

The Quorum Report

Editor: Harvey Kronberg
P.O. Box 8 Austin, Texas 78767
Voice: 512-292-8191
Fax: 512-292-0099
Email: kronberg@quorumreport.com

September 5, 2007 5:06 PM

© Copyright September 5, 2007 by Harvey Kronberg, www.quorumreport.com, All rights are reserved

WRESTLING WITH HOW TO INSURE THE TEXAS COAST AGAINST HURRICANES

Insurance companies underfunded in the face of the big one

Texas has dodged some bullets in recent hurricane seasons. *Katrina* hit east of here. More recently, *Dean* and *Felix* hit south of here. And even though *Rita* brought major destruction to East Texas almost two years ago, it could have been much worse.

That said, it seems unlikely that Texas can avoid every catastrophic hurricane destined to blow into the Caribbean in the future. And since no one seems to believe the globe is about to experience global cooling, the number of storms in future years could very well increase.

What has got state policymakers concerned is that when the Big One strikes, the state's windstorm insurance fund will be grossly inadequate to cope with the expected losses. At a policy primer on the subject hosted by the *Texas Public Policy Foundation* today, *House Insurance Committee* Chairman **John Smithee (R-Amarillo)** said that the *Texas Windstorm Insurance Association* was meant to be an insurer of last resort for coastal residents who could not otherwise qualify for private insurance.

The reality, though, is that *TWIA* has ended up charging below market rates that not only drive private insurers out of the market but also ensure that the *TWIA* would be unable to cover the losses caused by a major storm, Smithee said.

Those losses would be recovered instead from other insurance companies in the state, Smithee added. In other words, ratepayers around the state would be on the hook for *TWIA's* uncovered losses. Forcing those companies to underwrite those losses also serves as a powerful disincentive for insurance companies to set up shop in Texas, he said.

And those losses could conceivably be tremendous. A storm the size of *Hurricane Dean* could cause \$8 billion to \$10 billion if it cut across Galveston Island, according to **James Oliver**, *TWIA's* general manager. The same storm could cause \$3 billion if it cut into Corpus Christi. *TWIA* could cover about \$1 billion of those losses.

University of Houston law professor **Seth Chandler** said the problems at *TWIA* are the equivalent of the inadequate levee system around New Orleans prior to *Katrina*. Many people knew the levees would not stand up to a major hurricane but the potential problem was not communicated adequately to ensure a proper response. The same thing is happening with *TWIA*, he said.

Chandler said the state has options to pay smaller amounts on the front end to avoid billions of losses should a major storm strike the coastline. One option could be for lawmakers to put more money into the catastrophe reserve fund, he said.

Sen. **Mike Jackson (R-LaPorte)** disagreed with the other panelists' conclusion that *TWIA* was charging below market rates. He said that private insurers were refusing to write more policies in Texas not because of *TWIA's* rates but because of their losses in Florida, Louisiana and elsewhere. He suggested that the Legislature should penalize insurance companies that don't write policies for coastal residences while providing financial incentives for the companies that offer coverage to coastal clients.

In the end, it comes down to what is the coast's fair share in preparing for a major storm. Coastal residents could not possibly be expected to cover all the losses that would be incurred by a monster storm like *Dean*, Smithee acknowledged. But is it fair to ask ratepayers in Midland and El Paso to subsidize an insurance policy on a \$1.5 million Gulf Coast home, as is currently allowed?

Jackson was unwilling to answer when asked directly by an audience member if he would support a rate increase for *TWIA* policyholders. How much would be enough, Jackson wondered, before saying that coastal residents do not mind paying their fair share of insuring against a future storm. People on the coast are paying high enough rates, he said, and they have a hard time

believing when others say that **TWIA** is subsidizing rates.

Chandler, though, wondered how the absence of private insurers from the coastal market could lead someone to believe that ratepayers are paying their fair share. Insurers would want to write policies where rates were high enough to turn a profit, he said. The lack of private insurers suggested to him that the rates weren't high enough to attract those insurers.

Smithee said that he thought the state should reform **TWIA** enough to where coastal ratepayers could absorb the losses incurred by a major storm, such as one that happens once every 50 years. It would be too much to expect those ratepayers to cover a catastrophic storm – one that comes every 100 years.

To get there, Smithee suggested that the state buy more reinsurance, perhaps doubling the \$1 billion purchased this past legislative session. Another immediate solution would be the use of bonding authority to cover losses instead of assessing the losses to insurance companies.

The bigger task is to change a system that does not penalize risky development in coastal areas vulnerable to big storms. In the past few years, **TWIA's** exposure to loss has skyrocketed. In 2001, **TWIA** was liable for \$13.2 billion in residential, commercial and governmental property. By 2003, its liability was \$18.8 billion and by 2005, it was at \$23.3 billion.

Last year, **TWIA's** liability jumped to \$38.3 billion, a 64.7 percent increase over the previous year. Oliver said that **TWIA** has \$58.3 billion in liabilities currently. He expected that number to be in the \$65 billion range by year's end. By the end of 2008, total liabilities could reach \$75 billion to \$80 billion, he said.

Smithee said that addressing the rate structure is not as easy as it first seems because inland coastal residents don't carry the same risk that as coastal residents directly on the water. Folks living 30 to 40 miles inland could well be paying their fair share into **TWIA**. Meanwhile, someone building a home on the water would not be paying their fair share no matter what rate he pays.

The state should seriously consider not allowing **TWIA** to write policies on those riskiest structures, he said.

© Copyright September 5, 2007 by Harvey Kronberg, www.quorumreport.com, All rights are reserved