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Texas Windstorm Insurance — What's Next?

Law360, New York (July 02, 2009) -- During the recently completed 81st Legislative Session, the Texas legislature adopted the most significant reforms to the Texas Windstorm Insurance Association ("TWIA") since 1997 with the passage of House Bill 4409 ("HB 4409").

This legislative reform was forced upon legislators due to $2.5 billion in losses from Hurricane Dolly and Hurricane Ike in 2008.

These losses were paid from $1.5 billion in reinsurance proceeds, the totality of TWIA reserves in its catastrophe reserve trust fund ("CRTF"), and $530 million in assessments to TWIA insurer members.

Of the total assessed to insurers, $230 million will be repaid to insurers in premium tax credits over a five year period. Without legislative reform, TWIA would have began the 2009 storm season without reserves, reinsurance or the ability to pay any additional losses except through the use of additional assessments to insurers.

History of TWIA

TWIA was created by the Texas legislature in 1971 after Hurricane Celia struck the Corpus Christi area in 1970 and many insurers stopped writing insurance on the Texas coast.

To provide adequate windstorm coverage and protect consumers, the Texas Catastrophe Property Insurance Association, renamed TWIA in 1993, was created to provide windstorm and hail coverage in the 14 coastal counties or Tier One counties[1] along the Texas coast.

Each insurer authorized to engage in the business of property insurance in Texas is required to participate in TWIA membership and assessments.[2]

TWIA coverage is available to residential and commercial entities in the Tier One counties, and a small area of Harris County was added to TWIA's catastrophe area designation in the mid 1980s.

Since its creation, TWIA has only had to assess insurers three times: Hurricane Alicia (1983), Hurricane Rita (2005), and Hurricanes Dolly and Ike (2008).

2009 Legislative Reforms

Governor Rick Perry announced on Feb. 3, 2009, that legislation to reform TWIA and legislation to fund the CRTF would be emergency items for the 2009 legislative session.

Two early legislative proposals, House Bill 911 ("HB 911") and Senate Bill 14 ("SB 14") were considered by coastal legislators to be punitive and financially burdensome to their constituents.

Most disturbing to coastal legislators were several provisions in HB 911 that would have capped insurance residential coverage for TWIA policies at $250,000, required a 60-day waiting period, and resulted in higher rates to TWIA policyholders.

However, SB 14 did not satisfy coastal legislators and the needs of their constituents. Senate Bill 14, as filed, could have resulted in surcharges to coastal policyholders of over 60 percent when taking into consideration rate increases, automatic surcharges to fund the CRTF, and surcharges to noncompliant structures and second homes.

As SB 14 was passed by the Senate, all of the surcharge issues were removed from the legislation, but one provision still caused concern for coastal House members. Section 37 of SB 14 would have required that TWIA rates migrate to actuarially sound rates by Aug. 31, 2012.

It was estimated that the migration would have resulted in rate increases of almost 35 percent over three years without any consideration of additional rate increases due to catastrophe and non-catastrophe losses of TWIA.

Coastal House members successfully blocked consideration of both HB 911 and SB 14 in the House Insurance Committee because a majority of committee members did not support either bill.

It was not until May 20, 2009, that significant steps were made to move TWIA legislation. On that day, Governor Perry threatened to call a special session to address TWIA if legislators failed to pass a bill by the end of the session, June 1, 2009.

Significant discussions occurred to amend SB 14 which resulted in the legislation being passed by the House Insurance Committee and set on the House calendar.

However, due to delays caused by other legislation, SB 14 was not able to pass the House before a May 26 deadline. Legislators were already considering how to address TWIA issues in a special session when an unrelated bill relating to disaster preparation and management, HB 4409, was amended in the Senate to include the version of SB 14 as it had passed the Senate.

The amendment of HB 4409 created a legislative vehicle to address TWIA issues. With Senate amendments added to a House bill, the House moved to not concur in the amendments thus moving discussions on TWIA reform into a conference committee of Senate and House legislators.

A flurry of activity between House and Senate members negotiating a solution occurred on May 29 and May 30 which ultimately resulted in a compromise on the funding of TWIA losses and passage of the HB 4409 into law. Governor Perry signed HB 4409 into law on June 19, 2009.

Summary of House Bill 4409

The funding structure in House Bill 4409 provides funding for losses up to $2.5 billion. Any surplus revenue in TWIA from premiums not used to pay losses will be deposited in the CRTF.

If no catastrophic events occur, the CRTF could increase annually up to $240 million as TWIA places its profits from premium not used to pay losses or expenses into the CRTF. However, in the event of a catastrophe, excess losses will be paid in the following sequence:

— Level 1: Any available TWIA premium and other revenue.

— Level 2: Any available funds in the CRTF.

— Level 3: Public securities (Class 1 Public Securities) not to exceed $1 billion with repayment not to exceed 10 years by payment from TWIA available revenues.

— Level 4: Public securities (Class 2 Public Securities) not to exceed $1 billion with repayment not to exceed 10 years. Thirty percent or $300 million of the public securities will be repaid by insurers' assessments and seventy percent or $700 million will be repaid by surcharges on coastal property and casualty policies.[3]

The surcharges on the coastal property and casualty policyholders will not exceed 2.8 percent a year for 10 years unless multiple storms occur over multiple years.

In other words, if a hurricane's landfall results in TWIA losses up to $2 billion, then coastal property and casualty policyholders will see up to a 2.8 percent increase in annual premiums for a 10 year period. That is equivalent to $28 for every $1,000 in premiums, which is under $2.50 a month.

— Level 5: Public securities (Class 3 Public Securities) not to exceed $500 million with repayment not to exceed 10 years paid by assessments on insurers or via the purchase of reinsurance by insurers to cover the assessment. Insurers will no longer be able to claim a premium tax credit for the payment of assessments under the new legislation.

Reinsurance may be purchased by TWIA to operate in addition to or in concert with the CRTF, public securities, financial instruments, and assessments.

TWIA in the very near future could purchase reinsurance of $700 million or more to ensure that TWIA policyholders will never see a surcharge to repay any losses resulting from a catastrophe paid by Class 2 Public Securities.

In fact, TWIA will, most likely, move towards the purchase of reinsurance in excess of $1 billion to protect TWIA policyholders and insurers from the burden imposed on multiple bond issuances to avoid similar problems faced by Florida policyholders last year which was caused by several bond issuances and a weak bond market.

For the setting and adoption of rates, rating territories may be adopted, but rates within a county may only vary 5 percent in 2009 and increase 1 percent annually until 2012 for an 8 percent variance of rates within a county. However, there is no limitation on the variance of rates between rating territories outside a particular county.

For the first time, catastrophe models may be used in determining rates. The legislation allows for a file and use of 5 percent that must be approved by the Insurance Commissioner. TWIA will need rates approved that exceed 5 percent and rates increases of less than 5 percent go into effect after 30 days.

However, a 10 percent rate cap increase per year was retained in HB 4409 unless the new rate is the result of catastrophic losses which have occurred to TWIA policyholders from a tropical system(s) to justify the higher rate and the proposed rate is approved by the Commissioner or Insurance.

New structures along the Texas coast will need to be built to the windstorm building code to insure they will be eligible for coverage during and after construction.

All construction, alteration, remodeling, enlargement and repair of, or addition to, any structure located in the catastrophe area that is begun on or after the effective date of the act must be performed in compliance with the applicable building code standards to qualify for TWIA coverage.

Even though purchasers may be able to obtain insurance coverage in the private market on their newly constructed property, if that person ever loses that private insurance, TWIA cannot provide future coverage to that property unless it was built to the windstorm building code.

Today, some TWIA policyholders have coverage only because they were able to obtain coverage through an approval process that was implemented in 2006 after large numbers of policies were not renewed by private carriers in reaction to losses of Hurricanes Katrina, Rita and Wilma in 2005.

These private carriers wanted to limit their coastal exposures and large numbers of policies were shifted to TWIA to provide windstorm coverage. The new law retains the approval process for existing structures.

It is possible, even though these reforms have been passed, that some private insurers may still withdraw from areas in coastal Texas that will require the approval process to be utilized on these existing structures to obtain TWIA coverage.

Further, if a structure is built on or after Sept. 1, 2009, and the structure is located in Zone V or another similar zone with an additional hazard associated with storm waves, as defined by the National Flood Insurance Program, and if flood insurance under the federal program is available, TWIA may not issue an insurance policy unless there is evidence the property is covered by a flood insurance policy.

In addition, another new change requires new TWIA applicants and TWIA renewals to provide a declination from a private insurer before obtaining TWIA coverage. The current TWIA board of directors will continue through the current storm year until the end of 2009.

A new 9-member board of directors will be established before Jan. 1, 2010, and all members will be appointed by the Commissioner of Insurance. The board’s composition will be four insurer representatives, four coastal residents with, at least one being an agent, and one noncoastal member.

Impact of the Legislation on Consumers and Insurers

TWIA policyholders and coastal legislators have claimed victory based on the passage of HB 4409.

On its face and with a little luck, TWIA policyholders will most likely see only a five percent rate increase this year and future years despite the fact that TWIA began the 2009 storm season with no reserves and the payment of $2.5 billion in losses, unless there is a large catastrophe loss or several noncatastrophe losses to TWIA.

House Bill 4409 was passed because coastal legislators could support it without any adverse rate impact to their constituents.

In addition, consumers and public members will now represent the majority of the TWIA board of directors. The existing board had a majority of five insures, two independent agents and two public members, and insurers typically prevailed on contested issues by a 5-4 majority.

It will be interesting to see how TWIA operates under the new board and whether the loss of insurance expertise results in decisions that could adversely impact TWIA's operations.

In addition, the board retains its four coastal representatives of the nine members. It is very likely that future board decisions may become more consumer oriented and coastal-friendly.

With the change to allow rating territories, it is possible that the solidarity of the coast will become divided in the future through higher rates between territories.

It could certainly be argued by some that rates should increase in the Galveston area because of Hurricane Ike losses and the fact that approximately 50 percent of TWIA's exposure is situated there.

Because of losses from Hurricane Dolly in South Texas and Hurricanes Rita and Ike in Southeast Texas, TWIA rates for those areas might also increase.

However, the Corpus Christi area has not experienced a hurricane since 1980. Based on that fact, Corpus Christi might see sizable decreases while rates go up for other TWIA policyholders who supported HB 4409.

It is certain that insurers can claim some success from the passage of HB 4409. Despite losing the majority governance of the board, the reforms removed a key concern to insurers, unlimited assessments to insurers to pay losses in excess of available revenues, reserves, and reinsurance.

In addition, there are no barriers to entry for new insurers coming into the Texas marketplace as they will not be subject to paying any TWIA assessments until two years after they enter the marketplace.

Under the funding structure in HB 4409, insurers will be subject to $300 in losses for Class 2 public securities and $500 million in losses for Class 3 public securities from the $2.5 billion in total coverage limits per year for TWIA losses.

The Future of TWIA

Although HB 4409 will insure TWIA losses up to $2.5 billion per year, it does not address losses in excess of that amount. TWIA has not experienced losses in excess of $2.5 billion in its history, but it may be a matter of time.

A probable maximum loss to TWIA in the Galveston area could total $8-$10 billion while a probable maximum loss to TWIA in the Corpus Christi area could total $4 billion. TWIA has yet to be tested by even a Category 4 storm since it began its existence in 1971.

What was the legislative intent to cover losses in excess of $2.5 billion? Have the governor call a special session. It is widely believed that if a hurricane was to strike the Texas coast and losses exceeded the $2.5 billion amount, a special session would be needed to address all the related issues to state government resulting from a storm of such magnitude not to mention the possible impact to the private insurance market.

In summary, the future of TWIA's stability is based on denial. A denial that a storm will impact the coast thus allowing TWIA to rebuild its CRTF.

This denial could lead to monstrous reliance on bonding to provide funding of storm losses that could adversely impact TWIA policyholders and non-TWIA policyholders along the Texas coast who will be subject to surcharges to repay these bonds.

We, along with all Texans, hope for good weather this and every hurricane season on the Gulf Coast.

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[1] "First tier coastal county" means: Aransas County, Brazoria County, Calhoun County, Cameron County, Chambers County, Galveston County, Jefferson County, Kenedy County, Kleberg County, Matagorda County, Nueces County, Refugio County, San Patricio County or Willacy County. See §2210.003(4), Texas Insurance Code.

[2] This includes a county mutual insurance company, a Lloyd's plan, and a reciprocal or interinsurance exchange. It does not include a farm mutual insurance company, a nonaffiliated county mutual fire insurance company, or certain other mutual insurance companies. See §2210.006, Texas Insurance Code.

[3] Excluding federal flood insurance, workers' compensation insurance, accident and health insurance, and medical malpractice insurance, Section 2210.613(c), Texas Insurance Code, as enacted by HB 4409.