehicle body work since 2013.
- Replacement cost for all parts and equipment for personal auto rose 22.9% from January 2020, peaking in May 2023. As of January 2024, motor vehicle parts and equipment had fallen but remains well 27.6% above pre-COVID levels.
- From January 2020 to December 2023, the CPI of the cost of building materials (concrete, lumber, gypsum, etc.) increased 19.2% causing implications for property insurers.

Driving behavior resulting in more severe and costly accidents - During the COVID-19 pandemic, people drove less, but the severity of accidents increased. Increased severity of accidents persists, resulting in more claims with higher vehicle repair and replacement costs.

- Texas experienced a higher increase in traffic fatalities with a 7.54% increase from 2019 to 2020. Even more striking, there were 4,573 fatalities on Texas roads in 2021—an 18% increase from 2020.
- How this translates to rates- Collision claim severity reached a record high in 2023, with an average loss of $5,678 in the third quarter of 2023. Severity is up 42.6% from the first quarter in 2020 ($4,206 average loss). Inflation is a major factor in the sharpness in increase of severities.

$19.6B

for Hurricane Harvey

Increased frequency and severity of weather events - Texas is susceptible to a range of natural disasters including hurricanes and even winter storms. Texas ranks at the top of the list of states when it comes to natural disasters including hailstorms, tornadoes, and even wildfires.

- Texas represented **12 of the top 22 mostly costly insured events in US history** occurring between 2010 and 2022
    - 2017's Hurricane Harvey costing **$19.6 billion** and the 2021 winter storm at **$11.2 billion**.

- Texas was impacted by three of the 18 events in the US in 2022 that caused at least $1 billion in economic damage (southern and central severe weather in May 1-3; Texas hailstorms in Feb.21-22; southern severe weather in April 11-13)

Reinsurance - Reinsurance acts as a safety net for insurance companies, allowing them to share the financial burden of major disasters. By purchasing reinsurance, companies ensure financial stability in the face of significant losses. Any increase in reinsurance costs can directly impact the premiums passed on to customers by insurance companies.

- US reinsurance pricing is sensitive to catastrophe losses, impacting primary insurance pricing, terms, and conditions. US property catastrophe reinsurance rates increased by 35% in 2023 and another 5.3% in 2024.

But I haven't filed a claim, why are my rates increasing?

Insurance functions by pooling risks among policyholders. Premiums contribute to a collective fund used to cover claims for all policyholders. Rates or unused coverage does not work like a savings account. Rather, a higher rate of claims in a specific area or category can lead to adjustments in premiums for all policyholders in that category. Policyholders can still take steps to reduce their risk profile, which may lead to lower premiums. This can include implementing safety measures, maintaining properties, and in the case of auto insurance, modifying driving behavior.

Insurance regulation in Texas

The Texas Department of Insurance (TDI) regulates the Texas insurance industry. However, TDI does not set insurance rates or premiums. Since 2003, the type of regulation used in Texas is called “file and use”. Insurance companies can change their rates and premium formulas by “filing” them with TDI (analysis that supports the rate change must be included in this filing). Once filed with TDI, companies can choose to use the rate immediately or choose a later effective date. While specific approval by TDI is not needed, TDI reviews all rate filings and does have the right to disapprove a rate. TDI’s actuaries review a company’s analysis and evaluate whether the rate changes are supported and follow state law.

Texas law sets three rate standards

- **Rates cannot be excessive** - A rate is considered “excessive” if it is likely to produce a long-term profit that is unreasonably high in relation to the insurance coverage provided.
- **Rates must not be inadequate** - A rate is considered “inadequate” if it is insufficient to sustain projected losses and expenses to which the rate applies and continued use of the rate would endanger solvency or have the effect of reducing competition or creating a monopoly in the market.
- **Rates must not be unfairly discriminatory** - A rate is considered “unfairly discriminatory” if it is not based on sound actuarial principles; doesn’t have a reasonable relationship to the expected loss and expense experience among risks; or is based wholly or partly on the race, creed, color, ethnicity, or national origin of the policyholder.

Texas is a competitive market and consumers are urged to shop around

Competition is a crucial factor in effectively regulating rates. Trends in Texas (and other states) have shown that insurers often select rates to be used that may be less than what is actuarially indicated to maintain customers and market share.

Texas is extremely competitive with 3,001 companies writing property and casualty insurance in 2023. Texas also has the most domestic insurance companies (202), meaning that Texas issued their primary license, in the country.

Several public resources are available, including HelpInsure.com, a website developed by the Texas Department of Insurance (TDI) to help consumers shop for and compare insurance options in Texas. Additionally, the Office of Public Insurance Counsel (OPIC), a state agency, represents Texas consumers' interests in insurance matters. OPIC educates and advocates for consumers, working to maintain a balanced marketplace.

About ICT

ICT is a non-profit trade association representing the interests of Texas property and casualty insurers. ICT is the largest state-based insurance trade association in the country with nearly 400 member companies and 40 associate member businesses who support the property and casualty industry. Our member companies represent **86%** of the Texas property and casualty market.

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