SUBJECT: Restructuring the Texas Windstorm Insurance Association

COMMITTEE: Insurance — committee substitute recommended

VOTE: 6 ayes — Smithee, T. Smith, Taylor, Eiland, Hancock, Vo

0 nays

3 absent — Martinez, Thompson, Woolley

WITNESSES: For — Lee Loftis, Independent Insurance Agents of Texas

Against — Lee Otis Zapp, Jr., Galveston Windstorm Action Committee, Inc.

On — Beaman Floyd, Allstate, American Insurance Association, Nationwide, State Farm, USAA; Parker W. Rush, The Republic Group; Joe Woods, Property Casualty Insurers Association of America; (*Registered, but did not testify:* Kimberly Edwards, Texas Public Finance Authority; Jay Thompson, AFACT)

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 2960 would amend the Insurance Code provisions 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.

Purpose of TWIA. The bill would eliminate fire insurance from TWIA's current statement of purpose and add the following: "The purpose of TWIA is to serve as a residual insurer of last resort for windstorm and hail insurance in the seacoast territory. The association shall function in such a manner as to not be a direct competitor in the private market and shall provide insurance coverage to persons who are unable to obtain coverage in the private market."

Incentive plan. The Texas Department of Insurance (TDI) would have to maintain a list of all property and casualty insurers that sell insurance in the voluntary market in the seacoast territory and develop incentive programs for insurers to write insurance on a voluntary basis and to minimize the use of TWIA as a means of obtaining insurance.

Funding methods of TWIA. If, in any calendar year, an occurrence within the defined catastrophe area resulted in insured losses and operating expenses in excess of premium and other revenue of TWIA, any excess losses would be paid from available association reserves and the catastrophe reserve trust fund. The bill would eliminate assessments on insurers and premium tax credits and authorize TWIA to purchase reinsurance as part of its annual operating budget for deposit into the trust fund.

If premium and trust fund revenue were insufficient to pay the excess losses, the bill would authorize the issuance of two types of bonds. Class 1 bonds could be issued before, on, or after a catastrophic event. Class 2 bonds could be issued only on or after a catastrophic event.

Class 1 bonds could be issued to provide an additional amount necessary to fund up to 45 percent of TWIA's required solvency level. If that amount were insufficient to pay the excess losses, additional Class 1 bonds could be issued to fund up to 50 percent of TWIA's required solvency level. These bonds could be issued only after a named storm had caused damage in the seacoast territory and the TWIA board determined that all other resources were insufficient to cover losses.

For losses in excess of those paid through these mechanisms, the TWIA board could request that TDI authorize member company public securities of up to $500 million to be issued after a catastrophic event. For losses in excess of these amounts, the commissioner could authorize Class 2 post-event public securities on or after a catastrophic event of up to $3 billion.

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 seven members appointed by the governor. The bill would change the board's composition to:

- three insurer representatives who were members of TWIA, who could reside anywhere in the state;
- two public members, one of whom would have to own property or reside in one of first tier coastal counties and one who could not; and
- two licensed insurance agents, one of whom would have to sell insurance in coastal counties and one who could not.

The bill would alter the board members' terms from the current three years to two-year, staggered terms.

The current TWIA board would be abolished December 31, 2007, and terms for the new board would begin on January 1, 2008. Current board members would be eligible for reappointment.

Duties of the board. The primary goal of the board would be to ensure that the association operated in accordance with the law, complied with sound insurance principles, and met solvency standards.

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 bill would remove requirements that TDI approve structures for compliance with building codes and specify that inspectors would contract with TWIA rather than TDI. Properties that were not in compliance with building codes would be subject to a surcharge.

Rates. The bill would repeal current statutes limiting TWIA rate increases to 10 percent and requiring uniform rates throughout the TWIA seacoast counties. The board would file rates with TDI for insurance coverage provided by TWIA. These rates could be used, but would be subject to disapproval by the insurance commissioner.

Rates would have to be actuarially sound and include rating factors necessary to fund the catastrophic reserve fund, pay any bond obligations, and pay all TWIA losses and expenses, regardless of the ultimate source of losses and expenses.

Solvency. The board would be required to maintain TWIA's solvency level at the level of funding necessary to pay 100 percent of losses for which the association was liable. The board annually would have to certify to the governor, the lieutenant governor, the speaker of the House, and the TDI commissioner that TWIA's required solvency level was satisfied. After calendar year 2008, TWIA could not issue any new coverage if the board did not certify TWIA's solvency by April 15. Using at least two recognized catastrophe models, the board would have to determine the association's current probable maximum loss for calendar year 2008 and 2009 and ensure the ability of the association to cover these projected losses.

Revenue bond program. CSHB 2960 would state that the Legislature finds that the issuance of public securities to provide a method to raise funds to provide windstorm and hail insurance through TWIA in certain designated portions of the state is for the public benefit.

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 sufficient to fund TWIA, including funding necessary to:

- establish and maintain reserves to pay claims and pay incurred claims and operating expenses;
- purchase reinsurance;
- 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.

The bill would establish procedures and responsibilities for the issuance and servicing of Class 1 and Class 2 public securities bonds for TWIA.

The bill 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, 2007.

SUPPORTERS SAY:

CSHB 2960 would give TWIA the tools it needs to cover losses in the event of one or a series of catastrophic storms along the Texas coast. TWIA's current funding level and mechanism for covering losses is insufficient to cover losses should one or more catastrophic events like hurricanes Katrina or Rita occur in the coming years. Without a new funding structure, the state would have to use general revenue to cover most losses in such a catastrophic event.

In the wake of hurricanes Katrina and Rita, many private insurers have withdrawn from the coastal market, leaving TWIA as the insurer of last resort for an increasing number of coastal residents. Over the past five years, policies in force at TWIA have increased dramatically. Between 2001 and 2006, the number of TWIA policies has nearly doubled, from 68,758 to 135,000, in the 14 coastal counties and a portion of Harris County that make up the TWIA coverage area. As of November 30, 2006, TWIA's exposure for windstorm losses from all costs reached more than $40 billion. As of January, 2007, the association had about $180 million of premiums in force, of which about $100 million could be used to cover the cost of windstorm-related losses.

CSHB 2960 would allow TWIA more flexibility in setting rates to meet projected demands and issuing bonds to cover losses in the event of one or more catastrophic storms. The bill would remove insurer assessments from the funding structure, a cost that is passed on to the state through premium tax credits.

This improved structure would better prepare TWIA to cover losses in the event of one or more catastrophic storms and would stimulate economic growth along the coast by providing sufficient windstorm coverage. This economic growth would benefit the whole state by generating increased tax revenue. While windstorm insurance may be an issue of special importance to coastal residents, it is in the entire state's interest to establish a solid system to protect against windstorm losses.

OPPONENTS SAY:

CSHB 290 would change the entire structure of TWIA so that the organization no longer would serve its original purpose of providing insurance coverage to protect coastal residents from losses in major storms. The bill would give the TWIA board too much flexibility in setting rates, which likely would to lead to significant rate increases for coastal residents.

Five members of the new seven-member board would not be required to live on the coast. These board members would not directly be affected by the costs or other effects of their decisions. A majority of the governing board should have to be coastal residents.

By eliminating assessments and premium tax credits, the bill would remove insurers from having any direct involvement in covering losses in a catastrophic event. Insurers already are withdrawing from the private market along the coast. The bill would allow them to further withdraw from involvement in this area.

The bill could lead to higher TWIA rates in coastal areas, which could inhibit economic activity and growth.