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Texas' Windstorm Insurance System Still Does Not Work

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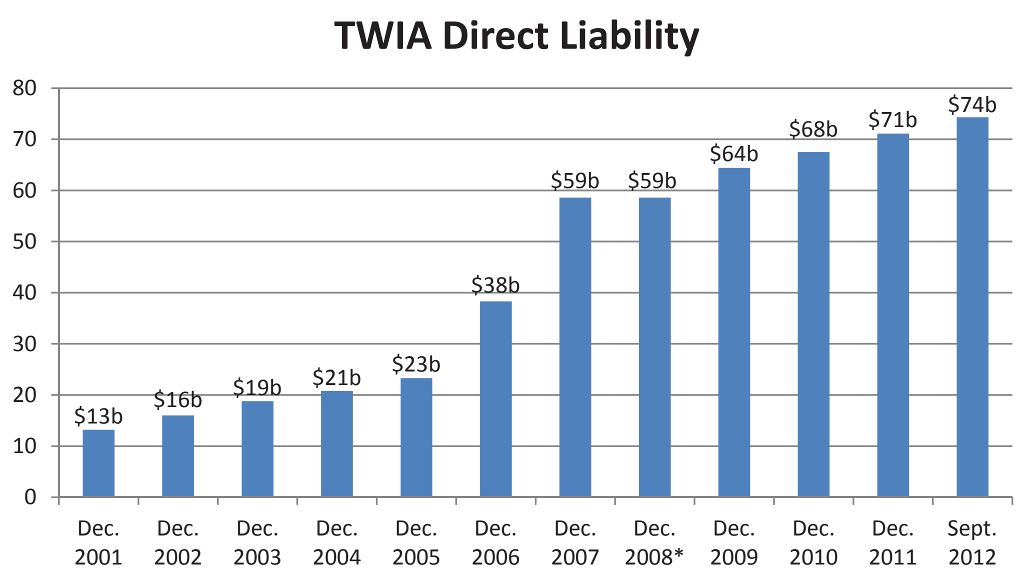
Key Points

- Underpriced rates for windstorm insurance crowd out private insurers, putting the system at risk.
- TWIA has about $3 billion on hand to deal with a catastrophic hurricane, which could bring in more than twice as much in claims.
- The only way to work through the problem of our underfunded windstorm insurance is to begin to let rates rise to more closely reflect actuarial reality.

Overview

Following Hurricane Celia in 1970—the costliest storm in Texas history until 1983—private insurance companies fled the coastal regions of Texas, making it impossible for some property owners to find insurance. As a result, the state of Texas established what later became known as the Texas Windstorm Insurance Association (TWIA). TWIA's mission is to be the insurer of last resort to provide hail and windstorm insurance to Texas property owners in the 14 coastal counties and specially designated parts of Harris County. All insurance companies operating in the state are required to become TWIA members and take part in the residual market as a percentage of their total operations in the state. Although it was designed to provide service only to those who would not otherwise be served by the private insurance market, it has since become a major insurer of coastal Texas property.

As of December 2001, TWIA had a total direct exposure of $13.2 billion. In only ten years that number has grown to $74.3 billion as of September 2012 *(see graph below)*. This explosive growth has been brought on by artificially low prices that have forced private insurers out of the market due to their inability to compete. A state mandated rate increase cap of 10 percent is the source of the low rates and can only be bypassed following a catastrophe and approval of the Texas insurance commissioner. This inefficient policy has led to TWIA becoming the standard windstorm insurer for the coastal Texas region instead of the insurer of last resort it



Source: Texas Windstorm Insurance Association Overview by Texas Department of Insurance (18 Jan. 2013) 35.

* The total number of policies in force as of 12/31/08 decreased by 13,357 policies and the total liability in force decreased by approximately $3.6 billion. The decrease in the number of policies may have been attributed to consumers canceling policies due to the property being totally destroyed by Hurricane Ike, shopping for other windstorm coverage, or having concerns about the economy.

was designed to be. As of 2011, TWIA's residential market share for their operating area was 62 percent. TWIA also has over $81 billion total of combined direct and indirect exposure with over 267,000 policies, making them far from an insurer of last resort.[1]

Along with the low rates comes an inadequate funding structure. The current funding system was designed in 1993 when TWIA had around $6.5 billion of exposure.[2] With the recent expansion of TWIA, the available funds have become woefully inadequate with around $2.6 billion available in 2012 to cover damages in the event of a catastrophic hurricane or windstorm.

The funding structure begins with a base layer of up to $100 million in premiums and other revenues; TWIA can then access the Catastrophe Reserve Trust Fund that holds between $250 and $275 million. This is followed by up to $1 billion in Class 1 public securities, $1 billion in Class 2 public securities, and $500 million in Class 3 public securities. Furthermore, a report by consulting firm Alvarez & Marsal calls TWIA's ability to successfully raise those funds in recent capital markets into question.[3] Any remaining losses would be paid from unlimited assessments against insurers in return for premium tax credits that would put a significant strain on the state's general revenue fund.

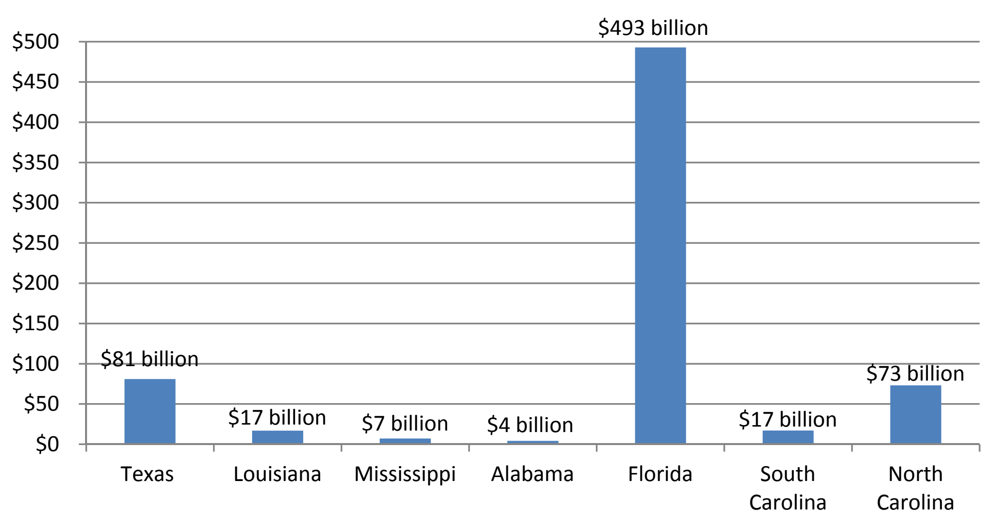
USA Today reports that the chance of a hurricane making landfall within 75 miles of Galveston, Texas in any year is 14.3 percent. The chance of a major hurricane with winds above 111 miles per hour doing the same is 4.2 percent; however, the average loss for TWIA alone from a single, major hurricane hitting Galveston is estimated to be between $4 and $5 billion.[4] Equivalent predictions for Corpus Christi and Brownsville show estimated average losses at $3.75 billion and $606 million respectively. Keeping in mind the maximum of $2.6 billion available to TWIA, Texas cannot afford such a liability in the coming years.

Overall, TWIA's current situation puts at risk coastal Texas TWIA policyholders whose policies have no definite funding source, all private insurance companies operating in the state of Texas due to the possibility for unlimited assessments, and all Texas taxpayers due to the potential impact on the general revenue fund following a catastrophe. In order to provide a nurturing climate for development and economic growth, homeowners and businesses need to insure their property against the formidable winds and hailstorms produced by hurricanes and tropical storms. Although TWIA has the potential to do this effectively, current restrictions and regulations have created a dangerous situation by forcing TWIA to overextend its resources.

Insurers of Last Resort in Other States

Of course Texas is not the only state with significant coastal property that is not served by the private insurance market. Louisiana, Mississippi, Alabama, Florida, South Carolina, and North Carolina all provide wind only residual insurance coverage to their citizens. Florida far exceeds any other state in their coverage with $493 billion in 2011 while Texas comes in a distant second with $81 billion *(see graph below)*.

Residual Market Coastal Exposure by State



Source: House Insurance Committee Request, Windpool Survey 2012.

Despite its large amount of coastal property and propensity for hurricanes, Louisiana has only $16.8 billion of exposure—a much more manageable amount. Part of the Louisiana Citizens Property Insurance Corporation's ("Louisiana Citizens") strategy to keep exposure low is a requirement that its rates be more costly than private insurers. This ensures that Louisiana Citizens only serves those who would not otherwise be served by the private insurance market and creates a *true* insurer of last resort. Although it would be a significant change to move TWIA from artificially low rates to artificially high, there are some smaller steps that can be taken in order to get the Texas Windstorm Insurance Association started on the right path.

Recommendations for Improvement

Our recommendations for improving the situation of the Texas Windstorm Insurance Association are based on the idea that the free market will provide the correct rates and improve the situation of the company and all those affected by its operations. The acute problems affecting TWIA are a product of its artificially low rates that push private insurers out of the market and create an inadequate source of funds.

The current system of limiting rate increases inhibits the operation of the free market and produces a business practice that is neither actuarially sound nor financially solvent in the case of a catastrophe. Removing Section 2210.359 from the insurance code will remove the maximum per annum rate increase restriction which currently throttles TWIA's coffers and results in actuarially unsound business practices. We also recommend modifying Sec. 2210.351 to allow TWIA to implement new rates with an average increase of up to 10 percent without the approval of the commissioner. Alvarez & Marsal estimate that increases of 45 percent or more on residential and 35 percent or higher on commercial rates would be needed.[5] Furthermore, TWIA needs to implement a file-and-use system for their rates by amending Subsections 2210.351(c) and (d) in order to operate more flexibly and efficiently.

In order to more effectively serve their clients, TWIA should also differentiate rates based on actual risk by eliminating the current restrictions on rating territories in Sec. 2210.355(i). This rate differentiation is done by private insurance companies as well as the state-run, residual insurance companies in Louisiana, Mississippi, Alabama, Florida, South Carolina, and North Carolina (i.e., all states with state-run, wind-only insurance on the Gulf and East Coasts).

These recommendations regarding rates will benefit coastal property owners by creating a financially sound TWIA, reducing the number of TWIA policy holders, and also by creating an opportunity for private insurers to re-enter markets previously rendered uncompetitive by TWIA's low rates. This competition amongst private insurers will ultimately benefit the consumer by providing actual coverage at the lowest possible rates.

The current code also allows structures built before 2009 to be eligible for windstorm and hail coverage under TWIA without federal flood insurance. The rationale behind this is nonsensical since federal flood insurance should be required for all structures regardless of their construction date. The legislature should require in Sec. 2210.203(a-1) that an applicant for TWIA coverage have federal flood insurance before being eligible for approval.

Conclusion

TWIA is too big of a liability for Texas to continue to ignore. It is only a matter of time before the Texas coast is hit by another major hurricane, and the damages that will result from such a catastrophe may far exceed the funding available to TWIA. The most effective way to deal with this is to allow the free market to provide the rates and operating environment that can sustain an actuarially sound insurance climate on the coast of Texas. ☆

Endnotes

[1] "Texas Windstorm Insurance Association Overview," Texas Department of Insurance (18 Jan. 2013) 34, 36.
[2] Ibid, 35.
[3] Alvarez & Marsal, "Texas Windstorm Insurance Association: Restructuring Options Report," Texas Department of Insurance Contract No.4541200135 (Sept. 2012).
[4] "Hurricane Probabilities," *USA Today*.
[5] Alvarez & Marsal.

About the Authors

Bill Peacock is the vice president of research and director of the Texas Public Policy Foundation's Center for Economic Freedom. He has been with the Foundation since February 2005. Peacock has extensive experience in Texas government and policy on a variety of issues including, economic and regulatory policy, natural resources, public finance, and public education. His work has focused on identifying and reducing the harmful effects of regulations on the economy, businesses, and consumers.

Prior to joining the Foundation, Peacock served as the Deputy Commissioner for Coastal Resources for Commissioner Jerry Patterson at the Texas General Land Office. Before he worked at the GLO, he was a legislative and media consultant, working with groups like Citizens for a Sound Economy and Putting Children First. Peacock also served as the Deputy Assistant Commissioner for Intergovernmental Affairs for Commissioner Rick Perry at the Texas Department of Agriculture and as a legislative aide to Rep. John Culberson in the Texas House of Representatives.

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