TEXAS WINDSTORM INSURANCE ASSOCIATION

Biennial Report to the 87th Texas Legislature, Regular Session

September 21, 2020

The Honorable Greg Abbott, Governor
The Honorable Dan Patrick, Lt. Governor
The Honorable Dennis Bonnen, Speaker of the House
Members of the Sunset Advisory Commission
Members of the Senate Business & Commerce Committee
The Honorable Kent Sullivan, Commissioner of Insurance
Members of the House Insurance Committee

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 as a result of legislation passed by the 86th Legislature, Regular Session and proposed legislative changes for your consideration ahead of the 87th Legislative Session.

Established by the Legislature in 1971, TWIA is a nonprofit insurance organization that provides coastal Texans access to wind and hail property insurance when declined by voluntary market insurance companies. Without TWIA, many property owners in the 14 Texas coastal counties would be unable to adequately insure their homes, freely buy and sell property, or soundly operate commercial businesses.

TWIA is a more efficient and more policyholder-focused organization than in the past. We are driven to continuously improve by the knowledge that what we do impacts the lives of our policyholders and the economic welfare of the Texas coastal region. This past year TWIA focused on the implementation of laws passed by the 86th Legislature. A summary of the implementation of new processes and procedures can be found in the enclosed report.

TWIA policyholders and other stakeholders benefit from the continued collaboration among the Legislature, the Texas Department of Insurance (TDI), and TWIA to identify, enact and implement laws and rule changes that allow TWIA to fulfill its mission. 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 David Durden, Vice President of Legal at (512) 505-2255 or Jennifer Armstrong, Vice President of Communications & Legislative Affairs at (512) 637-4031.

Sincerely,

John W. Polak, CPCU
General Manager

Legislative Implementation

The Texas Sunset Commission completed its review of the Association and issued recommendations in November 2018. The 86th Legislature responded by enacting legislative changes in two major bills—Senate Bill 615 and House Bill 1900. TWIA launched an enterprise-wide program to ensure that all aspects of the new laws are implemented on or before their respective statutory deadlines.

The following information describes the key legislation impacting TWIA passed by the 86th Legislature and the Association's actions and progress in implementing the specific provisions.

Underwriting and Policy Administration:

Requirement to allow for premium installment payments and the acceptance of credit card payments. (Senate Bill 615)

- TWIA is on track to begin accepting premium payments from policyholders by credit card and in installments as required on or before January 1, 2021.

Development of a process for auto renewal of policies. (Senate Bill 615)

- The first renewal offer packages were mailed to TWIA policyholders beginning January 1, 2020 for policies effective March 1, 2020.

Determination of replacement cost value at the time of policy issuance. (Senate Bill 615 & House Bill 1900)

- TWIA's new policy contracts reflecting this change have been approved by TDI and went into use on January 1, 2020.

Transfer of the WPI-8-C process to TDI with additional modifications designed to strengthen oversight over the process. (Senate Bill 615 & House Bill 1900)

- TDI has assumed responsibility for the issuance of Certificates of Compliance for completed improvements as of June 1, 2020.

Claims Handling and Deadlines:

Authorization of TWIA's existing supplemental payments process. (Senate Bill 615)

- TDI approved the required policy form changes on April 9, 2020; revisions to TWIA's claim notices have been completed and put into use as required by the law on or before July 1, 2020.

Authorization for the Insurance Commissioner to extend TWIA policyholder claim-handling deadlines at his discretion and extend the claim-handling deadlines applicable to TWIA to a maximum of 120 days. (House Bill 1900)

- While the Commissioner has not yet had a need to extend claim-handling deadlines under this provision, we are fully prepared should he do so in the future.

Modifications to deadlines and processes related to the payment of replacement cost coverage claims. (House Bill 1900)

- TWIA's claim notices include language as required to comply with this provision and policy forms are updated to reflect the law changes.

Funding:

New requirement to call an emergency meeting of the TWIA Board for the purpose of notifying member companies of the need for an assessment to pay storm losses. (House Bill 1900)

- TWIA announced a third potential member insurer assessment at its August 2019 meeting and the Board of Directors approved submitting a request to the Commissioner of Insurance for a $90 million member insurer assessment for losses from Hurricane Harvey at its December 2019 meeting.

New requirement that TWIA assess member companies for the purchase of reinsurance above the 1-in-100- year funding requirement. (House Bill 1900)

- The TWIA Board purchased reinsurance equal to the 1-in-100 probable maximum loss for the 2020 hurricane season, therefore no member assessment is necessary.

New requirement clarifying TWIA's use of premiums and reserves for the payment of storm losses. (House Bill 1900)

- Since this provision went into effect, the Texas coast has not experienced a storm requiring any expenditures on claims beyond that which TWIA can cover with current-year premiums.

Association Governance and Reporting:

New standards for the TWIA Board, including training and additional transparency and conflicts of interest measures. (Senate Bill 615)

- All current TWIA Board members have completed training and TWIA has implemented a procedure by which TWIA Board and Committee members report potential conflicts to TWIA's legal counsel and those conflicts are disclosed at the beginning of each meeting.

New requirement to make Association rate adequacy analyses, with specific format requirements, publicly available on TWIA.org at least 14 days before a vote of the board on a proposed rate filing. Also requires TWIA to accept public comment prior to the TWIA Board's vote on a proposed rate filing. (Senate Bill 615 & House Bill 1900)

- TWIA posted its 2020 rate adequacy analysis on July 21, 2020 ahead of the August 4 Board meeting at which its required annual rate filing will be considered. Public comments on the Association's rate adequacy analysis have been accepted in writing and in person at all applicable meetings of the Board of Directors since the law passed.

Discontinuation of the Association's Bimonthly Report Card. (Senate Bill 615)

- The final Bimonthly Report Card was published August 1, 2019.

Regulatory:

Authorization for TWIA to propose rules for adoption by the Texas Department of Insurance (TDI) and to request a public hearing in connection with a rule. (Senate Bill 615)

- To date, TWIA has not proposed rules for adoption by TDI under this provision.

New requirement that TDI change the Assumption Reinsurance Depopulation Program rules to eliminate the requirement for agents or policyholders to act on offers made during hurricane season and decreasing the policyholder decision period on offers to no more than 60 days. (Senate Bill 615)

- TDI adopted the rules to implement this change on January 22, 2020. The new rules will apply to the fifth round of the program which is expected to occur at the end of 2020. TWIA is developing a revised timeline in accordance with the changes to the statute and rule.

Proposed Legislative Changes

The table below summarizes five proposed legislative changes. Supporting detail for each proposed change may be found in the following sections. The supporting detail contains endnotes which have been used to denote references to specific statutes and administrative rules. The endnotes can be found on page 8.

Item #	Topic	Description/Alternative	Page #
1	Authorize Agent Requirements & Performance Standards	Revise TWIA's statute to enable TWIA to mirror the Texas FAIR Plan Association (TFPA) producer requirements and performance standards.	Page 5
2	Authorize Premium Payment Grace Period	Revise TWIA's statute to allow for TWIA to have a grace period to accept premium payments rather than requiring full or partial payment before the effective date.	Page 6
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 6-7
4	Exclude Commercial Risks from Automatic Renewal Process	Revise TWIA's statute to exclude commercial risks from the automatic renewal process.	Page 7
5	Consider FORTIFIED Home Construction	The TWIA Board recommends that the Legislature consider FORTIFIED home construction effectiveness in other states, whether TWIA should pursue such a program, and whether the State of Texas could provide funding support.	Page 8

Proposed Legislative Changes

1 Agent Requirements & Performance Standards

Issue: 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.[1]
- Agents are not appointed by TWIA nor do they contract with TWIA.
- TWIA is required by its Plan of Operation to audit agents' compliance with certain TWIA eligibility requirements but does not have express authority in statute or rule to take any action in response to agent noncompliance.[2]
- In contrast, statute governing the Texas FAIR Plan Association (TFPA) provides broad guidance for a Plan of Operation and the Plan explicitly directs TFPA to maintain producer requirements and performance standards and authorizes their enforcement.[3]

Proposed Change: 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/or 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.

2 Premium Payment Grace Period

Issue: Chapter 2210 in conjunction with the Plan of Operation requires TWIA to collect partial or full payment of the premium *prior* to the effective date in order to renew without a lapse in coverage.

- If a premium payment is sent by regular mail, TWIA must use the date payment is received by the Association to determine the effective date of the policy, unless payment is sent by one of the approved mailing methods outlined in the Plan of Operation.
- TWIA recently implemented a new automatic renewal process as a result of legislation passed by the 86th Legislature, Regular Session.
- As renewal offers are now mailed directly to policyholders and mortgagees for the first time, some agents have expressed concerns that policyholders' lack of familiarity with the approved mailing methods may result in lapses in coverage due to unforeseen and unavoidable circumstances that delay mail delivery until after the effective date.

Proposed Change: Provide express statutory authority to allow TWIA the option of offering a grace period for premium payments to mitigate lapses in coverage.

- Texas FAIR Plan and many other insurers in the standard market offer grace periods.
- This recommendation has support from TWIA's Agent Advisory Group.

3 Expert Panel

Issue: The Expert Panel's recommendations are costly to implement and applicable to less than 5% of policies.

- Statute requires the Association to utilize guidelines adopted by the Insurance Commissioner that are based on recommendations provided by a panel of experts ("Expert Panel") to determine the extent to which a loss to insurable property was incurred as a result of wind, waves, tidal surges, or rising water not caused by waves or surges or water (also known as "slab" claims).[4]
- TWIA implemented the Expert Panel recommendations as adopted by the Commissioner on June 1, 2018, engaging in a contract with vendors needed to implement the recommendations.
- TWIA's costs to comply with the Expert Panel's recommendations and the Insurance Commissioner rules, as of January 31, 2020, totaled $9,430,292.
- TWIA expects to spend an additional $3.8 million to maintain the program prior to the April

2022 expiration of the Association’s contract.

- The Association estimates that the annual rate to maintain the program after the contract expires in 2022 will be approximately $500,000 to $1 million.
- As the Association continues to experience declining policy count, eliminating the costs associated with maintaining the program presents the Association with an opportunity for preserving policyholder premiums.
- TWIA would incur a $1,554,375 penalty if its current contract is cancelled on or after May 2020 or a $889,048 penalty if canceled during or after May 2021.
- A complete table of costs is included in Appendix A.

Proposed Change: Modify statute and regulations to eliminate the requirements to use the Expert Panel’s recommendations and guidelines adopted by the Commissioner in April 2022 when the Association’s contract with the vendors needed to implement the requirements ends.

- 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.
- In the absence of a statutory requirement to use the Expert Panel’s methodology to handle and resolve “slab” claims, the Association will employ the methods commonly used by the insurance industry in addition to hiring engineers and weather experts who can help the Association assess the nature of the damage to a property.

4 Exclude Commercial Risks from Automatic Renewal Process

Issue: 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 recently implemented a new automatic renewal process for all policies as a result of 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.

Proposed Change: Eliminate the option for commercial risks to automatically renew.

- 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.

5 FORTIFIED Construction

Issue: 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.

Proposed Change: Consider FORTIFIED home construction effectiveness, whether TWIA should pursue such a program, and whether the State of Texas could provide funding support.

Appendix B includes the relevant statutory language related to the following citations:

[1] Texas Insurance Code (TIC) Section 2210.202 (b)
[2] Texas Administrative Code (TAC), Chapter 28 Section 5.4902 (d)
[3] TIC Section 2211.054, the contents of TFPA's Plan of Operation, and 28 TAC 5.9913 (d).
[4] TIC Section 2210.578

Public Policy Considerations

The TWIA Board of Directors believes that modifications are necessary to improve the Association's ratemaking process and the Association's funding structure. 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 Legislative Funding and Funding Structure Oversight Board (LOB) created by House Bill 1900 (86th 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. In support of the LOB'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. The Appendices include an overview of the funding structure and its individual components as well as stakeholder suggestions for funding changes.

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 2019 TWIA rate adequacy analysis indicated that its residential and commercial rates were 41.7% and 50% below adequacy, respectively. In response to recent questions on actuarial methodology, the TWIA Actuarial & Underwriting Committee recently selected an actuarial consulting firm to perform an independent analysis of TWIA rate adequacy.
- 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 and there have been no rate increases approved by the TWIA Board in three of the last four years.

Proposed Change: 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; and/or
- Creating a separate rating bureau or similar entity to assess TWIA's rate adequacy and propose or implement rate changes.

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 C.

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.

Funding

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).**

Proposed Change: 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 (86th 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.

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.

Funding in excess of the 100-year minimum funding level

Challenge: There is no statutory provision for funding in excess of the 100-year minimum funding level (plus any additional reinsurance paid through company assessments).

Every year the TWIA Board of Directors determines how much reinsurance to buy for the upcoming storm season. If an event or series of events results in losses in excess of the total amount of funding secured by the Association, there is currently no statutory provision prescribing a source of revenue to pay the excess losses.

Possible Alternatives:

- Allow for additional funding from existing sources if necessary.
- Identify additional sources of funding for losses in excess of the 100-year funding level.

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	Low Volume Agency Business	TWIA incurs additional expense working with agents with small policy counts; these agents require significantly more maintenance and training.
2	Limit Eligible Commercial Risks	Limit TWIA eligibility for some complex commercial structures
3	Named Peril Policy	Allow the Association to offer a named peril policy (Texas HO-A) for residential properties in the designated coverage area.
4	Reorder Funding Sources	Reorder the funding sources by putting Class 1 member assessments before the issuance of Class 1 public securities and Class 2 and 3 member assessments before their companion Class 2 and 3 public securities.
5	Excess Funding	Develop a Terrorism Risk Insurance Act-like system to ensure adequate funding in the event of catastrophic losses that exceed TWIA's funding stack.
6	Member Company Purchase of Public Securities	Obligate member companies to purchase Class 2 and Class 3 debt in advance of public issuance as a liquidity bridge (with public market takeout, if available) or for member companies to purchase and hold in order to reduce the risk of limited market access following a catastrophe and to reduce TWIA's funding costs.
7	Small Business Premium Financing	Require state government or local municipalities to fund the difference between actual premium rates and adequate rates for wind and hail coverage for low income residents, "critical" small businesses, and institutions.
8	Association Employment	Modify statute to align the Association's hiring practices with those outlined in Texas Government Code, Chapter 573.

Appendix A: Expert Panel Costs

TWIA Expert Panel Costs	
Year 1 - October 30, 2017 through Jun 1, 2018	
Components	**Fee (Breakdown)**
PMO, Accenture Module Design & Development on AIP	$1,457,635
RMS Internal Project Management	$285,085
HWIND Hazard	$182,455
Surge Hazard	$855,256
Wind Data Vendors	$961,892
Surge Data Vendors	$205,261
Property Data Augumentation	$570,170
Total	$4,517,754

TWIA Expert Panel Costs	
Fee Breakdown - Maintenance - 4 year Total	
Components	**Fee (Breakdown)**
Accenture Module Maintenance	$2,874,029
RMS Internal Project Management	$187,129
HWIND Hazard	$66,832
HWIND License Fee	$1,002,476
Surge Hazard	$374,257
Surge License Fee	$1,002,476
Wind Data Vendors	$1,210,577
Surge Data Vendors	$481,188
Property Data Augumentation	TBD
Total	$7,198,964

TWIA Expert Panel Costs	
Five Year Total	
Term	**Fees**
Year 1 - October 2017 - June 1, 2018	$4,517,754
Year 2 - May 2018 - April 2019	$1,642,920
Year 3 - May 2019 - April 2020	$1,749,746
Year 4 - May 2020 - April 2021	$1,840,739
Year 5 - May 2021 - April 2022	$1,962,559
Total	$11,713,718

Per Event Fees
$645,000

Termination for Convenience Fees	
Break Date	**Break Fees**
October 2017 - April 2018	$685,503
May 2018 - April 2019	$758,829
May 2019 - April 2020	$2,435,603
May 2020 - April 2021	$1,554,375
May 2021 - April 2022	$889,048

Appendix B: Statutory References

[1]Texas Insurance Code (TIC) Section 2210.202 (b)

Sec. 2210.202. APPLICATION FOR COVERAGE; DECLINATION REQUIREMENT. (a) A person who has an insurable interest in insurable property may apply to the association for insurance coverage provided under the plan of operation and an inspection of the property, subject to any rules established by the board of directors and approved by the commissioner. The association shall make insurance available to each applicant in the catastrophe area whose property is insurable property but who, after diligent efforts, is unable to obtain property insurance through the voluntary market, as evidenced by one declination from an insurer authorized to engage in the business of, and writing, property insurance providing windstorm and hail coverage in the first tier coastal counties. For purposes of this section, "declination" has the meaning assigned by the plan of operation and shall include a refusal to offer coverage for the perils of windstorm and hail and the inability to obtain substantially equivalent insurance coverage for the perils of windstorm and hail. Notwithstanding Section 2210.203(c), evidence of one declination every three calendar years is required before renewal of an association policy.

(b) A property and casualty agent must submit an application for initial insurance coverage on behalf of the applicant on forms prescribed by the association. An application for initial coverage must contain:

> (1) a statement as to whether the applicant has submitted or will submit the required premium payment from personal funds or, if not, to whom a balance is or will be due; and
>
> (2) a statement that the agent acting on behalf of the applicant possesses proof of the declination described by Subsection (a) and proof of flood insurance coverage or unavailability of that coverage as described by Section 2210.203(a-1).

[2]Texas Administrative Code (TAC), Chapter 28 Section 5.4902 (d)

TITLE 28	INSURANCE
PART 1	TEXAS DEPARTMENT OF INSURANCE
CHAPTER 5	PROPERTY AND CASUALTY INSURANCE
SUBCHAPTER E	TEXAS WINDSTORM INSURANCE ASSOCIATION
DIVISION 10	ELIGIBILITY AND FORMS
RULE §5.4902	Additional Requirements

(d) The Association shall implement an agent audit procedure to verify that agents possess and maintain proof of the declination and flood insurance as required under §5.4903 of this division and, if applicable, §5.4904 of this division.

[3]TIC Section 2211.054, the contents of TFPA's Plan of Operation, and 28 TAC 5.9913 (d).

Sec. 2211.054. CONTENTS OF PLAN OF OPERATION. The plan of operation must:

(1) provide for a nonprofit association to issue residential property insurance under this chapter and distribute the losses and expenses in writing that insurance in this state;

(2) provide that all insurers that write residential property insurance shall participate in the association in accordance with Sections 2211.101(b) and (c);

(3) provide that a participating insurer is entitled to receive credit in accordance with Section 2211.101(d);

(4) provide for the immediate binding of eligible risks;

(5) provide for the use of premium installment payment plans, adequate marketing, and service facilities;

(6) provide for the establishment of reasonable service standards;

(7) provide procedures for efficient, economical, fair, and nondiscriminatory administration of the association;

(8) provide procedures for determining the net level of participation required for each insurer in the association;

(9) provide for the use of deductibles and other underwriting devices;

(10) provide for assessment of all members in amounts sufficient to operate the association;

(11) establish maximum limits of liability to be placed through the program;

(12) establish commissions to be paid to the insurance agents submitting applications;

(13) provide that the association issue policies in the association's own name;

(14) provide reasonable underwriting standards for determining insurability of a risk;

(15) provide procedures for the association to assume and cede reinsurance; and

(16) provide any other procedure or operational matter the governing committee or the commissioner considers necessary.

[4]TIC Section 2210.578

Sec. 2210.578. EXPERT PANEL. (a) The commissioner shall appoint a panel of experts to advise the association concerning the extent to which a loss to insurable property was incurred as a result of wind, waves, tidal surges, or rising waters not caused by waves or surges. The panel shall consist of a number of experts to be decided by the commissioner. The commissioner shall appoint one member of the panel to serve as the presiding officer of the panel.

(b) Members of the panel must have professional expertise in, and be knowledgeable concerning, the geography and meteorology of the Texas seacoast territory, as well as the scientific basis for determining the extent to which damage to property is caused by wind, waves, tidal surges, or rising waters not caused by waves or surges.

(c) The panel shall meet at the request of the commissioner or the call of the presiding officer of the panel.

(d) The panel shall investigate, collect, and evaluate the information necessary to provide recommendations under Subsection (e). The cost and expense incurred by the panel associated with the work of the panel under this section shall be paid or reimbursed by the association.

(e) At the request of the commissioner, the panel shall recommend to the commissioner methods or models for determining the extent to which a loss to insurable property may be or was incurred as a result of wind, waves, tidal surges, or rising waters not caused by waves or surges for geographic areas or regions designated by the commissioner.

(f) After consideration of the recommendations made by the panel under Subsection (e), the commissioner shall publish guidelines that the association will use to settle claims.

(g) A member of the panel is not individually liable for an act or failure to act in the performance of the official duties in connection with the individual's work on the panel.

(h) In any review of a claim under this subchapter, and in any action brought against the association under Section 2210.575, the guidelines published by the commissioner under Subsection (f) govern the claim and are presumed to be accurate and correct, unless clear and convincing evidence supports a deviation from the guidelines.

Appendix C: 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 Board 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 5%,
   ii. does not increase the rate for an individual rating class by 10%, 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. 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 5%,

   ii. does not increase the rate for an individual rating class by 10%, and

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

   iv. the commissioner has not disapproved the filing

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

Appendix D: Funding Overview

Funding Overview and Recent Legislative Changes

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.

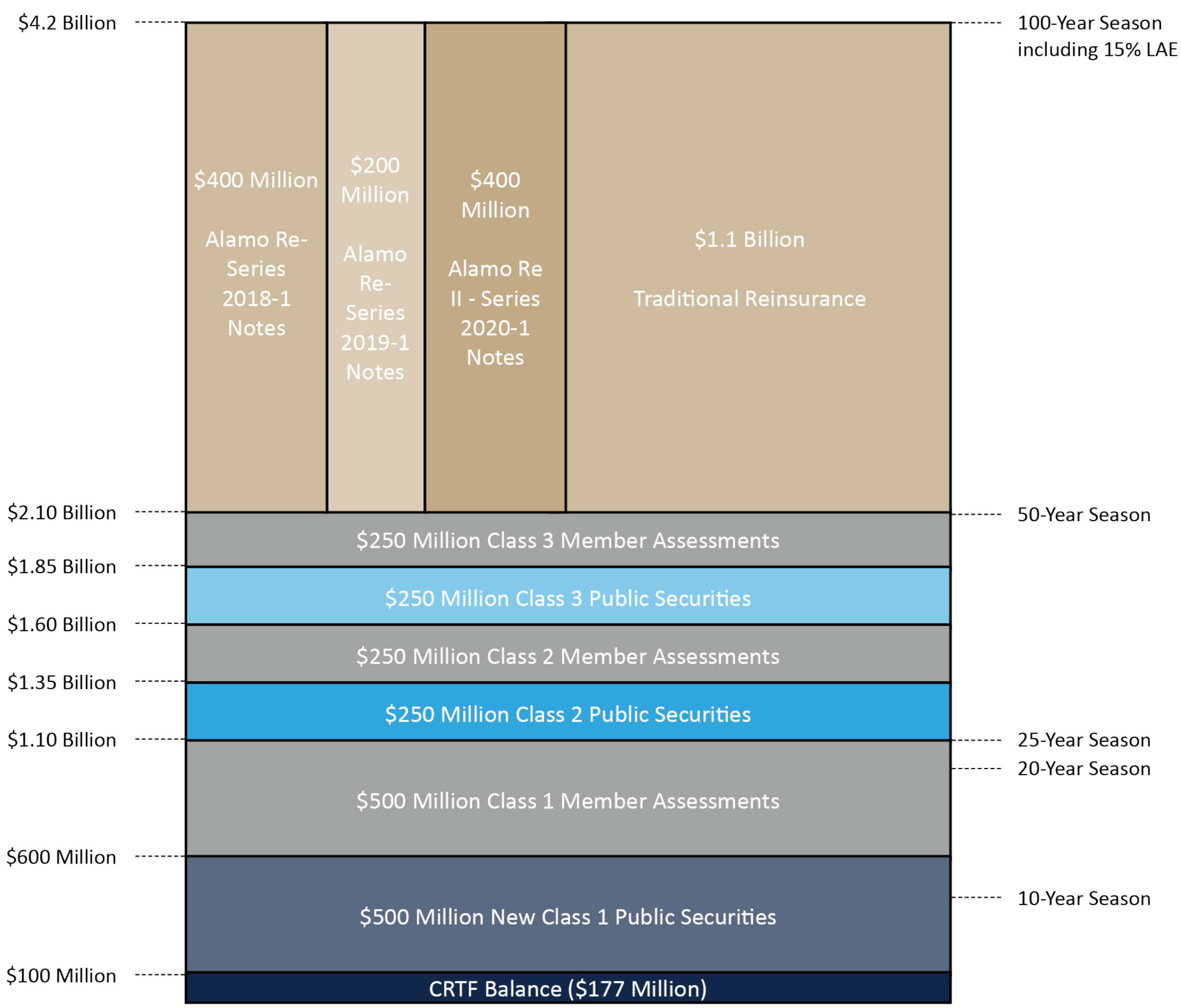
Under Senate Bill 900, all Classes of public securities are intended to be backed solely by TWIA revenues and are not obligations of the State of Texas. Class 1, 2, and 3 public securities are repaid by TWIA premiums and surcharges on TWIA policies. However, Class 2 and 3 public securities, after a finding 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.

Most recently, 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.

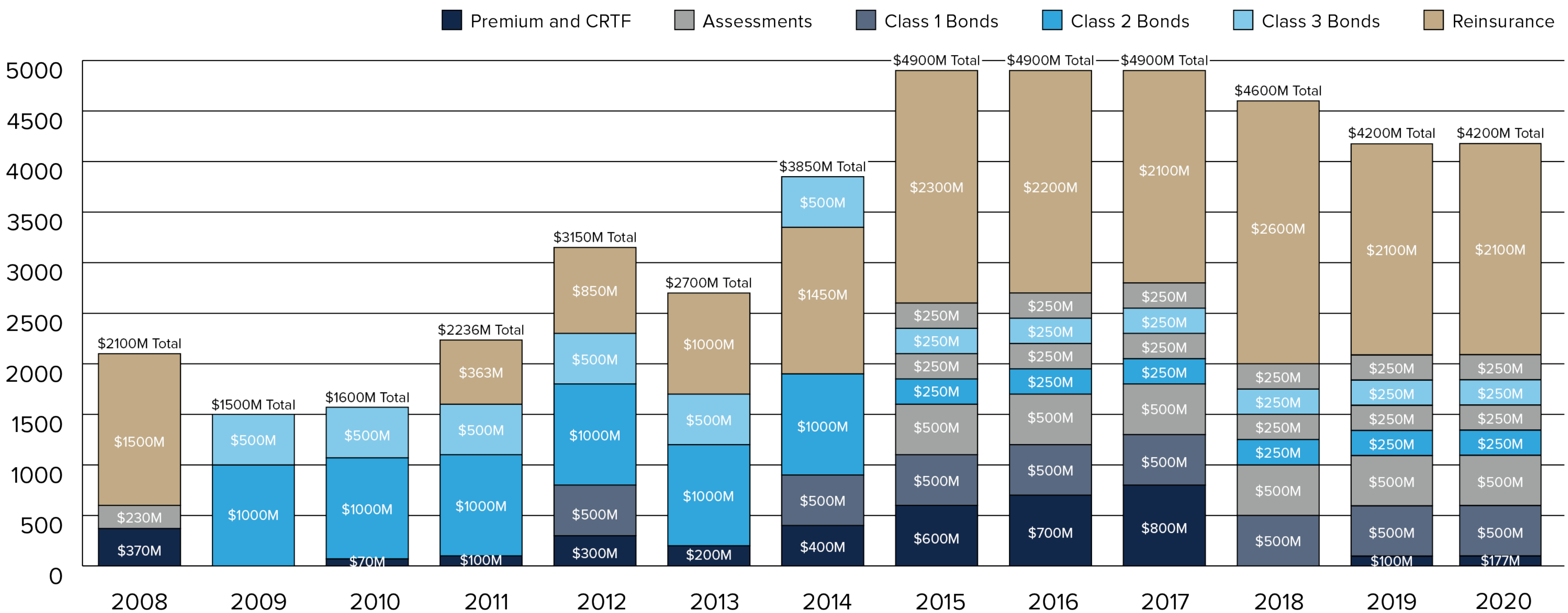
2020 Hurricane Season Funding

TWIA's 2020 catastrophe funding program, effective June 1, 2020 to May 31, 2021, provides access to $4.2 billion in total funding. The funding program includes $1.1 billion of traditional reinsurance and $1.0 billion in new and previously outstanding catastrophe bonds placed atop the $2.1 billion of funds on hand and total statutory funding sources. The traditional reinsurance program has a one-year term and provides coverage on an aggregate basis, meaning multiple hurricane events would be covered under the same reinsurance program. The 2020 program also includes a contribution of $52.6 million to the CRTF from 2019 net gains from operations. The current CRTF balance is $177 million.

TWIA's funding for the 2020 hurricane season is illustrated by the chart below followed by historical funding for the past 13 years:



Historical Funding (2008-2020)



2008 Funding for Hurricane Ike and post-Hurricane Dolly; unlimited additional funding available via reimbursable assessments
2009-2011 & 2013 Funding assumes $0 Class 1 Public Securities issuable
2012 & 2014-2015 Funding includes $500 Million pre-event Class 1 Public Securities
2015 Funding incorporates the changes from Senate Bill 900
2015-2016 Funding incorporates bond funding sources that differ from prior years
2018 Funding was impacted by the depletion of the CRTF to pay losses from Hurricane Harvey (2017)
2019 Funding includes approximately $100 Million in the CRTF from 2018 net gains from operations
2020 Funding is effective June 1, 2020 – May 31, 2021

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 collected 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.