

Reference Materials

Texas Department of Insurance

December 13, 2010

Creation and Purpose/ Governance and Oversight

- Created by the Texas Legislature in 1971 to provide windstorm and hail coverage to those unable to obtain insurance from the voluntary insurance market. Impetus: Market conditions after Hurricane Celia (Corpus Christi, 1970), \$500 million in losses.
- Current law establishes TWIA as provider of last resort for wind and hail insurance in the seacoast area.
- TWIA: 10 member (9 voting members) Board of Directors, appointed by Commissioner of Insurance, representing industry, public/consumers, agents, and engineering interests; General Manager runs day-to-day affairs
- Regulatory Oversight: Texas Department of Insurance; Office of Public Insurance Counsel
- Legislative Oversight: Standing Legislative Committees and Legislative Oversight Board (HB 4409, 81st Session)

Rates & Premiums

Basic Rate Components: Non-hurricane and hurricane loss experience, expenses, profit/contribution to the CRTF, debt obligations.

Current Status: In October 2009, the Commissioner disapproved TWIA's August 2009 rate filing requesting a 10% rate increase in residential and commercial rates. In August 2010, TWIA submitted a rate filing requesting a 5% rate increase in residential and commercial rates to be effective January 1, 2011.

- 2009 Average Premiums:**
- Residential: \$1,175
 - Commercial: \$6,394
- Annual Premium**
- 4 qtrs. ending 9/30/2010: \$378 million

Rate Change History

Cumulative Changes Since 2003 (including 2011)

Residential: 50.2% Commercial: 100.2%

Changes by Year (Residential/Commercial)

2003: 0%/10%	2006: 0%/5%	2008: 8.2%/5.4%
2004: 9.6%/10%	2006: 3.1%/8%	2009: 12.3%/15.6%
2005: 0%/10%	2007: 4.2%/3.7%	2011: 5.0%/5.0%

- Building Code Discounts & Surcharges**
- Based on proximity to coastline vs. further inland
 - Highest Seaward discount is 28% for building; highest Inland discount is 33% for building
 - Structures not built to code are not eligible for discounts and are surcharged an additional 15%

Catastrophe Reserve Trust Fund (CRTF)

Approx. balance in the CRTF as of December 2, 2010: \$76.3 million

Summary of Rating Law

- Prior approval; file and use under certain circumstances
- Annual rate filing, due by 8/15; may also make interim rate filing
- Rate standards apply; may also
 - Establish rating territories
 - Vary rates among territories
 - Use recognized catastrophe models

Policy Form – Coverage

- Covers damage to the structure and its contents caused by windstorm or hail
- Optional Coverages:
 - Additional living expenses/business income and extra expense;
 - Wind-driven rain coverage (residential only);
 - Increased cost of construction
- Deductible applies to each occurrence and each item insured
 - Residential deductible options are \$100 or \$250, or 1%, 1.5%, 2%, 2.5%, 3%, 4% or 5% of the limit of insurance for the item insured.
 - Commercial deductible options are 1%, 2% or 5% of the limit of insurance for the item insured, with a \$1,000 per item minimum deductible.

Total and Regional Exposure Information

- Probable Maximum Loss (PML) for a 1 in 100-year storm: \$3.75 billion
- Hurricane Ike (2008) – approx. a 1 in 40-year storm, category 2, hit Galveston Island – TWIA est. insured losses: \$2.3 billion as of 12/7/2010
- Hurricane Dolly (2008) – less than a 1 in 10-year storm, category 1, hit South Padre Island – TWIA est. insured losses: \$280 million
- Hurricane Rita (2005) – less than a 1 in 10-year storm, category 3, hit Sabine Pass – TWIA est. insured losses: \$160 million
- Top 5 Counties and Exposure (Direct Insurance in Force for buildings and contents)

County	Exposure	Policies in Force	% of Total Exposure
Galveston	\$21.0 billion	67,643	31.1%
Nueces	\$12.8 billion	48,821	18.9%
Brazoria	\$12.7 billion	45,356	18.8%
Jefferson	\$ 7.0 billion	28,447	10.3%
Cameron	\$ 4.9 billion	17,189	7.2%
Total – Top 5	\$58.3 billion	207,456	86.3%
Total	\$67.6 billion	242,321	100%

Data source: TWIA Quarterly Statistical Report as of 9/30/2010.

Scope

- TDI performed two reviews of TWIA; one in mid-2009 and one in early 2010.
- First review was focused on the claims process, specifically, as it related to Hurricane Ike claims.
- Second review, conducted under the Financial Examination authority, was a comprehensive financial examination covering the period January 1, 2006, through December 31, 2008. The examination reviewed areas of TWIA's operations with the ability to affect TWIA's financial condition as well as verified TWIA's compliance with statutes and rules. In addition to the review of the accuracy and completeness of TWIA's 2008 annual financial statement, some aspects of claims processing as well as internal controls related to procurement and human resources were reviewed.

Key Findings

Claims Process

- Communication with claimants was lacking in certain aspects, for example, when explanations were provided to claimants as to how TWIA calculated the settlement amount and what and how replacement cost coverage information was provided to claimants.

Adjuster Management

- Adjuster training may be inadequate.
- The use of different claims adjusting software may cause inconsistency in claims handling.
- Adjuster oversight was not uniform and policies and procedures were not in place to effectively manage adjusters.
- Claims management staff were not in the field handling problems, training, and quality control of adjusters.
- Uniform denial letters were not used by the independent adjusters.

Claims Management

- TWIA captured information regarding the number of claims filed; however, there were limited management reports available to provide regular updates about the current status of pending claims.
- Certain claims were not processed within the timeframes specified in the policy.

Complaints Handling

- TWIA did not maintain written complaint procedures or a complete complaint log.
- TWIA only tracked complaints received from TDI.

Financial Issues

- The examination was limited in scope since the letter of representation was qualified and loss and loss adjustment expenses were supported primarily by management's judgment and included a substantial accrual for anticipated litigation expense.

Corrective Action Taken -- While TWIA management may not have agreed

with all of the findings, they have taken steps to address many of the issues that were identified in the reviews.

Key Findings -- Continued

- Failure to comply with various provisions of statutory accounting guidance which resulted in material misstatements of "Losses," "Loss Adjustment Expenses," and "Unearned Premium" as well as other accounting issues.
- Contrary to the NAIC Annual Statement Instructions, TWIA did not complete certain portions of its Annual Statement, and some of the completed portions were incorrect.

Operational Activities

- Department heads made purchasing decisions and could initiate contracts or procure and approve goods and services without a contract as long as the expenditures were within the budget approved by the board of directors. TWIA did not have well defined specifications for the process of selecting or contracting with claims adjuster firms. There were no formal written contracts with any of the adjusting firms.
- TWIA did not enforce its Business Ethics and Practices Policy as included in the Employee Handbook with respect to hiring practices and conflict of interest disclosure. Human Resource practices and administration over personnel files were not consistent and did not provide adequate documentation for personnel actions taken by management.
- Control weaknesses associated with the information systems were identified. They were in the areas of documentation, security monitoring, and contingency and disaster planning.

Board Issues

- Minutes of the directors' meetings did not reflect adequate approval and support of all the Association's activities.
- There was no evidence that the board determined the amount of funds that should be maintained in checking accounts or the specific securities in which the excess funds would be invested pursuant to the plan of operation requirements.

Area of Further Review -- A third review dealing with the issue of

slab claims is underway. We expect that this phase will be completed in the next 30 days.

Adopted Rules

TWIA eligibility rules: 28 Tex. Admin. Code Secs. 5.4902 – 5.4907

- Effective August 31, 2009 (Permanent Rule effective February 24, 2010)
- Provides that rules implementing HB 4409 were part of TWIA’s plan of operation.
- Defines what constitutes a declination of coverage and established documenting requirements.
- Implements flood insurance coverage and documenting requirements.
- Implements minimum retained premium period (statutory minimum of 180 days) and procedures for handling exceptions and issues related to premium finance.
- Adopts the Approval program by rule and addresses continuing coverage issues.
- Creates the Transition program and addressed issues related to continuing coverage. Program closes August 31, 2011 and all coverage must cease prior to September 1, 2012.

Procedural rules and definitions

- \$5.4901 (Section 35. 2210.354)
Effective August 19, 2009: Established formal procedure and time line for requesting additional information related to annual filing. Proposed rule moves the provision to \$5.4701.
- \$5.4908 (Sec. 11/ 2210.008(c))
Effective August 31, 2009 (Permanent Rule effective February 24, 2010): Defines the terms alter and alteration.
- \$5.4909 and \$5.4910 (Sec. 28 / 2210.204(d) & (e))
Effective September 28, 2010: Adopts policy forms and manual rules necessary to implement minimum retained premium requirement. These rules expired and forms were adopted under \$5.4911.
- \$5.4911 (Sec. 11 / 2210.008(a))
Effective February 24, 2010: Establishes procedure for the adoption of TWIA policy forms and manual rules.

Proposed Rules -- TWIA funding

- \$5.4101 - 5.4147 (Sec. 16 & Sec. 41 / 2210.072 thru 2210.074, 2210.609 – 2210.6135)
Establishes procedures and requirements related to the issuance and payment of financial instruments and public securities.
- \$5.4161 - 5.4192 (Sec. 16 & Sec. 41 / 2210.072 thru 2210.074, 2210.609 – 2210.6135)
Establishes member insurer assessment procedure based on existing procedure and establishes the methodology and procedure for determining and collecting the class 2 public security catastrophe area policy holder premium surcharge.

Additional Rules

- Transition Program Alternative Certification (Sec. 30 / 2210.251(a) & (h))
Informal draft: Rule will provide for continued coverage of a structure in the Transition program if a qualifying building component of the structure that protects the building envelope is inspected and determined to meet the current windstorm building code. The rule will list the qualifying building components.
- Amend Plan of Operation (Sec. 46(b))
The adopted rules amend the plan of operation. Additional HB 4409 rules will continue to amend the plan of operation. Following implementation, the remainder of the plan of operation will be reviewed and amended as necessary.
- TDI Charging Inspection Fees. (Sec. 30 / 2210.251(i) – (m)) [Initial drafting conceptual stage]
- Company Assessments to Fund Inspections Program. (Sec. 40 / 2210.454(b))
HB 4409 repealed portions of Insurance Code \$2210.454 that transferred funds from the CRTF to fund the Department’s windstorm inspection program. Insurance Code \$2210.253 provides the Department with an alternate funding source.

Enforcement Cases

Cases Related to Hurricane Ike:

7 cases against TWIA

- 2 cases in litigation (lifted shingles and prompt pay)
- 1 case resolved by consent order (complaint log)
- 2 cases closed with warning letters
- 2 cases pending investigation

16 cases against other insurers

- 3 cases in litigation
- 2 cases closed with warning letters
- 4 cases closed with no action
- 7 cases pending investigation

Cases Against Agents and Public Insurance Adjusters:

75 cases

- 24 open files
- 14 cases closed with licenses revoked or administrative fine or restitution ordered
- 27 cases closed with warning letters or licensed surrendered/expired
- 10 cases closed without action (lack of evidence/witness or violation)

Public Insurance Adjuster Cases

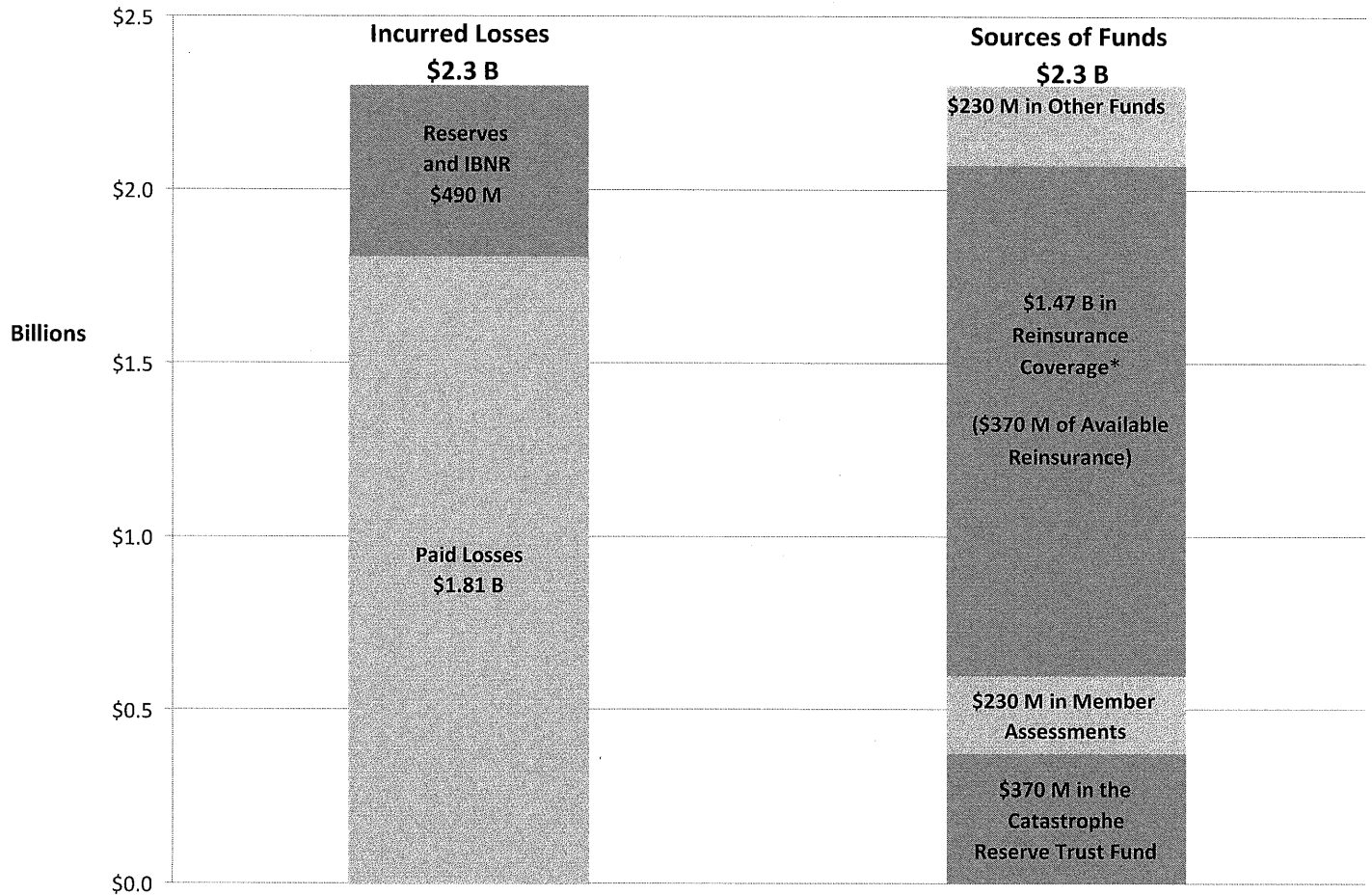
- 21 open files
- 3 closed without action
- 3 closed with warning letters
- 2 closed after Cease and Desist

Complaints and Claims

Key Statistics as of December 6, 2010, including data relating to TWIA:

- 8,800 consumers assisted at DRCs
- 11,924 calls answered
- 6,137 complaints/inquiries received – TWIA number = 2,135
- 6,122 complaints/inquiries closed – TWIA number = 1,277
 - 4,892 complaints resolved
 - 1,230 inquiries resolved
- 2,328 justified complaints closed – TWIA number = 782
- \$42 million returned to consumers – TWIA number = \$15.3 million
- 43,721 inspections completed (*as of 7/31/10* TDI: 16,754; TWIA: 26,967)
- Claims paid to date on personal lines of business *as of 6-30-2010*: over \$6.7 billion (TDI Call for Ike claims data) – TWIA number = over \$956 million
- Claims paid to date on commercial lines of business *as of 6-30-2010*: over \$5.1 billion (TDI Call for Ike claims data) – TWIA number = over \$411 million
- Residential property only *as of 6-30-2010*
 - *Top companies – includes 33 TX counties – no separate TWIA data*
 - ~ 618,700 reported claims
 - ~ 610,000 closed claims (98.6%)
 - ~ \$4.8 billion in claims paid

Texas Windstorm Insurance Association Ike Paid and Incurred Losses and Sources of Funds As of December 7, 2010



Source: Texas Windstorm Insurance Association

* \$1.5 B catastrophe reinsurance was reduced to \$1.47 B as a result of default by Lehmann Re.