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The Texas Windstorm Insurance Association and the State of Texas Financial Implications

The Facts

The Texas Windstorm Insurance Association (TWIA) has become the insurer of first resort for a number of reasons, prominent among which is the fact that TWIA charges artificially low prices for the coverages it provides. The Commissioner of Insurance has the final say as to whether requested rate increases are granted and, historically, needed rate increases have not been given – resulting in charges to policyholders that are inadequate to cover the risk.

As of December 31, 2007, the TWIA insured exposure was \$58.6 billion, not including business interruption coverage and additional living expense coverage. When business interruption and additional living expense coverages are included, the total TWIA exposure is \$ 64 billion. This is a \$ 20.3 billion increase in exposure since December 31, 2006.

The TWIA coverage area is the 14 coastal counties and a small portion of Harris County, and a major hurricane or multiple hurricanes striking this area would send shockwaves across the entire state of Texas.

In a study commissioned by the *Independent Insurance Agents of Texas* and conducted by *The Perryman Group*, a distinguished Texas research firm, the following was noted:

The Texas Gulf Coast area serves as an economic engine for the entire state.

- *About 40% of Texas jobs are directly tied to its production categories.*
- *44% of the state's total income is linked to key Gulf Coast sectors.*

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- *The Port of Houston is one of the world's busiest ports in cargo volume and six Texas ports are ranked among the Top 50 in total tons.*
- *Produces 87% of Texas and 25% of the nation's refined petroleum. Provides diesel fuel for High Plains agribusiness and jet fuel for Dallas-based airlines.*
- *Regional economic success is directly linked to Gulf Coast industries, with critical dependence for output ranging from about 33% in the Upper Rio Grande Region to more than 56% in the Golden Crescent and Texoma regions.*

Effects of a Katrina-like storm would be catastrophic for the state's overall economy, not only the Gulf Coast. Losses would include:

- *\$52.2 billion in gross state product*
- *\$43.8 billion in personal income*
- *617,000 jobs*
- *\$1.8 billion a year in fiscal revenue*
- *As much as \$450 million per year from premium tax offsets over an extended period*

*If a storm hit the Port of Houston, an even larger percentage of regional economic activity would be at risk. ***

The Problem

TWIA for several years has been seeking solutions to secure funding to pay losses and avoid compromising the state and its General Revenue fund should a major hurricane, or a series of small hurricanes, make landfall on the gulf coast. Particularly concerning is the possibility of a hurricane impacting Galveston or Corpus Christi, given the tremendous exposure in those areas.

TWIA has \$1.7 billion in funding, but when considering a hurricane or multiple hurricanes with the potential of causing \$4-5 billion or more in losses along the Texas coast, that funding is wholly inadequate.

Under the current TWIA funding mechanism, once the insurance companies have paid their initial assessments, the Catastrophe Reserve Trust Fund has been depleted, and the reinsurance that TWIA has purchased has been used, any remaining losses would be paid by unlimited assessments on insurance companies.

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These unlimited assessments affect the General Revenue of the state of Texas because the insurance companies that pay them are allowed premium tax credits for up to 20% of the assessments over the next 5 or more years. While it is necessary to find a way to keep the market stable by limiting assessments against companies, the recoupment of such tax credits would throw the entire state's budget into chaos.

As noted above, the Texas General Revenue Fund could lose up to \$450 million in revenue over several years from insurance premium taxes if Texas were to suffer one or more catastrophic hurricane-related events. This statewide fund provides monies for schools, housing and urban development, highways, health and human services, and a vast number of other public programs.

Options

The best solution would be to give insurers incentive to again write coverage on the coastline and compete for coastal consumers' business.

In an opinion piece published by Forbes Magazine, Howard Kunreuther wrote, "One reason that insurers have abandoned certain hazard-prone states is that state regulators force them to charge premiums that don't cover their actuarial exposure and the cost of holding the capital they'd need if a hurricane hit."

He went on to say, "State regulators should continue to assure the solvency of insurers but should stay out of the rate setting business. Unless they give insurers the freedom to charge premiums that reflect risk, long-term homeowners insurance is bound to flop."

There was no TWIA legislation passed in the 2007 legislative session. This means that unless an emergency session is called in 2008, funding reforms would not be enacted until the legislature meets in 2009. If legislation were to pass in 2009, the solutions wouldn't truly be in place and available as protections until 2010. If this turns out to be the case, Texans will need to hold their collective breaths through two more hurricane seasons.

In July 2007, the Texas Department of Insurance approved the TWIA purchase of \$1 billion in catastrophe reinsurance -- hardly a drop in the bucket to cover multi-billions in losses that would wreak havoc among the entire state.

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The TWIA Board approved legislation that would have allowed TWIA to issue pre-event and post-event bonds to pay losses that resulted from a catastrophic hurricane or a series of hurricanes. The pre-event bonds would reduce the amount of reinsurance TWIA purchases. The post-event bonds would eliminate the need for the unlimited assessments thus protecting the General Revenue of the state of Texas. These bonds, if used to pay losses, would be repaid by a surcharge on Texas property and casualty insurance policies (except workers' compensation, medical malpractice, and health and accident policies).

Finding a resolution to the funding of the Texas Windstorm Insurance Association is imperative to protecting all residents of Texas when one or more hurricanes eventually hit the Texas coast.

**** The Perryman Group:**

An Economy at Risk: Our Vulnerable Coast and its Importance to the Texas Economy

Southwestern Insurance Information Services, Inc.

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