

TEXAS COUNTY MUTUALS: THEIR TRADITION AND THEIR FUTURE

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Introduction

Who would have thought back in 1937, when the Texas legislature authorized “county” mutual insurance companies to write limited property and casualty coverage on barns and other farm, dairy, hennery and ranch buildings and improvements, on vehicles, harness, implements, tools and machinery used on farms, dairies, henneries or ranches, and on fowls, domestic animals and livestock, that by 1999 they would collectively write 26.2% of the private passenger automobile insurance premium in Texas?¹ Initially, their authority to write automobile insurance was limited to physical damage coverage for family automobiles as a part of dwelling coverages. In 1955, county mutuals were authorized to write all lines of automobile insurance, both liability and physical damage, on a statewide basis.² Because county mutuals are exempt from a number of insurance laws in Texas, including laws establishing the benchmark rating system imposed on other auto insurers, Texas county mutuals wrote 22.4% of the private passenger vehicles in Texas as of December 31, 1999.³ This article analyzes how county mutuals rose to this position, why they have a regulatory and marketing advantage in today’s automobile insurance market in Texas, and what the future may hold for them.

The Past

In 1955, following the failure of 16 county mutuals over a six year period, the legislature dramatically changed the laws regulating such insurers. The formation of new county mutuals was prohibited, although the law grandfathered the existence of all existing county mutual insurers.⁴ The Act expanded the authority of the grandfathered county mutuals to write all automobile coverages, both physical damage and liability, on a statewide basis.⁵

There are presently 25 county mutual insurance companies in Texas. Two are classified as industrial county mutuals which are limited to writing only industrial fire insurance policies covering dwellings, household goods and wearing apparel on a weekly, monthly or quarterly basis. As a result, there are only 23 county mutuals which can write automobile insurance in Texas.

It has been suggested that statewide automobile-writing authority was granted to county mutuals in 1955 under a “gentleman’s agreement” that they would write only non-standard business presumably because the rate-regulated market was unable to charge adequate rates for non-standard risks.⁶ At that time, the rate-regulated carriers could not deviate from state-set rates which were set for the average risk. It was believed that county mutuals, with freedom from rate regulation, might be able to satisfy the needs of the non-standard risks and write those insureds whose hazards required higher rates than were available from the standard, rate-regulated market. For a number of years thereafter, county mutuals wrote automobile insurance primarily for those non-standard risks. County mutuals also provided a market for those insureds who could not obtain insurance from the automobile insurance assigned risk plan, presently called the Texas Automobile Insurance Plan Association (“TAIPA”). TAIPA does not presently, and did not then, provide coverage for physical damage insurance nor for liability insurance greater than the minimum amount required by the Texas Motor Vehicle Safety Responsibility Act.⁷ Thus, when statewide automobile writing authority was extended to county mutuals, there was no market of last resort, like TAIPA, for those insureds who needed physical damage or increased limits coverage.

The increasing role that county mutuals have played in Texas since the law was changed is due to a combination of inadequate rates in the voluntary market, compulsory financial responsibility laws (enacted in 1981), and increased use of consumer credit to finance automobile purchases creating a need for physical damage coverage on automobiles being financed.

County mutuals have continued to write both property and automobile insurance since the law was substantially changed in 1955, but the primary growth for county mutual insurers since that time has been in the area of automobile insurance. As indicated previously, county mutuals now write 26.2% of the private passenger auto premium in Texas.⁸

The Present

Why are Texas county mutuals writing such a significant portion of the automobile business in Texas today? There are many reasons, but the primary ones include:

1. Their rates and classifications are not regulated by the Texas Department of Insurance.
2. They are not required to accept TAIPA assignments.
3. Their insurance can be placed by an agent holding a "Group II" license or a local recording agent license.

In many ways, county mutuals are like their rate-regulated competitors. They must use the same policy forms as other automobile insurers in Texas, are subject to the same solvency requirements, and must submit to financial and market conduct examinations. The primary advantage a county mutual has over its competitors is in its exemption from rate and classification regulation. All other rate-regulated automobile insurers must use the classifications established by the Texas Department of Insurance ("TDI") in the auto manual, and they may only charge rates which are within plus or minus 30% (the "flex band") of the benchmark rate set by the TDI unless they receive TDI approval to charge rates which are outside of the "flex band."⁹ County mutuals may use their own classification system, and, although county mutuals must file schedules of their rates and fees with the TDI, the TDI does not approve or disapprove county mutual rates and has no authority to do so. However, rates charged by county mutuals must be applied in a non-discriminatory manner, just as rates which are charged by rate-regulated insurers.¹⁰ County mutuals can adjust their rates quickly and as many times as they see fit in order to match their insurance risks. Rate-regulated auto insurers may only change their rates twice during any 12-month period without the prior approval of the Commissioner of Insurance.¹¹ Thus, county mutuals are more flexible than other insurers when it comes to classifying and pricing risks.

A county mutual's exemption from TAIPA assignments can be important if TAIPA rates are not adequate to cover the risks which are to be insured. TAIPA rates are set by the TDI and there have been times when TAIPA's rate inadequacies have been very costly to rate-regulated insurers. Rate-regulated insurers must accept assignments from TAIPA and write the assigned policies at state promulgated rates. (TAIPA assignments are based on the volume of voluntary business written by rate-regulated carriers.¹²) County mutuals can increase their volume of business at any time without regard to a possible increase in TAIPA assignments. Rate-regulated insurers, on the other hand, increase their exposure to TAIPA assignments with any increase in their share of writings in the voluntary market.

Finally, the availability of Group II licensing permits county mutuals to broaden their distribution system because of the ease with which they can license their agents. Virtually any person without a criminal record can obtain a Group II license by simply applying for one. There is no examination and no continuing education requirement for Group II agents.¹³ Most automobile insurance in Texas is written through local recording agents. In order to qualify for license as a local recording agent, a person must pass a written examination and maintain compliance with annual continuing education requirements.¹⁴ Rate-regulated insurers are required to use local recording agents (or home office salaried employees if a direct writer). Home office salaried employees must register with the TDI and are required to satisfy continuing education requirements similar to those required of local recordings agents.¹⁵ Interestingly, many county mutuals still insist on using local recording agents notwithstanding the availability of Group II licensees, presumably because of their interest in maintaining quality in their agent force.

Although county mutuals do not take assignments from TAIPA, they reduce pressure on TAIPA to the extent that they voluntarily write insurance which might otherwise be assigned through TAIPA to the rate-regulated market. For many years, county mutuals focused primarily on writing non-standard automobile insurance. Generally, the rate-regulated market accepted the county mutual role, and in many cases welcomed it, because their writings reduced the other insurers' exposure to TAIPA assignments, particularly during periods of rate inadequacy in TAIPA. There is, however, no law which requires county mutuals to write only non-standard risks and many county mutuals have recently increased their writings beyond non-standard risks and are now writing standard and even preferred business.

In 1996, USAA decided to shift approximately 40% of its standard auto business into its newly acquired county mutual.¹⁶ Both the TDI and the legislature objected, with the legislature going so far as to pass a bill which would prevent any county mutual affiliated with any other rate-regulated private passenger auto carrier in Texas from charging rates less

than the highest rate allowed under the flex band. Although the bill was vetoed on grounds that it violated the equal protection clause of the Texas Constitution, the TDI and Texas legislators convinced USAA to roll back into the rate-regulated market the preferred and standard business which it had placed in its county mutual. Progressive Casualty Group, on the other hand, has openly touted its use of its Texas county mutual to write all types of risks, and its private passenger auto premium writings have increased significantly, growing from \$104 million in premiums in 1992 to \$466 million in 1997.¹⁷ It is now the fourth largest writer of private passenger auto insurance in Texas.¹⁸

Although it would appear that county mutuals are poised for continued growth due to the obvious advantages they hold over their competitors, their future remains uncertain.

The Future

What does the future hold for county mutuals in Texas? No one knows, but one can be sure that the regulation of auto insurance, and in particular the impact of county mutuals on the auto market in Texas, will be debated in the upcoming session of the Texas legislature. The legislature meets from early January to late May in odd numbered years only, unless a special session is called by the Governor. The legislative session for 2001 is scheduled for January 29 to May 28, and it is anticipated that county mutuals and auto insurance regulation will again be a hot topic. In 1999, a huge spectrum of bills dealing with auto insurance was filed, ranging from a bill establishing complete rate freedom for all property and casualty insurers (requiring only the filing of a schedule of rates), to a bill requiring that the automobile benchmark rating system apply to all companies writing auto insurance, including county mutuals. Another bill would have required county mutuals to write at rates that were not less than the upper level of the flex band; i.e., 30% above the benchmark rate approved by the Commissioner. None of these bills passed. As is probably the case in every state, rate regulation in auto insurance is a highly political and emotional issue because it affects so many people in the pocketbook, whether it be the insureds who pay the premiums or the carriers who pay the claims. Texas is no exception, and 2001 is likely to be a year of continued debate over the extent of auto insurance rate regulation.

Interestingly, the various insurers comprising the automobile insurance industry in Texas are not in agreement as to how rate regulation for county mutuals should be handled. Because there are only 23 affected county mutuals in Texas, not every insurer has easy access to a county mutual within its holding company system. Therefore, those without direct access are at a competitive disadvantage. They must either do without or must contract with a county mutual to front their business. Fronting carries a significant cost, usually ranging from 3 to 6 percent of written premium above all costs incurred by the fronting company. Companies without direct access to a county mutual generally want a level playing field, either by allowing all companies the same rate and classification freedom as the county mutuals, or by restricting the type of business or the rates which can be charged by the county mutuals. Even some rate-regulated insurers with direct access to a county mutuals are in favor of eliminating their county mutuals' rate and classification advantages provided that the rate-regulated market is given the same pricing and classification freedoms. Some county mutuals do not want any change because they either front a significant amount of business for others, at a substantial profit, or they do not want to lose the value of the significant investment they have made in their county mutuals. County mutuals have sold for significant "blue sky" value (the purchase price over and above the surplus of the county mutual), ranging in recent times from \$5,000,000 to in excess of \$10,000,000 "blue sky." There are also those who argue that county mutuals ought to retain their rate and classification freedom, but be subject to TAIPA assignments.

It is anticipated that the benchmark rating system for rate-regulated insurers will be reviewed once again during the 2001 legislative session. The Texas Commissioner of Insurance has expressed his unhappiness with the rate making system, as have most of the insurers in Texas. The existing system has been criticized as cumbersome, time-consuming and expensive, and not responsive to rapidly changing experience in Texas. By the time rates become effective, the data on which the rates are based is oftentimes three years old, which may not be reflective of current experience. We expect the Commissioner to propose a change to the current benchmark rate procedure where parties present evidence to an administrative law judge who proposes a decision for the Commissioner, to a rule-making procedure, where parties present evidence directly to the Commissioner. It is not known whether the Commissioner will go so far as to suggest greater rate and classification flexibility for the rate-regulated market, but any proposal to do so, whether proposed by the Commissioner or by the insurance industry, will most certainly face objection by not only consumer groups which have historically fought for stricter rate regulation, but also by those insurers which benefit from the current system. County mutuals are expected to once again be drawn into this debate, and one can also expect that bills either reducing or eliminating their advantages will be filed in the 2001 legislative session.

While no one can say for sure what will happen with county mutuals, we can predict with reasonable certainty that their continued existence and the advantages that they possess will be a hot topic in 2001.

Endnotes

1. Texas Department of Insurance Private Passenger Auto Statistical Plan (Quarterly Market Report).
2. Tex. 1955, 54th Leg., p. 413, ch. 117, § 37A.
3. Texas Department of Insurance Private Passenger Auto Statistical Plan (Quarterly Market Report).
4. Tex. 1955, 54th Leg., p. 413, ch. 117, § 31.
5. *Id.* § 37A.
6. Julie Lake, *The Great County Mutual Debate*, Insurance Journal/Texas, November 22, 1999, p. 10.
7. See Texas Motor Vehicle Safety Responsibility Act, Tex. Trans. Code, §§ 601.001-601.410 (Vernon 1995).
8. Texas Department of Insurance Private Passenger Auto Statistical Plan (Quarterly Market Report).
9. Tex. Ins. Code Ann. art. 5.101, § 3(g) (Vernon Supp. 2000).
10. Tex. Ins. Code Ann. arts. 21.21 – 6 and 21.21 – 8 (Vernon Supp. 2000).
11. Tex. Ins. Code Ann. art. 5.101, § 3(p) (Vernon Supp. 2000).
12. Tex. Ins. Code Ann. art. 21.81, § 3(a) (Vernon Supp. 2000).
13. Tex. Ins. Code Ann. art. 21.07 (Vernon Supp. 2000).
14. Tex. Ins. Code Ann. art. 21.14, § 5a and § 6(a).
15. Tex. Ins. Code art. 21.14, § 20A(b) (Vernon Supp. 2000).
16. Julie Lake, *County Mutuals*, Insurance Journal/Texas, November 30, 1998, p. 10.
17. Julie Lake, *The Great County Mutual Debate*, Insurance Journal/Texas, November 22, 1999, p. 10.
18. Texas Department of Insurance, Quarterly Legislative Report on Market Conditions as of Third Quarter of 1999.