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2011 Property and Casualty Insurance Report Card

A state-by-state analysis of regulatory burden

By Eli Lehrer*

1. Introduction

Each of the past four years, The Heartland Institute has released a report that asks fundamental questions about the nation's property and casualty insurance regulatory environment. In this 2011 report we again ask, as we have since 2007, two basic questions about property and casualty insurance products:

(1) How free are consumers to choose the property and casualty insurance products they want?

(2) How free are insurers to provide the property and casualty insurance products consumers say they want?

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Reviewing the data on insurance in 2011, we see once again a modest, uneven, but nonetheless real trend towards more freedom for consumers and businesses in the homeowners' and

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* Eli Lehrer is vice president of Washington, DC operations for The Heartland Institute and national director of its Center on Finance, Insurance, and Real Estate. CFIRE operates in Chicago, Washington, Austin, and Tallahassee, addressing issues relating to insurance, risk, and credit markets. He thanks Jesse Buggs, formerly of The Heartland Institute, and Robert Hartwig and Madine Singer of the Insurance Information Institute, for their assistance in compiling and correlating the data used in this report card. Any errors remain the author's own.

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automobile insurance realms. Although state-level insurance bureaucracies make it difficult, sometimes impossible, for insurers to offer consumers the products they need, want, and deserve, burdensome regulation shows signs of easing.

As with any complex policy issue – particularly one where public policies differ in each of the 51 U.S. jurisdictions that regulate insurance – progress did not happen evenly, and positive trends came along with negative ones. Among the major events in 2010:

- With significant bipartisan majorities, Florida's legislature attempted to reduce the size and scope of the state's extensive insurance market interventions. Reforms passed by the legislature would have created more rate freedom for insurers, provided new choices for consumers, and reduced the size of the state government's insurance liabilities. Gov. Charlie Crist (I) vetoed the reforms, and Florida's insurance environment continued on a potentially disastrous course.

- Florida experienced a wave of insurer insolvencies resulting mostly from over-regulation of the market. Many insolvencies that the Florida Office of Insurance Regulation kept secret from consumers in the early months of the year ended up sending consumers and regulators scampering to other companies and the state's residual market, the Florida Citizens Property Insurance Corporation.

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- Even as residual market mechanisms around the country contracted on average (a positive development), residual mechanisms in Florida and Texas expanded significantly.

- The widely accepted, pro-consumer practice of using credit scores to help determine insurance rates came under attack in Massachusetts, Michigan, and Washington State. Despite significant state legislative action, however, no state actually passed a law banning the practice. Near the end of the year, Massachusetts' attorney general proposed to issue regulations that would have banned the use of credit scoring.

- Sweeping, market-restricting automobile insurance reforms in Massachusetts and Michigan gained significant support but did not pass legislatures in either state. In Massachusetts, chief advocate for the new law, Martha Coakley, won reelection as Attorney General. In Michigan, Gov. Jennifer Granholm (D), the main supporter of the law, was term-limited, and Michigan's governorship passed to the other party.

- Federal-level reforms to regulation of financial services industries and health care avoided major effects on property and casualty insurance. Nonetheless, both the Patient Protection and Affordable Care Act and the Dodd-Frank financial reform bill included provisions affecting P&C insurance. Dodd-Frank establishes a first-ever federal-level office to deal with insurance issues and facilitates interstate sales of reinsurance and excess and surplus lines policies, and provisions of PPACA will affect automobile insurance.

- The Deep Water Horizon oil spill raised questions about certain types of commercial

coverage and resulted in record-high claims for BP's insurers.

This study consists of four sections: This introduction, which outlines the purpose of this annual study; an explanation of the methodology we used; the state rankings; and a review of major events in insurance during 2010.

We continue to conduct this annual study for three reasons: because insurance is an important economic activity; because it is regulated almost entirely at the state level, resulting in significant variations of rules from state to state; and because we hope an objective look at state insurance regulation will encourage states to compete by creating freer insurance environments.

Insurance and Government Regulation

Insurance is the largest and most important economic activity regulated almost entirely at the state level. In some cases this regulation leads to inefficiency.

> Major property and casualty insurers have not introduced a single major new personal lines property and casualty insurance product since modern homeowners' insurance became available in 1959.

Although federal and international entities oversee banking, trade, manufacturing, and many service industries, states alone have had the power to oversee property and casualty insurance since the McCarran-Ferguson Act was enacted in 1945. As a result, insurers and consumers have to navigate a confusing and expensive maze of state regulations. International insurers have difficulty entering the U.S. market because they have to enter each state market separately.

State regulation makes insurance more expensive on average because incumbent insurers can lobby political authorities for rules that limit competition and thus allow them to raise rates. Some self-declared consumer groups (often representing the interests of the best-off and most-organized individuals) use their political influence to support rate caps and subsidies to socialize the cost of insuring against risks they face due to the choices they make and should pay themselves.

This system has not facilitated innovation. Whereas nationally organized companies sell most property and casualty insurance, every state regulates the industry under its own idiosyncratic rules. And these rules aren't very good. In fact, major property and casualty insurers have not introduced a single major new personal lines property and casualty insurance product since modern homeowners' insurance became available in 1959.

As rate freedom has increased, however, one market – automobile insurance – is showing signs of real innovation: In 2011, one company continued to roll out products that monitor driver behavior to set rates, and "pay per mile" auto insurance grew in the one state (Texas) where it is

explicitly allowed. Some new automobile insurance policy features, one-time accident forgiveness among them, became more common as well.

No state does a perfect job of regulating insurance, but some do better than others. We produce this ranking to give states a sense of what they ought to do if they wish to free their insurance markets.

No state does a perfect job of regulating insurance, but some do better than others. We produce this ranking to give states a sense of what they ought to do if they wish to free their insurance markets. We tried to collect data that show what states should and shouldn't do as they consider changes to their insurance regulatory environments.

We conducted this study for the sake of consumers, elected officials, and the insurance industry – in that order. Its findings may not consistently reflect the opinions of those in the insurance industry or "consumer rights" advocacy groups and may sometimes run directly contrary to them. We believe that an open and free insurance market maximizes the effectiveness of competition and best serves consumers. States in which the industry does not love to operate, such as Maine, rank high by these measures because they have open and competitive markets and no obviously terrible practices. California's burdensome automobile insurance regulatory system receives an "F."

Proper Role of Government

Insurance is one of the key institutions that make economic prosperity possible. Properly designed, insurance makes the management of risk possible and thereby helps make long-term planning and investment possible. Insurance markets best accomplish their risk-management function when insurers are allowed to charge actuarially determined rates that accurately reflect the risk their policyholders incur. When government regulation interferes with these price mechanisms, the result is either rate suppression or a redistribution of the cost burden, resulting in wealth redistribution from policyholders who behave prudently to those who take greater risks.

Prices do more than provide fair compensation; they also convey information. In insurance markets, this information is very important. Political manipulation of insurance rates, regardless of its intentions, distorts the competitive signals of the private market and reduces the range of products available for consumers. Price controls inevitably reduce the supply and lower the quality of insurance products.

Government plays an important and necessary role in regulating insurance. Enforcement of laws against fraud, for example, clearly is needed, and such enforcement belongs in the hands of the state. Enforcement of reserve requirements, ensuring timely response to claims, and requiring the use of clear language in insurance contracts are all legitimate government functions that have been demonstrated to benefit and protect consumers. Most importantly, perhaps, the entire existence of admitted market property and casualty insurance (the types of insurance that individuals and all but very large businesses typically purchase) – the principle of sales in "utmost good faith" most prominently – requires a degree of form regulation (oversight of the

Methodological Changes, 2011

We relied on the same data sources and used the same fundamental methodology in 2011 as we did in 2010.

We dropped two rating categories – market entry (auto) and loss ratio stability – that some users of our report card had commented about. Based on several years of data and experience using these factors, we found these categories were less revealing than we had hoped they would be. Entry and exit of small insurance companies can happen for any number of reasons; some states gain auto insurers or lose them for reasons unconnected to regulation. In addition, the fluctuation of insurance company automobile loss ratios, although a useful data point in theory, is more affected by non-regulatory factors than we assumed – Hurricane Katrina affected these ratios greatly in many states, and in some places positive overall changes in systems can create instability by allowing profits where losses previously existed or, better, reducing monopoly rents of a few companies.

In addition to those two changes, we made some other minor alterations:

- We have broadened the database we use to determine whether states use or administer desk drawer rules.
- Because of differences in the implementation of similar legislative language relating to territorial rating, we have tried to examine regulations as well as statutes in determining the extent to which states use territorial rating.
- Because we don't see any evidence it necessarily changes practices for better or worse, we have eliminated the bonus we previously gave to states without any law concerning territorial rating.

The next several pages justify our choice of variables, explain how we calculated them, and identify the data we used to determine them.

terms of insurance contracts and disclosures made) that, in some cases, may be more stringent than insurers would like.

The current regulatory environment in many states, however, goes far beyond this role. It is characterized by heavy-handed regulations that are largely unknown to the general public and created through a regulatory process dominated by special-interest groups and a small number of elected officials. This regulatory process imposes large costs on businesses and deprives individuals of reliable, affordable insurance products. In addition, it increasingly threatens to place U.S.-based financial services companies at a competitive disadvantage with those in Europe and Asia. We believe most decisions – especially the price charged for insurance products – should remain largely in the hands of market forces and voluntary arrangements.

2. Methodology

This study focuses largely on regulatory environments, not regulators. A grade of "F" is not an attack on a state's insurance department, nor is a grade of "A" an endorsement of the people running it. Nonetheless, we attempt to go beyond simply looking at the laws on the books. In two categories – "regulatory clarity" and "regulatory environment" – we explicitly measure the nature of the regulatory environment.

Additional opportunities for reform exist in many states but are not highlighted by our methodology. If a state with reasonable insurance laws under-staffs its insurance department such that consumers with fraud complaints and companies wishing to file rates cannot get timely assistance, there is a need for reform that would not be revealed by our methodology. A state that favors in-state

domestic insurers over those based elsewhere may likewise create a seemingly "competitive" market without a very level playing field. Our methodology does not make these distinctions.

We assess nine variables and use the most recent one-year data available. We use 2010 data throughout this study except where the nature of a variable dictated a multiyear approach.

> A score of zero does not reflect a lack of regulations, only that a state is typical for the nation in the country for that variable.

For most variables, the "modal" score, the score assigned to a plurality of states, is zero. It is important to note that a score of zero does not reflect a lack of regulations, only that a state is typical for the nation in the country for that variable. When we scored actions, policies, and characteristics of the insurance environment as "pro-free market," we added points. Conversely, we subtracted points for factors deemed anti-market.

We weighted variables based on their importance in preserving a free and competitive marketplace, giving greater weight to those variables that matter most to consumers. Things that are mostly affairs of insurers, political control of insurance departments, and regulatory inconsistency received modest weightings. Things that reflect consumer experiences – residual market size and market concentration – were more heavily weighted. Although it attempts to rank overall levels of freedom, our study gives an "edge" to the factors most important to consumers.

Any objective rating must apply the same criteria to each item being rated. This requirement, however, can cause a rating system to miss some important differences among the things being rated. To begin with, we are limited to quantifiable data we could find, create, or compile for all 50 states. For example, we were unable to collect systematic data about the quality of state programs intended to investigate fraud in the insurance industry or figure out a good way to assess the quality of state form regulation.

We also tried to focus on laws and regulations and situations common to, at minimum, a great part of the country. Thus, some very special situations – such as a South Carolina program to assist with disaster mitigation – aren't reflected in these rankings.

Politicization (-6 to 0 points)

Regulation of property and casualty insurance is a heavily technocratic task that ought to consist mostly of monitoring companies for solvency and preventing fraud. It involves law enforcement and effective and efficient management of compliance systems. Putting insurance rate regulation in the hands of an elected insurance commissioner has a tendency to politicize a job that should have far more to do with spreadsheets than politics. We realize it is necessary and valuable for the people to have oversight over their government's activities, but we believe this is best exercised by elected representatives and governors who oversee insurance regulation as part of their responsibility to oversee all state regulatory activities.

We downgraded states in which it appears insurance is a hot political issue or where market-restricting legislation gained traction. States were penalized if:

- The nature of property and casualty insurance regulation was a major issue in at least one statewide election held during the past four years. (Score -2 for each election in which that occurred.) States with an elected insurance commissioner automatically receive a score of -2 unless we have evidence that property and casualty insurance was not a factor in the election.

- Laws that would reduce a state's score on this scorecard have gained serious support in the legislature, with regulators, or are seriously proposed as ballot referendums. This means such measures have either passed at least one house of the legislature or passed the insurance committees in both houses. (Score -2 for each major piece of legislation or legislative package pending up to a total of -4.)

It's important to note these variables are intended to measure the degree of politicization, not its consequences. States such as Louisiana and North Carolina, which have generally moved insurance regulation in positive directions (and have seen their scores improve in recent years), still receive negative scores by this criteria; each received scores of -2.

Even though neither has an elected insurance commissioner, Florida and Michigan are two of the states that received the lowest possible grade on this measure, -6. Both states had governors (Florida Republican-turned Independent Charlie Crist and Michigan Democrat Jennifer Granholm) who ran for election on insurance issues, and Florida also saw insurance involved in its race for chief financial officer.

Regulatory Clarity (-5 to 5 points)

Effective insurance regulation requires consistency and clear rules. We penalized states that our survey of insurance industry regulatory liaisons identified as requiring filings under unclear rules – "desk drawer rules," in industry jargon.

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The complaints differ from state to state, but the basic charge is that state administrators take advantage of legal ambiguity in the code or latitude in how provisions are to be enforced, treating similar cases differently or violating the plain meaning and intent of the law. Each state found using "desk drawer rules" (based on at least two independent reports) received a score of -5. We rewarded states that make the rules very clear and administer them in a particularly unambiguous fashion.

A lack of regulatory clarity undermines the fundamental principle that like cases should receive like treatment and different cases should be treated differently. When a state sets deadlines arbitrarily or doesn't define what information it wants insurers to file with their paperwork, it makes product innovation impossible. Note that we penalized states for failing to make their

rules clear and rewarded them for making them particularly clear – not for having good or bad rules per se. The fact that a rule is unclear does not in itself make it bad. California, for example, receives a "desk drawer rules" penalty because it allows filing analysts to set their own deadlines for responses to requests instead of establishing a response deadline through statute or regulation. It's likely that at least some analysts set perfectly reasonable deadlines for responses, but that isn't the point. The point is that California allows analysts to arbitrarily define something that ought to be a matter of statute or regulation.

North Carolina, on the other hand, continues to base all automobile insurance rates on a rate-bureau-established rate plan, a once-common system that now exists in no other state. Many in the industry believe the system is anachronistic and unnecessary, but even the system's harshest critics agree the state's Department of Insurance makes the rules very clear and, as long as they are followed, provides clear feedback. Thus North Carolina received bonus points for regulatory clarity even though the law itself is problematic.

Finally, the existence of burdensome requirements did not result in penalties being assessed against states under this category. Many in the insurance industry complain that Florida requires filings that differ substantially from those in other states. This may represent an unnecessary burden, but by all accounts Florida makes it clear what it wants in these filings. As a result, Florida did not receive a penalty on this factor.

Residual Automobile and Homeowners' Insurance Markets (-10 to 0 points)

> Residual insurance markets serve consumers for whom state government officials believe coverage in the private market cannot be found at a "reasonable" price.

Residual automobile and homeowners' insurance markets serve consumers for whom state government officials believe coverage in the private market cannot be found at a "reasonable" price. In the property and casualty insurance realm, two states (Florida and Louisiana) run full-fledged property insurance companies as state agencies, and two states (North Carolina and Rhode Island) run a semi-private "shared" auto insurance market as reinsurance facilities. All states have residual automobile insurance market laws, although three do not write policies under these laws and nine wrote fewer than 15 policies in 2010.

Although many states have laws that forbid the bailout of residual pools or make them independent of the government, no state government has ever allowed such a pool to fail. Thus for all intents and purposes all such pools are government-supported enterprises that will be bailed out if they get into trouble.

Using data from the Automobile Insurance Plans Service Office (AIPSO) and the Property Insurance Plans Service Office (PIPSO) (two organizations that provide national services for residual property and automobile plans), we measured the size of residual markets for automobile and homeowners' insurance. When we had more recent figures than AIPSO and PIPSO provided, as we did for several states, we used them instead.

Residual markets represent a state subsidy for policyholders who take risks the market is unwilling to absorb without higher premiums or some other form of compensation. The existence of large residual insurance markets in a state is evidence of regulatory restrictions that prevent the market from meeting consumers' needs.

Most residual insurance markets are very small. It's unlikely, for example, that a few involuntarily written auto insurance policies representing less than one-half of 1 percent of the market would have serious consequences for automobile insurance prices in any state or affect consumers outside of it.

For each state where the residual market was either nonexistent or represented less than half of 1 percent of the policies in the market, we scored 0. For states whose residual markets represented between .50 and .99 percent of the policies written, we scored -1. For states that assigned more than 1 percent of policies in the residual market, we subtracted points equal to the percent number in the residual market plus 1. (Thus a state with 2 percent of consumers written in the residual market would receive a score of -3.) We "capped" reductions in each category at -10 percent to avoid distortions in the overall scores.

Some examples: South Carolina writes three policies in its residual automobile insurance market and received a score of zero in this category. Vermont maintains a residual market that includes about .6 of 1 percent of the state's drivers, so it received a score of -1. Massachusetts' fast-shrinking residual market includes about 5 percent of that state's drivers, so it received a score of -6. North Carolina, home to the largest residual auto insurance market in the country, insures more than 20 percent of its drivers through the state-mandated, privately run Reinsurance Facility. It received a score of -10.

Market Concentration (-10 to 10 points)

A well-functioning market of any type will tend to have a variety of competitors whose products fill different and competitive niches. Such competition tends to benefit consumers.

A well-functioning market of any type will tend to have a variety of competitors whose products fill different and competitive niches. Such competition tends to benefit consumers.

Although low market concentration does not by itself prove that consumers are being ill-served, it can be a sign of regulatory barriers to entry and market dysfunction. Therefore, we reward states with competitive insurance markets and deduct points from those with highly concentrated markets.

We calculated concentration using 2010 market data collected by SNL financial. Using the widely accepted standard for measuring market concentration, the Herfindahl-Hirschman Index (HHI), we analyzed the market percentage share of all insurance companies in the market. After squaring the market share of each of the top ten companies for total private passenger auto policies, we added the results to calculate the HHI. We used the same method to calculate the HHI for homeowner's market concentration.

Vermont is an example of a state that scored high in our market competition measure: Although it has a small population, a mix of national, regional, and Vermont-centric companies gives its residents a wide array of choices for automobile and homeowners' insurance. Alaska, on the other hand, has highly concentrated automobile and homeowners' insurance markets. Perhaps because it is so remote, only a handful of companies wrote significant numbers of policies there.

On the report card, in each category we gave the ten most-concentrated states a score of -5 and the ten next-most-concentrated a -3. The middle ten received a score of 0. The ten least-concentrated states received a score of 5, and the ten next-least-concentrated states received a score of 3.

We scored homeowners' and automobile markets separately because different types of regulations may affect the two markets.

Rate Regulation (-20 to 20 points)

Regulators typically set lower rates for politically favored groups and higher rates for disfavored groups.

Forty-seven states exert a significant degree of direct control over the rates insurance companies charge for automobile and homeowners' insurance. When regulators establish rates or require specific justification for the rates insurance companies establish, factors other than risk become more important to the rate-setting process than they should be. Regulators typically set lower rates for politically favored groups and higher rates for disfavored groups. For example, in Florida a massive state-run insurance company, the largest homeowners' insurer in the state, guarantees lower-than-market rates for people who live in coastal areas and, as a result, tends to raise private homeowners' insurance rates in inland areas.

Based on surveys of employees at three large insurers and a review of state laws as compiled by the National Association of Insurance Commissioners (NAIC), we gave each state one of six scores. The scores are based in part on the laws on the books and in part on the way they are administered.

State-Made Rates: -20 (Prior Approval, Commissioner-Determined, Price-Controlled). States with "state-made rates" use a variety of mechanisms to establish insurance rates through the political process. In the homeowners' insurance market, only one state, Florida, received this designation. In Florida, a state agency, the Florida Citizens Property Insurance Corporation, will sell property insurance to anyone who gets a single quote even 15 percent above its prices. Thus the rates that Citizens establishes – plus 15 percent – represent a de facto state-mandated price ceiling on what people can pay for property insurance.

Low Flexibility: -10. (Prior Approval with Little Flexibility, Burdensome File and Use). States with "low flexibility" do not establish insurance rates by political fiat but do make it difficult to change rates. Texas received a low flexibility score. Although Texas has a "file and use" law on the books, insurers report that the filings are so burdensome they amount to prior approval of rates. The state's two largest insurers and its government-mandated residual wind

market mechanism (the Texas Windstorm Insurance Association) have had rates rejected outright by the state's insurance commissioner in recent years. Auto insurance ratemaking, although not as politically charged, encounters similar hurdles in Texas.

Below Average Flexibility: -5 (Prior Approval with More Flexibility, File and Use with Minimal Flexibility). States with "below average" rate flexibility make some types of rate change unnecessarily difficult but typically don't maintain overall policies that restrict rate freedom. North Carolina, for example, received a below average flexibility score. Its insurance system establishes central rate plans for most lines of insurance through a rate bureau and then allows companies to file "deviations" (essentially rate plans of their own) within certain clearly specified guidelines. So long as these guidelines are followed – and some of them tend to cap certain types of rates – the plans are never disapproved arbitrarily. No state with a "prior approval" law on its books for property and casualty insurance received a score higher than -5.

Moderate Flexibility: 0 (File and Use or Flex Rating Conventionally Administered). States with moderate flexibility generally allow market forces to establish rates, but sometimes they interfere for a variety of reasons and will often hold up and sometimes deny price changes. Michigan was rated as having moderate flexibility. Although some aspects of its insurance system are structured a bit differently from those in some other states, Michigan generally allows insurers to "file and use" rates and, for the moment, typically approves rates submitted to regulators. States with moderate flexibility have either "file and use" or "flex rating" laws on their books.

Above Average Flexibility: 5 (Use and File, File and Use Administered Lightly). States with above average flexibility allow market forces to play a leading role in the setting of insurance rates. Typically, states with above average flexibility will have authority to disapprove rates and may sometimes delay rate approval, but they rarely or never interfere with the functioning of market mechanisms. Virginia is an example of a state with above average flexibility. Operating under a "file and use" system, Virginia often regulates forms in ways that insurers find difficult, but it rarely challenges or disapproves rates. States with above average flexibility have "file and use," "use and file," or "flex rating" laws on their books.

States with above average flexibility allow market forces to play a leading role in the setting of insurance rates.

High Flexibility: 10 (Use and File with Limited Ability to Refuse Rates). States categorized as high flexibility typically cannot interfere with the insurance markets' functioning. Such states may have the ability to disapprove rates, and may sometimes do so if regulators determine proposed rates endanger a company's actuarial adequacy or violate civil rights laws, but in theory and in practice they generally allow market forces to set rates. Vermont is an example of a state with high flexibility: Although regulators can disapprove rates under very limited circumstances, insurers typically can "use and file" rates and rarely have them rejected.

No File: (20). Under no-file systems – which exist only in one state (Illinois) – insurers generally do not have to file rates with regulators at all. Under state law, homeowners' insurance rates are generally not filed with the state (although insurers must keep documentation of their

rates open for regulators' inspection), and auto rates are approved under a largely informational "use and file" system. States with "high flexibility" have "no file," "informational file," or "use and file" laws.

Credit Scoring (-5 to 0 points)

Because credit scores are widely available and reasonably reliable for determining risk factors, insurance companies consider them valuable for setting rates. States that allow the use of credit scores generally have lower overall rates than those that forbid them.

Seven states significantly restrict insurance companies' use of credit-scoring information for setting rates in ways that amount to all-out bans. States that ban its use entirely, or impose restrictions so severe it becomes useless, received a score of -5.

States that allow the use of credit scores generally have lower overall rates than those that forbid them.

We did not score restrictions on the use of credit scoring in fields other than automobile insurance and homeowners' insurance, and we ignored state laws that bar the use of credit scores as a "sole" factor in determining insurance rates. No company uses such scores as a "sole" factor, so this legal restriction has no real meaning.

Territorial Rating (-5 to 0 points)

The location of insured property, such as a residence or an automobile, can have a great effect on risk of damages. People who build houses on sand dunes should expect to pay higher homeowners' insurance rates than those who live well inland, and those who live in neighborhoods plagued by auto theft and vandalism should expect to pay higher automobile insurance rates than those in more secure neighborhoods. Although no state makes it impossible to use geography in any way, many states place significant limitations on the practice.

Most states disallow the use of territorial rating as the "sole" factor in determining rates or place other similarly broad limitations on the degree to which it may be used in determining rates. All states with such laws received a score of 0, as did states with no law involving territorial rating at all.

But the laws are enforced to varying degrees, and further research on this point is needed to determine more accurately how onerous the laws are in practice. In some cases, where we found regulations that appeared to significantly limit the use of territorial rating (despite laws similar to those elsewhere in the country), we downgraded the state with a -5.

3. Grading and Results

We calculated scores for every state by adding all variables and calculating a standard deviation from the mean. (The mean was -4.08.) States were graded as follows:

> Vermont and Ohio had the best property and casualty insurance regulatory environments in the U.S. in 2010, followed by Illinois, Maine, and Wisconsin.

More than two standard deviations above the mean: A+

More than one standard deviation above the mean: A

Above the mean by less than one standard deviation: B range

Below the mean by less than one standard deviation: C range

Below the mean by more than one standard deviation but less than two standard deviations: D range

Below the mean by more than two standard deviations: F

We awarded pluses and minuses to recognize states at the top and bottom end of each grade range. To determine grades, we rounded averages in favor of states. This resulted in more B- and C- grades than otherwise would be awarded.

We didn't grade the District of Columbia. The District's grade is brought down largely because of market concentration. Because Washington, DC is only one city of roughly 600,000 inhabitants, it's not surprising it has a more concentrated market than many states. (The remoteness of Alaska may be a major cause of the same problem there.)

Vermont and Ohio had the best property and casualty insurance regulatory environments in the U.S. in 2010, followed by Illinois, Maine, and Wisconsin. The best state, Vermont, scored 24 of a maximum possible score of 35. It lost one point for the size of its residual auto markets and 10 points for having price regulations that are good ("high flexibility") but not as good as Illinois' no-file system. Ohio was similar to Vermont, losing one point for the size of its residual homeowners market, two points for concentration in the homeowners market, and 10 points for not matching Illinois' no-file system. Illinois came in third place largely on the strength of its no-file status.

The worst states were Hawaii, Texas, California, and Florida. They scored between -22 (Hawaii) and -35 (Florida). Florida lost points for every variable except market concentration for the homeowners market and credit scoring. California lost points for every variable except market concentration for its auto insurance markets. Texas avoided losing points on only two variables: credit scores and territorial restrictions.

Tables presenting all of the results appear on the following pages.

State-by-State Analysis (in order by score)

State	Letter Grade	Score	Politicization	Regulatory Clarity	Residual Auto	Residual Homeowners	Market Concentration - Auto	Market Concentration - Home	Regulatory Environment	Credit Scores	Territorial Restrictions
Vermont	A+	24	0	5	-1	0	5	5	10	0	0
Ohio	A+	22	0	5	0	-1	5	3	10	0	0
Illinois	A	15	0	5	0	0	-5	-5	20	0	0
Maine	A	13	-2	0	0	0	5	5	5	0	0
Wisconsin	B+	10	0	0	0	0	0	5	5	0	0
Arizona	B+	8	0	0	0	0	5	3	0	0	0
North Dakota	B+	8	0	0	0	0	5	3	0	0	0
Utah	B+	8	0	0	0	0	3	0	5	0	0
Idaho	B+	7	0	0	0	-1	3	3	0	0	0
South Carolina	B+	7	0	5	0	-3	-3	3	5	0	0
New Hampshire	B+	5	0	0	0	0	5	5	0	0	-5
Virginia	B+	5	0	5	0	0	0	0	5	-5	0
Indiana	B	3	0	0	0	0	3	0	0	0	0
New Jersey	B	2	0	-5	0	-1	3	5	-5	0	5
Mississippi	B	1	0	0	0	-2	-3	-3	5	0	0
Rhode Island	B	1	0	0	-3	-4	3	5	0	0	0
South Dakota	B	1	0	0	0	0	3	3	0	0	-5
Montana	B	0	0	0	0	0	3	-3	0	0	0
Nevada	B	0	0	0	0	0	5	0	-5	0	0
Wyoming	B	0	0	0	0	0	-5	-5	10	0	0
Kentucky	B-	-1	0	0	0	0	-3	-3	5	0	0
Missouri	B-	-1	0	0	0	0	-3	-3	10	0	-5
Nebraska	B-	-1	0	0	0	0	-3	-3	5	0	0
Iowa	B-	-2	0	0	0	0	3	0	-5	0	0
Louisiana	B-	-4	0	5	0	-6	-5	-3	5	0	0

State	Letter Grade	Score	Politicization	Regulatory Clarity	Residual Auto	Residual Homeowners	Market Concentration - Auto	Market Concentration - Home	Regulatory Environment	Credit Scores	Territorial Restrictions
Connecticut	C+	-5	0	-5	0	0	5	5	-5	0	-5
District of Columbia	NG	-5	0	5	0	0	-5	-5	0	0	0
Minnesota	C+	-5	0	0	0	0	0	0	-5	0	0
West Virginia	C+	-5	0	0	0	0	-5	-5	5	0	0
Alabama	C	-6	-2	0	0	-1	-3	-5	5	0	0
North Carolina	C+	-6	-2	5	-10	0	3	3	-5	0	0
Pennsylvania	C	-7	0	-5	0	0	0	3	-5	0	0
Oklahoma	C-	-8	0	0	0	0	0	-3	0	0	-5
Oregon	C-	-8	0	0	0	0	0	-3	0	0	-5
New Mexico	C-	-10	0	0	0	0	0	-5	-5	0	0
Arkansas	C-	-11	0	0	0	0	-3	-3	-5	0	0
Georgia	C-	-11	0	-5	0	-1	0	-5	0	0	0
Washington	C-	-11	-4	-5	0	0	5	3	-10	0	0
Kansas	C-	-12	-2	0	0	0	0	0	-10	0	0
Maryland	C-	-12	-4	0	-3	0	-5	0	10	-5	-5
Delaware	D+	-13	-4	0	-1	0	-5	-3	0	0	0
Colorado	D+	-14	0	0	0	-1	0	0	-10	0	-5
Tennessee	D	-14	0	0	-1	0	-3	-5	-5	0	0
Alaska	D	-15	0	0	0	0	-5	-5	-5	0	0
Michigan	D-	-16	0	-5	0	-1	-3	3	-10	0	0
New York	D-	-17	0	-5	-1	-1	-5	5	-10	0	0
Massachusetts	D-	-18	-6	0	-4	-8	-5	5	5	-5	0
Hawaii	F	-22	0	0	-1	-1	-5	-5	-5	-5	0
Texas	F	-25	-6	-5	-2	0	3	-5	-10	0	0
California	F	-28	-6	-5	-1	-1	5	0	-5	-5	-10
Florida	F	-35	-6	0	-1	-10	-3	5	-10	0	-10
Standard Deviation	**11.79634373**										
Mean	**-4.08**										

State-by-State Analysis (in alpha order)

State	Letter Grade	Score	Politicization	Regulatory Clarity	Residual Auto	Residual Homeowners	Market Concentration - Auto	Market Concentration - Home	Regulatory Environment	Credit Scores	Territorial Restrictions
Alabama	C	-6	-2	0	0	-1	-3	-5	5	0	0
Alaska	D	-15	0	0	0	0	-5	-5	-5	0	0
Arizona	B+	8	0	0	0	0	5	3	0	0	0
Arkansas	C-	-11	0	0	0	0	-3	-3	-5	0	0
California	F	-28	-6	-5	-1	-1	5	0	-5	-5	-10
Colorado	D+	-14	0	0	0	-1	0	0	-10	0	-5
Connecticut	C+	-5	0	-5	0	0	5	5	-5	0	-5
Delaware	D+	-13	-4	0	-1	0	-5	-3	0	0	0
District of Columbia	NG	-5	0	5	0	0	-5	-5	0	0	0
Florida	F	-35	-6	0	-1	-10	-3	5	-10	0	-10
Georgia	C-	-11	0	-5	0	-1	0	-5	0	0	0
Hawaii	F	-22	0	0	-1	-1	-5	-5	-5	-5	0
Idaho	B+	7	0	0	0	-1	3	3	0	0	0
Illinois	A	15	0	5	0	0	-5	-5	20	0	0
Indiana	B	3	0	0	0	0	3	0	0	0	0
Iowa	B-	-2	0	0	0	0	3	0	-5	0	0
Kansas	C-	-12	-2	0	0	0	0	0	-10	0	0
Kentucky	B-	-1	0	0	0	0	-3	-3	5	0	0
Louisiana	B-	-4	0	5	0	-6	-5	-3	5	0	0
Maine	A	13	-2	0	0	0	5	5	5	0	0
Maryland	C-	-12	-4	0	-3	0	-5	0	10	-5	-5
Massachusetts	D-	-18	-6	0	-4	-8	-5	5	5	-5	0
Michigan	D-	-16	0	-5	0	-1	-3	3	-10	0	0
Minnesota	C+	-5	0	0	0	0	0	0	-5	0	0
Mississippi	B	1	0	0	0	-2	-3	-3	5	0	0

State	Letter Grade	Score	Politicization	Regulatory Clarity	Residual Auto	Residual Homeowners	Market Concentration - Auto	Market Concentration - Home	Regulatory Environment	Credit Scores	Territorial Restrictions
Missouri	B-	-1	0	0	0	0	-3	-3	10	0	-5
Montana	B	0	0	0	0	0	3	-3	0	0	0
Nebraska	B-	-1	0	0	0	0	-3	-3	5	0	0
Nevada	B	0	0	0	0	0	5	0	-5	0	0
New Hampshire	B+	5	0	0	0	0	5	5	0	0	-5
New Jersey	B	2	0	-5	0	-1	3	5	-5	0	5
New Mexico	C-	-10	0	0	0	0	0	-5	-5	0	0
New York	D-	-17	0	-5	-1	-1	-5	5	-10	0	0
North Carolina	C+	-6	-2	5	-10	0	3	3	-5	0	0
North Dakota	B+	8	0	0	0	0	5	3	0	0	0
Ohio	A+	22	0	5	0	-1	5	3	10	0	0
Oklahoma	C-	-8	0	0	0	0	0	-3	0	0	-5
Oregon	C-	-8	0	0	0	0	0	-3	0	0	-5
Pennsylvania	C	-7	0	-5	0	0	0	3	-5	0	0
Rhode Island	B	1	0	0	-3	-4	3	5	0	0	0
South Carolina	B+	7	0	5	0	-3	-3	3	5	0	0
South Dakota	B	1	0	0	0	0	3	3	0	0	-5
Tennessee	D	-14	0	0	-1	0	-3	-5	-5	0	0
Texas	F	-25	-6	-5	-2	0	3	-5	-10	0	0
Utah	B+	8	0	0	0	0	3	0	5	0	0
Vermont	A+	24	0	5	-1	0	5	5	10	0	0
Virginia	B+	5	0	5	0	0	0	0	5	-5	0
Washington	C-	-11	-4	-5	0	0	5	3	-10	0	0
West Virginia	C+	-5	0	0	0	0	-5	-5	5	0	0
Wisconsin	B+	10	0	0	0	0	0	5	5	0	0
Wyoming	B	0	0	0	0	0	-5	-5	10	0	0
Standard Deviation	**11.79634373**										
Mean	**-4.08**										

5. 2010 in Review

As the U.S. economy emerged – slowly – from a severe recession in 2010, the nation's property and casualty insurance environments continued to evolve.

Four major trends deserve particular note:

- the establishment of more significant-than-ever federal government controls over insurance regulatory functions that had previously been performed largely or entirely at the state level;
- a continued evolution of the coastal insurance market characterized by real steps forward in the Carolinas and Louisiana combined with the near-collapse of former Florida governor Charlie Christ's 2007 property insurance reform scheme;
- continued shrinkage of the overall property and casualty markets made all the more uncertain by the weak economy; and
- the failure of several major anti-market efforts to change automobile insurance systems.

Federal Role in Insurance

> The growth of federal government power over insurance appears to be the most talked-about but, in some respects, least consequential trend of 2010.

The growth of federal government power over insurance appears to be the most talked-about but, in some respects, least consequential trend of 2010. On one hand, two sweeping pieces of legislation that make repeated references to insurance – a health care reform bill and a financial reform bill – both passed Congress and were signed into law. Both, however, appear to have limited (albeit important) affects on property insurers, at least in the short term.

The health care bill, the major provisions of which go into effect between 2010 and 2014, contains few explicit mentions of property and casualty insurers but promises to affect their businesses nonetheless.

The property and casualty and life and health insurance businesses have become very distinct, and with some very narrow exceptions, major property and casualty insurers do not underwrite health coverage (although some market it) and major health insurers do not underwrite property insurance coverage, and thus their businesses will not be directly impacted.

But certain provisions of the law seem likely to affect property and casualty insurers. Among these, the "individual coverage" mandate contained in the law, if enforced in full, would significantly affect the "med pay" portions of automobile insurance policies and, in states with

no-fault automobile insurance systems, might make auto insurance largely superfluous for individuals who do not want collision coverage.

The financial reform bill has more explicit likely impacts on the property and casualty insurance industry. Four stand out.

Many provisions of the financial reform bill involve businesses such as banking, credit cards, and lending, which insurance holding companies play major roles in.

- First, the bill establishes a federal government office in the Department of Treasury intended explicitly to deal with insurance. Although the office will have no regulatory authority, it will serve as a repository of knowledge within the federal government.

- Second, very large insurers may find themselves designated "systemically significant" and thus subject to an entirely new set of regulations, the specifics of which will largely be determined via rulemaking.

- Third, the merging of regulatory agencies in a variety of fields may streamline certain complex investments that insurers engage in.

- Finally, unlike the health insurance bill – which has its greatest effects on businesses that property and casualty insurers do not engage in – many provisions of the financial reform bill involve businesses such as banking, credit cards, and lending, which insurance holding companies play major roles in. Although these laws won't directly affect the provision of insurance, they could modify significantly the overall financial environment in which these companies operate.

Evolution of Coastal Insurance Markets

Coastal insurance markets, long the focus of the most serious public policy debate in the property and casualty insurance realm, also continued to evolve – albeit unevenly – in 2010. States that had moved in market-freeing directions saw their reforms worked; Louisiana largely succeeded in removing from its publicly run Citizens Property Insurance Corporation nearly all of the policies (in net) that it had added in the wake of Hurricane Katrina. South Carolina and North Carolina, both of which had seen significant growth of their residual insurance markets, managed to shrink their residual markets and attract new private carriers into the state. Massachusetts, whose residual market remained the third largest in the nation, experienced similar trends.

By contrast, Florida – the lowest-rated state in our report for the fourth year in a row – saw its property insurance market go from bad to worse. The Florida Citizens Property Insurance Corporation, which had shrunk for two consecutive years, grew significantly, while several property and casualty insurers that had recently entered the market and used taxpayer subsidies to prop up their businesses collapsed and turned their books of business over to Citizens. Unlike other major insolvencies of Florida property and casualty insurers (and similar insolvencies

elsewhere), these insolvencies took place in the absence of any significant loss event – the companies simply ran out of money in a storm-free year.

Contraction of P&C Market

For the third straight year (and the only such three-year period on record), the entire property and casualty insurance industry shrank. Although job losses in insurance-related industries slowed somewhat in 2010, the industry showed no sign of having turned a corner. One of the three major property insurance trade associations engaged in yet another round of layoffs, which served to reduce its presence both in the states and in Washington, DC.

Failure of Efforts to Burden Insurance Markets

> Efforts to create burdensome new mandates on property and casualty insurance proved largely unsuccessful in states where they were attempted.

Finally, efforts to create burdensome new mandates on property and casualty insurance proved largely unsuccessful in states where they were attempted. Efforts in Michigan to place extensive new regulatory burdens on insurers and consumers in the auto insurance realm passed the state's House but failed in the Senate. Similar proposals from Massachusetts' attorney general also failed to move forward, as did additional restrictions in Washington State's already tightly regulated auto insurance system.

Wisconsin, alone among states where auto insurance was being debated, passed a sizeable automobile insurance reform package, which increased coverage mandates and made it easier for individuals to file lawsuits against insurers. The package, although partially supported by segments of the automobile insurance industry, has proved controversial, and the legislature voted to repeal most of its major provisions in the spring of 2011.

In short, trends shaping the property and casualty insurance marketplace were complex. Change was uneven. But, gradually, free-market forces appeared to be gaining strength.

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