

Focus on Texas: TWIA

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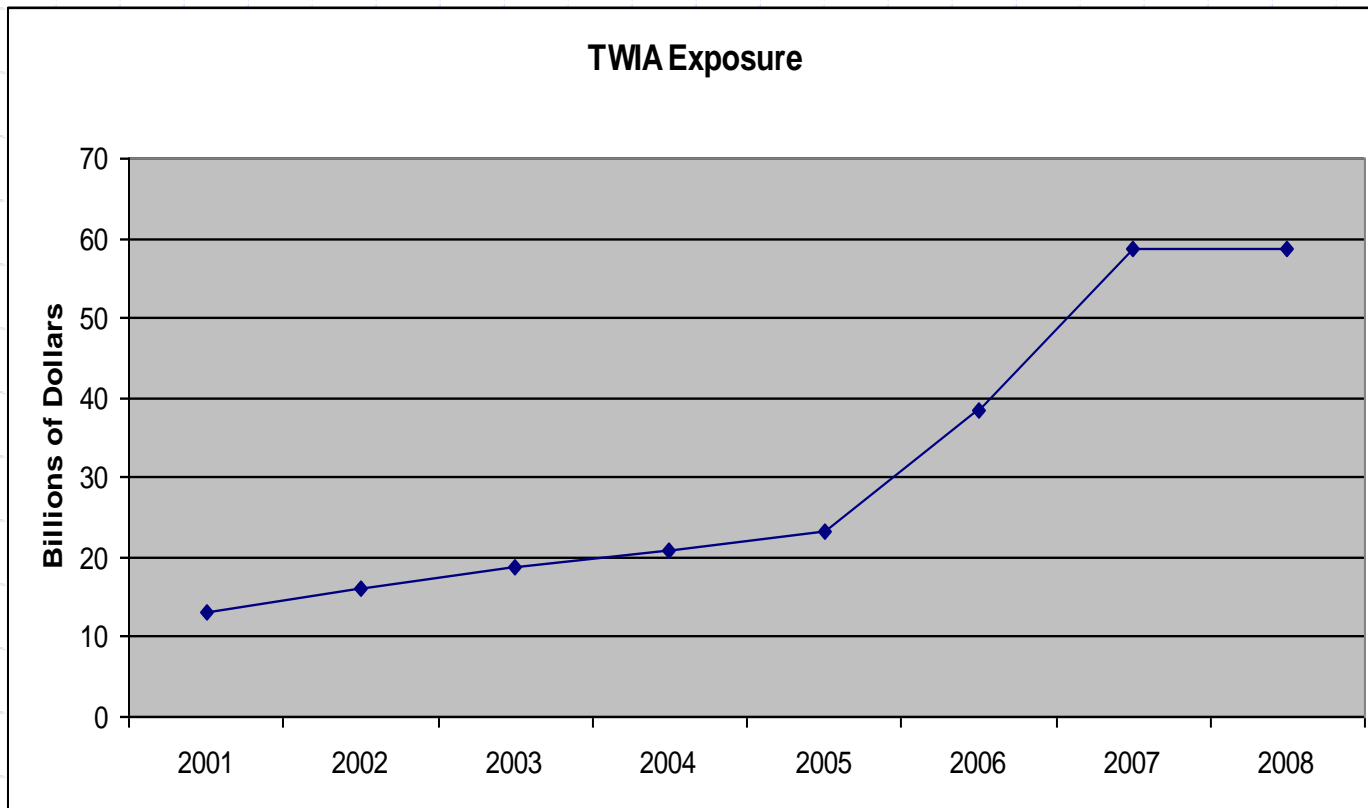
What is TWIA's Biggest Problem?

- ◆ The danger of growing too large to reform.

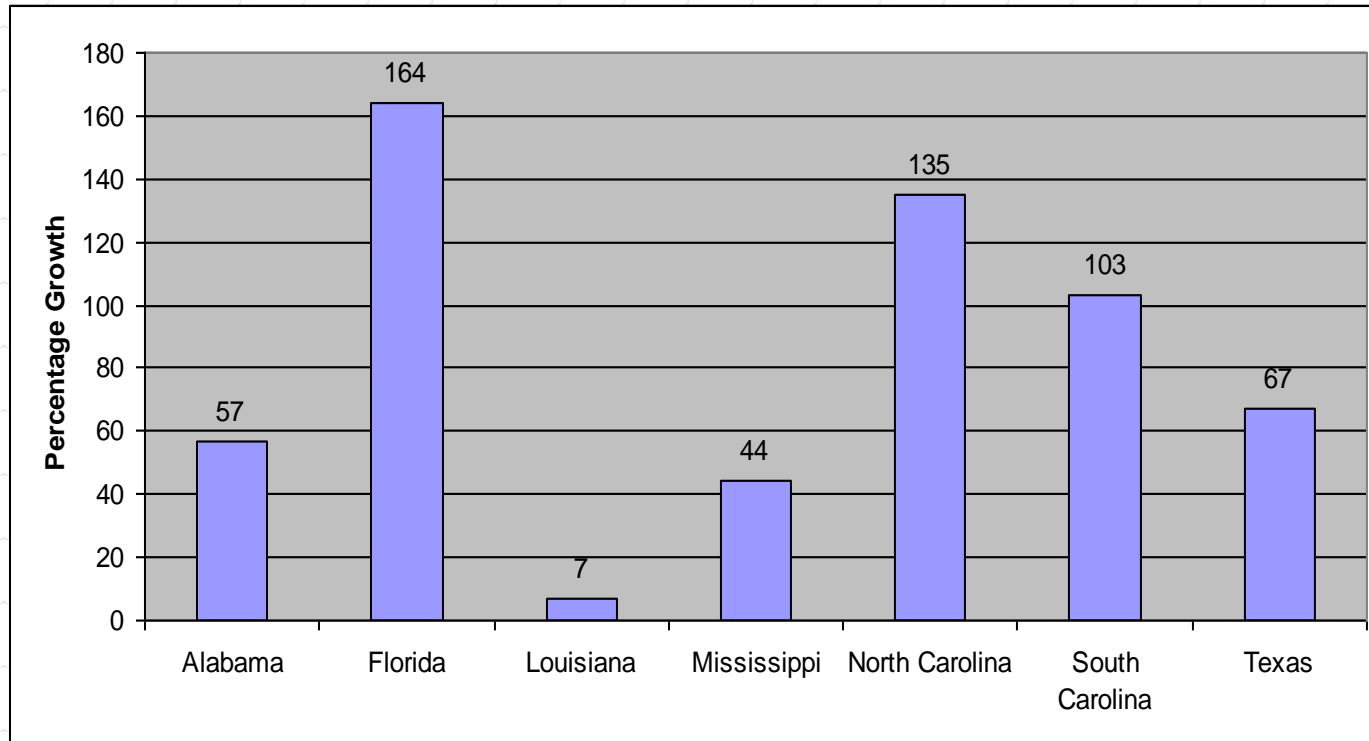
TWIA has grown substantially in the past decade, although the growth has leveled off for now.

As large a problem as TWIA is now, the wind pool would be even more of a burden if it were to double in size, which is not out of the question.

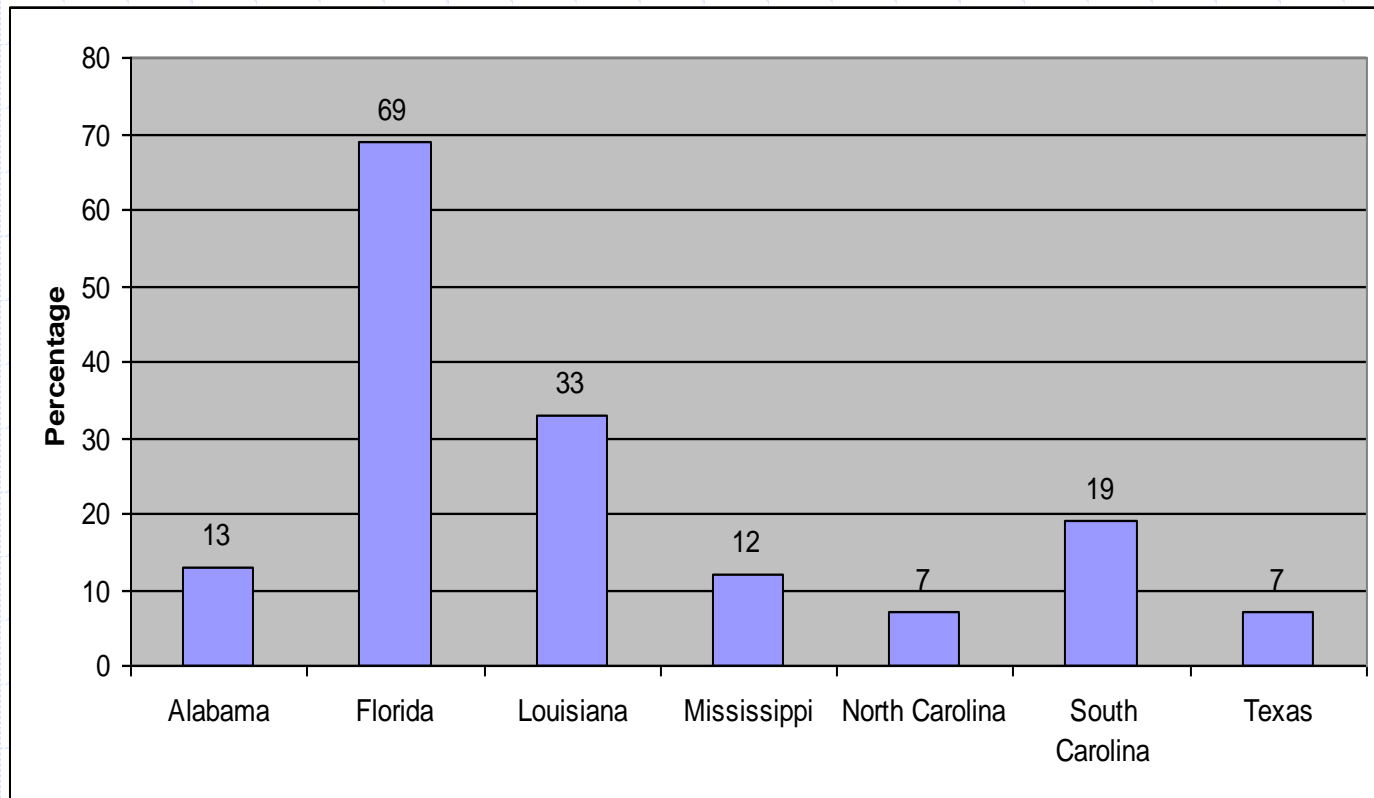
TWIA's Recent Growth



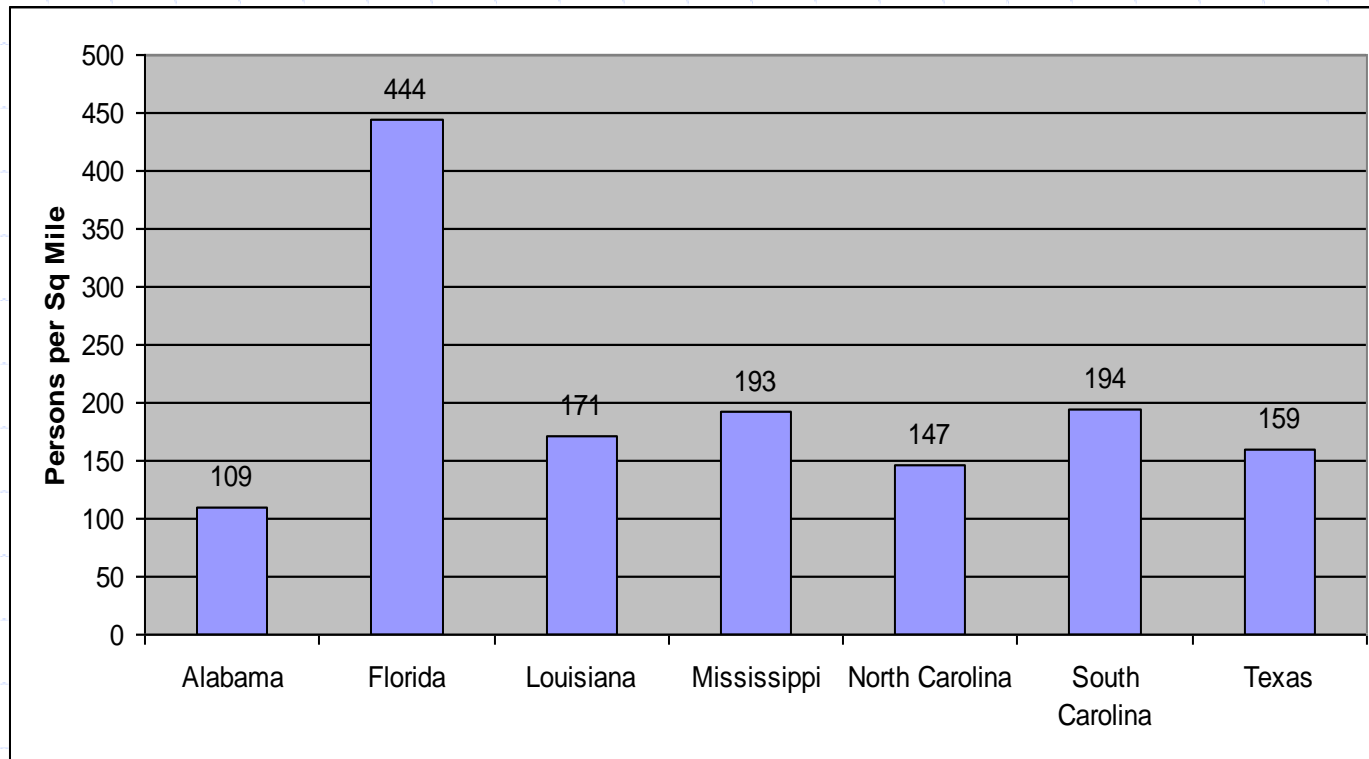
Growth of Coastal County Population Since 1970



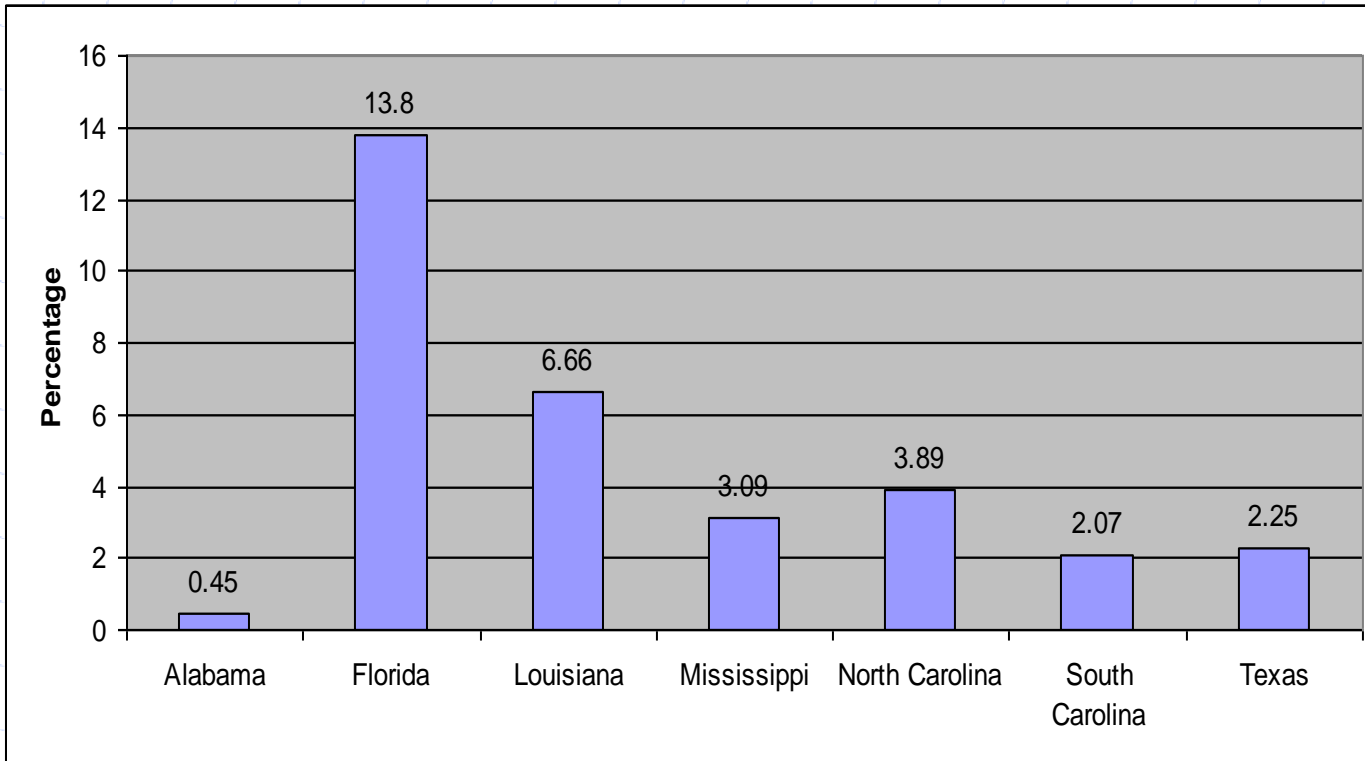
Percentage of State Population in Coastal Counties



Population Density of Coastal Counties



Wind Pool Participation as Percentage of State Households (2008)



What Measures Have or Haven't Worked Elsewhere?

- ◆ Despite the form of changes, the main policy which leads to a large residual market are inadequate rates for private insurers and artificially low rates offered by the wind pool.
- ◆ Participation in the residual market is a reflection of a shortage in the regular market, and shortages are the result of price controls.

Meaningless Gestures

- ◆ Other states have implemented some very poor policies to depopulate their wind pools. Florida paid bonuses to companies in the early 2000's for take-outs, and the primary recipient of the bonuses failed in the 2004-05 hurricanes.
- ◆ Florida has established many Florida-only insurers which do not effectively spread the risk and are unlikely to survive the next big hurricane. The losses will be shifted to other policy holders through the state guaranty fund.
- ◆ The goal is a small residual market due to a healthy, vibrant property insurance market. Measures to reduce the size of TWIA but which don't lead to a healthy market are not a solution.

Funding Mechanisms and TWIA

- ◆ Assessments on the state insurance industry are the worst mechanism to fund a residual market, and the unlimited assessments possible with TWIA was the worst of the worst. The 2009 legislation was an improvement by eliminating unlimited assessments.
- ◆ Direct assistance from the state is preferable to assessments; losses still get shifted to third parties, but the state can use broad based taxes (e.g. sales tax revenues) instead of a potentially crippling tax on one industry, which would already be reeling after a major hurricane.

Reinsurance

- ◆ With the 2009 reforms, TWIA has stopped purchasing reinsurance. Reinsurance may not always be the best way to finance TWIA exposure, but it is a good way.
- ◆ Reinsurance provides a way to mobilize resources from around the world to help Texans rebuild after a hurricane, and in a voluntary, contractual fashion (as opposed to taxation).
- ◆ Market supplied reinsurance also rules out any subsidy, in contrast with Florida's government run reinsurance program.

Savings and Self-Assessment

- ◆ With the 2009 reforms, TWIA is going to attempt to rely on internal savings (building up the Catastrophe Reserve Trust Fund) and bonds to be secured by self-assessment (assessment of only TWIA policyholders).
- ◆ Both of these options are valid alternatives to reinsurance, and each avoids shifting of losses to third parties.
- ◆ The major challenge with self-assessment would be the potential for policy holders to default on what could be substantial assessments, and resulting difficulty in issuing bonds.

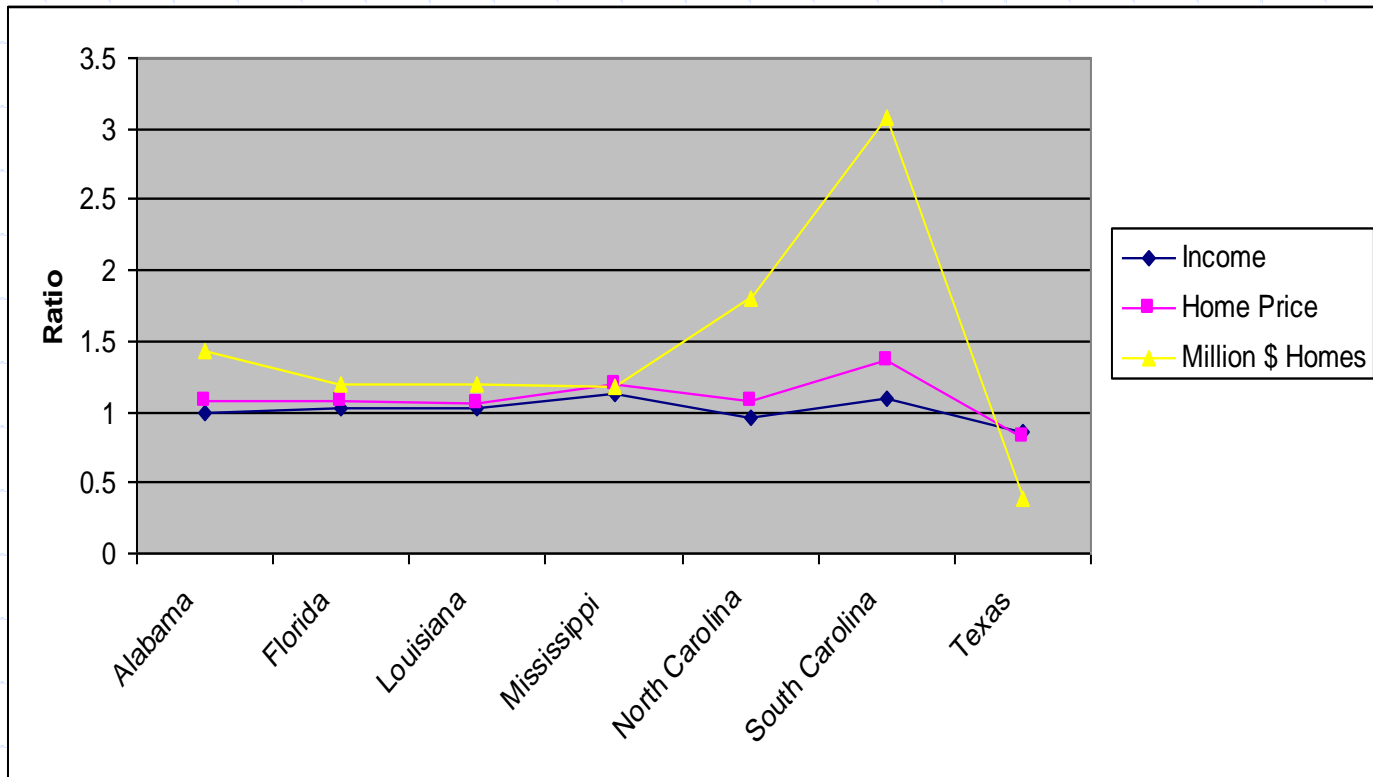
Impact of TDI's Regulatory Process

- ◆ The Department of Insurance is ultimately responsible for the price controls on private insurance and the underpricing of TWIA's coverage which creates the large residual market.
- ◆ As a move toward a market solution for wind insurance, TDI should consider insurers offering coverage in the TWIA coverage area. Insurers would still face solvency regulation, but the rates and terms of coverage would be freed up.
- ◆ Since TWIA would still be offering subsidized coverage, we wouldn't expect large numbers of customers to move to the private market. But insurers could compete on quality of service dimensions, which some homeowners might find attractive.
- ◆ Also any reduction in TWIA policies will be due to market forces, not disguised subsidies or political sleight of hand.

The Texas Coast Isn't all Beach Homes

- ◆ The coastal counties of most Gulf of Mexico and Atlantic seaboard states are relatively affluent. Subsidized hurricane insurance in these states helps some of the wealthiest residents of these states.
- ◆ Texas is an exception to this pattern, as coastal counties are less affluent than the remainder of the state. Many TWIA policy holders have modest residences and would have difficulty making ends meet without TWIA's subsidized rates.

Affluence of Coastal Counties (2000)



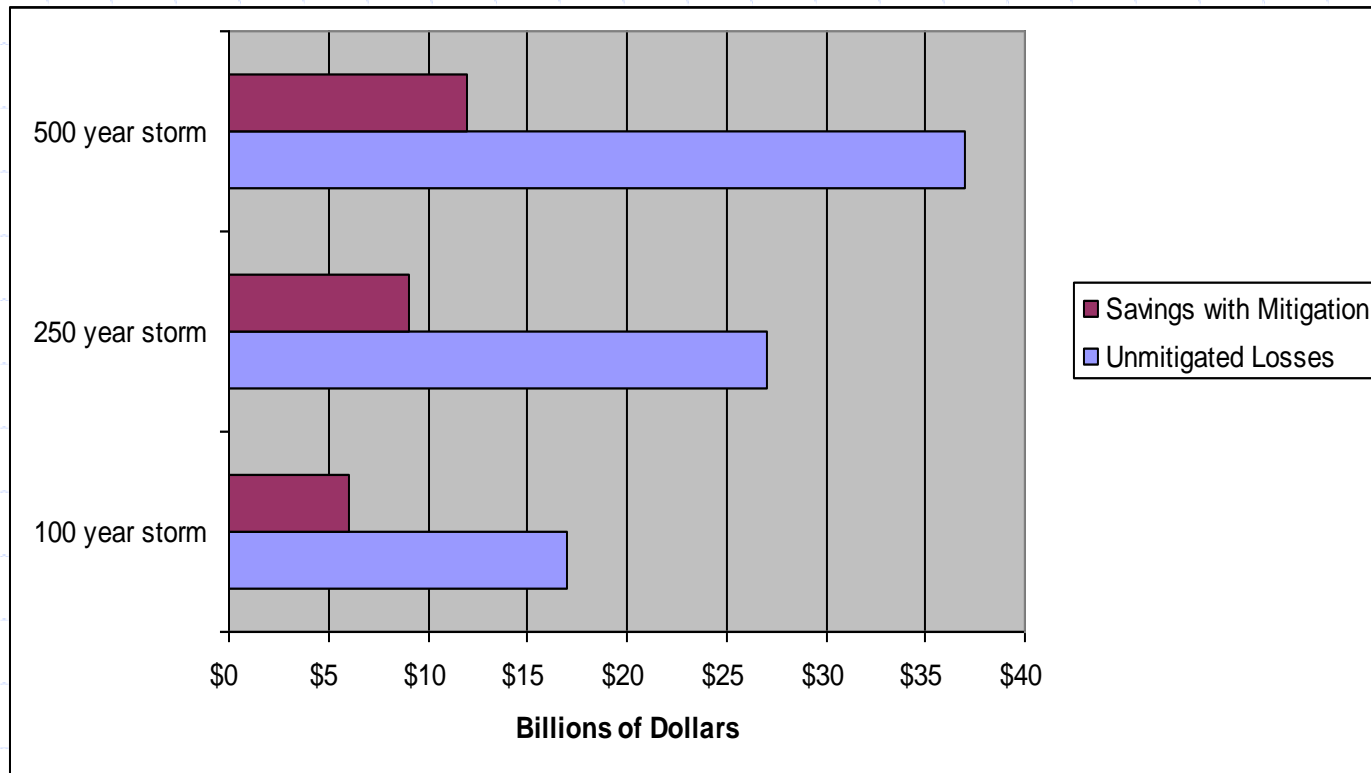
Assisting Low Income Households

- ◆ If the state legislature considers helping low income households with the cost of hurricane insurance, the way to do this is through means-tested financial assistance.
- ◆ Consider the food stamps program: we don't keep the price of milk artificially low for all consumers just to help low income households.
- ◆ If TWIA moves to charging risk based rates, this can be coupled with a system of direct assistance to low income households.
- ◆ The assistance could be limited to households residing in the TWIA coverage area at the time of the policy change, to assist only those who have been benefiting from TWIA rates.

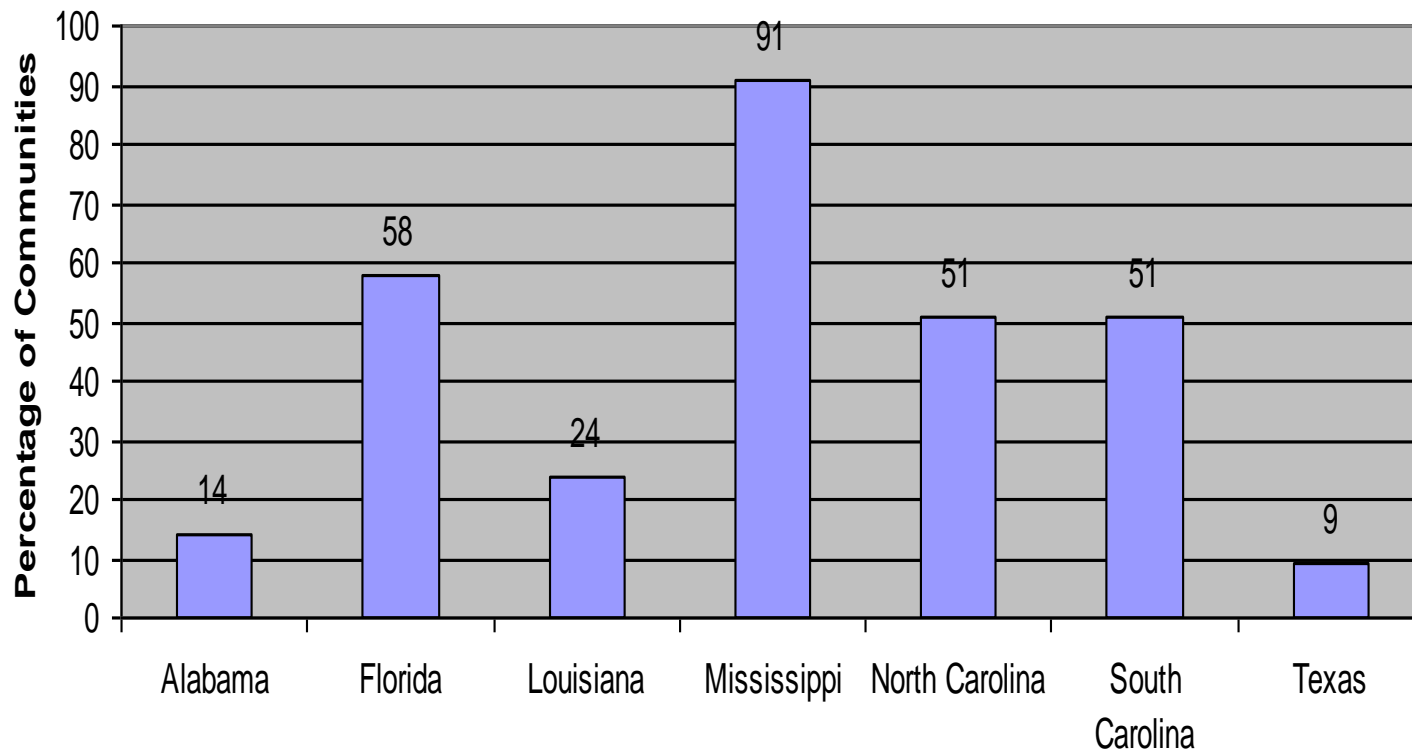
Mitigation and TWIA

- ◆ Mitigation can play an important part in reducing hurricane losses.
- ◆ Unfortunately Texas lags behind other hurricane exposed states in mitigation, as measured by participation in the NFIP's Community Rating System or the Insurance Services Office building code enforcement ratings.

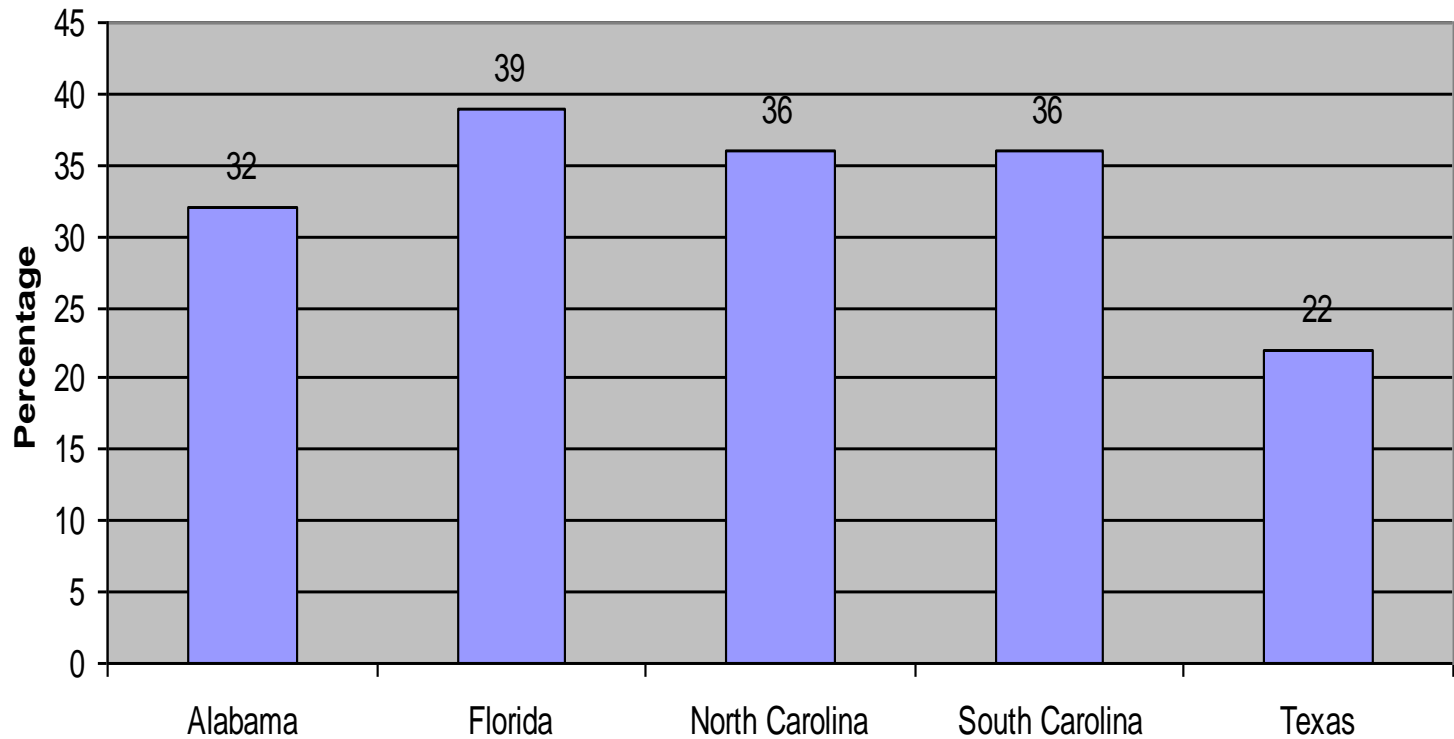
Potential Benefits from Mitigation in a future Texas Hurricane



Coastal County Community Participation in the NFIP's Community Rating System



Communities Participating in ISO's Building Code Enforcement Grading program



Options for Mitigation

- ◆ Texas could enact incentives for retrofit mitigation, similar to Florida's My Safe Home and South Carolina's Safe Home programs.
- ◆ Other options include offering low interest, long term home improvement loans to cover retrofit mitigation for existing homes.

More Mitigation Options

- ◆ Howard Kunreuther has proposed long term insurance contracts as a way to encourage mitigation. He proposes that the Federal government allow the NFIP to make long term contracts. State legislators could enable TWIA to offer long term contracts to encourage mitigation.
- ◆ If wind coverage is deregulated in the TWIA service area, insurance companies might come up with their own innovative incentives or long term contracts to encourage mitigation.

Summary

- ◆ Exclude new construction from eligibility for TWIA coverage.
- ◆ Resist assessments on the state insurance industry as a means to fund TWIA.
- ◆ Deregulate the market for wind coverage in the TWIA service area.
- ◆ Phase out the subsidies in TWIA rates, but offer means tested assistance for current TWIA low income customers.
- ◆ Allow TWIA and insurers to make long term contracts to encourage mitigation.