TEXAS WINDSTORM INSURANCE ASSOCIATION

Legislative & External Affairs Committee Meeting

Meeting Materials

July 20, 2022

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Executive Summary

1. Report Purpose and Requirements

Texas Insurance Code Section 2210.0025 requires the Texas Windstorm Insurance Association (TWIA) Board of Directors to submit to the Commissioner of Insurance, the Senate Committee on Business and Commerce, the House Committee on Insurance, and the Sunset Advisory Commission a written report relating to the operations of the association during the preceding biennium. The report must include:

I. Any proposed changes in the law relating to regulation of the association and a statement of the reasons for the changes; and

II. Any information regarding association operations or procedures that is requested by the department to be addressed in the report.

2. Process and Materials

The Board of Directors directed the Legislative and External Affairs Committee (the "Committee") to develop potential legislative recommendations for the Board's consideration.

The Committee held a second meeting on June 24 to continue their consideration of potential legislative recommendations for the 2022 Biennial Report. At the meeting, the Committee reviewed several items proposed by Association stakeholders. The Committee asked staff to gather additional information on these items for their consideration and discussion at a third meeting before the August quarterly meeting of the TWIA Board of Directors. See page 3 for the items pending Committee discussion.

The Committee did not approve or propose any new legislative recommendations at the meeting.

The Committee intends to propose final recommendations to the Board at the August meeting. If the Board adopts the Report content at the August meeting, staff will then finalize the Biennial Report for submission to the Legislature with the recommendations approved by the TWIA Board of Directors, the required statement of reasons for the changes, and a summary of the Association's accomplishments and operations.

Items Pending Discussion

Item	Topic	Description/Alternative	Status
1	Cyclonic Wind Policy	Adjust TWIA's policy to cover only "cyclonic winds."	Legislative Input
2	Write Your Own Policy	Allow private insurers to write TWIA policies	Legislative Input
3	Merge TWIA and TFPA	Consider the feasibility of a merger between Texas Windstorm Insurance Association and the Texas FAIR Plan Association	Stakeholder Input
4	TWIA Reinsurance-Only Facility	Eliminate TWIA as a policy-issuing and servicing insurer and reform TWIA as a reinsurer only.	Stakeholder Input
5	Statewide Surcharge	Collect a statewide surcharge through private market carriers and use the funds to replace the public security funding layers that total $1 billion in the existing funding structure.	Stakeholder Input/Public Policy Consideration

Discussion

1. Cyclonic Wind Policy – Legislative Input

Discussion: This proposal contemplates changing the perils TWIA insures against, limiting covered perils to only cyclonic winds, including hurricanes and tropical storms, but not necessarily tornadoes. The concept, essentially, returns wind and hail claims not associated with a named storm from TWIA to the voluntary-market company that issues the underlying property policy. This change potentially reduces TWIA's ultimate loss because it would no longer cover wind and hail claims from more common types of bad weather. However, TWIA would remain liable for damage caused by hurricanes and tropical storms. Over the last ten years, named storms account for approximately 70% of TWIA's losses and loss adjustment expenses. The remaining 30% are attributable to the types of weather events that voluntary-market companies would cover through this proposal.

Advantages of the proposal include some reduction in TWIA ultimate loss amounts and a reduction in TWIA claim volume, generally. But there could be issues with a division of premium between the two policies, disputes regarding which policy must respond to an individual claim, and perhaps problems with idle resources in the TWIA claims area. TWIA's claims department is currently kept active, productive, and efficient by handling garden-variety bad weather claims that often occur with thunderstorms along the Coast. However, this proposal would eliminate these types of claims.

2. Write Your Own (WYO) Policy – Legislative Input

Discussion: This proposal, modeled after the FEMA/voluntary market partnership that has existed since 1983 in the National Flood Insurance Program (NFIP), would authorize voluntary market insurers to issue TWIA policies directly. The issuing voluntary market companies would service both policies and claims. However, TWIA's funds would still be used to pay claims. WYO carriers would remit premiums to TWIA, less an administrative fee.

In addition to the WYO program, consumers can purchase flood insurance directly through the NFIP/FEMA via private contractors acting on behalf of FEMA, called direct servicing agents. Currently, approximately 12% of NFIP policies are issued directly.[1] A TWIA WYO program could be constructed so that voluntary market carriers become a second distribution channel or in such a way that the WYO carriers are essentially a third-party administrator servicing all TWIA policies and claims.

Advantages to a WYO with either approach may include reduced operational costs to TWIA, but those costs would be shifted to the policy issuing WYO carriers. TWIA does not have data on the levels of these expenses in the voluntary market. However, TWIA currently spends approximately 26% of its premium dollars on operating and administrative expenses (16% commissions, 8% operating expenses, and 2% taxes and fees). Loss adjustment expenses vary considerably depending on claim activity. This type of program would likely shift these costs to the voluntary market companies. The concerns raised by this proposal may include TWIA's loss of quality control and consistency over policy administration and claims adjusting, notwithstanding its continuing financial obligation as the ultimate payor of the claims.

It may be useful to compare the goals of this proposal with the goals of the NFIP's Write Your Own (WYO) Program as published in the May 2006 edition of the *Answers to Questions About the NFIP.*

"The goals of the WYO Program are:

- Increase the NFIP policy base and the geographic distribution of policies;
- Improve service to NFIP policyholders through the infusion of insurance industry knowledge; and
- Provide the insurance industry with direct operating experience with flood insurance."

[1] Horn, D. P., & Webel, B. (2022, June 30). *Introduction to the National Flood Insurance Program (NFIP)*. Congressional Research Service. Retrieved July 12, 2022, from https://crsreports.congress.gov/product/pdf/R/R44593

3. Merge TWIA and TFPA – Stakeholder Input

Discussion: When the Texas FAIR Plan Association (TFPA or FAIR Plan) was activated in late 2002, the Commissioner of Insurance directed that it be managed and serviced by TWIA under an agreement that he approved, and which remains in effect. As a result, TWIA employees, facilities, and IT systems are used in the operation of the FAIR Plan. Further, TWIA and TFPA have accomplished much in consolidating operations in the intervening years. The two organizations also moved onto the same insurance software platform earlier this year. Therefore, opportunities to achieve cost savings and economies of scale through a merger are limited.

TWIA and TFPA have dissimilar funding structures for losses:

- In any one catastrophe year, TWIA's funding involves the use of the Association's surplus and dollars held in the Catastrophe Reserve Trust Fund, followed by a total of $2 billion in layered tiers of policyholder-funded bonds and member company assessments. Above that level, TWIA is required by statute to purchase reinsurance protection to a 1:100-year catastrophe event ceiling, which is currently just above $4 billion. TWIA has no funding in place above this level.
- TFPA's funding consists of its existing surplus, which is modest, and then reinsurance protection (currently to an approximate 1:100 level or $335 million in excess of an attachment point of $30 million). Above the reinsurance, and to fill any other surplus gaps as needed, TFPA can assess member companies, making TFPA's funding, in theory, unlimited. Unlike TWIA, TFPA member companies can recoup assessments through surcharges on their Texas property policyholders statewide.

As TFPA does not write wind and hail in the TWIA territory, those risks are, therefore, written by TWIA. Neither plan is a member company for purposes of the other plan's assessments.

In the event the Legislature were to proceed to merge TWIA and TFPA, the following issues would need to be addressed:

- **Funding.** The risk pools of the two formerly independent organizations could be left separate and funding for losses could continue to be provided under current law.
  - Of course, the Legislature could change the funding in any manner desired, including a structure that spreads the entire risk statewide.
- **Policy Issuance/Administration, IT, and Claims.** The same staff currently handles these functions for both TWIA and TFPA. A merger would cause no major changes or disruptions.
- **Finance/Accounting/Actuarial.** Again, the same staff handle these functions for both TWIA and TFPA. However, a merger would result in some changes in financial accounting and reporting.

There would likely be one less audit to perform and one less annual statement to prepare. The complexity of accounting for the two risk pools would be driven by the Texas Legislature's approach to funding in the statutory language associated with the merger. Reinsurance purchasing is market-driven, and the merged Association would need to work with its reinsurance broker to approach the market in the most efficient manner possible.

- **Coverages Offered/Maximum Limits/Dispute Resolution/Commercial Policies.** TWIA and TFPA have differing approaches to each of these items that would need to be reconciled in a merger.

In summary, depending on the chosen implementation a merger may cause relatively mild disruption due to the existing shared services or require a more significant effort if the funding or coverages offered were combined. However, there is relatively little remaining to achieve in terms of cost savings or other efficiencies.

4. TWIA as a Reinsurance Facility – Stakeholder Input

Discussion: This proposal would eliminate TWIA as a policy-issuing and servicing insurer and instead reform TWIA to be a reinsurer only. TWIA may also need to serve, in some capacity, to help find coverage for risks no insurer wishes to write. Although, the FAIR Plan might be a solution to that problem.

The proposal would provide for the voluntary market to issue wind and hail coverage in the seacoast territory with policies that have a $25,000 primary coverage limit. Wind and hail claims above that amount up to the total coverage limit provided would ultimately be paid by TWIA under a reinsurance program in which the voluntary-market companies cede the excess risk to TWIA as reinsurer.

As reinsurer, TWIA would need some source of capital to cover losses because the annual reinsurance premium collected from the ceding companies will only cover a small percentage of the loss potential in the event of a large catastrophe. By way of example, in 2008, TWIA paid an initial reinsurance premium to its reinsurers of $184 million. It then filed and collected a claim of $1.5 billion to cover Hurricane Ike losses and expenses. This was the full limit of coverage under the reinsurance agreement.

A process would need to be established by which TWIA's reinsurance premium charge is set in an amount fair to TWIA as reinsurer and to the ceding companies. Further, there may be challenges in terms of the willingness of the voluntary market companies, which already write over half of the residential policies in the catastrophe area, to take on more risk, even under a low-retention policy/excess of loss structure as contemplated by the proposal. The proposal contemplates TWIA making the reinsurance available beyond the territorial limits of TWIA's existing catastrophe area. This feature would represent a change to the entire Texas residential property market.

TWIA has a unique claims/dispute resolution process in its enabling statute enacted by the Legislature in 2011 in response to Hurricane Ike litigation concerns. It is not clear whether or how the proposal might affect that structure.

In summary, this proposal would significantly change TWIA's operations, structure, and funding, essentially removing TWIA from the Texas insurance marketplace as a fully functioning policy issuing, servicing, and claims-paying insurer.

Appendix A is a City of Galveston Fact Sheet with a proposal to reform TWIA as a reinsurer for the private market.

5. Statewide Surcharge – Industry Trade Group Proposal

Discussion: This proposal focuses on funding issues and would make no operational changes to TWIA. A major element of the proposal is removing the existing $1 billion of public security funding layers and replacing them with a $1 billion fund collected from property insureds statewide. These funds would be deposited into TWIA's Catastrophe Reserve Trust Fund (CRTF), which is used to pay losses and expenses in the event of a major hurricane and to purchase reinsurance if needed. This proposal would keep the existing $1 billion layer of member company assessment funding. The advantages of this proposal include removing the costs associated with public security issuance and the long-term post-hurricane burden on policyholders related to debt repayment. In exchange, the proposal would burden statewide property policyholders with surcharges levied in advance of a catastrophic event and held for the benefit of TWIA as a fund to be used when needed. With estimated statewide property premiums of $16 billion, a surcharge of approximately 2% of premium over three years would be needed to fund the full $1 billion.

Appendix B is the Industry's TWIA funding proposal.

Appendix A: City of Galveston Fact Sheet

21st Century Role for Texas Windstorm Insurance Association

The current TWIA primary insurer role relies upon increasingly unaffordable, unstainable premiums.

Since 1971, the Texas Legislature created the Texas Windstorm Insurance Association to provide insurance to those who cannot purchase it elsewhere.

- TWIA is not a state agency receiving general revenue funds, but an "insurer of last resort" as a primary retail insurance provider in the fourteen (14) counties along the Texas coastline.
- TWIA relies primarily on premiums and debt repaid by policyholders for funding.
- In 2019, the Texas Sunset Advisory Commission reported to the 86th Texas Legislature conclusions that emphasize the need to restructure a sustainable TWIA:
  - TWIA's current funding structure is too uncertain to endorse and did not adopt any recommendations to address TWIA's funding and objectives.
  - The Legislature should weigh in on the best strategy to ensure adequate windstorm insurance along the coast.

Texas Legislature seeks examination of TWIA funding, funding structure, and sustainability.

The 87th Legislature enacted SB 1448 directing a study to be conducted by the Windstorm Insurance Legislative Oversight Board include:

- Examining TWIA's current funding and how this funding structure operates, problems with the funding and funding structure, and how the catastrophic risk pools of other states operate.
- Submitting a report that include the study's findings and recommendations for legislative action related to the funding, funding structure, and sustainability of TWIA, including TWIAs reliance on debt and reinsurance.

Through risk transfer, TWIA can promote a more competitive statewide windstorm insurance market and sustainable funding structure.

Reinsurance is a risk management tool that can be used as a safety net against low frequency, high severity natural disasters that produce substantial insured losses. The Reinsurance Association of America identifies four essential reasons for the purchase of reinsurance: 1) limit liability on specific risks; 2) stabilize loss experience; 3) protect against catastrophes; and 4) increase capacity.

The City of Galveston advocates the Texas Legislature examine transitioning TWIA into a reinsurer role.

As a reinsurer, TWIA could sell low cost attachments to private market insurance companies.

1. A significant number of windstorm claims processed by TWIA involve smaller claim amounts.
2. A low-cost attachment could restrict TWIA coverage to claims above $25,000 thereby reducing risk for the private insurance companies.
3. TWIA could market the low-cost attachment statewide to induce greater private sector participation as well as further spread and reduce risk.
4. A minimal processing fee could be applied to each windstorm policy across the state as a revenue source.
5. In a reinsurer role, TWIA reduces its costs with administrative overhead, processing small claims, or an expensive claims adjudication process.
6. By addressing claims up to $25,000, the low-cost attachment would benefit communities across the state with non-hurricane events such as tornados and hailstorms. This will diversify risk and access greater capital.
7. In addition, such an arrangement could allow private insurance companies to bundle policies (i.e. homeowners, automobile, life, and windstorm), thus providing an even more lucrative incentive.
8. By creating an appropriate TWIA risk-bearing role and expanding private insurance market involvement statewide, premiums will be based upon more competitive risk-based pricing that can prompt affordable opportunities for policyholders.
9. Strengthen private public partnerships through the use of private reinsurance and catastrophe bonds (insurance linked securities) tools for larger scale claim losses (above the $25,000 low cost attachment.

Appendix B: Industry Trade Group Funding Proposal

PROPOSAL FOR REVISED TWIA-FUNDING OF CATASTROPHE LOSSES

Background

The Texas Windstorm Insurance Association (TWIA) was created by the Texas Legislature in 1971 to serve as the "insurer of last resort," providing windstorm and hail insurance coverages to residential and commercial properties in counties along the Texas coast that cannot find coverage elsewhere. TWIA is not a state agency and does not receive general revenue. Rather, TWIA is an insurance company that collects premiums, issues, and services policies, and is responsible for paying covered losses.

Texas insurers protect the majority of Texas coastal homeowners and businesses.

As of December 31, 2020, TWIA covers 184,890 policies with $55 billion in liability for residential and commercial risks in the 14 coastal counties. By comparison, Texas insurers write 63% of the wind coverage in Tier 1 and provide coverage for $82.7 billion for residential wind. Insurers who write coverage in that area, review their risks and potential losses, have sufficient reserves and meet financial requirements of the Insurance Code, plan for potential storm losses in the area, and set their rates accordingly. TWIA is different as it does not have the financial reserves of a traditional insurance company and limited revenue.

TWIA's current funding structure is not sustainable.

The current loss funding program for TWIA, created by the Texas legislature to cover up to a 1 in 100 probable maximum loss (PML), which was $4.03 billion in losses for 2021 and includes the following:

- **68% of Premium Revenue is Allocated to Expenses**- Based on estimated policy holder premiums for 2021, TWIA will collect approximately $381.2 million in premiums. However, according to TWIA's rate adequacy analysis, TWIA's fixed expenses for 2021 are 45.3% and variable expenses are 22.9%, meaning approximately 68%% of premium revenue goes to expenses. TWIA must also account for non-hurricane losses, and has factored in a 14.6% loss provision for these types of losses.
- **Catastrophe Reserve Trust Fund (CRTF)**- TWIA is required to put net gains from operations into the CRTF. The purpose of the CRTF was to pay future catastrophe losses. Since 68% of premium revenue is already accounted for, there is not much left to put in the reserve fund. As of June 2021, the reported CRTF balance was $180.7 million, and a small hurricane would have depleted its balance.
- **Up to $1 billion in public securities**- After TWIA uses it reserve funds, TWIA's loss payment structure relies upon letters of credit and selling bonds to raise up to $1 billion. These bonds are costly to sell, approximately $8-10 million for each class of bonds, and create additional debt for TWIA, which must be paid in later years from TWIA premiums and other revenue.
- **Up to $1 billion in assessments against insurance companies**- Texas insurers are required by law to pay up to $1 billion in assessments to cover TWIA losses resulting from storms in any calendar year. For example, after Hurricane Harvey, insurers paid $372 million in assessments to help pay TWIA losses. This was in addition to the $8.9 billion insurers paid for their policyholders' auto, home, and business losses after Harvey.
- **$1.93 billion in reinsurance** – TWIA buys reinsurance to guard against the risk of losses up to the 1 in 100 PML.

This funding program relies heavily on debt and puts TWIA in a precarious financial situation.

Purpose

The purpose of this legislation is to create a sustainable funding structure for TWIA to ensure its ability to meet its obligations to policyholders. 2021 brought insured catastrophe losses that were 58% higher than the 10-year annual average. This trend is expected to continue. For example, our neighboring state, Louisiana, experienced devastating hurricanes in 2020 and 2021. If either storm shifted slightly westward, one or both could have hit the Texas coast causing billions in damages. Texas has averted the brunt of recent hurricanes but may not in the future. TWIA's precarious funding structure and possible inability to pay claims following a storm threatens policyholders statewide. This proposal offers a solution that is a step in the right direction to ensure TWIA can better take care of its policyholders.

Bill Summary

The proposed legislation amends Chapter 2210, by adding new Subchapters B-2 and M-1, among other changes, to Insurance Code as follows:

- For losses on or after January 1, 2024, creates the Contingent Hurricane Relief Surcharge Program, requiring all property insurers to collect and remit the surcharges to support coastal insurance losses. Surcharges apply to all fire and allied lines, farm and ranch owners' policies; residential property insurance; and the property insurance portion of commercial multi-peril policies.
- Authorizes an initial statewide hurricane surcharge in order to collect up to $1 billion for TWIA funding. The amount collected is intended to bring the total CRTF balance to $1 billion subject to the CRTF balance at the time the surcharge is set by the Commissioner. The surcharge replaces the current public securities funding structure in Insurance Code chapter 2210, Subchapters B-1 and M. The surcharge is deposited into the CRTF. The initial surcharge:
  - shall be set by the Commissioner as a percentage of premium to be collected by each insurer over a period of time not to exceed three years
  - is a separate charge in addition to the premiums collected and is not subject to the premium tax or commissions
  - is not refundable
  - failure to pay the initial surcharge constitutes failure to pay premium for purpose of policy cancellation
- Authorizes the Commissioner to order a Subsequent Contingent Surcharge if the Commissioner determines, after a catastrophic event, that:
  - TWIA has insufficient funds in its reserves, CRTF, and other funding sources to continue to provide coverage for their risks, and
  - TWIA has no other sources of funding to provide funding for the next catastrophe year.
  - Amount authorized to collect may not exceed $1 billion, which the Commissioner can collect over a period of time not to exceed three years
- Proceeds from Hurricane Relief Surcharges would be deposited to the Texas Treasury Safekeeping Trust Company and TWIA can show the balance as an admitted asset in its financial statements
- Surcharges can be used to:
  - → pay incurred claims and operating expenses;
  - → purchase reinsurance;
  - → pay TWIA's cost for implementing the contingent surcharge program administrative expenses, if any;

- → pay the principal of any debt, including loans from the Rainy Day Fund; and
- → provide a contingent reserve or surplus for catastrophic losses
- → any excess can be transferred to the CRTF

- Requires each policy have a disclosure of the surcharge
- Allows TWIA to purchase reinsurance at any level to protect minimum balances in the CRTF. The Commissioner may promulgate or approve TWIA's method of determining what constitutes 1:100 risk. The determination must be provided to the association on or before February 1 of each year.
- Maintains member insurer assessments at $1 billion maximum to help pay TWIA losses.

For questions or information, please contact:

Jay Thompson, Association of Fire and Casualty Companies in Texas (AFACT), jthompson@thompsoncoe.com, (512) 415-8191

Lee Ann Alexander, American Property and Casualty Insurance Association (APCIA), leeann.alexander@apci.org, (512) 557 5916

Beaman Floyd, Texas Coalition for Affordable Insurance Solutions (TCAIS), Beamanfloyd1@gmail.com, (512) 731-9939

TEXAS WINDSTORM INSURANCE ASSOCIATION

Biennial Report to the 88th Texas Legislature, Regular Session

TEXAS WINDSTORM
INSURANCE ASSOCIATION

August XX, 2022

The Honorable Greg Abbott, Governor
The Honorable Dan Patrick, Lt. Governor
The Honorable Dade Phelan, Speaker of the House
Members of the Sunset Advisory Commission

Members of the Senate Business & Commerce Committee
Members of the House Insurance Committee
The Honorable Cassie Brown, Commissioner of Insurance

Dear Governors, Speaker, Committee Members, and Commissioner,

In accordance with Texas Insurance Code §2210.0025, I submit the Biennial Report of the Texas Windstorm Insurance Association (TWIA or Association) on behalf of its Board of Directors. The enclosed report summarizes the recent changes implemented due to legislation passed by the 87th Legislature, Regular Session, and proposed legislative changes for your consideration ahead of the 88th Legislative Session.

The Texas Legislature created the Texas Windstorm Insurance Association (TWIA) in 1971 after several storms, including Hurricane Celia (1970), caused private market insurers to begin excluding wind and hail coverage from their coastal homeowners insurance policies. TWIA gives Texans living in our coastal communities access to wind and hail property insurance when no other insurer will provide it. The availability of windstorm coverage provides a financial umbrella that allows our coastal cities and towns to prosper, supporting the entire state's economy.

Since our last Biennial Report, TWIA has launched a significant upgrade to its online systems for issuing policies and handling claims. The project will fundamentally change how we interact with our policyholders and work with insurance agents. It also enhances policyholders' ability to self-serve regarding their TWIA insurance needs. Reforms suggested by the Texas Sunset Commission in 2018 and enacted in the past two legislative sessions have allowed TWIA to offer some of the same tools private insurance carriers have used for many years, improve customer service, and realize reductions in expenses.

Looking ahead to the 88th Legislative Session, TWIA is committed to continued collaboration with lawmakers and the Texas Department of Insurance to better serve our policyholders and other stakeholders. Thank you for the opportunity to provide this information for your consideration.

Should you have any questions or need additional information, please do not hesitate to contact Jennifer Armstrong, Vice President of Communications & Legislative Affairs at (512) 637- 4031 or David Durden, Vice President of Legal at (512) 505-2255.

Sincerely,
John W. Polak, CPCU
General Manager

TEXAS WINDSTORM INSURANCE ASSOCIATION

Legislative Implementation

TWIA has implemented all provisions enacted by the 87th Legislature. We remain prepared to assist the Windstorm Insurance Legislative Oversight Board in its charge to study the Association's funding and a possible merger of TWIA and the Texas FAIR Plan prior to the 88th Legislative Session.

The following information describes the key legislation impacting TWIA passed by the 87th Legislature and the Association's actions and progress in implementing the specific provisions.

Ratemaking:
Board Vacancy on Rate Vote (House Bill 769, Sec. 1): The TWIA Board is prohibited from voting on a proposed rate increase if there is a Board vacancy of more than 60 days.

Commissioner Approval of Rate Increases (Senate Bill 1448, Sec. 1 and 2): Annual and non-annual filings for a rate greater than the rate in effect on the filing date must be approved by the Insurance Commissioner.

Two-Thirds Vote for Rate Increase (Senate Bill 1448, Sec. 1 and 2): A two-thirds vote of the TWIA Board is required to raise rates on annual or non-annual rate filings.

- TWIA staff briefed the Board on these statutory changes to the ratemaking process at the August 2021 Board meeting and has updated the Board Training Manual to reflect these changes.
- The Texas Department of Insurance adopted changes to TWIA's Plan of Operation on November 12, 2021, to implement these provisions.

Reinsurance:
Reinsurance Purchase Requirements (House Bill 769, Sec. 2 and 3): TWIA is prohibited from purchasing reinsurance from an insurer or broker that obtains the catastrophe modeling TWIA uses to determine the probable maximum loss or make rate decisions.

- The TWIA Board selected a reinsurance broker and a separate vendor to provide catastrophe modeling analysis for the 2022 storm season.
- The Texas Department of Insurance adopted changes to TWIA's Plan of Operation on November 12, 2021, to implement this provision.

Premium Payment Grace Period:
Premium Payment Grace Period (House Bill 2920): The Texas Department of Insurance must adopt rules, with advice from TWIA, establishing a grace period of not more than 10 days after the due date for the receipt of payment of premium for the renewal of a policy.

- TDI issued a rule establishing the grace period on April 11, 2022.
- TWIA implemented this provision as part of the systems upgrade launched April 18, 2022.

Interim Studies:
Funding and Merger Studies (Senate Bill 1448, Sec. 3 and 4): Permits the Windstorm Insurance Legislative Oversight Board to study TWIA funding and structure issues and issue a report to the Legislature due November 15, 2022. Extends deadline to January 1, 2023 for the Windstorm Insurance Legislative Oversight Board to evaluate a merger of TWIA and TFPA and produce a report to the Legislature.

- TWIA is prepared to assist the Legislative Oversight Board in its deliberations.

Proposed Legislative Changes

The table below summarizes eleven proposed legislative changes.

Item	Topic	Description/Alternative	Page #
1	Agent Requirements & Standards	Revise TWIA's statute to enable TWIA to mirror the Texas FAIR Plan Association (TFPA) producer requirements and performance standards.	Page 4
2	Exclude Commercial Risks from Automatic Renewal Process	Revise TWIA's statute to exclude commercial risks from the automatic renewal process (AAG Request).	Page 5
3	Eliminate Expert Panel	Modify statute and regulations to eliminate TIC Section 2210.578 requiring the use of an Expert Panel after the Association's contract to implement the requirements ends in April 2022.	Page 5
4	FORTIFIED Home Construction	Consider feasibility and possible public funding of FORTIFIED home construction and other mitigation programs.	Page 6
5	Premium & Maintenance Tax	Exempt TWIA from premium and maintenance taxes.	Page 7
6	Appraisal Process	Allow TWIA to have a formal objection process related to issues or concerns with a policyholder's selected appraiser or umpire.	Page 7
7	Appraisal Deadlines	Set statutory deadlines for completing an appraisal to prevent delays in the process.	Page 8
8	Payment of Appraisal Costs	Revise the statutory provision requiring TWIA and the policyholder to split the cost of their respective appraisers to require each party to pay their own appraisal costs.	Page 9
9	Earned Premium	Revise cancellation rules and procedures so Association policies may be canceled fully earned for certain reasons.	Page 10
10	Depopulation	Authorize TWIA to activate and deactivate the Assumption Reinsurance Depopulation Program as necessary according to market fluctuations.	Page 11
11	Board Vacancies	Repeal the provision requiring TWIA to provide TDI with a roster of recommendations to fill Board vacancies.	Page 12

Proposed Legislative Changes

1 Agent Requirements & Performance Standards

Subject: Currently, TWIA does not have express authority to limit an agent's ability to transact business with the Association in the event of audit noncompliance or other inappropriate acts in connection with agents' work on behalf of their clients.

- Any Texas-licensed property insurance agent may submit applications to TWIA.
- TWIA does not appoint agents, nor do they contract with TWIA.
- The Plan of Operation requires TWIA to audit agents' compliance with specific TWIA eligibility requirements. However, it does not have express authority in statute or rule to take any action in response to agent noncompliance.
- In contrast, the statute governing the Texas FAIR Plan Association (TFPA) provides broad guidance for a Plan of Operation. The Plan explicitly directs TFPA to maintain producer requirements and performance standards and authorizes their enforcement.

Possible Solution: Revise TWIA's statute to enable TWIA to mirror the TFPA producer requirements and performance standards.

- Provide TWIA specific authority to enact producer requirements and restrict agents' ability to submit applications to the Association when standards aren't met.
- TWIA would have clear authority to take appropriate action to limit agents' Association activities in response to audit noncompliance and other inappropriate acts or failure to act.
- Agents would continue to represent only the policyholder and would not become agents of the Association.
- Holding agents accountable to specific standards would increase agents' Association knowledge, improve operational efficiency and customer service, and help ensure policyholders' best interests are served.
- This recommendation received support from TWIA's Agent Advisory Group and would have no material fiscal impact on TWIA's operations.

Statutory and Rule References:
Texas Insurance Code (TIC) Section 2210.202 (b)
Texas Administrative Code (TAC) Chapter 28 Section 5.4902 (d)
TIC Section 2211.054, the contents of TFPA's Plan of Operation, and 28 TAC 5.9913 (d)

2 Exclude Commercial Risks from Automatic Renewal Process

Subject: Commercial policy underwriting can be complex, and it may not be in policyholders' best interest to renew commercial policies directly with TWIA through the automatic renewal process.

- TWIA implemented a new automatic renewal process in January 2020 due to legislation passed by the 86th Legislature, Regular Session.
- If there are no changes in coverage, residential and commercial policyholders can remit payment directly to TWIA and renew their policy without agent involvement.

Possible Solution: Eliminate the option for commercial risks to renew automatically.

- Due to the complexities of commercial properties and the more dynamic nature of property and coverage needs, commercial policyholder needs may be better served by a traditional, non-automatic renewal process that requires the assistance of an agent.
- TWIA's Agent Advisory Group supports this recommendation.

3 Expert Panel

Subject: Although the Expert Panel's recommendations apply to less than 5% of Association policies, the Association has paid more than $11 million over the last five years to implement the recommendations and expects to have annual expenses of about $1.8 million for ongoing software maintenance and data analysis costs.

- Statute requires the Association to use guidelines adopted by the Insurance Commissioner based on recommendations provided by experts ("Expert Panel").
- The purpose of the recommendations is to assist the Association in determining the extent to which wind, waves, tidal surges, or rising water caused a loss to insurable property when very little of the property remains. These losses are referred to as "slab claims."
- TWIA implemented the Expert Panel recommendations as adopted by the Commissioner on June 1, 2018.
- TWIA's contract with the vendors to implement the recommendations expires on April 30, 2022. However, additional annual expenses to maintain the program after the contract expires in 2022 will be approximately $1 million to $1.25 million.

TWIA Expert Panel Costs 2013-2022	
Expert Panel Members 2013 - 2018	$1,441,977
Implementation 2017-2018	$4,517,754
Maintenance 2017-2022	$8,295,812
Total Costs 2013 - 2022	**$14,255,543**

Possible Solution: Modify statute and regulations to eliminate the requirements to use the Expert Panel's recommendations and guidelines adopted by the Commissioner.

- If the Legislature would prefer TWIA to retain and use the Expert Panel's recommendations, consider transferring the costs to the Texas Department of Insurance.
- If the Legislature and TDI repealed the Expert Panel methodology, TWIA would use methods commonly used by the insurance industry to evaluate slab claims, including hiring engineers and weather experts who can help the Association assess the nature of the property damage. Alternative processes would likely create some delays in claim processing.

Statutory and Rule References:
Texas Insurance Code Section 2210.578

4 Fortified Construction

Subject: TWIA does not have any programs associated with FORTIFIED construction.

- FORTIFIED is a nationally recognized building method that goes beyond building codes to strengthen residential and commercial buildings against specific natural hazards such as high winds and hurricanes. FORTIFIED standards are based on more than 20 years of scientific research and real-world testing by the Insurance Institute for Business & Home Safety (IBHS).
- More resilient construction can improve both the availability and affordability of insurance coverage and can lead to less community damage, reduced costs of emergency management and disaster recovery resources, and lower insurance losses after a catastrophic event.
- Other coastal states, notably Alabama and North Carolina, have encouraged FORTIFIED construction for both new and existing homes through a combination of public grants and policy endorsements covering upgrades to the FORTIFIED construction standards.

Possible Solution: Consider providing funding support from the State of Texas, the Catastrophe Reserve Trust Fund, or other sources for FORTIFIED home construction.

- Alternatively, given recent discussions among the TWIA Actuarial & Underwriting Committee and the TWIA Board of Directors, consider expanding the scope of this recommendation to include TWIA incentives or public funding support for all types of wind mitigation efforts, such as retrofitting existing construction with upgraded opening protections, roof attachments, and other certified improvements.
- In the absence of a request for public funding, implementing this possible solution would not require a legislative change.

5 Premium & Maintenance Tax

Subject: Texas premium and maintenance taxes impact rate indications and lessen the affordability of TWIA policies.

- TWIA has spent $7-8 million in premium and maintenance taxes annually for the past five years. Before 2017, when policy counts and, therefore, written premiums were higher, TWIA incurred more than $9 million in some years.

Year	Premium Tax	Maintenance Tax & Other	Total
2010	$6.2 Million	$1.2 Million	$7.3 Million
2011	$6.5 Million	$1.2 Million	$7.7 Million
2012	$7.1 Million	$1.3 Million	$8.4 Million
2013	$7.6 Million	$1.4 Million	$9.0 Million
2014	$7.9 Million	$1.5 Million	$9.4 Million
2015	$8.1 Million	$1.5 Million	$9.6 Million
2016	$7.8 Million	$1.5 Million	$9.3 Million
2017	$6.8 Million	$1.3 Million	$8.0 Million
2018	$6.3 Million	$1.2 Million	$7.5 Million
2019	$6.0 Million	$1.1 Million	$7.1 Million
2020	$5.9 Million	$1.1 Million	$7.0 Million
2021	$6.3 Million	$1.2 Million	$7.5 Million

Possible Solution: Exempt TWIA from paying premium and maintenance taxes.

- A reduction in expenses has a corresponding impact on rate indications. Elimination of premium and maintenance taxes would reduce TWIA expenses by roughly 1.86% of the annual written premium.

6 Appraisal Deadlines

Subject: Current statutes and rules define deadlines for beginning the appraisal process, for a policyholder to demand appraisal after receiving TWIA's Notice of Claim Acceptance, and for informing the other party of the fees to be charged when hiring an appraiser. However, there are no deadlines for completing an appraisal.

- In the Association's experience following Hurricane Harvey, several factors led to appraisers and appointed umpires causing unnecessary delays.

- The average duration of an appraisal for a residential claim was nearly 200 days, while appraisals for commercial claims took up to 40% longer or 277 days on average.[1]

Policy Type	Number of Appraisals	Average Duration (in days)
Commercial	109	277
Residential	748	199
Total	**857**	**209**

Possible Solution: Set statutory deadlines to complete an appraisal to prevent delays in the process.

- Incentives to complete an appraisal timely and/or requiring the parties involved to agree to extend the duration of an appraisal will benefit both policyholders and the Association and lead to a timelier resolution of disputes.
- As there are variations in the size and complexity of losses, applying deadlines to the appraisal process should be flexible to allow for an adequate investigation of the claim and preserve the independence of the appraisers involved.

Statutory and Rule References
Texas Insurance Code Section 2210.574
Texas Administrative Code Chapter 28 Section 5.4211

7 Appraisal Process

Subject: TDI rule requires appraisers to disclose potential conflicts of interest when appointed, but it does not disqualify appraisers with conflicts of interest from engaging in an appraisal. Additionally, there are no methods by which an appraiser can be challenged or disqualified before the appraisal's completion.

- The appraisal process is based partly on the appointed appraisers' independence and disinterest. TDI rule requires appraisers to disclose potential conflicts of interest when appointed.
- Many potential conflicts in the rule focus on the appraiser's financial motivations to minimize or maximize the claim's value regardless of its merits.
- However, none of the potential conflicts outlined in the TDI rule disqualifies the appraiser from engaging in an appraisal.
- As a result, policyholder appraisers appointed to Hurricane Harvey claims rarely followed the disclosure rules, and even when potential conflicts existed, they continued to engage in the appraisal process.
    - For example, several Public Adjusters and repair contractors routinely appointed

[1] Based on a preliminary analysis of a sample of 857 appraisals for Hurricane Harvey claims (2017).

themselves or their employees as the appraiser for their clients, despite having a financial interest in the outcome of the claim.

- Moreover, an appraiser cannot be challenged or disqualified before the appraisal's completion. Instead, the parties can only raise an appraiser's misconduct by filing a suit to set aside the award and begin a new appraisal.

Possible Solution: Allow TWIA to have a formal objection process related to issues or concerns with a policyholder's selected appraiser or umpire.

- TWIA proposes adding an objection process to the current rules governing appraisal to balance the need to remove those who participate in the process in bad faith with the imperative of keeping the appraisal process streamlined and inexpensive for the policyholder.
- The Association proposes referring objections to the TDI Ombudsman, and to the extent this would add additional expense to the Ombudsman's budget, TWIA would bear that expense.

Statutory and Rule References
Texas Administrative Code Chapter 28 Section 5.4212

8 Payment of Appraisal Costs

Subject: Statute requires TWIA and the policyholder to split appraisal costs. But, the overall cost of an appraisal can be imbalanced, with the policyholder paying a higher share than they would if they were only responsible for the costs of their appraiser.

- The appraisal process for handling TWIA claims is established in Texas Insurance Code and states, "the claimant and the association are responsible in equal shares for paying any costs incurred or charged in connection with the appraisal, including a fee charged under Subsection (e)."
- The appraisers TWIA hires charge an hourly rate for their service.
- As the appraisal process is designed to be separate and independent from TWIA's claim handling, TWIA provides little direction and oversight of appraisers.
- TWIA often experiences situations in which the amount of work that a TWIA appraiser performs on a file exceeds the amount of work performed by the policyholder's appraiser.
- The TWIA appraiser may also charge a higher rate than the rate charged by the policyholder's appraiser.
- The result of these scenarios is that the cost of TWIA's appraiser is often higher than the cost of the policyholder's appraiser, sometimes substantially so.

Possible Solution: Revise the statute to require each party to pay for their appraiser instead of splitting the total cost of both appraisers.

- In Hurricane Harvey appraisals on residential claims, TWIA's appraisal expense averaged about $500 higher than the policyholder's.
- If the appraisal award is a nominal amount, payment of the fees may significantly reduce the policyholder's final payment.
- This difference in costs can also cause disputes with the policyholder and may be detrimental to TWIA's efforts to settle a claim. Allowing TWIA and the policyholder to pay their own appraisal costs may eliminate the negative issues incurred in the appraisal process.

Statutory and Rule References
Texas Insurance Code Section 2210.574 (d)(2)
Texas Administrative Code Chapter 28 Section 5.4221

9 Earned Premium

Subject: TWIA does not have a mechanism to discourage policyholders from obtaining a policy at the start of storm season and then canceling the policy in December and receiving a pro-rata refund amount.

- Seasonal cancellations create additional operating expenses for the Association and reduce the income available for paying claims or contributing to the Catastrophe Reserve Trust Fund.
- The Mississippi Windstorm Underwriting Association's Plan of Operations includes similar cancellation provisions.
- TWIA currently uses a 90-day minimum earned premium (MEP) to prevent short-term issuance and cancellation of policies. The Legislature reduced the MEP from 180 days to 90 in 2011.

Possible Solution: Revise cancellation rules and procedures so the Association may cancel policies on a pro-rata basis for the following reasons only:

- Coverage is replaced by another company (Evidence must be provided)
- The property is sold (Evidence must be provided)
- There is a total loss of the property (Evidence must be provided)
- TWIA determines that the property is no longer insurable under TWIA rules and procedures
- Cancellation for any reason other than the above reasons would result in a fully earned, non-refundable premium to TWIA.

10 Depopulation

Subject: Participation in the Assumption Reinsurance Depopulation Program ("Assumption Program") has dramatically declined over the past five years. Regardless of the volume from year to year, TWIA must perform the same complex steps.

- The Assumption Program seeks to provide TWIA policyholders with alternative wind and hail insurance options in the private market.
- TWIA provides policy data to participating companies, who then make offers to assume, or transfer, TWIA policies.
- The participation of insurers, agents, and policyholders in the program is entirely voluntary.

Assumption Reinsurance Depopulation Program Participation					
Program Year	**2016-2017**	**2017-2018**	**2018-2019**	**2019-2020**	**2021-2022**
Participating Carriers	4	3	2	2	1
Policies Selected by Carriers	102,171	109,356	75,039	64,380	32,318
Agent-Approved Offers	18,047	3,091	3,967	1,866	210
Policies Assumed	11,164	1,634	2,080	1,002	125

- The Sunset Commission staff detailed the complexity and inefficacy of the Assumption Program in their 2018-2019 report. That report explains in more depth the following findings:
  1. The Assumption Reinsurance Depopulation Program is administratively complex, creating unnecessary confusion.
     a. Policyholder confusion delays claim payments.
     b. The complexity of the program requires logistical and financial gymnastics.
  2. The industry's interest in the Assumption Reinsurance Depopulation Program is limited and the benefits to policyholders are questionable.
  3. Insurance agent interest in and ability to participate in the Assumption Reinsurance Depopulation Program is limited.
     a. Insurance agents have expressed concerns about the program's viability.
     b. Many insurance agents contractually cannot sell depopulation policies.
- While Sunset staff recommended that the Sunset Commission eliminate the Assumption Program, the Commission elected to modify certain logistical elements of the program's timeline to make it less complex.

Possible Solution: Authorize TWIA to activate and deactivate the Assumption Reinsurance Depopulation Program as necessary according to market fluctuations.

Statutory and Rule References
Texas Insurance Code Subchapter O (2210.701 - 2210.705)

11 Board Vacancies

Subject: The Association has been unable to compile the slate of nominees required by statute to fill an insurance industry representative vacancy on the board of directors.

- The TWIA Board of Directors includes three representatives of the insurance industry. When one of those positions becomes vacant, TWIA's governing statute establishes a process for filling the vacancy.
- The process requires the Association to solicit nominations from member insurers and to provide a slate of nominees to TDI for the Commissioner's consideration.
- The slate of nominees submitted to the Commissioner must include at least three more nominees than the number of vacancies. The Commissioner may, but is not required to, appoint an industry representative from the slate of nominees.
- TDI routinely requests a slate of nominees when the term of an industry representative is expiring.
- The Association solicits all members companies requesting nominees, as required by statute.

Possible Solution: Repeal the provision requiring the Association to provide a slate of nominees to the Commissioner to fill a vacancy on the Board of Directors reserved for an insurance industry representative.

- The Association has not received the required number of nominees to meet the statutory requirement in the past four years, (2019, 2020, 2021, and 2022).
- In each of those years, TWIA sent multiple solicitations and/or staff contacted companies to request candidates.
- Because the member insurers have routinely not provided a sufficient number of nominees to provide a slate as required by the statute and because the Commissioner is not required to appoint a nominee from the slate requested from the Association, elimination of the requirement to provide a slate of nominees would not be detrimental to the process of appointing industry representative to the Board of Directors.

Statutory and Rule References
Texas Insurance Code Section 2210.102 (f)

Public Policy Considerations

The Legislative & External Affairs Committee has elected to continue to present the issues of Association rates and ratemaking and the funding, funding structure, and financial sustainability of the Association as matters of public policy. This approach, first taken in the Association's 2020 Biennial Report, leaves resolution of challenges related to the Association's ratemaking and funding to the Texas Legislature in conjunction with the Windstorm Insurance Legislative Oversight Board (WILOB).[2]

While the calculation of an indicated actuarial rate is a technical exercise, the ultimate decision of what rates should be charged to coastal policyholders has increasingly become a public policy decision due to affordability and availability concerns raised by coastal policyholders and officials. Additionally, the Association's funding, funding structure, and financial sustainability are also matters of public policy and are most appropriately undertaken by the Texas Legislature in coordination with the WILOB.

The WILOB is tasked with completing a study of the Association's current funding and funding structure and developing recommended changes for consideration by the full Legislature. In support of the WILOB's charge, the Board of Directors has provided information about the challenges with the existing funding structure and a list of possible alternatives to the Legislature as well as information on the Association's funding methodology and history. Similarly, the following pages also contain information regarding the challenges of the existing ratemaking process and several options the Legislature might consider to address those challenges.

[2] Senate Bill 1448 (87th Legislature, Regular Session) requires the WILOB to study TWIA funding and structure issues and issue a report with information and legislative recommendations to the Legislature by November 15, 2022.

TWIA Ratemaking

Issue: The current ratemaking process makes it difficult to meet the statutory requirements that "rates must be reasonable, adequate, not unfairly discriminatory, and nonconfiscatory as to any class of insurer" while balancing stakeholder concerns regarding affordability of Association premiums.

- The 2021 TWIA rate adequacy analysis indicated that its residential and commercial rates were 39% and 46% below adequacy, respectively.
- Inadequate rates may jeopardize TWIA's ability to issue public securities to fund catastrophic losses, or repay the debt once issued.
- The Association's annual, statutorily required rate filing process has come under considerable public and political pressure since Hurricane Harvey. The 5% rate increase effective January 1, 2022 is the first rate increase implemented since 2018.
- Recently passed legislation now prohibits the TWIA Board of Directors from voting on a proposed rate increase if there has been a vacancy on the board for at least sixty days and all rate increases now require approval of two-thirds of the board to be filed.

Possible Alternatives: Review the TWIA ratemaking process and modify the statute as necessary to address these concerns. Some alternatives to the current process identified by TWIA include:

- Requiring that rate inadequacy be addressed through a "glidepath" approach consisting of a series of smaller rate increases over time;
- Holding an administrative hearing before an Administrative Law Judge who would submit a rate change proposal to the Commissioner of Insurance;
- Creating a separate rating bureau or similar entity to assess TWIA's rate adequacy and propose or implement rate changes;
- Moving rate-setting authority and processes to TDI;
- Modifying statutory ratemaking standards and requirements to address concerns about policy affordability; and/or
- Addressing concerns about actuarial fairness by specifically authorizing the Association to implement territorial rating.

Additional information on possible implementation of these alternatives is presented below.

Historical information on how TWIA has approached the process of rate filings over time is included in Appendix A.

Glidepath Approach:

- This approach would involve smaller incremental annual rate increases intended to move toward rate adequacy while avoiding larger sudden rate increases.
- Since there are a number of variables impacting rate adequacy, including storm frequency and severity, inflation impacts, etc., the glidepath approach may not close the gap depending upon the nature of these and would require an annual evaluation by the Board.

Administrative Hearing:

- Another approach to consider is requiring a hearing through the State Office of Administrative Hearings (SOAH) to set rates. The hearing would be before an Administrative Law Judge (ALJ) who would submit a rate change proposal to the Commissioner.
- SOAH hearings are currently used when certain TWIA actions are appealed by policyholders and/or member insurers.
- Interested parties would be allowed to provide written and oral comments, as well as empirical evidence, at the ALJ hearing. TWIA would provide data, which would include staff's rate adequacy analysis, to the ALJ for consideration.
- The statute should include a timeline for required actions. The Commissioner's Order setting the rates would be based on acceptance or modification of the ALJ's proposal.
- There is likely a fiscal note to the State with this approach.

Rating Bureau:

- A third possible change to the current process would be to create an independent rating bureau or other entity, similar to what some other states have established.
- The bureau would analyze rate need and set rates for the Association independently.
- This would limit TWIA's role to providing statistical data such as catastrophe modeling results and loss and expense information.

As an example, the North Carolina Rating Bureau sets rates for several types of insurance in North Carolina, including property, auto, and workers compensation. Texas could implement a similar model specifically focused on TWIA rates.

The NCRB enabling statute can be found at:
https://www.ncleg.net/enactedlegislation/statutes/pdf/byarticle/chapter_58/article_36.pdf.

It provides a methodology for ratemaking; requirements for filing proposed rates with the Department of Insurance; and a process for Department approval or disapproval, including public inspection, comment, and hearing.

TDI Rate-Setting:

- Similar to a separate rating bureau, an additional alternative would be to authorize TDI to set TWIA rates.
  - TDI could promulgate rates through an annual process, similar to the process in place in the 1990s, with TWIA providing loss experience and expense data to the Department for their analysis, **OR**
  - TDI could be granted the authority to approve, deny, or modify annual TWIA rate filings, similar to the process in place in the 2000s.
- See Appendix A: Historical TWIA Ratemaking for more information.

Affordability:

- The current statutory requirements for Association rates are that "rates must be reasonable, adequate, not unfairly discriminatory, and nonconfiscatory as to any class of insurer." There is no language in statute specifically addressing affordability, even though this is a key issue for many coastal stakeholders.
- One way to address this issue would be to include statutory guidance on defining and addressing affordability as it relates to Association rates. As a matter of public policy, the specific incorporation of affordability as a rate consideration could be defined in statute or through TDI rule.
- Affordability could be addressed by providing the TWIA Board of Directors with a standard to consider for its rate filing decisions or an actual premium assistance program that could be funded either by TWIA or the State.
- An additional element impacting affordability is the possible discrepancy between the credit offered by voluntary market carriers to exclude wind coverage and the premium charged by TWIA to provide wind coverage. Additional regulation on the credits provided by private insurers may address this issue.

Territorial Rating:

- Actuarial analysis indicates that rates for Association policies could vary materially geographically, with some areas potentially seeing rate decreases.
- In order to promote fairness among TWIA policyholders, a possible change to current statute would be to revise Texas Insurance Code section 2210.355(i) to make clear that TWIA continues to have the authority to implement rating territories.

Funding

The following information outlines challenges with the existing funding structure and a list of possible alternatives to the Legislature. Additionally, Appendix B includes an overview of the funding structure and its individual components as well as stakeholder suggestions for funding changes.

Issue: Current statute provides funding for TWIA losses and expenses in excess of its premium and other revenue up to a set amount and includes the requirement that TWIA secure funding for a catastrophe year with a probability of one in 100 through the purchase of reinsurance with an attachment point in excess of all statutory funding sources. The Association has identified several challenges associated with the current funding structure:

- **Public securities may not be fully marketable or funded sufficiently quickly.**
    1. Proceeds issued after a catastrophic event may not be available for up to six months after a catastrophic event, potentially delaying claim payments.
    2. Not all proceeds are available to pay claims due to reserve accounts required by bond investors.
    3. Securities may not be able to be issued in their full, authorized amount due to general financial market conditions or the uncertain financial condition of TWIA and the economic conditions on the Texas coast following a major hurricane.
- **The current structure imposes a financial burden on TWIA and its current and future policyholders in the years following a catastrophic event.**
    1. A depleted CRTF would require TWIA to purchase more reinsurance to meet the minimum funding requirement, increasing costs after an event.
    2. Reinsurance itself will most likely be more expensive after an event.
    3. TWIA policyholders may not be able to afford policy surcharges that may be required to repay multiple Class 1 issuances.
- **There is no statutory provision for funding in excess of the 100-year minimum funding level (plus any additional reinsurance funded through member company assessments).**

Possible Alternatives: Modifications to improve the Association's funding, funding structure, and financial sustainability are matters of public policy to be undertaken by the Legislature in coordination with the Legislative Funding and Funding Structure Oversight Board (LOB) created by House Bill 1900 (86^{th} Legislature, Regular Session). The LOB is tasked with completing a study of the Association's current funding and funding structure and developing recommended changes for consideration by the full Legislature.

TWIA has included additional information on the challenges noted above and possible alternatives for consideration, individually or in combination, below.

Public securities may not be fully marketable or funded quickly enough

Challenge 1: Proceeds issued after a catastrophic event may not be available for up to six months after a catastrophic event, potentially delaying claim payments.

Most sources of funding are available to pay claims within days or weeks after a catastrophic event. Post-event public securities, however, may take up to six months after an event to become available to pay claims, due to the lengthy process of issuing this type of debt. At up to $1 billion, this represents a significant portion of TWIA's overall funding.

TWIA has addressed this concern by purchasing a line of credit, which allows TWIA to borrow against public security proceeds during the issuance process. The line of credit has become increasingly expensive and this quick source of cash to pay claims may not be reliable in the long-term.

Possible Alternatives:

- Allow TWIA to collect from its policyholders a CRTF surcharge separate from premiums to fund the CRTF directly.
- Authorize a statewide policy surcharge to build the CRTF to a minimum level.

Building the CRTF balance reduces the likelihood that public securities will be necessary to fund claims and allows TWIA to deposit more of its premiums in the CRTF due to reduced reinsurance costs.

- Reorder TWIA funding to place post-event securities "higher up".
- Provide a temporary source of funds that could be used to pay claims until proceeds from public securities become available.

Challenge 2: Not all proceeds are available to pay claims due to reserve accounts required by bond investors.

A portion of the proceeds from public securities is not available to pay claims. Investors require various reserve accounts to ensure the Association's ability to repay the debt, and these accounts must be funded directly from bond proceeds. Reserve amounts and issuance costs both reduce the total amount available to pay claims, resulting in a potential funding shortfall.

Possible Alternatives:

- Provide additional funding from assessments or other sources to fund any difference between the $1 billion of authorized public security issuances and the actual amounts available to pay claims.

- Authorize issuance of public securities in amounts over $1 billion such that the net amount available to pay claims is $1 billion.
- Allow flexibility in the attachment point of reinsurance to address the potential gap created by issuance costs and/or debt reserve amounts.

Challenge 3: Public securities may not be able to be issued in their full, authorized amount due to TWIA's financial condition or general financial market conditions.

In general, the issuance of debt is subject to the availability of capital in the financial markets and the creditworthiness of the borrower. For TWIA specifically, this means that general market conditions may restrict the amount of public securities that can be issued as part of the Association's funding. Being authorized in statute to issue up to $1 billion in public securities does not guarantee that the financial market will be willing to provide those funds.

In addition to general market conditions, the perceived ability of TWIA to repay any debt is a significant factor in both the amount of debt that can be obtained and the cost of that debt, in terms of the interest rate charged. Existing debt service obligations from previous catastrophe years, the collectability of TWIA and coastal policyholder surcharges, and the uncertainty of future legislative or regulatory changes are all concerns that have previously been raised by investors. These concerns impact the interest rates charged to TWIA and could possibly limit the amount of public securities that could be issued.

Possible Alternatives:

- Allow for the issuance of public securities guaranteed by the State of Texas.
- Allow for the issuance of public securities on a tax-exempt basis for investors.
- Allow TWIA to account for the balance in the CRTF as surplus.

Each of these would increase the marketability, and potentially reduce the cost, of public securities.

- Provide additional funding from assessments or other sources to fund any difference between the $1 billion of public securities authorized and the actual amounts issued.

Financial burden on TWIA and its policyholders following a catastrophic event

Challenge 1: A depleted CRTF requires TWIA to purchase more reinsurance to meet the minimum funding requirement, increasing costs after an event.

Hurricane Harvey resulted in an ultimate loss estimate of $1.71 billion, which completely depleted the $737 million in the CRTF. Current statute requires the Association to exhaust the CRTF before using any other funding sources.

As the Association must provide for funding to a 1-in-100-year event each year, a smaller amount in the CRTF requires TWIA to purchase additional reinsurance to meet the minimum funding requirement. Reinsurance also attaches at a lower level because of the diminished CRTF, making the cost of reinsurance more expensive.

Possible Alternatives:

- Allow TWIA to charge its policyholders a CRTF surcharge separate from premiums.
- Authorize a statewide policy surcharge to build the CRTF to a minimum level.
- Allow flexibility in the minimum required funding level after a catastrophic event to reduce the amount of reinsurance required to be purchased.
- Establish a public reinsurance facility for TWIA and the private market similar to the Florida Hurricane Catastrophe Fund.

Challenge 2: Reinsurance itself will most likely be more expensive after an event.

In years following a significant storm, the Association can also expect the price of reinsurance to be higher than normal due to a reaction from the market, further straining available premium revenue.

Possible Alternatives: Each of the alternatives above also addresses this challenge.

Challenge 3: TWIA policyholders may not be able to support repayment of multiple Class 1 issuances.

Hurricane Harvey also required TWIA to use the amounts available from the $500 million in pre-event public securities issued in 2014. TWIA's premiums earned in subsequent years must be shared among paying the principal and interest on the outstanding bonds, Association operating expenses (including payment of routine non-catastrophe claims), and reinsurance costs. This leaves little left over for deposit into the CRTF.

Another catastrophe year requiring the issuance of Class 1 public securities could require TWIA policyholder surcharges of over 20% to repay the additional bonds.

Possible Alternatives:

- In addition to the alternatives above, allow a contingent source of funding for Class 1 public securities similar to existing sources for Class 2 and Class 3 public securities.
- Provide a cumulative maximum amount of public securities to be repaid by TWIA premiums and policyholder surcharges at any one time.

Revise the existing bond repayment surcharge on TWIA policies to apply at renewal, rather than during the policy term.

Other Topics Considered

The following items were considered by the LEA Committee and Board but are not recommended for inclusion in the Biennial Report at this time.

#	Topic	Description/Alternative
1	Stricter Eligibility Requirements	Require agents to produce three confirmed declinations from private market carriers annually, and exclude applicants with private market coverage or offers from eligibility.
2	ACV Policies	Similar to some other residual market property insurers, only offer an Actual Cash Value (ACV) policy.
3	ACV Policy for Older Roofs	With some exceptions, require ACV policies for properties with roofs older than ten years.
4	Binding Arbitration	Make binding arbitration a mandatory dispute resolution option to vacate an appraisal award and for denied TWIA claims.
5	Deductible Requirements	Require higher deductibles in certain circumstances.
6	Discounted Storm-related Advertising	Require broadcast media to provide the Association with a substantial discount to run hurricane preparedness and response information.
7		
8		
9		
10		

Appendix A: Historical TWIA Ratemaking

Below is an outline of the various processes by which TWIA rates have been set in the past.

I. TWIA filed rates with State Board of Insurance/Department of Insurance

a. TWIA Board of Directors filed rates with the State Board of Insurance (SBI). SBI could approve, modify or disapprove the filed rates. Rates were deemed approved if not modified or disapproved within 30 days of filing.
   i. Secondary requirement that rates could not be more than the maximum rates set by the Board for similar risks or classes of risks
   ii. Commissioner could request additional information from TWIA
   iii. Commissioner required to have a hearing on the rate filing before acting on the filing

II. State Board of Insurance promulgated rates for the insurance industry and TWIA was based off the promulgated rate. Process was used for commercial and non-commercial. TWIA Board of Directors did not make a rate filing but provided experience to be used in the rate hearings

a. State Board of Insurance set a benchmark rate and TWIA's rate could not exceed rate set by SBI for **non-commercial** lines or the manual rate promulgated by the Board.
b. State Board of Insurance promulgated a rate for commercial risks.

III. TWIA Board of Directors required to make an annual rate filing no later than August 1 of each year for commercial risks.

a. Filings were submitted to the Commissioner of Insurance.
b. The Commissioner could approve, disapprove, or modify the filing.
c. Rate change limited to 15%.

IV. Annual Rate Filing – Current Process

a. Must be submitted no later than August 15 for all types and classes of risks written by TWIA.
b. Association may use the rate if the rate change
   i. does not exceed the rate in effect on the date the rate filing is made,
   ii. and
   iii. is filed not later than 30 days before the date of use
c. If the rate change does not meet the criteria of IV., B.
   i. Commissioner shall provide interested parties opportunity to review the filing and provide comments
   ii. Commissioner shall approve or disapprove the filing not later than October 15 otherwise the filing is considered approved
   iii. Commissioner does not have express authority to modify the filing submitted by TWIA
   iv. A rate change is limited to 10% average rate change and 15% for an individual rate

class.

v. Any proposal to increase the current rate must be approved by two-thirds of the Board of Directors

vi. The Board of Directors may not vote on a proposed rate increase if there is a vacancy on the Board and the vacancy has existed for at least 60 days when the vote is taken.

V. Other Rate Filings – Current Process

a. Rate change must be filed with the Commissioner for approval

b. Commissioner must approve or disapprove as soon as reasonably possible

c. A filing not disapproved on or before the 30th day of filing is considered approved

d. TWIA may use the filed rate if the rate:

   i. does not exceed the rate in effect on the date the filing is made,

   ii. is filed not later than 30 days before the date of use, and

   iii. the Commissioner has not disapproved the filing

Commissioner does not have express authority to modify the filing submitted by TWIA

   iv. Any proposal to increase the current rate must be approved by two-thirds of the Board of Directors

The Board of Directors may not vote on a proposed rate increase if there is a vacancy on the Board and the vacancy has existed for at least 60 days when the vote is taken.

Appendix B: Funding Overview

Texas Insurance Code Chapter 2210 provides the funding structure to be used to pay TWIA's insured losses and operating expenses. Prior to 2009, the Association funded losses through premiums and potentially unlimited assessments on insurance companies. House Bill 4409, enacted in 2009, significantly changed Association funding, providing for the issuance of up to $2.5 billion in Class 1, 2, and 3 public securities.

Senate Bill 900 (84th Legislature, Regular Session), effective September 1, 2015, further modified the sources of funding and requires overall funding to cover at least a 100-year season, a storm or series of storms with a 1% or less chance of occurring. TWIA's current funding structure is, in order:

- TWIA premiums and amounts in the CRTF
- $500 million in Class 1 public securities
- $500 million in Class 1 member company assessments
- $250 million in Class 2 public securities
- $250 million in Class 2 member company assessments
- $250 million in Class 3 public securities
- $250 million in Class 3 member company assessments
- Reinsurance or alternative risk financing in an amount sufficient to achieve total funding not less than a 100-year hurricane season.

Under Senate Bill 900, all Classes of public securities are intended to be backed solely by TWIA revenues and are not obligations of the State of Texas. Class 1, 2, and 3 public securities are repaid by TWIA premiums and surcharges on TWIA policies. However, Class 2 and 3 public securities, after a finding by the Commissioner of Insurance, may also be repaid by surcharges on coastal property and auto policies if premiums and TWIA policy surcharges are insufficient.

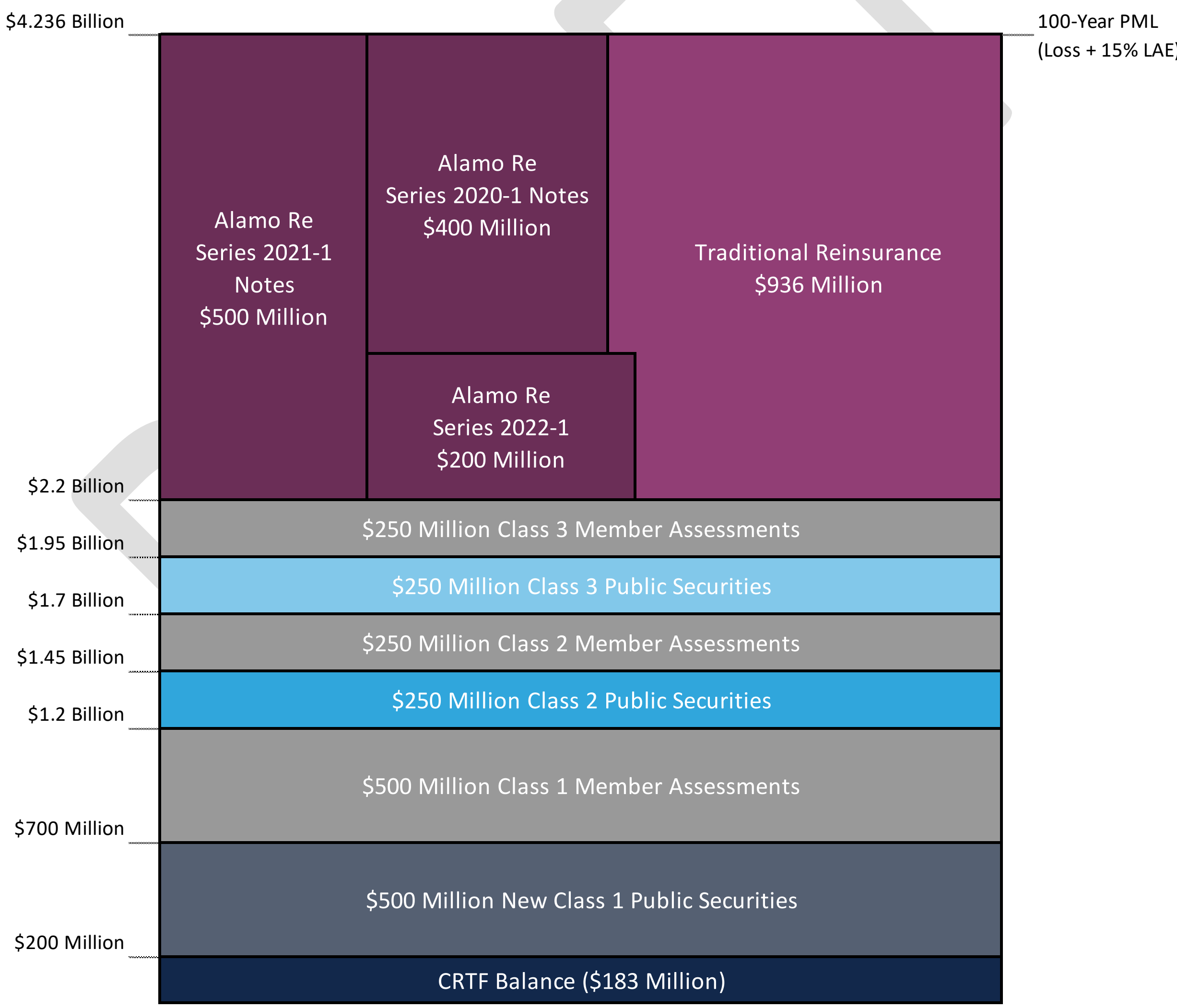
House Bill 1900, effective June 10, 2019, clarified how TWIA can use its funding sources to repay losses. House Bill 1900 prohibits TWIA from paying excess losses from a catastrophe year with premium and other revenue earned or reserves available or accrued in subsequent years. The bill also requires TWIA's purchase of reinsurance above its minimum required funding level to be paid for by an assessment on member companies.

Most recently, House Bill 769, effective September 1, 2021, made changes to how TWIA completes its annual purchase of reinsurance. The law prohibits TWIA from purchasing reinsurance from an insurer or broker that provides the catastrophe modeling TWIA uses to determine the probable maximum loss or make rate decisions.

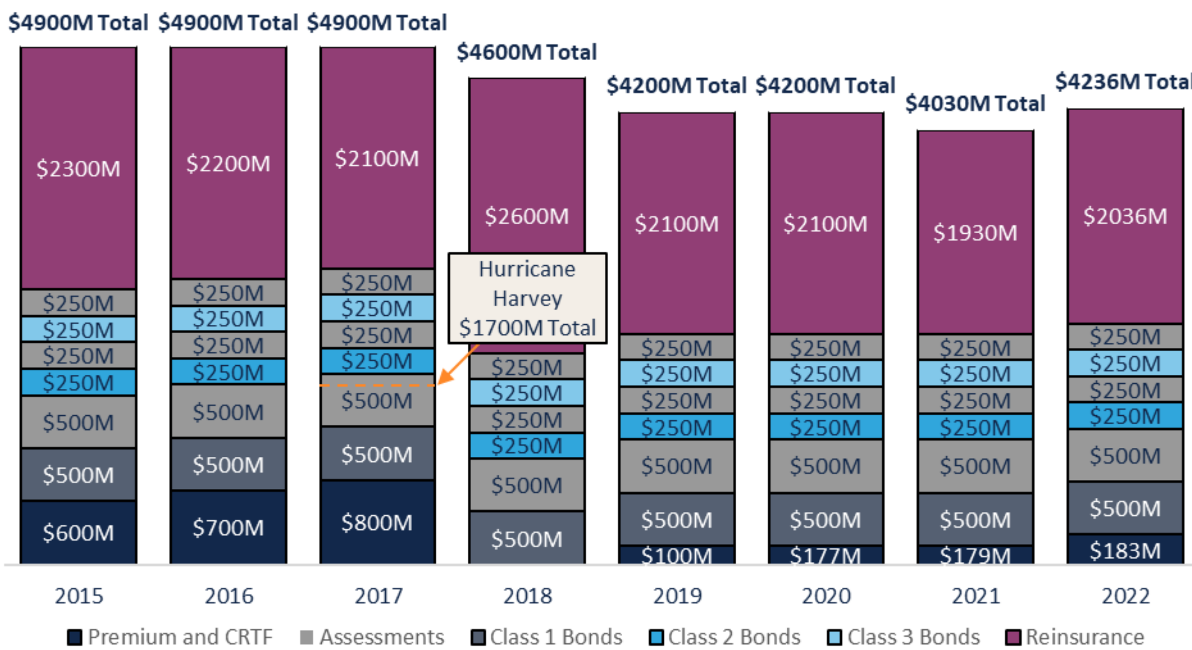
2022 Hurricane Season Funding

TWIA's 2022 catastrophe funding program, effective June 1, 2022 to May 31, 2023, provides access to $4.236 billion in total funding. The reinsurance program includes $936 million of traditional reinsurance and $1.1 billion in new and previously issued catastrophe bonds placed atop the $2.2 billion of other statutory funding sources. The traditional reinsurance program provides coverage on an aggregate basis, meaning multiple hurricane events would be covered under the same reinsurance program. The current Catastrophe Reserve Trust Fund (CRTF) balance is approximately $183 million. No net gains from operations in 2020 or 2021 were available to be deposited into the CRTF due to 2020 hurricane season losses and the early redemption of public securities used to pay Hurricane Harvey losses.

TWIA's funding for the 2022 hurricane season is illustrated by the chart below, followed by a historical comparison of funding levels since 2015:



Historical Funding (2015-2022)



Association Funding Sources

TWIA funding has historically been provided from the following general sources, each with differing benefits and challenges:

TWIA Premiums

The premiums paid by TWIA policyholders in the current year are always the first source of funding for both catastrophe and non-catastrophe claims. The other sources of funding are only utilized if a catastrophe or series of catastrophes results in losses and expenses in excess of premium and other revenue.

Premiums paid by TWIA policyholders are immediately available to pay claims and are a guaranteed source of funds but are limited in amount to those premiums earned in the current year.

Catastrophe Reserve Trust Fund (CRTF)

In most years, TWIA premiums are greater than losses and expenses. Every year, TWIA transfers all remaining premiums into the Catastrophe Reserve Trust Fund (CRTF), a separate account administered by the Comptroller on behalf of TDI. Certain TWIA policy surcharges are also transferred to the CRTF. In this regard, the CRTF represents premiums and surcharges paid by TWIA policyholders in prior years. Funds in the CRTF may only be used for purposes directly related to the funding of insured losses, as described in statute.

Like current year premiums, the CRTF is available immediately after an event and is a guaranteed source of funds. As the entire balance of the CRTF may be used after a catastrophic event, the amount available in any given year is limited to the premiums and surcharges transferred since the most recent catastrophic event.

Public Securities

The Texas Public Finance Authority is authorized to issue up to $1 billion in public securities to fund TWIA losses. There are three different classes of securities available, each in differing amounts and with different sources of repayment. Public securities are effectively a means for TWIA to borrow funds from the financial market to pay losses and to repay those funds over a maximum of 14 years through premiums and surcharges on TWIA policies and, if necessary, all property and auto policies in the catastrophe area. Class 1 public securities may be issued either pre- or post-event; Class 2 and 3 securities may only be issued post-event.

The process of issuing public securities is lengthy and expensive. Proceeds from public securities may not be available to pay claims until months after an event. Additionally, the ultimate availability of securities is dependent on general financial market conditions, which are highly variable.

Member Company Assessments

TWIA has the authority to assess its member companies, comprising all insurance companies authorized to write property insurance in Texas with limited exceptions, up to $1 billion to fund losses. These assessments are levied by the TWIA Board of Directors with approval by TDI and may not be directly recouped by companies through premium surcharges or tax credits. In practice, companies generally include a provision for potential assessments in their rates.

Assessments are due from companies 30 days after receipt of the notice of assessment and are limited to amounts specified in statute. Payment of assessments is enforced by TDI, and there have, historically, been very few uncollected assessments. The ultimate source of assessment funds are the premiums paid statewide by insurance company policyholders, to the extent companies have included this potential expense in their rates.

Reinsurance

Reinsurance is a form of insurance purchased by insurance companies from specialized reinsurance companies. TWIA may purchase catastrophe reinsurance to cover its losses and expenses after a catastrophic event. The costs associated with reinsurance can be significant. Reinsurance in an amount in excess of other funding sources, up to the estimated amount of a catastrophe with a probability of one-in-100, is purchased directly by TWIA. Any additional reinsurance purchased beyond the minimum funding level is paid by assessments to member companies.

TWIA also utilizes catastrophe bonds as an additional source of funding. These function identically to traditional reinsurance, except the reinsurance is offered by capital market investors on a collateralized basis, rather than by reinsurance companies. This allows TWIA to more effectively manage the cost of reinsurance and mitigate any credit risk associated with reinsurance companies being unable to pay.

Funds from reinsurance and catastrophe bonds are available immediately after a qualifying event, as determined contractually.