HOUSE RESEARCH ORGANIZATION bill analysis — 5/12/2005 — HB 1890, Smithee, Escobar (CSHB 1890 by Smithee)

SUBJECT: Operating and funding of the Texas Windstorm Insurance Association

COMMITTEE: Insurance — committee substitute recommended

VOTE: 7 ayes — Smithee, Seaman, Eiland, Isett, B. Keffer, Oliveira, Taylor

0 nays

2 absent — Thompson, Van Arsdale

WITNESSES: For — None

Against — Wayne Faircloth; Bob Bonar; Don Hanson, Geico Insurance Co.; Brad Kading, Reinsurance Association of America; Craig Nadziejka, State Farm Insurance Co., Texas Windstorm Association; Jay Thompson, AFACT, Farm Bureau Insurance Company; Lee Otis Zapp, Jr., Galveston Windstorm Action Committee, Inc.

On — Ron Cobb, American Insurance Assn.; James Elbert, Galveston Windstorm Action Committee; Jose Montemayor, Texas Department of Insurance; Jim Murphy, Texas Windstorm Insurance Association; Jim Oliver, Texas Windstorm Ins. Association

BACKGROUND: Insurance companies are not required to write windstorm insurance coverage for the Texas coast. Individuals who cannot obtain windstorm insurance through the voluntary market may obtain coverage through the Texas Windstorm Insurance Association (TWIA), the predecessor of which the Legislature created in 1971. Structures complying with building specifications or qualifying for grandfather provisions are eligible for insurance coverage through TWIA. TWIA, composed of all property insurers authorized to write business in Texas, administers day-to-day operations, including issuing policies and processing claims. In the event that TWIA was unable to cover losses from collected premiums, the following funding mechanism would apply in this order:

- $100 million assessed to member insurers;
- Catastrophe Reserve Trust Fund and reinsurance (about $1 billion, combined);
- $200 million assessed to member insurers;

- unlimited assessment to member insurers, which would be subject to premium tax credits for five or more successive years.

DIGEST:

CSHB 1890 would amend the Insurance Code for operating and funding the Texas Windstorm Insurance Association, including funding of coverage for catastrophic events through a revenue bond program by issuance of public securities.

Composition of the board of directors. The TWIA board of directors would be accountable to the governor and the commissioner of insurance and would include nine members appointed by the governor. The bill would change the board's composition to three members who were residents of first tier coastal counties, one of whom would have to be a licensed insurance agent; three insurer representatives who were members of TWIA, who could reside anywhere in the state; and three members who were residents of counties other than first tier coastal counties, at least one of whom would be a licensed insurance agent. The bill would alter the board members' terms from the current three years to two-year, staggered terms. A person appointed to the board would have to have business, insurance, or financial experience to be eligible. A board member would serve at the pleasure of the governor and could be removed before the board member's term expired. The bill would delete a provision that a person could hold a seat on the board for three consecutive, full terms, or nine years. The governor would designate one member of the board to be the presiding officer. That person would serve at the pleasure of the governor and would be entitled to vote on all matters before the board.

Duties of the board. The primary goal of the board would be to make the association financially sound.

If an event within the defined catastrophe area resulted in payment of losses, TWIA immediately would notify the commissioner. On receiving notice, the commissioner would notify the governor and appropriate committees of the Legislature as to the amount of eligible insured losses.

The board would report annually to the governor, the lieutenant governor, and the speaker of the House of Representatives regarding:

- the solvency of TWIA;
- the sufficiency of TWIA's reserves;
- the sufficiency of the rates charged for insurance coverage

through TWIA, including an analysis of any difference between rates actually being charged and actuarially sufficient rates; and
- any outstanding risks to TWIA and its members.

The board would recommend rates to TDI for insurance coverage provided by TWIA and would determine coverage limits, applicable deductibles, and any premium surcharges to be assessed for noncompliance with applicable building codes.

Funding methods of TWIA. If, in any calendar year, an occurrence within the defined catastrophe area resulted in insured losses and operating expenses of TWIA in excess of premium and other revenue of TWIA, any excess losses would be paid as provided by statute. After application of available revenue to losses, $100 million would be assessed to the members of TWIA with a portion of the loss allocable to each insurer determined in the same manner as its participation in TWIA had been determined for the year.

The legislation would specify that any losses in excess of $100 million would be paid from the catastrophe reserve trust fund, not to exceed an amount equal to 50 percent of the balance of that fund. If the amount available was insufficient to pay the excess losses, an additional amount not to exceed $500 million would be funded through the issuance of public securities under a revenue bond program. If that amount were insufficient to pay the excess losses, reinsurance proceeds recoverable by TWIA and available under any reinsurance program established by TWIA would be used to pay the losses. For any losses in excess of those paid by the above-mentioned funding methods, an additional $500 million would be funded through the issuance of public securities under a revenue bond program.

The commissioner could adopt rules as necessary to implement these provisions related to TWIA funding.

Revenue bond program. CSHB 1890 would state that the Legislature found that the issuance of public securities to provide a method to raise funds to provide windstorm, hail, and fire insurance through TWIA in certain designated portions of the state would be for the benefit of the public.

At the request of TWIA and with the approval of the commissioner, the Texas Public Finance Authority would issue, on behalf of TWIA, public securities in an amount not to exceed $2 billion to fund TWIA, including funding necessary to:

- establish and maintain reserves to pay claims and pay incurred claims and operating expenses;
- pay costs related to the issuance of public securities; and
- pay other costs related to the public securities as could be determined by the board.

Public securities. The bill would apply Government Code, chs. 1201, 1202, 1204, 1205, 1231, and 1371, and ch. 1206, subch. A to public securities issued by this legislation. Public securities issued under these provisions could be issued at public or private sale and would have to be issued in the name of TWIA and would have to mature not more than 10 years after issuance.

In a public security resolution, the board could make additional covenants with respect to the public securities and the designated income and receipts of TWIA pledged to the payment of the public securities. The board also could provide for the flow of funds and the establishment, maintenance, and investment of funds and accounts with respect to the public securities.

Funds generated through the issuance of public securities would be held outside the state treasury in the custody of the comptroller. TWIA could request disbursement of these funds for the purpose of establishing and maintaining reserves to pay claims and paying incurred claims and operating expenses.

A public security resolution could establish special accounts, including an interest and sinking fund account, reserve account, and other accounts. TWIA would administer the accounts.

Public securities would be payable only from the premium surcharges established by the bill or from other amounts that TWIA was authorized to levy, charge, and collect. Public securities would be obligations solely of TWIA and would not create a pledging, giving, or lending of the faith, credit, or taxing authority of this state. Each public security would have to

include a statement on its face that the state was not obligated to pay any amount on the public security.

Premium surcharges. The bill would establish that the public securities and all debt service on them would be paid by premium surcharges applied to each property and casualty insurance policy written by an insurer in Texas or by the FAIR Plan Association, other than a workers' compensation insurance policy, an accident and health insurance policy, or a medical malpractice insurance policy. Twenty percent of the necessary amount would be charged on insurance policies written on property located in first tier coastal counties, including policies issued through TWIA and otherwise. Eighty percent would be charged on policies written on property located in counties that were not first tier coastal counties.

The bill would provide that as a condition of business in Texas, an insurer that engaged in the business of property insurance in the state would agree that if the insurer left the insurance market, the insurer would remain obligated to pay the insurer's share of the premium surcharges in an amount proportionate to that insurer's share of the insurance market in the state, as of the last complete reporting period before the insurer stopped writing in that Texas market. The proportion assessed against the insurer would be based on the insurer's gross written premiums for insurance for the insurer's last reporting period.

TWIA would deposit all premium surcharges collected in a fund to be held outside the state treasury in the custody of the comptroller. Money deposited in the fund could be invested as permitted by general law. Money in the fund required to be used to pay bond obligations and bond administrative expenses would be transferred to the Texas Public Finance Authority or used by the comptroller in the manner specified in the resolution adopted with the bond issue to ensure timely payment of obligations and expenses. For bonds issued by the Texas Public Finance Authority, TWIA would provide for the payment of the bond obligations and the bond administrative expenses by irrevocably pledging revenues received from the premium surcharges and amounts on deposit in the fund, together with any bond reserve fund.

Revenue collected from the premium surcharges in any year that exceeded the amount of the bond obligations and bond administrative expenses payable in that year, and interest earned on those premium surcharges,

could be used, in the discretion of TWIA and with the commissioner's approval, to:

- pay bond obligations payable in the subsequent year, offsetting the amount that would otherwise have to be levied for the year; or
- redeem or purchase outstanding bonds.

The public securities issued, any interest from those public securities, and all assets pledged to secure the payment of the public securities would be free from taxation by the state or a political subdivision of the state. The public securities issued would constitute authorized investments under the Insurance Code.

The state would pledge to and would agree with the owners of any public securities issued in accordance with the bill that the state would not limit or alter the rights vested in TWIA to fulfill the terms of any agreements made with the owners of the public securities or in any way impair the rights and remedies of those owners until all obligations were met and fully discharged. TWIA could include this pledge and agreement of the state in any agreement with the owners of the public securities.

Mandamus and other remedies. A party at interest could use mandamus and all other legal and equitable remedies to require TWIA and any other party to carry out agreements and to perform functions and duties established by this legislation, the Texas Constitution, or a public security resolution.

The bill would change Insurance Code to provide that Art. 21.49 applied to Lloyd's plans. It also would make exchanges subject to Art. 21.49, among other provisions.

The bill would amend Insurance Code, Art. 21.49, sec. 4(d) to specify that on dissolution of the TWIA, all of its assets, including the unexpended and unobligated balance of the catastrophe reserve trust fund as of the date of the dissolution, would revert to the state.

CSHB 1890 would abolish the TWIA board effective January 1, 2006, as it exists under current law. The bill would require the governor to appoint new members by December 31, 2005. The terms of members serving immediately prior to the abolition of the board would expire on January 1,

2006, but a person serving on the existing board would be eligible for appointment to the new board.

The bill would take effect September 1, 2005. The provision establishing a revenue bond program would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2005.

SUPPORTERS SAY:

CSHB 1890 would amend the Insurance Code, Art. 21.49 in relation to funding TWIA, including creation of a revenue bond program to increase insurance capacity to cover catastrophic events. The bill would also restructure the board of TWIA and include a requirement that it report annually to the governor, the lieutenant governor, and the speaker of the Texas House.

TWIA's current insurance capacity that is not subject to future premium tax credits is approximately $1.3 billion for residential and commercial property combined. This amount is a combination of the Catastrophe Reserve Trust Fund, reinsurance, and member assessments and would be estimated to cover the probable maximum loss of a storm that would occur every 100 to 125 years – for example, a category III hurricane striking Galveston. The 2004 hurricane season in Florida proved that multiple hurricanes are possible in a single storm season, and these storms could exceed a category III level. If such a catastrophic storm were to hit the Texas coast, the effect would cause a significant impact to the state's general revenue stream from resulting insurance premium tax credits.

The combined exposure of insurers covering coastal property is estimated at $55 billion. This amount is separate from the sum that would be payable by TWIA, which currently has over $25 billion in exposure. As an additional consideration, insurers are precluded by IRS regulations from accumulating reserves for future catastrophe events on a tax-deferred basis.

This bill would state that the Legislature found that the issuance of public securities to provide a method to raise funds in order to provide windstorm, hail, and fire insurance through TWIA in certain designated portions of the state would be for the benefit of the public. The legislation would establish a funding mechanism from insurers, existing funds, reinsurance and the issuance of public revenue bonds.

Under the bill, the Texas Public Finance Authority would issue revenue bonds to pay for future losses with bond repayments funded by policyholders rather than with general revenue tax credits. With CSHB 1890, the state could begin, over time, moving toward a system that would not expose general revenue to hurricane losses while stimulating economic growth along the coast by providing sufficient windstorm insurance coverage.

OPPONENTS SAY:

The new structure of the board proposed in CSHB 1890 would have three members from coastal counties, including one insurance agent; three insurer members who could reside anywhere in Texas; and three members of counties other than coastal counties, at least one of whom would have to be an insurance agent. While the composition would seem to balance disciplines, it would not be a good geographic make-up. The proposed board could have anywhere from three to six of the its nine members who were not from the coast. While the majority of the bill addresses concerns related to a major, catastrophic loss, TWIA performs day-to-day operations. It would seem more appropriate to have more coastal board members operating TWIA because of their familiarity with the area and their stake in the process.

At the request of TWIA and with the approval of the commissioner, the Texas Public Finance Authority would issue revenue bonds up to $2 billion. The purpose of the bonds would be to fund TWIA, including establishing and maintaining reserves to pay claims, also paying incurred claims and operating expenses. Paying claims would be a reasonable, anticipated use of the bond proceeds; however, "maintaining reserves" would raise questions. These bonds and all debt service would be paid with surcharges to each property and casualty insurance policy written throughout the state.

The public securities would have to mature not more than 10 years after the date issued. The fiscal note attached to the bill would assume the maximum amount of bonds ($2 billion) issued on January 1, 2006 at a 6 percent interest rate with a 10-year level debt service amortization. The estimated debt service cost would be $163,505,000 for fiscal 2006 and $280,294,000 for fiscal 2007. In effect, enactment of this bill would "tax" every property and casualty insurance policy in the state—including personal lines of auto and homeowners insurance—to pay for the $2 billion in revenue bonds and debt service for the benefit of TWIA. In current law, TWIA rates are based on at least 30 years of actual Texas

experience while this bill would establish surcharges over a 10-year period for a projected 100-year catastrophe.

Twenty percent of the necessary surcharges would be on insurance policies written on property located in first tier coastal counties, which consist of 14 counties. Eighty percent would be charged on policies written on property located in the remaining 240 counties. The application to individual counties would be unknown. Even so, it would be hard to justify someone in the Panhandle subsidizing extended reserves for a category III hurricane that was not expected to occur but once every 100 to 125 years. Although language on the percentage of surcharge to counties would refer only to property, other references in the bill would address premium surcharges applied to each property and casualty insurance policy written by an insured in this state or by the FAIR Plan Association, other than workers' compensation.

NOTES:

The committee substitute would differ from the introduced bill in numerous ways, including the following:

- requiring the board to make an annual report to the governor, lieutenant governor, and speaker of the house and specifying what the report would contain;
- changing the structure and procedure for payment of losses including reinsurance and provisions regarding insurer surcharges; and
- moving the effective dates up for the funding provisions.