

IX. Policy Issues

Overview

To identify statutory changes that would improve agency operations and service delivery, the Texas Department of Insurance (TDI) considered four high-level questions:

- Should TDI's statutory authority be changed to better assist insurance consumers and injured employees and to maintain a stable insurance market?
- Should TDI's role be expanded to better ensure that Texans have adequate insurance coverage?
- Should TDI have additional policy flexibility to firmly and fairly regulate the insurance marketplace?
- Should TDI's statutory organizational structure be modified to better support the agency's mission?

From these four questions, we assessed issues raised by the agency, the Legislature and our stakeholders and identified the following policy recommendations:

- Regulate preferred provider organizations to increase protections for insurance consumers and injured workers
- Require insurers and agencies to maintain and test catastrophe and business continuity plans to strengthen the insurance industry's responsiveness to disasters, including weather, human-made, and pandemic events
- Create a system for fair reimbursement of out of network health care providers
- Increase the availability and affordability of health insurance as well as wind and hail insurance coverage
- Commence a pilot study for alternative rating structures for title insurance
- Engage the agency in greater policymaking authority to address technological advances that impact the type of products offered, the classifying of individual risks, and the rating of insurance products
- Moderate insurance coverage costs through greater rating flexibility for the Texas Windstorm Insurance Association, restructuring of the maintenance tax and fee assessments, and reviewing the continued viability of the Texas Health Reinsurance System
- Transfer the windstorm inspection function to the Texas Windstorm Insurance Association.

The policy issues that follow discuss the problems involved in these issues, TDI's role related to the issues, and the possible benefits and impacts of the recommended statutory changes.

A1. Brief Description of Policy Issue.

Should the Texas Department Insurance's (TDI) statutory authority be changed to better assist insurance consumers and injured employees and to maintain a stable insurance market?

B1. Discussion.

The following discussion examines three areas where changes in statutory authority could allow TDI to more effectively and adequately assist insurance consumers and maintain a stable insurance market. The areas are: preferred provider organizations, catastrophe and business continuity plans, and reimbursement of out-of-network providers.

Preferred Provider Organizations

A preferred provider is a health care provider, or an organization of health care providers, that contracts with an insurer to provide medical care or health care to insureds covered by a health insurance policy.¹ The organization of providers is often referred to as a Preferred Provider Organization (PPO). The *Texas Insurance Code*, however, does not define PPO and consequently TDI has little authority over a PPO despite the reality that a PPO may provide services under a TDI-regulated preferred provider benefit plan (PPBP). The statute defines PPBPs as benefit plans in which an insurer provides, through its health insurance policy, for the payment of a level of coverage different from the basic policy level of coverage if the insured person uses a preferred provider.²

In order to expand its network, a PPO may contract with other networks, sometimes referred to as silent PPOs, and thus may access discounts that the providers did not anticipate or grant through direct contract with the insurer. Many carriers rely on PPOs for a significant portion of the business of health care, such as developing networks, negotiating discounts with the providers on behalf of insurers, and processing and repricing claims. When problems with network adequacy or inappropriate discounts arise, carriers often direct the criticism and culpability to the PPO. However, as an unregulated entity, an indeterminate number of PPOs operate in the state without sufficient accountability and oversight.

In an attempt to address PPO regulation, TDI drafted an informal rule for comment and released it in November 2006 to the Technical Advisory Committee on Claims Processing, a formal working group comprised of providers and carriers. The rule would require a carrier to furnish a provider, at the time the carrier takes the discount, with proof of underlying contracts that permit the discount. Comments received to date reflect the opposing perspectives of providers and carriers. Providers generally state that, in cases involving silent PPOs, carriers benefit from discounts not specifically included in the provider's contract with the carrier. Carriers generally respond that most contracts with providers include a provision that authorizes the underlying contracts and discounts.

Catastrophe and Business Continuity Plans

In 2005, Hurricane Katrina devastated portions of the U.S. Gulf Coast. In the areas most heavily impacted by the storm, claims payment facilities for several insurance carriers, health maintenance organizations, workers' compensation carriers, and insurance agencies were destroyed or severely disrupted. As a result, TDI learned that a disaster need not happen in Texas in order to impact Texas' resources and require Texas governmental assistance. Hurricane Rita then followed, bringing with it the

¹ Insurance Code Section 1301.001(8)

² Insurance Code Section 1301.001(7)

stark reality that weeks without utilities to more than 1 million people and businesses in Southeast Texas can render cities and towns unlivable.

Presently, no statutory requirement exists for the insurance industry to maintain and test catastrophe and business continuity plans. Absent such authority, Texas insurers risk significant losses following a disaster and disruption of services. Additionally, Texas consumers and injured employees face delayed responses following a disaster, a time when rapid, effective response is needed the most.

Health Care Reimbursement for Out-of-Network Providers

Balance billing refers to the practice of non-contracted, out-of-network providers billing patients covered under HMO and preferred provider benefit (aka PPO) plans for the difference between the amount the benefit plan paid and the amount the provider believes to be adequate reimbursement.

HMO Plans

In HMOs, balance billing generally should be rare. An HMO provides or arranges to provide covered services for enrollees on a pre-paid basis through a network of physicians and providers, referred to as providers in this policy issue. The enrollee pays only a scheduled charge for these services, usually a copayment. As long as the enrollee stays within the HMO network, no payment issues should arise. If an enrollee obtains services outside the network, the HMO is generally not obligated to pay for services. Two exceptions to this rule exist: 1) when the HMO must refer an enrollee out-of-network because its network does not include the appropriate provider, and 2) when emergency services are required.

HMO out-of-network referral

While Texas law contains a number of requirements promoting adequate HMO networks, networks may be inadequate for a number of reasons, including the inability of HMOs and providers to agree to contractual terms, usually involving payment rates. In such instances, Texas law guarantees adequate coverage, requiring HMOs without a sufficient network to provide medically necessary services through an out-of-network referral. The HMO must then fully reimburse the out-of-network provider at the usual and customary rate or at an agreed rate. This provision anticipates the parties will agree to payment terms before services are provided. The advance nature of the agreement should prevent balance billing.

Increasingly, referral to out-of-network providers is occurring after services have been rendered – a circumstance that may result in balance billing. This type of situation most often occurs with hospital-based providers, such as radiologists, anesthesiologists, pathologists, emergency room physicians and neonatologists. An enrollee may choose a network hospital and surgeon, but may receive ancillary services from out-of-network providers while hospitalized. After the service has been performed, the HMO and the provider may disagree on the amount of payment, and the provider may seek to recover payment from the enrollee to make up the difference. In this case, the enrollee did everything reasonably necessary to receive care through the network and should not be obliged to pay an amount other than a copayment or deductible. TDI requires the HMO to fully reimburse the provider at the usual and customary rate or an agreed rate and ensure that the enrollee is not responsible for payment of a balance bill. Nevertheless, the current situation sometimes results in HMO enrollees paying more than anticipated or required because they are billed beyond their deductibles and copays for out-of-network referrals. An enrollee who receives a balance bill should simply forward the bill to the HMO; however, most enrollees do not know to do so. When TDI has become aware of such situations, it has been successful in requiring that the HMO take care of the bill so that the member is not required to pay it.

HMO Emergency Services

The HMO Act requires an HMO to reimburse emergency services providers at the usual and customary rate or an agreed rate. The emergency services provision does not include the term “fully” as does the

out-of-network referral situation discussed above. This creates ambiguity regarding what payment is required by the HMO and thus the possibility that the enrollee will be balance billed.

PPO Plans

With PPO plans, the balance billing issue is more complicated. PPO plans do not provide prepaid care, and some balance billing is inherent to such plans. PPO plans typically do not pay the entire amount billed by a provider, but pay only a percentage of an amount which is determined either by a contract with the provider (if the provider is a preferred provider) or by the carrier's determination of what is payable (if the provider is not contracted). The percentage level of reimbursement of out-of-network providers is lower than for network providers; accordingly, the insured would pay a higher percentage if using an out-of-network provider than if using a network provider. While network providers typically have contractually agreed to the amount of reimbursement (for which they will receive the higher percentage reimbursement), out-of-network providers have no such prior agreement or understanding. In such cases, the PPO issuer determines the amount of reimbursement. Some carriers might pay their percentage of the entire billed charge, while others might pay their percentage off of an amount they determine to be "usual and customary," "reasonable and customary" or an "allowable amount." When the out-of-network provider believes that amount is too low, the provider may seek to recoup from the member, not only the member's percentage, but also the entire remaining difference between the allowed amount and the billed charge. Often, the difference may be very large, and an enrollee often will not know in advance what amount a carrier will use in determining its payment.

The issue of balance billing has been more pervasive in the PPO environment, as a result of more services being obtained out-of-network. In addition, PPO members encounter similar instances of being billed by out-of-network providers who provide services in a network hospital. Necessary care that cannot be obtained in-network, as well as emergency care services, should be compensated at an in-network percentage; however, the insurer's ability to define the basic reimbursement amount may still lead to balance billing.

C1. Possible Solutions and Impact.

Regulate preferred provider organizations to increase protections for insurance consumers and injured employees.

To address concerns with the operation of Preferred Provider Organizations (PPO), the agency proposes providing TDI or the Texas Medical Board with additional authority to regulate PPOs, including authorizing TDI to require the registration of PPOs. Implementing these proposals would provide Texans with protections in this growing segment of the health coverage market.

Require insurers and agencies to maintain and test catastrophe and business continuity plans to strengthen the insurance industry's responsiveness to disasters, including weather, human-made, and pandemic events.

To address concerns with the potential loss of insurance business, services and assistance following a catastrophic event, TDI suggests a statutory requirement that insurance carriers, health maintenance organizations, workers' compensation carriers, and insurance agencies maintain and test catastrophe and business continuity plans.

Implementation of this proposal would reduce the potential for significant losses and delayed disaster response for Texas consumers and injured employees. This proposal would require the entire insurance industry to ensure that its disaster preparedness efforts meet the statutory requirements, both as to plan

components and testing requirements. TDI's increased regulatory responsibility would ensure that these disaster preparedness requirements were followed and would allow the use of enforcement actions as necessary. The benefits of such a statutory change include protection of insurance industry resources and solvency as well as an enhanced ability to assist consumers.

While the enactment of this proposal would positively affect Texas consumers during a time of need and would protect Texas insurers from significant loss of business, implementation would require considerable expenses and resources on the part of both the insurance industry and the agency. The insurance industry would be required to develop, maintain and test catastrophe and business continuity plans, while TDI would need to assess the impact on staffing resources required for financial examinations and legal enforcement.

Create a system for fair reimbursement of out of network health care providers.

The agency proposes that the Legislature consider setting a standard for compensation for out of network providers in the HMO and PPO contexts so that carriers are not required to pay unreasonably high billed charges and so providers are not forced to balance bill members due to carriers paying unreasonably low amounts. The Legislature could either set this rate by statute, delegate setting the rate to a state agency, or create a mandatory alternative dispute resolution system, such as arbitration, to resolve disputes over out of network payments. While determining rate standards would be contentious, once set, they would greatly simplify subsequent claims processing and prevent unexpected bills for consumers which sometimes can reach tens of thousands of dollars. Further, it should be noted that setting hard and fast price controls disrupts any economic system. Any law impacting usual and customary fees would need to be flexible, so the natural forces of supply and demand have influence over the final price.

A2. Brief Description of Policy Issue.

Should TDI's role be expanded to ensure that Texans have adequate insurance coverage?

B2. Discussion.

The following discussion examines various lines of insurance where affordability and availability for Texas consumers could be impacted if TDI's role were expanded. The lines of insurance included in the discussion are health, wind and hail, and title.

Health Insurance

Although TDI is not specifically charged with promoting the purchase of health insurance, the agency has become increasingly engaged in related activities as the number of Texans without health insurance has continued to increase. Consumers frequently contact the agency to ask for advice or assistance with efforts to find health insurance. The agency answers general inquiries and provide basic information on TDI's website and on TexasHealthOptions.com. The agency does not recommend a particular product or carrier. Nor has TDI undertaken the role to counsel the individual consumer regarding specific insurance choices. A change to TDI's statutory duties may be required if the agency is required to provide additional assistance by directing consumers to different health care options available in their area and appropriate to their needs.

Small employers in particular face numerous challenges when shopping for coverage. Estimates of the state's uninsured population indicate that approximately 80 percent of the uninsured either work for a small business or live in a family where at least one adult is employed by a small business. Since 2001, under a Federal State Planning Grant (SPG), the agency has been involved in a comprehensive study of the uninsured and has reviewed a wide range of options for expanding coverage within the small group market. Most recently, TDI received funds under the final stage of the SPG program to develop –but not implement – a pilot project for expanding coverage based on the earlier research conducted under the SPG program. At this point, the grant has concluded and the plan has been turned over to the Greater Houston Partnership to implement.

While legislative efforts over the past 10 years have greatly improved the opportunities for small groups to obtain health insurance, approximately 75 percent of small business owners do not offer health insurance. Though affordability is a primary barrier, employers also report numerous other challenges that discourage many small business owners from even looking for coverage. Following is a brief summary of the most common concerns raised by employers through focus groups, surveys and discussions with TDI staff as part of the SPG research work.

- Shopping for insurance is time consuming and confusing.
- Many health insurance agents will not work with small employers because of the time involved and small commissions.
- A strong belief that health insurance is unaffordable and difficult to understand.
- Health insurance is an added expense that provides little benefit to their business.
- The tax benefits are too difficult to understand (if the employer is aware of them at all).

Wind and Hail Insurance

Approximately 30 percent of Texas' population resides in counties along the Texas Coast and adjacent counties. The insurance industry estimates that in 2004, about \$750 billion in insured properties, both residential and commercial, in the state were vulnerable to hurricane losses. In 2005, hurricanes cost the

insurance industry about \$46 billion in losses countrywide, the worst season for losses on record. The only one to hit Texas, Hurricane Rita, caused an estimated \$2.6 billion in insurance losses in the state. The 2005 Atlantic hurricane season was a record year in terms of named storms, 28 in all. Some hurricane experts are predicting that the current cycle of very active Atlantic hurricanes will continue for several years. The Texas Windstorm Insurance Association (TWIA) was created in 1971 in response to Hurricane Celia. TWIA provides windstorm and hail coverage for property owners in areas of the state where it is not readily available. TWIA consists of all property insurers authorized to write property insurance in Texas and administers day-to-day operations, including policy issuance and claims processing. TWIA is authorized to provide wind and hail insurance in the 14 counties along the Texas coast and in other areas designated as “catastrophe areas” by the Commissioner of Insurance. The term “catastrophe area” is defined in the *Texas Insurance Code* to include, among other things, areas where “windstorm and hail insurance is not reasonably available to a substantial number of owners of insurable property.” To date, outside of the 14 coastal counties, only small portions of Harris County have been designated as “catastrophe areas.” In the event TWIA is unable to cover losses from premiums and other revenues (currently only premiums and investment income, which amounts to over \$200 million per year), the following funding mechanism currently applies (in order):

- \$100 million assessed to member insurers;
- Catastrophe Reserve Trust Fund (CRTF) (currently about \$380 million) and reinsurance (about \$1.0 billion);
- \$200 million assessed to member insurers; and
- Unlimited assessment to member insurers reimbursable from premium tax credits over five or more successive years (after the approximately \$1.7 billion provided from the above sources).

TWIA’s exposure has been growing rapidly in recent years. In 2001, TWIA had 68,758 policies. As of June 30, 2007, TWIA insured 181,826 policies with direct liability in excess of \$49 billion with more than half (\$23 billion) of its liability concentrated in Galveston and Brazoria Counties. It is estimated that TWIA’s exposure, including miscellaneous coverage such as business interruption, will exceed \$65 billion by the end of 2007.

This growth increases the possible losses arising out of a given storm, placing state revenues at an ever-increasing risk. The current catastrophe funding capacity available to cover losses before the reimbursable tax credits are triggered (approximately \$1.7 billion) is estimated to cover the probable TWIA losses from a storm that would be expected to occur about every 30-40 years (a 2.5 percent to 3 percent chance of striking in any given year). Texas’ general revenue stream would be at significant risk should a more severe storm strike the coast. For example, TWIA losses from a so-called 100-year storm (one having a 1 percent chance of striking in any given year) are estimated at about \$3.2 billion, placing about \$1.5 billion of state revenues at risk; a 250-year storm (one with a 0.4 percent chance of striking in any given year) would produce about \$4.9 billion in losses for TWIA, jeopardizing about \$3.2 billion in state revenues.

Several topics related to wind and hail insurance, whether combined or evaluated separately, impact the availability and affordability of coverage.

Designated Catastrophe Areas

In the spring of 2006, the agency began receiving numerous inquiries and feedback from various members of the public, including representatives of the Texas Apartment Association, the Independent Insurance Agents of Texas and the Texas Association of School Boards, regarding unavailable and unaffordable wind and hail coverage in counties along the coast (first-tier counties) and those bordering them (second-tier counties, particularly Harris County). The majority of affected properties were condominiums, town homes, apartments and schools located in the second-tier counties. The market

restrictions and price increases generated requests to expand the areas in which TWIA can provide wind and hail coverage so that property owners may obtain coverage through TWIA. The standard for “catastrophe area” as currently defined in the code requires that insurance not be reasonably available to a *substantial number* of owners of insurable property. Even though it is clear that some property owners are having difficulty obtaining wind and hail insurance, the number of property owners may not be sufficient to meet the *substantial number* standard for TDI to expand the catastrophe area.

Windstorm Mitigation

The Windstorm Inspection Program began in 1988 and is administered by TDI. The program is responsible for determining building code compliance for the purpose of obtaining and maintaining windstorm and hail insurance coverage through TWIA. Until May of 2006, a homeowner would have to obtain a Certificate of Compliance (WPI-8) in order to obtain or maintain windstorm and hail insurance through TWIA. Now, in lieu of a WPI-8, and for a specified period of time, a homeowner can obtain insurance by paying a premium surcharge based on meeting specific criteria. Currently, all Texas municipalities are required to adopt the International Residential Code (IRC) and International Building Code (IBC); however, the agency has adopted stronger wind-resistant construction criteria beyond what is required under the IRC and IBC. Loss mitigation is an important element of preparing for future windstorms. Even though municipalities are required to adopt the IRC and IBC, currently no provisions are in place to ensure that municipalities have adopted or are inspecting or enforcing these codes.

Reinsurance

The frequency and severity of recent hurricane losses and future predictions of a continuing pattern has had a dramatic impact on reinsurance capacity and pricing which in turn has impacted the affordability and availability of primary insurance along the Texas coast. In 2006, many insurers, including TWIA, indicated they were unable to purchase the amount of reinsurance desired and that the cost for the available reinsurance was substantially more than the prior year. Reinsurance prices increased between 100 percent and 200 percent from 2005 to 2006. The cost of reinsurance is passed on to policyholders. If an insurer is unable to purchase the desired reinsurance, the insurer itself will have to bear (or insure) the losses that have historically been reinsured or will have to restrict its writings. The 2006 estimated cost for TWIA to purchase the same amount of reinsurance that was purchased in 2005 was almost double, or approximately \$38 million dollars higher. TWIA ultimately purchased a lower level of reinsurance in 2006 at a cost that was approximately \$23 million higher than the 2005 reinsurance program. Additionally, participation in the 2006 reinsurance program was insufficient for TWIA to obtain the full amount of reinsurance it was seeking. The 2007 estimated cost for TWIA to purchase \$1 billion in reinsurance is approximately \$151 million.

Reinsurance availability and price are influenced by:

- changes in hurricane models that have increased probable loss figures used by primary insurers and reinsurers;
- rating agencies becoming more conservative in evaluation of insurers’ catastrophe management plans;
- forecasts of increased hurricane activity and strength;
- reinsurer needs to rebuild capital; and
- a dysfunctional market largely due to the absence of normal competitive pressure to contain costs.

Voluntary Market

The most immediate after-effect of the 2005 hurricane season has been the impact on affordability and availability of property insurance in the coastal counties. Several major insurers have filed for rate increases. In addition, several insurers have informed TDI that they will be restricting wind coverage along the coast by excluding it from their policies and in some limited instances, not writing coastal

business altogether. Moreover, some assert that the inadequate funding structure and rates of TWIA have increased the likelihood of insurer assessments and thereby stifled the full development of a competitive statewide homeowners market as insurers weigh expanding their market share against the potential for future assessments.

In response to an insurance availability problem sparked in part by mold claims and water damage claims, the Texas FAIR Plan Association (TFPA) was established in 2002 to provide residential property insurance statewide. The TFPA consists of all property insurers authorized to write business in Texas, and those members participate in any assessments due to shortfalls in revenue. In addition to relying on member insurer assessments and reinsurance to fund excess losses, the TFPA is also statutorily authorized to issue public securities as a method to raise funds for losses. The amount of public securities that may currently be issued to fund TFPA losses cannot exceed \$75 million. TFPA member insurers are expressly authorized to make a premium surcharge on each policy they issue to recoup assessments, including service fees to pay the debt service on public securities. In November 2004, the TFPA policy count peaked at more than 134,000 policies representing \$24 billion in liability. As of June 30, 2007, the policy count was approximately 89,000 with \$14.9 billion in liability.

While the TFPA policy count and liability has declined significantly in the last two years, the problem now is its concentration of risks in areas that are vulnerable to hurricane losses, primarily in Harris and Fort Bend Counties. These and the other coastal counties account for more than half of TFPA's policies and liability. Due to increased reinsurance costs and predictions of increased hurricane activity, voluntary insurers have restricted underwriting along the Texas coast, resulting in the likelihood that more and more of these coastal risks will have to obtain insurance through TFPA. TWIA and TFPA are similar in terms of their vulnerability to a catastrophic loss from a hurricane and how shortfalls in funding impact the policyholders of the state. Therefore, both TWIA and TFPA should be the subject of discussions on how funding should be changed and how funding shortfalls are to be funded and who should pay for it. Additionally, discussions should also take into account the related purposes of TFPA and TWIA.

Recent Legislation

The 80th Legislature considered House Bill (HB) 2960 and Senate Bill (SB) 1155; these proposed bills were not companion bills, but were merged by the Senate and further discussed under HB 2960. The proposed legislation initially included, in some form, the concepts embodied by the recommendations proposed in TDI's *Biennial Report to the 80th Texas Legislature*. These recommendations are discussed in Item C below.

Additionally, the 80th Legislature considered HB 698, SB 898 and SB 1027, which all considered extending coverage through TFPA.

Title Insurance

Texas is one of only three states in which the Commissioner of Insurance promulgates title insurance rates, policy forms and endorsements, and the associated rules. All title underwriters and agents must use these rates and forms. This regulatory system contrasts with other lines of insurance, where greater rate freedom is permitted. For instance, at present, rates for virtually all property and casualty coverage in Texas, other than title, are subject to a file-and-use regulatory system.

There are dynamics to remember in title insurance rates. Under a promulgated rate system, insurers must report their expenditures for purposes of setting rates. It is in the market's best interest that expenditures are reported fairly, so that the actual price reflects actual costs. Insurers do not have any disincentives to report as high a cost as possible, because under a promulgated rate system they will not be harmed by price competition if their expenditures are too high.

Under the current system, rates are set at biennial rate and rule hearings. These are long and costly processes that may produce results that are not indicative of the current market once the final rate and rules are adopted. Given that the use of the resulting rates is mandatory, consumers do not have the ability to shop for coverage on the basis of cost as they do in other states or for other lines of insurance.

The title insurance marketplace has no price competition, and very little direct competition for consumer business, except on service. This lack of competition results in inefficiencies in the marketplace. For instance, instead of competing directly for consumers' dollars, many, though not all, agents compete by expending their marketing efforts on real estate agents, lenders, builders, and other "producers" who can direct the property buyers to a particular title agency. Moreover, the current system allows builders, producers, lenders, and others to own agencies dedicated to particular real estate developments. While such integration may be efficient on its face, additional costs may find their way into the rate structure with no effective level of competition to keep those costs in check.

Some small, rural and/or independent agents contend that large, metropolitan, and/or underwriter-owned agents put them at a competitive disadvantage by their arrangements with large property developers that control the title transaction and pay the smaller agents only a fraction of the overall premiums. If a rural agent, who may be the only agent in a particular county, is put out of business, the local population loses the local title expertise needed to evaluate and minimize local title issues.

Any change in the system for regulating title insurance must be done gradually and initially limited to certain geographic areas. Possible outcomes of price competition include increased efficiencies and slightly lower prices for consumers. Conversely, an outcome may be the emergence of title agency services that are substandard because value is driven down by falling prices. Time and limited change are essential to initiating reform in order to maintain the balance of a properly priced market and high-value title agency services.

C2. Possible Solutions and Impact.

Increase the availability and affordability of health insurance as well as wind and hail insurance coverage.

Health Insurance

To address concerns with the affordability and availability of health insurance coverage, TDI suggests that the Legislature consider providing the agency with the strategic direction and authority to create mechanisms to promote and encourage more Texans to purchase health insurance.

While TDI's primary purpose is to regulate and protect the solvency of the insurance industry, the agency is well situated to examine creative ways to leverage public and private resources in a way that would expand health insurance coverage. While much of this work is currently performed on an ad hoc basis, pulling from multiple areas within TDI, explicit authority to promote health insurance coverage would allow the agency to centralize and dedicate resources for the purpose of developing and implementing strategies to ensure that more Texans have information to purchase health insurance coverage.

Possible approaches for accomplishing this goal include a governmental or quasi-public approach, private enterprise incentives or a combination of the various approaches. One governmental-based approach to resolving this issue is discussed below.

The Legislature could create a new division within TDI that assists small business owners and, on a more limited basis, individuals who are looking for health insurance. Activities could be focused exclusively

on the small employer market or could be designed to serve both individuals and small businesses looking for coverage. The division's key functions would be to:

- educate and inform the public of the importance and value of health insurance and the dichotomy between personal health care responsibility and insurance protection;
- assist consumers with technical information in order to understand the insurance products that are available to them;
- assist consumers with information on the benefits of working with a trusted agent and how best to communicate with an agent; and
- promote and facilitate the development and availability of new affordable options, such as the Houston pilot project described above.

Creating this division would allow the agency to examine policy best practices and successes from other states and modify them to meet the needs of Texans. Implementation could occur on a pilot or statewide basis. The division could develop a tax tool kit to better inform small employers of the tax benefits of purchasing health insurance for their employees.

The division could also work with appropriate stakeholders on an ongoing basis to develop public and private strategies to increase the number of insured Texans. It could also encourage and facilitate development of community-based health plans for the uninsured, and TDI staff would be available to provide technical assistance and support.

Wind and Hail Insurance

To address concerns with the affordability and availability of wind and hail insurance, TDI proposes amending the provisions that allow the Commissioner to designate additional catastrophe areas to provide flexibility for the Commissioner to expand TWIA eligibility by classification or type of risk. For example if certain types of property owners are having difficulty obtaining coverage through the voluntary market, the Commissioner could expand eligibility on a limited basis to include certain classifications or types of risk, such as public buildings or habitable risks.

This proposal would expand the areas in which TWIA can provide wind and hail coverage so that property owners may obtain coverage through TWIA. However, once an area is designated as a "catastrophe area," all insurable property located in the area is eligible for coverage through TWIA. As a result, the State's general revenue may be put at much greater risk in order to assist a segment of the market in obtaining wind and hail insurance. Therefore, this proposal would need to accompany additional changes as discussed below, including legislation that:

- requires local jurisdictions, including counties, to adopt and enforce windstorm building code standards in coastal counties that have a significant hurricane exposure;
- requires municipalities to develop windstorm inspection programs, including structural plan review by design professionals, windstorm inspections and certification as part of their current inspection programs to ensure compliance with the wind resistant provisions of the code; and
- provides for the long-term phase-in of any changes to allow for public education and compliance.

These proposals may encourage insurers to write more wind and hail coverage in the coastal counties, thus lessening the exposure for TWIA. It would also ensure that if some of these properties are eventually insured by TWIA, they will be in compliance with the windstorm building code standards and would not require expensive inspections after the structures have been completed nor would there be a need to pay premium surcharges in lieu of aWPI-8.

TDI also suggests establishing a windstorm reinsurance facility (Facility) similar to the Florida Hurricane Catastrophe Fund to provide a stable and ongoing source of reinsurance to insurers, TWIA, and the Texas FAIR Plan Association (TFPA) for a portion of the hurricane losses incurred by those entities. The purpose of a Facility would be to protect and advance the state's interest in maintaining insurance capacity in Texas and to improve the availability and affordability of residential property insurance in Texas by providing reimbursements to insurers, TWIA and TFPA for a portion of their catastrophic hurricane losses at a reasonable cost. Providing a stable and ongoing source of reinsurance for TWIA and the TFPA will enable these associations to obtain a greater level of protection against catastrophic hurricane losses which, in turn, may help minimize policyholder surcharges or premium tax credits. Options to consider in creating the Facility to help achieve the intended purpose of the Facility are:

- requiring all licensed insurers in Texas, including TWIA and TFPA, that write certain policies to purchase reinsurance from the Facility;
- providing the Facility pre-event and post-event bonding authority; and
- providing the Facility assessment authority to service the bonds or to pay for losses to the Facility.

To promote voluntary entry into the property market, statutory revisions may include:

- providing for the phase-in of potential TWIA assessments over several years for new property insurance writers; and
- creating a rate filing “safe harbor” that provides that a coastal rate change not exceeding five percent in a 12-month period following a storm is presumed reasonable. After the third consecutive increase, any future rate change would be governed by current law, i.e., subject to disapproval by TDI. This should be conditioned on an insurer continuing to directly insure for wind loss.

While these changes would promote voluntary entry into the property market, it should be noted that the outcome may be only incremental increases in capacity, or may merely slow the withdrawal of insurers from the coast after a major storm or storms.

Finally, an important issue to consider is providing adequate and consistent funding mechanisms to both TWIA and the TFPA to allow for growth, especially with regard to growth in areas highly subject to catastrophic loss.

Commence a pilot study for alternative rating structures for title insurance.

To address concerns with the rating structure of the title industry, the agency proposes that the Legislature should consider allowing the Commissioner of Insurance to undertake a comprehensive study of rating practices related to the title industry. Additionally, the Commissioner should be given the flexibility to apply study results and analyses to develop alternative rating structures that introduce some measure of price competition into the market.

Alternative rating structures could take on several forms, such as initially permitting the filing of independent rates on a prior-approval basis, followed by a file-and-use system over a longer period of time. Any alternative rating structures should have a delayed effective date to allow for any legislative changes.

As previously stated, because of the complexity of this reform, any change in law should be constructed around gradual and incremental change. Several considerations to implementing an alternative rating structure on an incremental basis follow. For example, should a rating structure permit rating distinctions

based on geographic region or the size of the underwriter or agency? Rating distinctions could include variations in the monetary split between underwriters and agents to account for the cost-shifting cited by many rural agents. Measures should be taken to prevent predatory pricing that may adversely impact title agencies and, therefore, the quality of title transactions in certain counties. Further, consideration should be given to whether title insurance premium rates should be all-inclusive, the scope of any changes, and the amount of time over which any changes are implemented.

These changes may result in some downward pressure on rates. Further, it could curb marketing and other expense practices that presently place some upward pressure in costs that would otherwise be kept at a minimum in a more competitive environment.

A3. Brief Description of Policy Issue.

Should TDI have additional policy flexibility to firmly and fairly regulate the insurance marketplace?

B3. Discussion.

In the course of monitoring and regulating the Texas insurance market, TDI at times is faced with procedural impediments that can impact the effective regulation of the insurance industry. As new developments and areas of regulatory concern are identified, the agency examines and analyzes the situation to determine the potential impact on the insurance industry and Texas consumers. Should this examination result in the recognition that modifications to the regulatory structure are necessary, TDI makes a recommendation during the next legislative session. In the event the requested legislation is enacted by the Legislature, the agency then develops and executes administrative rules as necessary. The accumulated time from the identification of a problem to the enactment of the necessary administrative rules can be several years. This lengthy process can ultimately be costly and harmful to Texas consumers.

The following discussion examines areas where additional policy flexibility could allow TDI to more firmly and fairly regulate a dynamic insurance market, and to do so in a timely manner that does not cause further harm to consumers. The areas of discussion include data mining and pattern recognition, the Texas Windstorm Insurance Association, maintenance taxes, and the Texas Health Reinsurance System.

Data Mining and Pattern Recognition

An increasing trend in insurance rating and underwriting is the combined use of data mining and pattern recognition technologies. These tools are used by insurers to identify new rating and underwriting criteria used to differentiate among policyholders both in terms of what they pay for coverage and their acceptability for coverage. The continual development and deployment of this new technology platform could far exceed anything in practice today. This discussion therefore is in anticipation of something that could develop over several years. In the insurance context, data mining and pattern recognition is difficult to define. For discussion purposes, the combined use of the two technologies can be characterized as a means of identifying relationships among variables that are used to predict differences in the expected losses of insureds. These differences allow insurers to create new and more refined risk classifications. Insurers currently deploy similar technology to detect fraudulent claims, identify subrogation opportunities and to improve marketing effectiveness. What lies ahead, however, poses some significant policy issues. For example, consider the use of financial information beyond what is captured in a credit report, such as rent payments, or the amount of purchasing activity at a hardware store. If a correlation is drawn indicating a pattern between either one of these variables and the potential for claims, this gives the market another tool for pricing or risk classification.

The use of this tool can have one of two outcomes. It has been argued by groups associated with its development that insurers will show greater willingness to enter previously underserved markets, particularly in urban areas, since this technology will increase their confidence to accurately price and underwrite insureds that previously would have been rejected. Further, these groups argue that more individuals will have access to insurance from more companies at reasonable rates. Others argue that the use of this technology will have the opposite effect. If adopted by the majority of the market, exponentially more risk tiers are likely to emerge resulting in sharp or severe rate differentials among insureds at the ends of the pricing spectrum. This may effectively make insurance unavailable to many, perhaps requiring the creation of state-sponsored pools to provide basic required coverage. They argue further that a higher segmentation of the market will have the potential for disproportionate impact on

various socioeconomic groups. Moreover, as the number of rate tiers proliferates (hyper-tiering), the risk transfer mechanism begins to break down. Policyholders could be grouped with such refinement at a very individualized scale that there would be little risk transfer because losses are virtually predicted to a person, rather than a group of people within a given risk class. In theory, over several years, insurers will have the means to determine who will file a claim with a very high degree of confidence. If the larger market share insurers begin to use hyper-tiering at the same time, other companies will rush to a defensive market position in order to avoid being adversely selected against (i.e., protecting against insuring only the higher, more volatile risks). Whether and to what extent either one of these outcomes will be realized is unknown. However, as technology advances, there may be little time to react as the industry responds to a sudden change in the market.

The Legislature may need to consider both the positive and negative aspects of technological development when formulating policy affecting the insurance market. For example, data mining technology may offer positive solutions for underserved markets where risks are diverse. This technology may enable some niche writers to enter those markets and offer better products at better prices. Still, the transfer of risk over the long-term will be diminished as larger carriers adopt new technologies and hyper-tiering becomes the norm.

Proposed SB 828, 80th Legislature, Regular Session reflected proposals made by TDI to mitigate sudden and/or harmful market changes resulting from the use of data mining and pattern recognition.

Texas Windstorm Insurance Association

As noted above, the Texas Windstorm Insurance Association (TWIA) was created in 1971 to provide windstorm and hail coverage for property owners in areas of the state where it is not readily available.

TWIA's exposure has been growing rapidly in recent years. It is estimated that TWIA's exposure, including miscellaneous coverage such as business interruption, will exceed \$65 billion by the end of 2007. This growth increases the possible losses arising out of a given storm, placing state revenues at an ever-increasing risk. For example, TWIA losses from a so-called 100-year storm (one having a 1 percent chance of striking in any given year) are estimated at about \$3.2 billion, placing about \$1.5 billion of state revenues at risk; a 250-year storm (one with a 0.4 percent chance of striking in any given year) would produce about \$4.9 billion in losses for TWIA, jeopardizing about \$3.2 billion in state revenues.

The procedures used in calculating TWIA rates are set out in great detail in the statute (*Texas Insurance Code*, Chapter 2210). For example, rates must be uniform throughout the first-tier counties, certain combinations of TWIA and non-TWIA data must be used to determine the catastrophe and non-catastrophe elements of the rates and certain numbers of years of experience must be used. This differs from other insurance pools in the state that have much greater flexibility in the actuarial procedures used and where greater freedom to adapt the rate structure for changing conditions.

The 80th Legislature considered HB 2960 and SB 1155; these proposed bills were not companion bills, but were merged by the Senate and further discussed under HB 2960. The proposed legislation initially included, in some form, all recommendations proposed to the Legislature in TDI's *Biennial Report to the 80th Texas Legislature*, including discussions to add more rating flexibility. HB 2960 was heavily discussed by the 80th Legislature and supported by TDI and many legislative members. However, the proposed legislation ultimately failed during the last days of the session.

Maintenance Taxes/Maintenance Fee

Texas Insurance Code, Chapters 251 and Chapter 256 and *Texas Labor Code*, Chapters 403, 405, and 407A govern the assessment of maintenance taxes for several lines of property and casualty insurance. *Texas Insurance Code*, Chapter 271 governs the assessment of the title insurance maintenance fee. The

chapters direct the Commissioner to annually set the rates imposed each year to produce the amount the Commissioner determines is necessary to pay the expenses during the succeeding year of regulating the specified line of insurance. Each chapter specifies the premiums/fees/revenues that are subject to taxation. The Texas Comptroller of Public Accounts collects the maintenance tax based on amounts provided by the companies in the National Association of Insurance Commissioners (NAIC) annual statements and other specified amounts provided by the entities being assessed. There are several issues related to setting multiple rates which vary for each line of insurance.

Insurance companies report premium dollars on the NAIC annual statement based on guidelines provided by NAIC. Certain product lines offered by the industry are difficult to categorize from a reporting perspective. The premium may be reported in a category that is inconsistent with the line of insurance tax base described in the *Texas Insurance Code* or is reported in a NAIC category that is not assessed a tax. For instance, several years ago there was a dispute as to whether mobile home insurance should be taxed as motor vehicle insurance or as home insurance (fire and allied lines under the statutes). The maintenance tax rates for motor vehicle insurance (*Texas Insurance Code*, Chapter 254) and home insurance (*Texas Insurance Code*, Chapter 252) are substantially different and therefore the categorization significantly impacts the tax for the company. The amount of tax assessed would depend on the NAIC category under which the company reports the mobile home insurance on the annual statement.

Insurance companies report premiums for certain product lines in an “Other” category on the NAIC annual statements. Since this category contains several different types of product lines, the associated premiums are not assessed maintenance taxes.

Each maintenance tax statute has a cap on the percentage maintenance tax rate. On occasion, the amount of maintenance taxes that can be generated is not adequate to fund that year’s costs for a particular line of insurance. Methodologies have been developed to allocate the unfunded need to other lines of insurance. This is necessary so that TDI funding needs are met.

Texas Health Reinsurance System

Texas Insurance Code, Subchapter G of Chapter 1501 establishes the Texas Health Reinsurance System (THRS), which is a mechanism for small employer carriers to reinsure risks covered under small employer health benefit plans. THRS operates like a reinsurer and spreads its aggregate loss among its member carriers. The system was initially established to address the concern that one small employer carrier could suffer financial problems if the carrier happened to insure a disproportionate share of sick persons since small employer health benefit plans are subject to guaranteed issue and renewability. A related initial objective was to ensure that reinsurance was available to small employer carriers, thereby decreasing the risk of financial harm and encouraging participation in the small employer marketplace. A small employer carrier may reinsure a small employer group, an eligible employee of a small employer or the employee’s dependent. A reinsured carrier’s liability to any insured individual may not exceed a maximum of \$10,000 in any calendar year.

Each small employer carrier must elect to participate in the system as a reinsured carrier or seek approval to become a risk assuming carrier. A carrier seeking to be a risk assuming carrier must be financially able to support the assumption of risk and meet other conditions required by statute. THRS’s nine member board of directors establishes the methodology for determining the premium to be charged small employer carriers for reinsuring small employer groups and individuals.

If the THRS incurs a net loss in a calendar year, the loss is recouped by assessments on reinsured carriers. A reinsured carrier’s assessment is in proportion to the carrier’s earned premiums from small employer health benefit plans issued in Texas.

As of late 2006, approximately 60 carriers write insurance for small employers in Texas. In 2007, only 15 insurers are “participating insurers” that cede risks to THRS. Of the 15 insurers, fewer cede lives to the system. THRS currently covers only 50 lives from nine insurers.

Over the years, the number of carriers participating in the system has steadily declined, mostly because carriers either withdraw from the small employer health plan market or become risk assuming carriers. However, over the same time period the cost of claims associated with the lives ceded to the system has for the most part increased.

Under current law, a reinsured carrier may not cede additional eligible lives to THRS during a calendar year if the assessment amount payable for the previous calendar year is greater than or equal to five percent of the total premiums earned in that calendar year from all small employer health benefit plans delivered or issued for delivery by reinsured carriers in this state. Over the past five years, the system’s experience has twice come close to reaching this trigger.

The current premium base in THRS is approximately \$86 million – a fraction of the overall small employer market. In its current form, the system is not credible because of the small premium base and the few participating insurers. As is, the system is not large enough to meet its purpose of spreading the risk over a large base, and does not serve Texans to its full potential.

C3. Possible Solutions and Impact.

Engage the agency in greater policymaking authority to address technological advances that impact the type of products offered, the classifying of individual risks, and the rating of insurance products.

TDI offers the following proposed solutions to more fairly and firmly regulate the insurance market.

Provide the agency and Commissioner of Insurance with authority to address the use of technological advances and pattern recognition methods that impact the type of available products, the classifying of individual risks, and the rating of insurance products. Specifically, the Legislature should consider:

- amending rate and underwriting provisions in the *Texas Insurance Code* to allow the Commissioner of Insurance the authority to define and require disclosure to TDI of all rating and underwriting variables derived from data mining and pattern recognition processes prior to their use in rating, tiering or underwriting; and
- granting the Commissioner the authority to require moderation in the application of such variables over two or more renewal cycles.

These recommendations would allow the agency to identify possible expansions and refinements of classification criteria and their likely effects on Texas consumers and the marketplace, and to mitigate possible adverse impacts.

Additionally, the agency should have a greater ability to regulate based on market changes and market performance. The Commissioner of Insurance should be given the authority to require disclosure of rating practices and methodologies in addition to actuarial standards. The Commissioner of Insurance should also be able to apply different methods of regulation based on an insurer’s market performance or to different segments of the market; e.g. large insurers vs. small insurers, national insurers vs. regional insurers, or Texas-only insurers. This could help alleviate market affordability and/or availability problems for certain currently underserved groups, encourage the entry of insurers into new markets, and help alleviate any perceived regulatory burden.

Moderate insurance coverage costs through greater rating flexibility for the Texas Windstorm Insurance Association, restructuring of the maintenance tax and fee assessments, and reviewing the continued viability of the Texas Health Reinsurance System.

TWIA

The Legislature should consider amending the rate-setting requirements in Texas Insurance Code, Chapter 2210 to allow greater rating flexibility for TWIA. Options to consider, at least in part, include:

- allowing a file-and-use implementation of rate changes not exceeding 5 percent in any 12-month period and applying the current regulatory standards (approve, disapprove, modify) to greater rate changes;
- eliminating portions of the existing law that specify the precise experience that must be used to develop rates, permitting actuaries to use whatever data would be most appropriate in the specific circumstances;
- permitting the limited consideration of the results of hurricane models, perhaps in conjunction with actual historic experience in the development of TWIA's rates (e.g., allow 5 percent rate increase based on the average of the hurricane models every 24 months);
- permitting geographic variations in TWIA rates where such variations can be actuarially supported;
- allowing a supplemental premium charge that would go directly (100 percent) to the CRTF (the charge would not be subject to agent commissions, administrative charges, etc.); and
- providing for the tempering of rate changes arising from changes in ratemaking procedures so as to avoid rate shock by maintaining the current statutory 10 percent cap.

Implementation of the above would allow the agency greater flexibility to adapt the TWIA rate structure for changing conditions. This, in turn, could increase the affordability of wind and hail insurance through TWIA.

Maintenance Tax System

TDI also recommends an examination be conducted to consider streamlining and simplifying the maintenance tax system. Participants should include members from TDI, the Comptroller of Public Accounts-Insurance Tax, the insurance industry, and other appropriate parties. TDI should have the authority and flexibility to enact regulatory changes based on the results of the examination.

Texas Health Reinsurance System

Finally, the agency recommends the Commissioner be provided with flexibility and authority to modify the operations of the THRS to better meet the needs of the small employer market, and, alternatively, to order the dissolution of the system and suspension of its activities.

Flexibility to modify THRS operations would permit the Commissioner to utilize THRS as a tool to lower the cost of health insurance and provide stability for lower-premium products by relying in part on successful models from other states, thereby making better use of the THRS for Texans.

The foundation for an improved system already exists in Texas, even though it is not presently operating at full potential or utility. System revitalization goals should be to:

- create an incentive to increase the number of carriers offering affordable health insurance to small employers.
 - Provide system protection against excessive losses to carriers that offer affordable health insurance products.

- Explore best practices from states with successful reinsurance systems.
 - Provide incentives to carriers to offer lower premiums.
- expand participation in the system among carriers in the small employer market to spread the risk across a larger population.
 - Explore strategies that have worked in other states and that will work within the private insurance marketplace in Texas.
 - Examine the benefits, feasibility, and pitfalls of mandating participation.
 - Create a structure that attracts carriers to participate.
- explore expanding system participation eligibility to carriers that serve the individual market.

Flexibility to order the dissolution of THRS and suspension of its activities would permit the Commissioner to take appropriate action if these efforts prove unsuccessful, or if the Commissioner determines that pursuit or attainment of system revitalization goals is impracticable.

A4. Brief Description of Policy Issue.

Should TDI's statutory organizational structure be modified to better support the agency's mission?

B4. Discussion.

The Texas Windstorm Insurance Association (TWIA) was established in 1971 by the Legislature to provide wind and hail coverage to residents and businesses in designated catastrophe areas along the Texas coast that are unable to obtain such coverage in the voluntary market. At its inception, TWIA insured a structure if the homeowner could show an existing residential property insurance policy, or if the structure was located in a municipality that had a building code. No additional inspection or certification process was required to obtain insurance under TWIA.

Following the devastation wrought in Galveston by Hurricane Alicia in 1983, the Legislature determined that building codes were not being enforced along the Texas Gulf Coast. Consequently, the windstorm inspection program under TDI began in 1988. Under this program, in order to be eligible for wind and hail coverage through TWIA, structures must be inspected and certified as compliant with windstorm building codes adopted by the Commissioner of Insurance. However, in lieu of being certified as compliant, and for a specified period of time, a homeowner can obtain insurance by paying a premium surcharge based on meeting specific criteria. Through four field offices, the Windstorm Inspections Section of TDI's Property & Casualty Program inspects and certifies property constructed, repaired or modified in the 14 coastal counties along the Gulf of Mexico and certain specified areas in Harris County. Pursuant to *Texas Insurance Code*, Sections 2210.251, 2210.254 and 2210.255, TDI may employ windstorm inspectors or may appoint Texas licensed professional engineers to conduct inspections of buildings and structures to determine compliance with windstorm building codes. The certification of structures is important to ensure compliance with the building specifications and standards set forth in the TWIA Plan of Operation before coastal property is declared eligible for wind and hail insurance coverage written through TWIA.

Since the windstorm inspection program began January 1, 1988, both TDI Windstorm Inspectors and Texas licensed professional engineers have been able to perform inspections and certifications for the purpose of obtaining wind and hail insurance coverage through the TWIA. In 1997, the Commissioner of Insurance adopted a Windstorm Building Code based on Engineer Design Standards (ASCE-7) which required the use of engineering plans and calculations. The adoption of the more stringent engineering based Windstorm Building Code resulted in an increase in the number of inspections and certifications performed by Texas licensed professional engineers. Consequently, beginning February 1, 1999, TDI began the formal process of appointing Texas licensed professional engineers as qualified inspectors to perform windstorm inspections. TDI adopted the appointment process to provide specific procedures that must be followed for the inspection and notification of compliance of a structure by a Texas licensed professional engineer. This process is designed to ensure that Texas licensed professional engineers appointed as qualified inspectors have the experience, education and skills necessary to design, inspect and certify structures for wind resistance in high wind areas. The appointment process is also designed to ensure that Texas consumers are adequately and fairly served by the engineers appointed as qualified inspectors.

In addition to inspecting and certifying structures as eligible for wind and hail insurance coverage through TWIA, the Inspections Division of the Property & Casualty Program provides building code development and enforcement, and assists in the adoption of building codes to ensure that construction and repairs are made to the building codes with the latest technology to mitigate losses due to wind. In conjunction with

the adoption of applicable building codes, the agency evaluates building products for application in the windstorm inspection program and publishes evaluation reports for posting on the Windstorm Inspections section of the agency website. TDI also performs oversight to ensure that the appointed inspectors are providing uniform and consistent inspections and to verify that the inspectors are properly certifying structures to the adopted building codes. This helps protect the exposure of TWIA and protects consumers by making sure that construction and repairs are performed to the adopted building codes.

At the time TDI began the windstorm inspection and certification process in 1988, TDI windstorm inspectors certified 92 percent of the structures applying for certification of compliance with windstorm building codes, while Texas licensed professional engineers inspected 8 percent of the structures. During the past eight years, this trend shifted and dramatically changed the services TDI provides. In FY 2006, TDI windstorm inspectors certified 18 percent of the structures applying for certification of compliance with windstorm building codes, while TDI-appointed licensed professional engineers inspected 82 percent of the structures. This shift can be attributed to the adoption of stricter building codes based on an engineer design standard requiring the use of engineering plans and calculations. While agency windstorm inspectors remain qualified to conduct inspections that do not require submittal of engineering analysis, the demand for this service has declined. With this change, TDI's focus moved from inspection and certification of structures to oversight of the appointed engineers. Consequently, TDI reduced the number of Windstorm Field Offices from seven to four and reduced the number of windstorm inspectors on staff from approximately 50 to 19, while continuing to service the 14 coastal counties along the Gulf of Mexico and certain specified areas in Harris County.

As a regulatory agency, TDI's primary mission is to regulate the marketplace firmly and fairly by enforcing and implementing the law. Although established by the Legislature and linked statutorily to TDI, TWIA also operates as an insurer under the regulatory authority of TDI. Through the windstorm inspection program, TDI has a direct impact on the policyholders and structures deemed eligible for insurance under TWIA. Additionally, the agency participates in the evaluation and adoption of building codes and building products required for insurance eligibility through TWIA. As a consequence, TDI processes are imbedded within an entity that TDI must also regulate. While TDI also oversees the statutorily created Fair Access to Insurance Requirements (FAIR) Plan Association and the Texas Medical Liability Insurance Underwriting Association (JUA), this involvement is limited to overseeing the Plan of Operation, manual rules, forms, rates and endorsements.

While most hurricane prone states have agencies involved in the adoption of statewide building codes and standards, Texas does not license contractors nor does it have an agency responsible for enforcing mandatory building codes for windstorm resistance. North Carolina, South Carolina and Florida specifically require plan review of structures and certification of inspectors, and are involved in various activities to mitigate damages as a result of high wind events. Florida also requires licensing of builders and roofers, which Texas does not. Other states are not as involved as Texas is in the inspection and certification processes for obtaining wind and hail coverage.

Additionally, as a state agency, TDI does not have the capability and flexibility to respond to market fluctuations affecting the need for additional services and/or funding. For example, following the tremendous extent of damage caused by Hurricane Rita in the Jefferson, Chambers and Galveston County areas, the agency was overwhelmed by requests for inspections as consumers sought to ensure compliance to windstorm building codes as they repaired damaged structures. Despite hiring several temporary inspectors, TDI was unable to meet the demand for inspections. TDI worked closely with TWIA to remedy the situation, and TWIA ultimately hired temporary qualified windstorm inspectors to assist the agency. TDI monitored the work of these inspectors to ensure code compliance; however, all expenses for these temporary staff were paid by TWIA.

C4. Possible Solutions and Impact.

Transfer the windstorm inspection function to the Texas Windstorm Insurance Association.

Windstorm inspections and certifications of compliance to windstorm building codes are vital to mitigating potential wind and hail losses and are required for wind and hail insurance coverage through TWIA. In lieu of being certified as compliant, and for a specified period of time, a homeowner can obtain insurance by paying a premium surcharge based on meeting specific criteria. However, the agency recognizes that trends in the process to inspect and determine compliance with windstorm building codes has altered the role of TDI in this process. Additionally, TDI believes that functions such as the development of building codes and the evaluation of building products may be more appropriately handled by TWIA.

To address changes in the Windstorm Inspection Program, TDI proposes that the Legislature consider transferring the Windstorm Inspections and Engineering Services functions to TWIA to better support the agency's mission and regulatory authority.

With a statutory change, the windstorm inspection and certification activities could be transferred from TDI to TWIA. Not only would this change improve the effectiveness of the windstorm compliance program, it would also result in a budget reduction of \$1,833,280 due to the reduction in force of approximately 32 FTEs.

Having TWIA serve as both inspector and insurer, however, could create the perception of a conflict of interest. For that reason, TDI proposes retaining limited staff to provide oversight of TWIA and their operations. TDI functions would include, but not be limited to the following: auditing the inspection and certification process performed by TWIA; performing quality assurance inspections of TWIA field inspectors and Texas licensed engineers appointed or contracted by TWIA; and reviewing building code recommendations submitted by TWIA to the Commissioner.

TDI believes that this transfer of functions would be beneficial to the agency and ultimately Texas consumers for several reasons. This transfer would allow TDI to focus resources on the oversight of TWIA, thus protecting consumers, policyholders and the general revenue of the State of Texas. As a statutory association, TWIA has the capability and flexibility to provide additional funding to enhance the performance and operation of the inspection and certification program. These enhancements could include additional education and outreach, public awareness, and enforcement of standards. Additionally, TWIA is better able to respond immediately to dramatic fluctuations or consumer needs in response to a catastrophic event or in the event of multiple occurrences.