

- SUBJECT:** Restructuring the Texas Windstorm Insurance Association
- COMMITTEE:** Insurance — committee substitute recommended
- VOTE:** 7 ayes — Smithee, Deshotel, Eiland, Hancock, Hunter, Isett, Taylor  
2 nays — Martinez Fischer, Thompson
- SENATE VOTE:** On final passage, April 30 — 27-4 (Hinojosa, Huffman, Lucio, Zaffirini)
- WITNESSES:** No public hearing.
- 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 that comply with building specifications or that qualify for certain grandfathered standards are eligible for insurance coverage through TWIA.
- TWIA, composed of insurers authorized to offer property coverage in Texas, administers day-to-day operations, including issuing policies and processing claims. In the event that TWIA is unable to cover losses from collected premiums or other revenue, the following funding mechanisms apply in this order:
- \$100 million assessed to member insurers;
  - Catastrophe Reserve Trust Fund and reinsurance;
  - \$200 million assessed to member insurers; and
  - unlimited assessment to member insurers, which could be credited against the insurer's premium tax for five or more successive years.
- Insurance Code, ch. 2210 is the Texas Windstorm Insurance Association Act. For the purposes of TWIA coverage, the seacoast territory includes 14 first-tier coastal counties and 14 second-tier coastal counties. TWIA rates are required to be uniform throughout the first-tier coastal counties.

**DIGEST:** CSSB 14 would revise the operation, oversight, and funding provisions of the Texas Windstorm Insurance Association Act, including funding coverage for catastrophic events, in part, through issuance of public securities.

**TWIA purpose.** CSSB 14 would state that the primary purpose of TWIA was the provision of an adequate market for windstorm and hail insurance in the seacoast territory. The association would:

- function in such a manner as to not be a direct competitor in the private market; and
- provide windstorm and hail insurance coverage to those who were unable to obtain that coverage in the private market.

The bill would remove fire and explosion insurance from the coverages for which TWIA would act as the residual insurer of last resort and would specify that TWIA would serve only the seacoast territory. The commissioner could designate a seacoast territory as a catastrophe area only if this determination would not result in an adverse impact to the exposure of the association.

**TWIA board of directors.** CSSB 6 would revise the composition and duties of the TWIA board of directors. TWIA duties would be subject to rules established by the commissioner of insurance. The nine voting members and one non-voting member of the board, all appointed by the commissioner, would include:

- four members representing the insurance industry, selected from a slate of people nominated by the industry;
- four members who resided in the first-tier coastal counties, including at least one person who was a property and casualty agent;
- one member who represented an area of the state not located in the seacoast territory; and
- one non-voting member who was a licensed engineer who resided in a first-tier coastal county.

The bill would allow board members to meet by a telecommunications method as long as the meeting met notice requirements, specified the primary meeting location in a tier-one county, and was recorded and posted on the TWIA website.

The primary objectives of the board would be to ensure that the association operated in accordance with applicable law and commissioner rules, complied with sound insurance principles, and met all standards imposed by the TWIA Act.

By December 31 of each even-numbered year, the TWIA board of directors would report to the insurance commissioner, the appropriate committees of the Legislature, and the Sunset Advisory Commission any proposed changes in regulation of the association, the reasoning for the changes, and any information requested by TDI.

**Issuance of public securities.** The bill would add to the payment methods authorized for TWIA losses public securities that were debt instruments or other public securities issued by the Texas Public Finance Authority (TPFA). These securities would be exempt from taxation and payable through various mechanisms within TWIA and would not be debt of the state. The state could not impede TWIA's ability to repay such debt or impair public security owners from rights and remedies regarding outstanding debt, including a writ of mandamus or other legal remedies to require payment.

Class 1 public securities would be those authorized for issuance before the occurrence of a catastrophic event, if the board determined premiums and other revenue might not be sufficient to pay insured losses. These securities could not be used to pay for catastrophic events occurring before their issuance. Class 2 public securities could be authorized to be issued on or after the occurrence. TPFA would issue the public securities in TWIA's name in the amount and according to the terms requested by TWIA, if approved by the commissioner. Public security proceeds would be held in trust for TWIA and used for authorized purposes. Any excess proceeds would be transferred to the Catastrophe Reserve Trust Fund.

Public security obligations that TWIA could not pay with available revenues would be paid with nonrefundable surcharges collected on property insurance policies that applied to policies located in a catastrophe area, first-tier coastal county, and the part of the second-tier coastal counties included in TWIA. These surcharges would not be subject to premium taxes or commissions. Excess revenues collected from these premium surcharges could pay obligations for the subsequent year, redeem outstanding public securities, or be deposited in the Catastrophe Reserve Trust Fund.

**Payment of losses.** The existing structure for payment of losses exceeding premiums and other revenue would be repealed. If an occurrence or series of occurrences in a catastrophe area resulted in insured losses and operating expenses in excess of premium and other revenue of TWIA, the losses would be paid from available association reserves and the Catastrophe Reserve Trust Fund. If losses remained unpaid after these resources had been exhausted, payments would be made from the following funding mechanisms in the order listed, subject to the noted maximum per occurrence amounts:

- \$300 million from class 1 public securities;
- \$300 million from class 2 public securities;
- \$300 million from member assessments that could not be recouped from a premium surcharge or tax credit and would be made in proportion to the member's share of premiums collected during the preceding calendar year;
- \$100 million from member assessments that would be repaid by a nonrefundable premium surcharges charged to policyholders in a catastrophe area;
- up to \$1 billion from reinsurance that had been purchased by TWIA from premiums and other revenue; and
- \$750 million from member assessments that could be credited against the insurer's premium tax at a rate of up to 20 percent per year for five or more successive years.

If the board of directors determined that the sale of public securities or the purchase of reinsurance was not possible or that other financing mechanisms would be more fiscally appropriate or economically beneficial to this state, the board, with the approval of the commissioner, could use any combination of financing arrangements allowed by the TWIA Act to pay the excess losses.

The bill would specify that each member of the association would participate in insured losses and operating expenses of the association in excess of premiums and other revenue. New members of the association would not be subject to this participation requirement until the second anniversary of the date of membership.

**Eligibility.** TWIA would provide initial or renewal coverage to applicants in the catastrophe area whose property was insurable but who were unable to obtain property insurance through the voluntary market as evidenced by

one declination from an insurer who wrote windstorm and hail coverage in the first-tier coastal counties.

Structures constructed, remodeled, or enlarged on or after this bill's effective date that were located in a zone with an additional hazard associated with storm waves could not receive TWIA coverage unless evidence of flood insurance was submitted with the application, if National Flood Insurance Program flood insurance was available for that property. An agent offering or selling a Texas windstorm and hail insurance policy in an area designated by the commissioner would offer flood insurance coverage to the insured if that coverage was available.

An insured who cancelled a policy could not be refunded the nonrefundable surcharge but would be refunded any unearned premium, less, in certain instances, the premium for 180 days of coverage.

**Inspections.** The bill would transfer direct responsibilities related to building inspections and appointment of inspectors from TDI to TWIA and would repeal provisions regarding the authority of TDI to discipline inspectors and collect fines. The TWIA board would establish reasonable fees for inspection. Structures would not be certified for insurability unless inspection fees were paid and documentation of compliance with the plan of operation was provided within six months of application. The bill would specify the inspection requirements for structures that had been remodeled or enlarged, including that those remodeled on or after January 1, 1988, would be subject to inspection by the association to be considered insurable. Structures built, remodeled, enlarged, or repaired on or after this bill's effective date would be performed in compliance with applicable building code standards.

A separate, nonrefundable premium surcharge of 15 percent would be charged for policies issued or renewed for coverage of a residential structure insured by the association as of June 1, 2009, that was not compliant with certain building codes. The surcharge would be deposited in the Catastrophe Reserve Trust Fund.

**Rate regulation.** Rate filings, including annual manual rate filings, could be used without prior commissioner approval under certain conditions, if the rate did not exceed 105 percent of the rate in effect on the date of the filing and the filed rate did not increase rates by more than 10 percent for an individual rating class. A public meeting no longer would be required

to be held regarding annual manual rate filings or amended rate filings subject to the commissioner's approval. The Office of Public Insurance Counsel, rather than any interested person, could file a written request with the commissioner for additional supporting information regarding a rate filing subject to the commissioner's approval.

Rates would be required to be sufficient to pay association operating expenses, non-catastrophic claim loads, reinsurance, and other funding requirement of the association. Rating territories could be established and rates could vary among territories, but a rating territory that subdivided a county could be used only if the rates within the county did not vary more than 5 percent.

Association rate filings and certain other recommendations no longer would be prohibited from further review by the State Office of Administrative Hearings if disapproved by the commissioner.

**Incentive plan.** 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.

**Additional oversight and review.** CSSB 14 would establish a six-member Windstorm Insurance Legislative Oversight Board. It would be composed of three members from the House and three members from the Senate, with at least one member from each chamber who did not represent a district in the seacoast territory. The board would review rules and legislation proposed by TDI and would monitor the fairness of rates, TWIA operations, and the availability of coverage. By November 15 of each even-numbered year, the board would issue a report analyzing problems identified and recommendations for legislation.

TWIA would be subject to Sunset review, paid for by the association, during the period in which state agencies abolished in 2015 would be reviewed but would not be subject to being abolished. The state auditor would conduct an audit of the association at least once every four years.

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, 2009.

SUPPORTERS  
SAY:

CSSB 14 would establish a fair funding and governance approach for the Texas Windstorm Insurance Association (TWIA), giving the association the tools it needs to cover losses in the event of another series of catastrophic storms along the Texas coast. The current TWIA funding structure was established at a time when the association's exposure was substantially less, but now TWIA's exposure is more than \$60 billion. The bill would help to ensure that if a major hurricane hit Texas in 2009, TWIA would not have to rely primarily on assessments in order to pay for billions of dollars in losses.

Losses associated with hurricanes Dolly and Ike in 2008 demonstrated the inadequacy of TWIA's current funding level and mechanism for covering losses. In 2008, hurricanes Dolly and Ike required TWIA to use all existing premiums, reinsurance, and the full balance of the Catastrophe Reserve Trust Fund, which was about \$470 million. In addition, \$530 million in assessments were made to Texas property insurers, of which \$230 million will be subject to premium tax credits. Large assessments such as these not only drive up Texas property insurance rates statewide because the costs are spread to all Texas property insurers, but the \$230 million subject to tax credits represents a long-term revenue loss to the state in premium taxes that will not be able to be collected.

Without the revisions in SB 14, Texas could face billions more in assessments if another major storm hit because the catastrophe fund and other resources have been depleted. SB 14 would provide new funding mechanisms to prevent policyholders statewide from having to foot too much of the bill to subsidize the insurance coverage for coastal residents. This could have a negative impact on both the availability and cost of property insurance for all Texans.

SB 14 would bolster funding in the Catastrophe Reserve Trust Fund with surcharges charged to policies issued for structures that were not compliant with building codes. These surcharges would have the added benefit of encouraging better building standards to minimize the losses incurred by coastal properties.

The bill also would allow bonds to be issued that could cover up to the first \$600 million in excess losses. The obligation on bond debt would be paid for by surcharges on the policies of coastal residents in the TWIA

covered areas. The Catastrophe Reserve Trust Fund and up to \$600 million of bond funds would act as a buffer before any assessment with a statewide influence could be imposed. This would be a fair process because the coastal residents benefit most from having TWIA coverage and fairly should pay a larger share of storm losses. Coastal residents still benefit from having an insurer of last resort to provide any coverage at all, and their higher payments for storm losses still would not reflect the actual risk that insuring their properties posed. The bond funding mechanism also has the advantage of allowing the obligations used to pay for the loss to be spread over a longer period of time. Higher costs for windstorm coverage for those with extreme risks does not violate the principle of insurance spreading risk over a larger, uniform population because hurricanes represent a unique risk exposure in their severity, scale, and regional influence.

After any bond funding was exhausted, a variety of assessments and reinsurance would spread costs more broadly across the state, which would acknowledge the need to prevent coastal property owners from being overburdened by insurance costs to the point they could not maintain their homes or businesses. The funding mechanisms established by SB 14 would allow up to \$2 billion in excess losses to be paid for before assessments that could be credited against the insurer's premium tax were made. The board would be granted authority as necessary to make changes to the funding mechanisms in the best interest of Texas taxpayers.

The bill also would update the rating structure by allowing beachfront and more inland properties to pay rates that were not uniform. Beachfront properties merit a higher rate based on the greater risk they pose. The bill would allow rates to be increased up to 5 percent without prior approval. This would allow incremental rate increases to occur, with the bill protecting coastal residents by requiring prior approval for higher rate increases.

Changes to the composition of the board would allow TWIA to be a tax-exempt entity, which would allow the state to maintain more TWIA revenue.

**OPPONENTS  
SAY:**

CSSB 14 would alter the structure of TWIA so that the organization no longer served its original purpose of providing affordable insurance to protect coastal residents from losses in major storms. Not only would the



base funding mechanisms for excess losses place too much of a burden on coastal residents, but the bill would give the TWIA board too much flexibility to alter this funding mechanism. With this authority, coastal residents would have no guarantee that even more of the cost of hurricane losses would not be placed on coastal policyholders.

The function of insurance is to spread risk, and while the current TWIA funding structure may not be ideal, it is more appropriate because the costs of excess losses are spread more widely throughout the state. While supporters of CSSB 14 would argue that statewide assessments drive up property tax rates at large, threatening affordability, the impact on rate increases from statewide assessments or other methods of spreading costs would be far less damaging to the state economy than concentrating costs so greatly along the coast that workers were forced to leave or businesses either moved or decided not to locate in the coastal areas of Texas. Another consequence could be people electing not to purchase adequate coverage or even any coverage at all because of a lack of affordability. These Texans would be subjected to total losses and potentially require more state assistance if a major storm destroyed their property.

All Texans benefit by ensuring that reasonably priced property insurance is available along the coast. The coastal area is host to a substantial portion of the oil and gas industry, and coastal ports are the gateway for a vast number of imports and exports that distribute Texas-produced goods abroad or that supply Texas manufacturers with the goods they need for production. Disruptions to coastal business would impact every aspect of the state economy. While efforts should be made to find workable solutions to stem increasing property insurance rates and address the risks associated with coastal property coverage, placing more of the cost burden on coastal residents is not the right approach.

NOTES:

The fiscal note indicates CSSB 14 would have no impact on general revenue funds during the fiscal 2010-11 biennium. There would be a cost of \$315,000 in general revenue funds in fiscal 2013 to pay for the TWIA audit that would be required. Transferring the windstorm inspection program from TDI to TWIA would result in a reduction of costs to TDI of \$1.6 million per year. Since TDI is required to generate revenue equivalent to its costs of operation, it is assumed that the agency's revenue would be reduced by an amount equal to this savings. According to the comptroller, premium tax credits would have a negative effect on general revenue for up to five years after a natural disaster that resulted in claims requiring an

assessment, but until such a natural disaster occurred, the specific cost could not be determined.