Hello, my name is Seth J. Chandler. I'm a professor of law at the University of Houston Law Center and Director of its Program on Law and Computation. I have studied the current Texas Windstorm Insurance Association funding mechanisms in depth for over five years, outlined Texas windstorm insurance issues in various op-eds and have my own blog on the topic before you, catrisk.net. The views here are my own.

Continuing with the current system of windstorm finance or merely tweaking it engineers a disaster waiting to happen. The 15% or so risk of TWIA insolvency over a ten year period, should leave every Texas legislator sleepless. The 50% risk over that time-frame that TWIA will need to resort to untested post-event bondings and surcharges or assessments is likewise disturbing. Endless reliance on costly reinsurance effectively traps TWIA in a cycle of inadequate capitalization.

But to leap from those woes to a new large government bureaucracy that socializes and further politicizes large segments of the insurance business is premature at best. The key idea now being floated surcharges all property and casualty policies in Texas (including auto, homeowner, business liability) some percentage of the premium to cover claims generated by a catastrophe. I don't have details yet, but such a triggering catastrophe would likely be defined by insured claims from some single occurrence exceeding some amount. Now, if this scheme were consistent with the rest of the Texas insurance code, which permits geographic rating where actuarially justified, it might have some virtue as a risk diversification mechanism. But the key part of the proposal I have seen throws actuarial justification out the window. It insists that the surcharge rate should not depend -- not even within some bounds -- on the location of the property or the insured. So, even though insureds in Laredo or Huntsville or Garland might have a risk of making a defined catastrophe claim with only 1/10 an expected value as frequently as those in Galveston or Corpus Christi or Beaumont, all of them would be charged alike.

As many wiser than I have noted, "there is no greater inequality than the equal treatment of unequals." Why is it just to permit high-risk and wealthy property owners in one part of Texas to get subsidized insurance paid for by low-risk and less wealthy property owners in other parts of the state? But, unfairness aside, there are problems with the proposal. Such a scheme enlists government to divert private resources to the riskiest parts of the state and thereby exacerbates future catastrophe losses. It will, unless there is, as I fear, an "individual mandate," result in lower take-up rates in catastrophe-sparse regions than in catastrophe prone ones, which will further drive up surcharges and threaten a death spiral. And who here can contemplate the bureaucracy necessary to define occurrences and catastrophes, to determine when payments should be made from the state cat pool rather than conventional markets, to fund and monitor funding of a state-wide cat pool, and to prohibit insurers selling in catastrophe-sparse areas from undercutting the pool price?

So, before we kill TWIA and transition into the unknown perils of more government regulation and bureaucracy, I suggest we test more thoroughly whether and how the private insurance market will perform when the seacoast playing field is leveled. I do not share the article of faith among some that the private market will never work there. I say that faith has not been tested for decades because the playing field has been badly tilted. TWIA charges rates that protect against only a portion of the risk posed by its policyholders whereas we insist that private insurers charge rates sufficient to cover the entire risk. I would love to see Allstate come in to Commissioner Kitzman's office and ask to continue selling policies in Texas when the odds of it failing over the next 10 years were acknowledged to be 15%. TWIA now gets special protection from lawsuits for improper claims handling. TWIA doesn't do what I think most sensible insurers would do when we know that stronger building practices significantly reduce expected losses: charge modest coinsurance, particularly for claims in excess of actual cash value, but possibly waive coinsurance upon proof of extraordinary effort. Finally TWIA fails to do what we would require of private insurers: prominently disclose to policyholders the special insolvency, assessment and surcharge risks posed by its current funding structure.

Basically, I want Texas to transition to a market for windstorm insurance on the coast that is only different insofar as truly necessary from the market for property insurance generally. I want an expanded but monitored private market, with a level playing field and greater information to seacoast policyholders. The key to the proposal is a downwards shift in the absolute magnitude of risks faced by TWIA and a program that builds reserves within a smaller TWIA. Such a move will reduce the risk of post-event financing or the disaster of insolvency. The idea is to do so, however, in a way that protects basic insurance for coastal insureds, including those in the densely populated counties, and not to leave them in the lurch in the event, even with a level playing field, private insurance still will not do business on our coast. To those ends I have attached to my written testimony ten immediately doable and specific proposals that I believe you should study as part of your work plan.

Four of those specifics here. Lower the TWIA maximum policy limits so long as excess insurers come in to fill the void, which I believe they will if given underwriting freedom. Insist that TWIA not sell policies without at least modest coinsurance. Require policy premiums that, over a ten year period, build TWIA reserves to a level where it would take more than a 1 in 100 year storm to deplete them. Increase Class 3 assessments so that they would cover up to a 1 in 500 year storm.

Thank you for listening. Please read my expanded testimony involving all ten ideas and bookmark my blog, catrisk.net.

Ten Specific Proposals

1. Reduce over a period of two years the maximum applicable policy limit for TWIA policies on residences. That limit should be reduced to $1 million for policies issued or renewed after May 31, 2013 and, subject to the certification described below, $500,000 (or the Federal Flood Limit, whichever is lower) for policies issued or renewed after May 31, 2014. The latter ceiling shall be in effect each year if and only if the Texas Department of Insurance certifies after an appropriate hearing that excess insurance was generally available at actuarially sound rates in the territory covered by TWIA during the preceding policy year for amounts in excess of the TWIA policy limits for the preceding year. Otherwise the maximum policy limit should revert to $1 million. Take proportional measures for non-residential properties.
2. Prohibit TWIA from issuing or renewing policies after May 31, 2013, unless those policies contain, in addition to a deductible, a coinsurance requirement of not less than 5% on claims payments up to actual cash value and not less than 10% on payments in excess of actual cash value, provided that TWIA shall have discretion to waive such coinsurance where the property owner provides evidence that its insured property meets the strictest building codes adopted by any state for coastal property.
3. Prohibit TWIA from entering into reinsurance arrangements in which the actuarial value of the risk transferred to the gross reinsurance premium is less than 20%. This computation should be made by TWIA actuaries using the best available historical evidence and contemporary models.
4. Maximally protect TWIA policyholders by prohibiting TWIA from entering into reinsurance arrangements for each catastrophe year with an attachment point lower than the sum of (a) its projected catastrophe reserve fund, and (b) the amount TWIA believes it can raise using Class 1 Securities, Class 2 Securities and Class 3 Securities.
5. Subject TWIA to the same geographic rating restrictions that other Texas insurers face pursuant to Chapter 544.002 of the Texas insurance code and clarify that it is equally protected by Chapter 544.053.
6. Subject TWIA to the same provisions regarding suit, statute of limitations, and extra-contractual damages as other insurers doing business in the seacoast territory. This could be done either by eliminating TWIA's current preferences or by according insurers selling primary or excess insurance in the seacoast territory the same preferences as TWIA, provided their policy form is substantially similar to that used by TWIA.
7. Set premiums and adjust the catastrophe reserve fund in accord with the concepts set forth in "An Idea for TWIA Finance" (http://catrisk.net/?p=126), which basically calls for a reserve trajectory that hits 1 in 100 year adequacy within a ten year adjustment period. Factor in all the reforms set forth here (or otherwise enacted) in making this computation.
8. Upon a certification from the Texas Department of Insurance at the start of each catastrophe year and based on the best available historical evidence and contemporary models, adjust the maximum amount of Class 3 securities that can be sold (and, correlatively, the maximum assessments on insurers) such that, after consideration of the catastrophe reserve fund, Class 1 securities, Class 2 securities Class 3 securities and any reinsurance or similar sources, the estimated risk of TWIA lacking funds to fully pay claims in the following catastrophe year is less than 1 in 500.
9. To the extent of any inability to accomplish #8, and insofar as feasible, require TWIA to adjust premiums, based the best available historical evidence and contemporary models to take into account the probability, based on the geographic location(s) of the property insured, that TWIA would be unable pay claims fully during the following catastrophe

year.

10. Require prominent disclosure to TWIA policyholders created by the financing structure in place (as modified by the reforms suggested here or otherwise enacted). This disclosure should, at a minimum, advise policyholders of the approximate probability, computed using the best historical data and contemporary models, of the risk that TWIA will become insolvent, will be impelled to increase premiums to pay off Class 1 securities and will be impelled to impose surcharges to pay off Class 2 securities. Disclosure should be made (a) on a document signed by applicants for TWIA policies (new or renewal); (b) stamped (similar to surplus lines stamping) on policies issued by TWIA; and (c) on a web site one or fewer clicks from the main TWIA page.