OFFICE OF PUBLIC INSURANCE COUNSEL

Deeia Beck
Public Counsel

William P. Hobby Building
333 Guadalupe, Suite 3-120
Austin, Texas 78701-3942

Phone: (512) 322-4142
Fax: (512) 322-4148
www.opic.state.tx.us

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JOINT LEGISLATIVE COMMITTEE TO STUDY SEACOAST TERRITORY INSURANCE

Dear Committee Members:

For the September 12, 2012 meeting of the Joint Interim Committee to Study Seacoast Territory Insurance, the Office of Public Insurance Counsel ("OPIC") has prepared this response in accordance with the Committee's charge as contained in Section 60(d) of House Bill 3, First Called Session of the 82nd Texas Legislature.

The information advanced in this response is not exhaustive of all possibilities by any means. It simply represents OPIC's view of some possible opportunities to:

1. Increase private carrier participation in the Seacoast insurance marketplace;
2. Minimize the risk of loss to the Texas Seacoast and the state at large; and
3. Bolster claim paying ability and other funding using non-premium based methods.

Additionally, OPIC has compiled some information regarding residual wind pools in other states as requested by the Committee. It is attached at the end of this document as Exhibit "A".
OPIC respectfully requests your consideration of the following:

I. Increasing Private Carrier Participation in the Seacoast Insurance Marketplace

The aftermath of Hurricane Ike revealed serious deficiencies in TWIA's claims handling. TWIA's new management team has worked to address many of these and improve TWIA's ability to respond to large catastrophic events. TWIA's structure, however, severely limits these efforts to handle the sudden volume of claims that occur after a hurricane. Claims response is consistently compromised when claims are encountered only on a sporadic and catastrophic basis. Because TWIA only provides coverage for wind and hail damage in a small geographic area it is not feasible to maintain the level of staff and infrastructure necessary to handle the volume of claims created by a hurricane on a permanent basis. This requires TWIA to staff up at the exact time its policyholders need the organization the most.

A. Pay voluntary market carriers to handle TWIA claims

Other residual markets have addressed this issue by having private market insurers handle claims for the residual market entity. In the North Carolina residual market associations and the California Earthquake Authority ("CEA"), the private insurer that writes the underlying coverage receives a fee to also adjust the catastrophic residual market claim. Similarly, TWIA could pay the voluntary market company writing the underlying property policy a fee in exchange for handling the policyholder's wind claim under the TWIA policy. After the voluntary market company determined the amount of the loss, TWIA would pay the policyholder for the loss. Having the company with the underlying coverage also handle the wind claim simplifies the claim process for insureds and creates a more efficient and cost effective program to provide insurance to the Texas seacoast.

B. Assign TWIA Policies to Companies Writing Property Insurance in Texas

Alternatively, TWIA could be converted into an assigned risk pool similar to TAIPA, the auto insurer of last resort. In an assigned risk pool voluntary market companies are randomly assigned policies from the residual market. The company uses a form and rate established by the Department of Insurance. The company must accept the assigned risk and the policyholder cannot choose another company. Texas could institute such a program by making the following adjustments to our residual wind pool program:

- Require companies writing policies in Tier 1 and 2 to cover wind and hail damage.
- Assign Tier 1 consumers who have obtained two denials from a voluntary market company writing residential or commercial property in Tier 1 to a company writing property insurance in Texas.
- Assign Tier 2 consumers who have obtained two denials from a voluntary market company writing residential or commercial property in Tier 2 to a company writing property insurance in Texas.
- Assign policies in proportion to the company's Texas residential and commercial property market share.
- Assigned company would provide a promulgated policy including both property and wind and hail insurance for a promulgated rate.

- Assigned company would handle all claims under the policy.

- Provide credits to companies that voluntarily write policies in Tier 1. Stagger the value of the credits to encourage companies to seek out higher risks in the front portions of Tier 1.

- Assigned company could cede Named Storm risk to TWIA.

- TWIA would insure against Named Storm risk with premium ceded by insurers, CRTF, bond program, and traditional reinsurance purchased from the private market.

Either paying voluntary market companies to adjust TWIA claims, or creating an assigned risk pool would prevent many of the complaints and unnecessary expenses associated with TWIA's handling of Hurricane Ike. First, either of the options outlined above would provide coastal residents with access to a network of qualified, well trained adjusters. Voluntary market carriers have ongoing claims events, some catastrophes, all over the country. Thus, they have a stable network of well-trained adjusters to tap into in the event of large catastrophic events. With access to such networks, the wind pool would no longer be required to compete with the voluntary market for claims adjusting resources after a hurricane. Relying on that network of professionals would simplify the claims process for coastal residents by allowing these Texans to have their claims handled by the same insurance professionals that handle claims for the rest of the state.

Second, both of these options allow voluntary market companies to write the underlying property coverage without requiring the company to take on the risk associated with hurricane activity. Under the first option, the company would not provide any additional insurance coverage. The company would simply handle and adjust claims for TWIA in exchange for a reasonable fee. Under the assigned risk program, the assigned insurer will retain the entire premium, and profit, associated with the underlying property insurance coverage, but may obtain reinsurance for the risk associated with named storms in exchange for a portion of the premium. Either of these options would remove TWIA from the claims handling process, without forcing the voluntary market to take on unwanted named storm risk.

II. Minimize the Risk of Loss to the Texas Seacoast and the State: Mitigation

Increased loss mitigation can provide many benefits to insurance consumers, insurers, and the State of Texas at large. Under Texas Insurance Code section 2210.454, the Commissioner of

Insurance is granted authority to develop, implement and fund a mitigation and preparedness plan for the Texas Seacoast.

OPIC conducted a feasibility study including analysis and recommendations for a wind mitigation program for residential property risks insured by TWIA. The analysis reveals that the largest benefit per wind mitigation investment dollar would be obtained in the Galveston and Corpus Christi metro areas, because these two metro areas have the highest concentrations of residential property values insured by TWIA. Also, residential building stock in these metro areas is generally older, lower valued and not compliant with the latest building codes.

TWIA insures approximately 72,000 homes within 25 miles of the city of Galveston (Galveston metro area) with a total insured value of roughly $16 Billion and approximately 57,000 homes within 25 miles of the city of Corpus Christi (Corpus Christi metro area) with a total insured value of roughly $10.8 Billion. The average TWIA insured home value with contents in the Galveston metro area is $223,754 and $189,823 in the Corpus Christi metro area. Furthermore, only 26% of homes in Galveston metro area and 17.5% of homes in the Corpus Christi metro area were built after 1988, or have retrofitted to comply with the latest building codes.

A. Mitigation Program Costs

The average investment required to fully retrofit the average coastal area home is approximately $2,400. However, new innovations and increasing competition in the mitigation product market will continue to decrease this average investment over time. Such average investment per home is expected to include protection of all glazed and non-glazed openings (including reinforcement of existing garage doors) and reinforcement of roof to truss attachments. If a spray-on application of foam adhesive is used to strengthen the roof to truss attachments, such investment is likely to be eligible for a 30% energy tax credit.

The total estimated cost to retrofit all the homes in Galveston metro area is $334,648,620 and in the Corpus Christi metro area is $206,781,669. TWIA's residential and commercial combined gross written premium for 2009 was $382,342,402. Consequently, if, for example, the program's payback period was set at nine years, the $60,158,921 per year needed to fully mitigate both the Galveston and Corpus Christi metro area's residential exposures over these nine years represents 15.7% of TWIA's current gross annual written premium (9.7% for Galveston and 6.0% for Corpus Christi).

B. Mitigation Funding Strategies

Several strategies could be used to fund wind mitigation. The first is to offer premium discounts for voluntary retrofitting of homes (discount program). The other basic alternative is to provide mitigation grants out of current premium or the Catastrophe Reserve Trust Fund

(grant program). These grants could be recovered directly through the Coastal Conservation Fee (see discussion herein) and indirectly through future reductions in TWIA losses and reduced reinsurance expenses. Mitigation discounts would not be offered under a grant program.

There are advantages and disadvantages to each program. The major advantage of the discount program to TWIA is that the initial burden for mitigation expense is entirely on the policyholder. The major disadvantage of the discount program is that it requires large initial expenditures by TWIA policyholders, which they may be unable or unwilling to make. Therefore, very little mitigation may take place, and consequently risks are more likely to continue to be underwritten by TWIA and subsidized through potential future assessments on all the property and casualty policyholders in the state.

The major advantage of a grant program is a guarantee that mitigation will occur under a controlled program. The major disadvantage of a grant program is that it requires large initial investments that may not be recovered if private insurers "cherry pick" the mitigated risks. However, if a private insurer "cherry picked" a risk subsidized by other TWIA policyholders, it could actually be an advantage to such policyholders. For example, a coastal risk paying a premium of $600 per year is mitigated via a grant program at a total cost of $2,400 and subsequently underwritten by a private insurer. If this risk should have been paying $900, then the mitigation of this risk had the effect of eliminating a $300 per year subsidy, which would take 8 years to recover ($2,400 / $300). It is impossible to predict at this time how many policyholders will voluntarily mitigate under an actuarially sound mitigation discount program and how many will be "cherry picked" by the insurance industry under a grant program.

A pilot program could be the best way to test the effectiveness of the grant versus discount strategy. It could combine actuarially sound retrofit mitigation discounts and actuarially sound rates with a program of prioritized grants. A TWIA policyholder in the pilot program could choose to voluntarily mitigate and begin to immediately receive annual mitigation discounts or wait for a grant and not receive mitigation discounts. The pilot program would be designed to collect experience to estimate future performance for the Galveston and Corpus Christi metro areas. Assuming the pilot program succeeds, the program could eventually be expanded to include all TWIA residential and commercial policyholders after the residential properties in the high risk metro areas have been fully mitigated. Such expansion will address the potential concern that the program is unfairly discriminatory. It is recommended that first priority be given to those properties that present the greatest risk of loss to TWIA.

C. Benefits of Mitigation Program

The major benefit of mitigation is the reduction of losses. Additionally, TWIA's reinsurance costs should be significantly reduced after the retrofitting of the Galveston and Corpus Christi metro areas is complete. A large reduction in reinsurance costs is possible because its cost is very sensitive to the concentration of risk that exists in these two high risk metro areas. Reinsurers attempt to diversify their risk by writing enough business on a global basis so that losses can be paid out of their current premium income. However, large concentrations of risk, such as exist in the two high risk metro areas in Texas, are less diversifiable. A large loss in these metro areas could result in a depletion of the reinsurance industry's surplus. Consequently, reinsurers charge much more for such concentrated risks, which TWIA must either absorb or pass on to its policyholders in higher rates.

Targeted and prioritized mitigation efforts directed at these two high risk metro areas are also expected to significantly reduce expected future assessments to non-TWIA policyholders. Under the current TWIA assessment procedure, only the largest hurricane losses will result in assessments against non-TWIA policyholders, and such losses are much more likely to occur in the high risk metro areas of Galveston and Corpus Christi.

In addition to TWIA and non-TWIA policyholders, the state as a whole benefits when losses are reduced via mitigation. As we know, major storms can wreak havoc on local economies and therefore hurt the state economy. If losses are reduced, communities can get back to the business of ordinary life and commerce much sooner. This means communities will be able to generate the taxes and fees necessary for both their ongoing operations and the State's.

III. Bolstering Claim Paying Ability and Other Funding Using Non-Premium Based Methods: An Alternative Source of Revenue

Funding for the residual wind pool is a constant concern for the residents of the seacoast and potentially impacts all Texans. OPIC requests the committee to consider generating additional catastrophe fund resources by authorizing a Coastal Conservation Fee to be applied to hotel and motel stays, short-term condominium rentals, and car rentals in all Tier 1 and Tier 2 areas. These fees could be assigned directly to the Catastrophe Reserve Trust Fund and used to pay claims or fund mitigation efforts as provided by statute. A program such as this provides an equitable way for Texans who visit and enjoy the Texas coast to support the rebuilding of homes, businesses, and communities after a hurricane. The fees are also designed to minimally impact the cost of living for coastal residents.

Texas has used similar programs to support economic activity. For example, organizers created user fees to fund construction of the new Cowboys' Stadium in Arlington. Some of these include a 10% fee on tickets sold to any event at the stadium, a $ 3 parking fee to park at the

stadium, a city wide 2% hotel occupancy fee, and a city wide 5% car rental fee. Also, the state adds an unrelated hotel occupancy tax to all hotel bills in Texas to promote tourism. The State presently assesses a 6% tax and counties and cities can collect up to an additional 9%.

The system used to collect current hotel fees can be used to collect a Coastal Conservation Fee. Hotels submit the current 6% fee directly to the State Comptroller on a monthly or quarterly basis. Similarly, Tier 1 and 2 businesses could submit the Coastal Conservation Fee directly to the Comptroller's Office when they submit the State Hotel Occupancy Tax. Relying on the Comptroller's existing reporting system should ease the adoption of the program and minimize costs associated with collecting the new fee.

For purposes of discussion, the table below shows the 2011 taxable receipts for hotels in some of the largest cities in Tier 1 and Tier 2.

2011 Hotel Taxable Receipts by City

City	2011
Houston*	$610,317,298.42
Corpus Christi	$124,015,443.21
Galveston	$113,551,900.58
McAllen	$45,833,874.56
So Padre Island	$69,154,288.16
Beaumont	$33,993,936.61
Victoria	$25,155,691.37
Port Aransas	$43,553,249.60
Brownsville	$17,572,888.60
Bay Town	$11,527,106.32
	$1,094,675,677.43
2011 1% CCF	$10,946,756.77
2011 2% CCF	$21,893,513.55

*Because some of Houston sits outside of Tier 2 we didn't include all of the reported taxable receipts for the city.

This of course does not include the entire Tier 1 and Tier 2 area, or fees associated with rental cars. So the actual amount generated by a Coastal Conservation Fee could be greater. As reflected above, the fees generated at the 1% or 2% levels will be significant. Having these fees deposited directly into the Catastrophe Reserve Trust Fund account (maintained by the Comptroller) ensures the fees will be utilized as intended by the legislature: to pay claims and support appropriate mitigation programs.

IV. Conclusion

We hope this information is helpful to the Committee. Please contact me if you would like to discuss any of these issues further, or if OPIC can assist the Committee on any other issues.

We thank you for your time and consideration.

Best Regards,

Deeia Beck
Public Counsel

Enclosures:

Exhibit "A" Other Residual Wind Pool Information

Exhibit "B" Texas Ins. Code Section 2210.454 (Mitigation)

Exhibit "A"

Other Residual Wind Pool Information: Florida, Louisiana, Mississippi, and Alabama

In OPIC's review of the other Gulf Coast states' residual wind pools, OPIC gathered information relating to the funding of losses and depopulation efforts for each pool. OPIC found that each of these wind pools have common elements for funding their losses. Losses are generally paid with existing funds (premium and investment income), reinsurance, bonds, other financial instruments, and assessments to both insurers and insureds. Some of the significant differences for funding losses are:

- Sources of reinsurance : All of the residual wind pools can purchase reinsurance through the private market, but Florida Citizens can also purchase reinsurance through the state ran reinsurance facility, Florida Hurricane Catastrophe Fund. Additionally, Alabama Insurance Underwriting Association allows member insurers to purchase reinsurance beyond what the association buys to decrease the likelihood of assessments.

- The types of assessments that may be levied and the insurers and policies which are subject to an assessment. For example:

  Florida Citizens

  - Applies assessments to Citizens' policyholders first, licensed property and casualty insurers second, and policyholders statewide third.
  - Property and casualty insurers pay the second assessment, but can recoup this assessment by surcharging policyholders.
  - The assessments apply to a broad range of property and casualty lines of insurance, including auto and liability, but do not apply to accident and health, workers' compensation, medical malpractice, National Flood Insurance Program or the Federal Crop Insurance Program.
  - The assessments also apply to policyholders who purchase an assessable policy from the surplus lines market.

  Louisiana Citizens

  - Louisiana Citizens' policyholders are assessed a market equalization surcharge when the insurers are assessed.
  - The assessments apply to property policies, but do not apply to auto and liability policies.
  - The assessments do not apply to policyholders who purchase an assessable policy from the surplus lines market.

Mississippi

- Implemented a surplus lines policy fee that applies to all surplus lines policies and is remitted directly to the Mississippi Windstorm Underwriting Association.

Alabama

- Assessments apply to all insurers licensed to write property insurance.

We found these residual markets have implemented various depopulation efforts and initiatives. One of these efforts is a depopulation program Louisiana Citizens began in 2007. This program appears to be effective in finding a voluntary market for a portion of Citizens' policyholders. Under the program, Citizens provides policy information and data to insurers that have expressed an interest in offering insurance through their company for Citizens' policyholders. Under this program approximately 67,000 Citizens' policies have moved to the voluntary market. This represents a policy reduction of 38.5% since 2008 for Louisiana Citizens.

Examples of other depopulation efforts include:

Amend or limit coverage provided by the residual market

- Increase deductibles or implement a separate named storm deductible for policies written through the residual market;
- Reduce maximum available coverage limits in the residual market; and
- Limit and/or strengthen eligibility requirements for coverage in the residual market.

Rate adequacy

- Review and compare the residual market rates to the private market rates; and
- Review the credits that may be available to residual market policyholders.

Take out programs

- Financial incentives for insurers to write risks in the coastal area;
- Credit on insurer assessments for writing risks in the coastal area;
- Penalties for insurers that do not write a certain amount of risks in the coastal area; and
- Providing residual market policy information to insurers that may be willing to take on more risk in the coastal area.

EXHIBIT "B"

Texas Insurance Code 2210.454 - Mitigation and Preparedness Plan

Texas Codes > Insurance Code > Title 10 > Subtitle G > Chapter 2210 > Subchapter J > § 2210.454 - Mitigation and Preparedness Plan

(a) The commissioner shall annually develop and implement a mitigation and preparedness plan.

(b) Each state fiscal year, the department may fund the mitigation and preparedness plan using available funds.

(c) The mitigation and preparedness plan must provide for actions to be taken in the seacoast territory by the commissioner, or by a local government, state agency, educational institution, or nonprofit organization designated by the commissioner in the plan, to implement programs to:

(1) improve preparedness for windstorm and hail catastrophes;

(2) reduce potential losses in the event of such a catastrophe; and

(3) provide research into the means to:

(A) reduce those losses;

(B) educate or inform the public in determining the appropriateness of particular upgrades to structures; or

(C) protect infrastructure from potential damage from those catastrophes.

(d) Money in excess of $1 million may not be used under this section if the commissioner determines that an expenditure of investment income from the trust fund would jeopardize the actuarial soundness of the fund or materially impair the ability of the fund to serve the state purposes for which the fund was established.

Added by Acts 2005; Amended 2009. Eff date June 19, 2009.