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Texas' Windstorm Challenge: Executive Summary

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RECOMMENDATIONS

- TWIA's exposure along the coast should be dramatically decreased.
- Ensure the availability of affordable windstorm insurance in Texas—without putting homeowners and taxpayers at risk—by fostering a healthy homeowners' insurance market.
- TWIA should seek, and TDI should approve, higher rates for most windstorm insurance policies.
- TWIA should be made a true insurer of last resort, much like the Texas FAIR plan for homeowners' insurance.
- Allow TWIA to differentiate rates based upon actual risk rather than offering uniform rates in all coastal areas.

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The Texas Windstorm Insurance Association (TWIA) is designed as an insurer of last resort for the 14 coastal counties of Texas. Unfortunately, rather than acting as a residual market, the agency has seen a dramatic increase in policyholders and exposure. In 2001, for example, the agency had 68,756 policyholders. However, by the end of May 2007 that number reached 173,404.[i] In spite of its rapid growth, TWIA's funding mechanism has not changed since 1993. Although a major storm striking the Texas coastline could cost TWIA upwards of $5 billion, it is only funded to cover about $1.04 billion.

TWIA was created in 1971 in response to Hurricane Celia. It provides windstorm and hail coverage in the 14 coastal counties and a few other specially designated areas. Although originally designed as a residual insurer for property owners that could not obtain insurance in the voluntary market, it has seen its exposure grow rapidly in recent years. TWIA is composed of all property insurers authorized to write policies in Texas.

The current funding system was designed in 1993 when TWIA only had about $6.5 billion in exposure. Today, TWIA's exposure has grown to nearly $50 billion. In the event of a storm, TWIA's current revenues allow it to cover any losses up to approximately $45 million per year. If losses exceeded this amount, the following funding system would kick in:

1. $100 million would be assessed to member insurers,
2. Catastrophe Reserve Trust Fund (about $322 million) and reinsurance (about $417 million),
3. $200 million assessed to member insurers, and finally
4. Unlimited assessment to member insurers from premium tax credits over five or more successive years.

Steps 1-3 would provide $1.039 billion. If more money were needed, it would come from unlimited assessments against insurers in return for tax credits. This would seriously harm the state's general revenue fund when it is considered that in 2005 alone, property and casualty insurance companies paid $472 million in premium taxes.[ii] If tax credits were to kick in, the state would probably lose revenue of about $500 million per year—revenue that would have to be replaced by Texas taxpayers.

The entire Gulf Coast has had to come to grips with insurance prices and availability in coastal areas. Some states have turned to government-sponsored solutions, while others have used less regulatory solutions to cure the insurance crisis. In South Carolina, for example, a "market-driven" bill was just passed that lays out a series of steps to help make insurance in the state's coastal areas more available and affordable.[iii]

[i] Southwestern Insurance Information Service, Fact Sheet (13 June 2007).

[ii] Floyd, Beaman, "Op-Ed: A broken TWIA is a coastal calamity," *Galveston County Daily News* (11 June 2007).

[iii] The South Carolina Omnibus Coastal Property Insurance Reform Act of 2007 was passed in the most recent South Carolina state legislature. The goal of the bill was to keep private insurers in the windstorm insurance market.

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South Carolina has offered tax incentives to insurance companies that cover property in hurricane zones and to property owners who take steps to mitigate potential storm damages to their homes. The bill also divides the South Carolina coast into tiers whereby the state's residual insurance provider can vary rates in the different tiers to reflect the relative risk. Additionally, insurance companies that change their rates must base those changes on statistical data related specifically to South Carolina. Another provision of the bill requires the state's wind pool to charge adequate rates in order to keep competitive private insurers in the game.

On the other side of the fence are states like Florida, which have adopted the government-centered approach to providing insurance. Florida legislators recently voted to lower insurance rates primarily in South Florida by throwing public money at the growing problem. In the event of a major hurricane striking Florida, the state would pay for the losses by taxing home, automobile, and other types of insurance.

As the Texas Legislature considers this issue leading up to 2009, it should keep the following principles in mind:

- **TWIA is simply too large, and its exposure along the coast should be dramatically decreased.**
- **The best way to ensure the availability of affordable windstorm insurance in Texas—without putting home-owners and taxpayers at risk—is to foster a healthy homeowners' insurance market.** The current regulatory stance at the Texas Department of Insurance which punishes innovation and efficiency is counter-productive and assures that insurance companies will minimize their risk by limiting their exposure along the Gulf Coast.
- **TWIA should seek, and TDI should approve, higher rates for most windstorm insurance policies.** For more than a decade, TWIA rates have been dangerously inadequate. While we can create multiple mechanisms for addressing the resulting shortfall, the best way is to minimize or eliminate the shortfall with rates that properly reflect risk.
- **TWIA should be made a true insurer of last resort, much like the Texas FAIR plan for homeowners' insurance.** It is too easy to today for anyone to get coverage from TWIA without having tried the private sector first.
- **TWIA should be allowed to differentiate rates based upon actual risk rather than offering uniform rates in all coastal areas.** Currently, uniform rates provide cross-subsidies from one class of consumers to another and encourage development in areas where builders and residents do not fully have to bear the cost of their decisions. Uniform rates also make it almost impossible for insurances to compete against TWIA in the higher risk areas along the coast.

Arguably the most serious threat facing the Texas economy is that of a severe hurricane strike. Although recent weather forecasts have predicted hurricane seasons for the upcoming years to be higher in volume and severity, Texas has taken very few steps to insulate itself from the threat. Unfortunately, the devastation of Hurricane Katrina and the near-miss of Hurricane Rita in 2005 did not change this. Now Texas faces the prospect of two full hurricane seasons before the next regular session of the Legislature.