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Via Hand Delivery

The Honorable John Corona, Co-Chair
The Honorable Robert Duncan
The Honorable Mike Jackson
The Honorable Leticia Van de Putte
Texas Senate
P. O. Box 12068
Austin, Texas 78711

The Honorable Larry Taylor, Co-Chair
The Honorable John Smithee
The Honorable Todd Hunter
The Honorable Ryan Guillen
Texas House of Representatives
P. O. Box 2910
Austin, Texas 78768

Re: Windstorm Insurance Legislative Oversight Board

The Office of Public Insurance Counsel (OPIC) is presently evaluating TWIA's operations as it impacts Texas insurance consumers. We are primarily focused on two areas of particular concern: 1. Loss mitigation; and 2. Claims handling. While our evaluations are not final and additional information is being sought, we want to provide the following to the Committee pending our final reports:

Loss Mitigation

Increased loss mitigation can provide many benefits to insurance consumers, insurers, and the State of Texas at large. OPIC has engaged a Consultant to conduct a feasibility study including analysis and recommendations for a targeted and prioritized wind mitigation program for residential property risks insured by the Texas Windstorm Insurance Association (TWIA). The analysis indicates that larger benefits per wind mitigation investment dollar are possible, if future wind mitigation expenditures are targeted at the Galveston and Corpus Christi metro areas, because these two metro areas have the highest concentrations of residential property values insured by TWIA. These properties are generally older, lower valued and not compliant with the latest building codes.

TWIA insures 177,911 homes within 25 miles of the city of Galveston (Galveston metro area) with a total insured value of \$18.3 Billion and 108,151 homes within 25 miles of the city of Corpus Christi (Corpus Christi metro area) with a total insured value of \$10.8 Billion. The average TWIA insured home value in the Galveston metro area is \$103,000 and in Corpus Christi the average value is \$100,000. Only 23.1% of homes in Galveston metro area and 18.8%

of homes in the Corpus Christi metro area insured by TWIA were built after 1988, or have been retrofitted to comply with the latest building codes.

It is estimated that the average investment required to fully retrofit the average home in these two metro areas is approximately \$2,400. An average investment per home is expected to include: 1) \$500 for plywood shutters to protect all glazed and non-glazed openings, 2) \$400 for reinforcement of existing garage doors, and 3) \$1,500 for 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 (\$450 of the \$1,500 estimated cost). It is expected to take approximately 9 years to fully recover such an investments through reductions in insured losses under a mitigation program.

The total estimated average annual cost (for nine years) to retrofit all the homes in Galveston metro area is \$37,183,180 per year and in the Corpus Christi metro area is \$22,975,741 per year. TWIA's 2009 residential and commercial combined gross written premium was \$382,342,402. Consequently, the \$60,158,921 estimated average annual cost to fund a grant program to fully mitigate both the Galveston and Corpus Christi metro area's residential exposures over the next nine years represents 15.7% of TWIA's current gross annual written premium (9.7% for Galveston and 6.0% for Corpus Christi).

It should be noted that the building stock in the high risk areas has not been tested by winds exceeding 100 miles per hour in the last 40 to 50 years. Galveston has not experienced winds recorded or estimated to exceed 100 miles per hour in the last 50 years, and Corpus Christi has not experienced winds recorded or estimated to exceed 92 miles per hour in the last 40 years.

A Mitigation Program Could Reduce TWIA's Reinsurance Costs

It is expected that TWIA's reinsurance costs will 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 the cost of reinsurance 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.

A Mitigation Program Could Result in Reduced Potential Assessments

Targeted and prioritized mitigation efforts directed at these two high risk metro areas are also expected to significantly reduce potential statewide assessments. Under the current TWIA assessment procedure, only losses exceeding one billion dollars 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.

It is important that building information used to evaluate wind risk is collected in a manner that is both detailed and comprehensive so that mitigation expenditures can be optimized. The State of Texas Statistical Plan for Residential Risks (Stat Plan) identifies those homes that were either built to the new codes subsequent to 1988 or have been retrofitted. Furthermore, the Stat Plan identifies those homes that qualify for a roof covering premium credit and the year of installation. However, the Stat Plan does not gather detailed building information such as protection for glazed openings, protection for non-glazed openings, roof deck attachment, roof anchors and roof geometry on all homes in the most hurricane vulnerable areas of the state. Such additional information would help optimize the prioritization of grants under a grant program.

Furthermore, such detailed building information tailored to fit the full input capabilities of computerized hurricane models would provide more accurate estimates of expected future hurricane losses. Such increased accuracy should increase reinsurers' confidence in hurricane model estimates for TWIA and lower TWIA's future reinsurance costs.

It is also recommended that the more detailed Stat Plan mitigation data be made available to private insurers as an incentive for them to write more business in TWIA's high risk areas. Widespread availability of this detailed information will enable insurers to implement rating plans that more accurately reflect each home's specific hurricane resistance. This will help private insurers offer competing alternative incentives for voluntary mitigation investments beyond any such incentives that may be offered by TWIA or the state of Texas.

OPIC is Studying Two Different Mitigation Programs

There are basically two alternative strategies that could be employed to fund wind mitigation of TWIA insured residential properties. The first strategy is to offer premium discounts for voluntary retrofitting of homes (discount program). The other basic alternative is to provide mitigation grants out of the Catastrophe Reserve Trust Fund or current TWIA premiums and recover them indirectly through elimination of subsidized risks and future reductions in TWIA losses (grant program). 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 is that the burden for mitigation falls almost 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.

The major advantage of a grant program is a guarantee that mitigation will occur under a TWIA or state of Texas controlled program. The major disadvantage of a grant program is that it requires large initial investments by TWIA 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. Therefore, adoption of a combination of these two strategies in a pilot program to be conducted in a selected smaller metro area such as Aransas, Cameron or San Patricio County is recommended.

A Pilot Study is Needed to Determine the Best Mitigation Program for Texas

Currently § 2210.454 of the Texas Insurance Code allows the Commissioner of Insurance to use funds from the Catastrophe Reserve Trust Fund to study potential benefits of mitigation. These funds could be used to conduct a mitigation pilot program. A pilot program could combine actuarially sound retrofit mitigation discounts and actuarially sound rates (higher rates along the immediate coast and lower rates inland within each county) with a program of prioritized grants. Actuarially sound rates within the pilot county could be phased in over an accelerated test period (shorter than the expected nine year grant program for the Galveston and Corpus Christi metro areas).

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. Such a pilot program may require specific enabling legislation. Assuming the pilot program succeeds, it is recommended that the grant program 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 grant program is unfairly discriminatory. It is recommended that first priority for grants in the high risk metro areas be

given to those properties that present the greatest risk of loss to TWIA, i.e. the higher valued properties closest to the coast.

Claims Handling

The aftermath of Hurricane Ike revealed serious flaws in TWIA's claims handling model for catastrophes. Despite protests by TWIA to the contrary, these flaws are pervasive and obvious. First, TWIA's 2009 complaint index is *twelve* times the average for insurers (several of which write wind). *See the attached charts*. Second, TWIA has entered into a 189 million dollar settlement with much more litigation pending. Third, in addition to policyholder complaints, the ALJ in the recent Proposal for Decision (PFD) in the TDI enforcement case involving TWIA held that TWIA misrepresented a material fact or provision relating to coverage under the Dwelling Policy, in violation of Tex. Ins. Code Ann. § 541.060(a)(1) and made an untrue statement of material fact related to coverage under the Dwelling Policy to policyholders, in violation of Tex. Ins. Code Ann. § 541.061. *See Proposal For Decision, SOAH Docket No. 454-09-6187.C, at p.138.*

Concerns regarding TWIA's handling of claims after Hurricane Ike are not new. Prior to the SOAH PFD, many others, including members of the Legislature, questioned TWIA's claims handling practices. It is clear that Texans deserve more from the state sponsored wind insurer of last resort.

This Committee could certainly help remedy these issues by altering the structure of TWIA and increasing the authority state regulators have over it. However, even if this was desired and enacted, additional issues would remain as claims response is consistently compromised when claims are encountered only on a sporadic and catastrophic basis.

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 also adjusts the catastrophic residual market claim. In the context of a Texas hurricane, this would reduce the number of adjusting groups from three to two (assuming NFIP (flood) coverage was implicated).

In addition to eliminating some complexity for the consumer, there are additional benefits as well. First, private carriers have ongoing claims events, some catastrophes, all over the country. Thus, they can typically "ramp up" quickly. Also, they have ongoing training and strict oversight of adjusters. Most notably, the claimants are also their customers creating a strong motivation to service them properly.

Of course, this will require an additional commitment of assets on behalf of private insurers to handle these claims. Insurers could be compensated for handling these claims via a

set schedule (as with the North Carolina Associations and the CEA) from a portion of the TWIA premium.

OPIC has met with a number of insurers to address their concerns about this proposal. The feedback we have received is that insurers are open to considering this type of arrangement subject to appropriate safeguards being placed.

Conclusion

We appreciate your consideration of these proposals and look forward to presenting completed proposals at the completion of our studies.

Best regards

A handwritten signature in cursive script, appearing to read "Deeia Beck".

Deeia Beck
Public Counsel

Enclosures as noted

§ 2210.452. Establishment and Use of Trust Fund

(a) The commissioner shall adopt rules under which the association makes payments to the catastrophe reserve trust fund. The trust fund may be used only to fund

the obligations of the trust fund under Subchapter B-1¹.

(b) All money, including investment income, deposited in the trust fund constitutes state funds until disbursed as provided by this chapter and commissioner rules. The comptroller shall hold the money outside the state treasury on behalf of, and with legal title in, the department. The department shall keep and maintain the trust fund in accordance with this chapter and commissioner rules. The comptroller, as custodian of the trust fund, shall administer the trust fund strictly and solely as provided by this chapter and commissioner rules.

(c) At the end of each calendar year or policy year, the association shall use the net gain from operations of the association, including all premium and other revenue of the association in excess of incurred losses and operating expenses, to make payments to the trust fund, to procure reinsurance, or to make payments to the trust fund and to procure reinsurance.

(d) The commissioner by rule shall establish the procedure relating to the disbursement of money from the trust fund to policyholders in the event of an occurrence or series of occurrences within a catastrophe area that results in a disbursement under Subchapter B-1.

(e) The trust fund may be terminated only by law. On termination of the trust fund, all assets of the trust fund revert to the state to provide funding for the mitigation and preparedness plan established under Section 2210.454.

Added by Acts 2005, 79th Leg., ch. 727, § 2, eff. April 1, 2007. Amended by Acts 2009, 81st Leg., ch. 1408, § 38, eff. June 19, 2009.

¹ V.T.C.A., Insurance Code § 2210.071

§ 2210.453 Reinsurance

(a) The association may :

- (1) make payments into the trust fund; and
- (2) purchase reinsurance.

(b) The association may purchase reinsurance that operates in addition to or in concert with the trust

fund, public securities, financial instruments, and assessments authorized by this chapter.

Added by Acts 2005, 79th Leg., ch. 727, § 2, eff. April 1, 2007. Amended by Acts 2009, 81st Leg., ch. 1408, § 39, eff. June 19, 2009.

§ 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, 79th Leg., ch. 727, § 2, eff. April 1, 2007. Amended by Acts 2009, 81st Leg., ch. 1408, § 40, eff. June 19, 2009.

SUBCHAPTER K. LIABILITY LIMITS

§ 2210.501. Maximum Liability Limits

(a) The board of directors shall propose the maximum liability limits under a windstorm and hail insurance policy issued by the association under this chapter. The maximum liability limits must be approved by the commissioner.

2009 TWIA COMPLAINT INDEX COMPARISON

Complaint Ratios: the ratio, expressed as a percentage, is the number of closed justified homeowners-related complaints divided by the number of homeowners policies the company had in force for 2009.

Complaint Index: indicates how a company's complaint ratio compares to the average for all insurers. The complaint indexes below were calculated by dividing the company's percentage of homeowners-related complaints by the company's percentage of homeowners policies in force. The average index is 1.00. A number less than 1 indicates fewer complaints than average; a number greater than 1 indicates more complaints than average.

TWIA COMPLAINT RATIO/INDEX COMPARED TO TOP 10 COMPANIES (2009)*		
COMPANY	RATIO	INDEX
TWIA	0.3293	12.4855
FARMERS INSURANCE EXCHANGE ^{1 2}	0.0257	0.9744
ALLSTATE TEXAS LLOYD'S	0.0234	0.8872
TRAVELERS LLOYDS OF TEXAS INSURANCE COMPANY	0.0146	0.5536
TEXAS FARMERS INSURANCE COMPANY ^{1 2}	0.0141	0.5346
NATIONWIDE PROPERTY AND CASUALTY INSURANCE CO ^{1 2}	0.0141	0.5346
STATE FARM LLOYDS ^{1 2}	0.0119	0.4512
ALLSTATE FIRE AND CASUALTY INSURANCE COMPANY	0.0114	0.4322
USAA TEXAS LLOYD'S COMPANY	0.0054	0.2047
UNITED SERVICES AUTOMOBILE ASSOCIATION	0.0029	0.1100
CHUBB LLOYDS INSURANCE COMPANY OF TEXAS ²	0.0000	0.0000

¹ Companies writing NEW business in Tier 1 with wind coverage (as of 04/18/2010)

² Companies RENEWING business in Tier 1 with wind coverage (as of 04/18/2010)

* INFORMATION COMPILED FROM TEXAS DEPARTMENT OF INSURANCE COMPANY PROFILES
(https://apps.tdi.state.tx.us/pcci/pcci_search.jsp)

2008 TWIA COMPLAINT INDEX COMPARISON

Complaint Ratios: the ratio, expressed as a percentage, is the number of closed justified homeowners-related complaints divided by the number of homeowners policies the company had in force for 2009.

Complaint Index: indicates how a company's complaint ratio compares to the average for all insurers. The complaint indexes below were calculated by dividing the company's percentage of homeowners-related complaints by the company's percentage of homeowners policies in force. The average index is 1.00. A number less than 1 indicates fewer complaints than average; a number greater than 1 indicates more complaints than average.

TWIA COMPLAINT RATIO/INDEX COMPARED TO TOP 10 COMPANIES (2008)*		
COMPANY	RATIO	INDEX
TWIA	0.0608	5.0037
TRAVELERS LLOYDS OF TEXAS INSURANCE COMPANY	0.0235	1.9340
ALLSTATE TEXAS LLOYD'S	0.0135	1.1110
NATIONWIDE PROPERTY AND CASUALTY INSURANCE CO ^{1 2}	0.0101	0.8312
FARMERS INSURANCE EXCHANGE ^{1 2}	0.0095	0.7818
TEXAS FARM BUREAU UNDERWRITERS	0.0081	0.6666
TEXAS FARMERS INSURANCE COMPANY ^{1 2}	0.0076	0.6255
ALLSTATE FIRE AND CASUALTY INSURANCE COMPANY	0.0071	0.5843
STATE FARM LLOYDS ^{1 2}	0.0070	0.5761
USAA TEXAS LLOYD'S COMPANY	0.0015	0.1234
UNITED SERVICES AUTOMOBILE ASSOCIATION	0.0008	0.0658

¹ Companies writing NEW business in Tier 1 with wind coverage (as of 04/18/2010)

² Companies RENEWING business in Tier 1 with wind coverage (as of 04/18/2010)