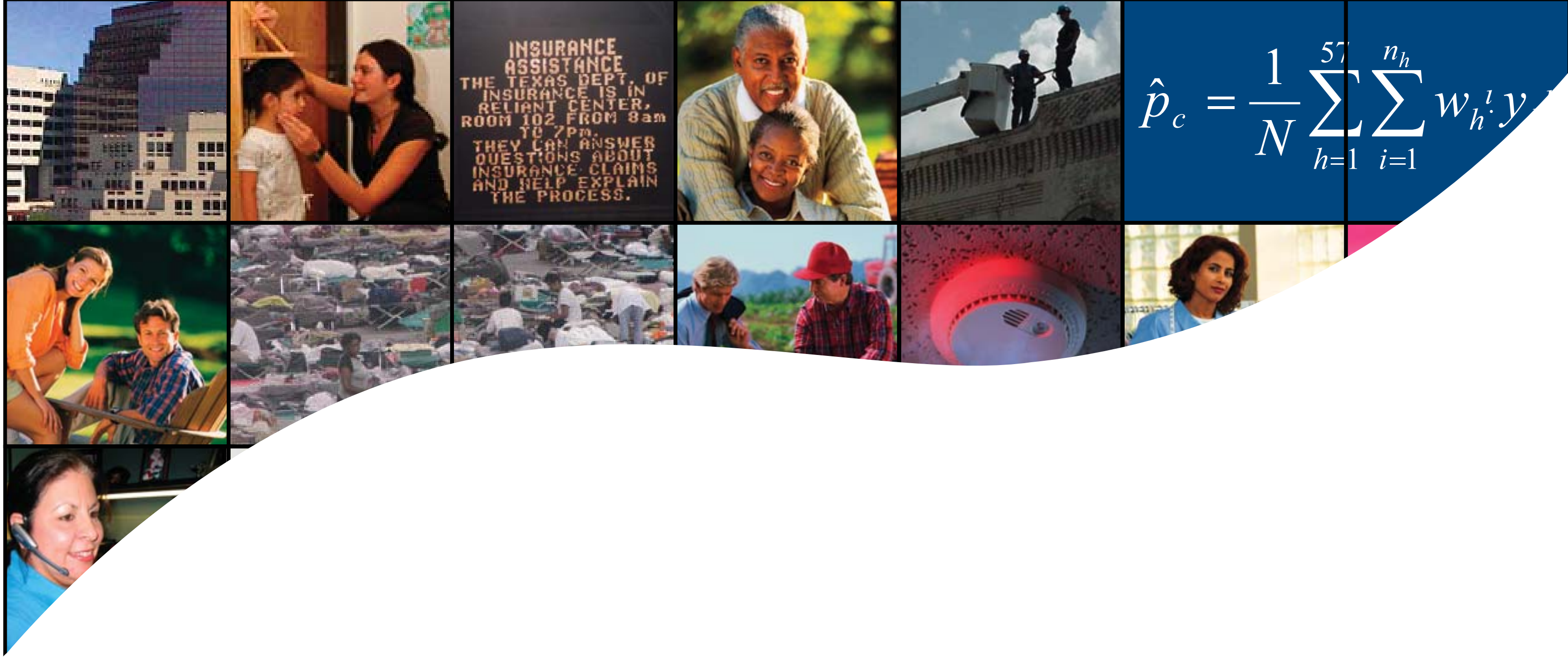


Texas Department of Insurance Response to Sunset Advisory Commission Staff Report

June 2008

Texas Department of Insurance
Office of the Commissioner, Mail Code 113-1C
333 Guadalupe • P.O. Box 149104, Austin, Texas 78714-9104
512 463-6464 telephone • 512 475-2005 fax • www.tdi.state.tx.us

June 9, 2008

Mr. Joey Longley, Director
Sunset Advisory Commission
6th Floor, Robert E. Johnson Building
1501 North Congress Avenue
Austin, TX 78701

Dear Mr. Longley:

I want to thank you and your staff for the thorough and professional review of the Texas Department of Insurance (TDI). We appreciate the detailed efforts of Chloe Lieberknecht, Leah Campbell, Michelle Downie, Kandice Sanaie, and Ginny McKay in providing a comprehensive review of our agency's regulation of the Texas insurance market.

TDI agrees with the recommendations in the Sunset Advisory Commission Staff Report. Our response includes suggested modifications to the recommendations concerning changes to Texas Windstorm Insurance Association (TWIA) rate, form, and operations requests, and proof of insurance declinations for TWIA coverage; regulation of preferred provider organizations; title insurance agent examinations; and State Fire Marshal's Office inspections of buildings. These suggestions are meant to strengthen and clarify the proposed statutory changes and management directives. Implementation of some of the proposed management directives regarding homeowners insurance rate regulation, advisory committee rule development, and State Fire Marshal's Office enforcement activities are already under way.

Our response includes one additional issue: a more comprehensive funding strategy for TWIA that addresses the current catastrophe exposure along the coast and better protects state revenues.

TDI has also included a response to the Sunset Advisory Commission Staff Report on the Office of Public Insurance Counsel (OPIC) and strongly urges the Commission to maintain OPIC as a separate state agency.

Thank you for the opportunity to provide feedback regarding the Sunset Staff Report. We look forward to the public hearing scheduled June 24 and 25. We welcome the improvements that the Sunset Review process will provide to insurance regulation that ensures consumer protection and promotes a competitive Texas market.

Sincerely,

Mike Geeslin

Mike Geeslin
Commissioner of Insurance

TDI Response to Sunset Advisory Commission Staff Report
Issues and Recommendations

Issue 1: Rate Regulation for Homeowners Insurance Lacks Clarity, Predictability, and Transparency.

The Texas Department of Insurance (TDI) agrees with the recommendations because additional clarity and transparency would help consumers, insurers, and regulators. The first two recommendations concern TDI's pre-market rate filing reviews, and the final two recommendations address prior approval standards. These recommendations would ensure greater rate regulation predictability. In the implementation of the statutory hybrid file-and-use system, TDI functions under the express purposes stated in Section 2251.001 of the Insurance Code, which include the promotion of price competition and the prohibition of excessive, inadequate, or unfairly discriminatory rates. Since 2003, as noted in the Sunset Staff Report, market conditions have improved. While the recommendations will improve the manner in which the current law is implemented, there remains a policy question about the degree of regulation and points in the market cycle at which regulation is best applied.

Recommendations for Statutory Changes:

1.1 Set limits for the amount of time the Department has to review and administratively disapprove filings under the file-and-use system.

Agency Response: TDI agrees with the pre-market review recommendation to establish set time limits for agency administrative disapproval of a rate filing. As the Sunset Staff Report noted, the current statutory contested-case process for disapproving a rate in effect is preserved. Although the number of administrative disapprovals has been few, this recommendation has several benefits. The recommendation promotes transparency as insurers could determine when a pre-market rate filing review will conclude. The recommendation also allows the agency to avoid lengthy and costly contested case hearings during which time consumers must continue to pay rates that may not meet statutory rate standards.

1.2 Require the Department to better define the process for requesting supplemental information from insurers, and to track all information requests and administrative rate disapprovals.

Agency Response: TDI agrees with the recommendation that the agency specify when insurers must submit additional information for the review of a rate filing and track and analyze factors that contribute to administrative rate disapprovals. The agency has begun an extensive review of informational requests, including the nature of the requests; the number of supplemental information requests; and industry response times. The agency will track and analyze rate filing disapprovals to tailor education efforts, identify best practices for rate development, and identify factors that contribute to disapprovals. This data will be used to draft a rule to clarify rate filing expectations and define the information needed to ensure that rates comply with Texas statutes. Such clarification will likely reduce or eliminate requests for supplemental information and expedite staff review of rate filings.

1.3 Require the Department to generally define, in rule, factors that could result in a company being placed under prior approval.

Agency Response: TDI agrees with the recommendation to use rulemaking to enumerate conditions that may contribute to an insurer's rate filings being placed under prior approval.

1.4 Require TDI to routinely evaluate the need for insurers to remain under prior approval, and require that insurers be notified in writing of the actions that need to be taken in order to return to file-and-use rate regulation.

Agency Response: TDI agrees with the recommendation to regularly assess the need for insurers' rate filings to remain under prior approval; to provide insurers with written instructions detailing the necessary actions required to return to file-and-use rate review; and when appropriate conditions are satisfied, to issue a Commissioner's order allowing an insurer's future rate filings to be subject to file-and-use rate review.

Issue 2: TDI's Involvement in TWIA's Operations, Along with Other Restrictions in Law, Limit the Department's Ability to Effectively Oversee TWIA as a Market of Last Resort.

Recommendations for Statutory Changes:

2.1 Increase the number of public members on the TWIA Board, and require the Commissioner to appoint all Board members and designate the presiding officer.

Agency Response: TDI agrees with the recommendation as it provides greater public representation and may enable TWIA to obtain federal tax exempt status.

2.2 Replace the Commissioner's authority to modify TWIA rates, forms and operations through hearings with a more traditional administrative approval process.

Agency Response: TDI agrees with the recommendation to replace hearings on TWIA rates, forms, and operations with a more traditional administrative approval process. Continuation of the Commissioner's authority to modify filings may eliminate delays in processing filings. When only an approval or disapproval determination is available, the final disposition of certain TWIA filings may be lengthened because a modification of a particular request is not permitted, and subsequent requests would require additional processing time.

2.3 Transfer the responsibility for windstorm inspections and the oversight of engineers from TDI to TWIA.

Agency Response: TDI agrees with the recommendation. The recommendation will improve the effectiveness of the oversight of licensed engineers. As noted in the Sunset Staff Report, TDI would retain some staff to provide oversight of the inspection process.

2.4 Remove unnecessary rate restrictions in law, permitting the Association to consider additional factors in developing rates.

Agency Response: TDI agrees with the recommendation as it provides TWIA with the flexibility to set rates based on the most appropriate data for a particular circumstance, noting changing market conditions.

2.5 Authorize TWIA to require applicants to provide proof of two declinations from insurers writing windstorm insurance in the state.

Agency Response: TDI agrees with the recommendation with a suggested modification. The recommendation would authorize TWIA to require applicants to periodically furnish two declinations prospectively on all new policies. Also, two declinations would be required of existing TWIA policyholders who apply to continue coverage through TWIA. TDI asks that the Sunset Advisory Commission consider enhancing this recommendation by including a provision or definition of what may constitute a declination. For example, an offer to provide coverage at a price that is 25 percent higher than what TWIA should charge for the same risk would constitute a declination, thus easing potential economic consequences to coastal policyholders. If the goal is to provide a higher threshold for TWIA eligibility, consider requiring that the declinations come from insurers actively writing windstorm insurance in the designated catastrophe area.

Issue 3: The State's Lack of Regulation of Preferred Provider Organizations Does Not Correspond with Changes in the Texas Healthcare Market.

Recommendation for Statutory Changes:

3.1 Require all Preferred Provider Organizations to obtain a certificate of authority from the Texas Department of Insurance to operate in Texas.

Agency Response: TDI agrees with the recommendation as a necessary tool to understanding more about the Preferred Provider Organizations (PPO) market and to enforcing the law. This recommendation provides an important first step in providing TDI with regulatory authority over a growing segment of the health insurance market, preferred provider organizations. TDI would encourage the Sunset Advisory Commission to consider principles that must be adhered to as a condition of maintaining a PPO certificate of authority.

Issue 4: TDI Cannot Effectively Regulate Title Insurance Without Independent Financial Examinations and More Comprehensive Reporting.

Recommendations for Statutory Changes:

4.1 Require TDI to regularly examine title agents, including verifying the expense data submitted for title insurance rate promulgation.

Agency Response: TDI agrees with this recommendation to conduct regular title agent examinations, including a review of an agent's overall financial condition, operating accounts, escrow accounts, as well as expense, profit, and loss data. A statutory mandate regarding the frequency of examinations and information to be analyzed may provide greater clarity.

4.2 Require title agents to annually submit audited financial statements of operating accounts to TDI.

Agency Response: TDI agrees with this annual financial reporting recommendation as an important regulatory tool to more accurately assess solvency. TDI agrees with the suggested case-by-case exemptions, the thresholds for which are established through rule, to lessen the fiscal impact on smaller title agents.

4.3 Require the Commissioner to assess what information is needed to promulgate title insurance rates every five years.

Agency Response: TDI agrees with this recommendation to collect data that will be relevant to title insurance rate making.

Issue 5: The Statutory Cap on the Maintenance Tax of One Insurance Line Forces TDI to Inequitably Spread Costs Across Other Insurance Lines.

Recommendation for Statutory Changes:

5.1 Increase the life, accident, and health insurance maintenance tax cap to allow TDI to equitably cover the cost of this regulation.

Agency Response: TDI agrees with this recommendation. The current life, accident, and health maintenance tax rate cap is too low to equitably cover the cost of regulation of that line, forcing TDI to rely on other lines to absorb the deficit. This recommendation will ensure that all lines of insurance pay the appropriate maintenance tax rate.

Issue 6: Most of TDI's Advisory Committees No Longer Need to Be in Law.

Recommendations for Statutory Changes:

6.1 Eliminate all but two TDI advisory committees from statute.

Agency Response: TDI agrees with the recommendation with a suggested modification. TDI asks that the Sunset Advisory Commission consider adding any other statutorily created advisory committees not listed in this recommendation. After the Sunset staff review work was completed and publication of the Sunset Staff Report, TDI identified the Utilization Review Advisory Committee, which was abolished by rule in 1998, but not included in the report. Similar dormant or permissive advisory committees may also have been overlooked and should be included in the recommendation.

6.2 Require the Department to adopt rules for its use of advisory committees, ensuring the committees meet standard structure and operating criteria.

Agency Response: TDI agrees with the recommendation. The adoption of rules to define the agency's process for establishing advisory committees will provide stakeholders with greater transparency and uniformity.

Recommendation for Management Action:

6.3 Direct the Department to clearly distinguish between the purpose and appropriate use of advisory committees and informal working groups.

Agency Response: TDI agrees with the recommendation and is in the process of revising the agency's Operations Manual regarding advisory committees. The revised policy will address informal working groups.

Issue 7: To Reduce the Risk of Fire Hazard, the State Fire Marshal's Office Needs Direction to Target Its Inspections of Buildings.

TDI-State Fire Marshal's Office (TDI-SFMO) agrees with the recommendations as they assist in preventing loss of life and property due to fire.

Recommendations for Statutory Changes:

7.1 Require the SFMO to periodically inspect state-leased buildings.

Agency Response: TDI-SFMO agrees with the need for additional oversight of all state-occupied facilities, including state-leased properties. In addition to an amendment to *Tex. Govt. Code* Chapter 417, directing the SFMO to inspect buildings under consideration for leasing, the Sunset Advisory Commission may consider additional statutory language requiring all state entities to inform the SFMO of possible building lease arrangements under consideration. A "pre-lease" inspection process would likely minimize resources demands and would eliminate the jurisdictional and enforcement issues evident in a process that requires inspection of existing leased properties. Inspection of all existing state-leased buildings would necessarily require additional staffing and coordination with state agencies, including the Texas Facilities Commission and the Comptroller of Public Accounts.

7.2 Require the SFMO to create a risk-based approach to conducting routine inspections of state buildings.

Agency Response: TDI-SFMO agrees that a risk-based approach to state building inspections will direct limited resources to the entities posing the greatest risk to public safety and allow for prioritizing of routine inspections.

7.3 Authorize the SFMO to charge a fee for inspections of privately owned buildings.

Agency Response: TDI-SFMO agrees that charging a fee for inspections of privately owned buildings allows the agency to recoup its costs. A reasonable fee would be established through the rulemaking process and consider staff resources, travel costs, and other expenses.

Recommendation for Management Action:

7.4 Direct the SFMO to work with local communities to help build capacity to more effectively assess and implement local fire prevention efforts.

Agency Response: TDI-SFMO agrees with the recommendation to provide fire prevention materials, including a step-by-step guide instructing local communities on how to increase fire prevention capacity at the local level and the benefits of a local city or county fire marshal.

Issue 8: The State Fire Marshal's Office Lacks the Ability to Issue Fines to Ensure Licensee Compliance.

Recommendation for Statutory Changes:

8.1 Require the Commissioner to establish a penalty matrix for violations by SFMO licensees, and to delegate administration of these penalties to the SFMO.

Agency Response: TDI-SFMO agrees that establishing, by rule, a penalty matrix for SFMO licensee violations would ensure better compliance with SFMO licensing standards. The recommendation also provides that SFMO write enforcement letters and issue fines for certain minor violations. This recommendation can be implemented through management action rather than a statutory change. TDI-SFMO will draft specific policies and procedures to implement the recommendation.

Issue 9: The State Has a Continuing Need for the Texas Department of Insurance.

Recommendations for Statutory Changes:

9.1 Continue the Texas Department of Insurance for 12 years.

Agency Response: TDI agrees that there is a continuing need to regulate the $90 billion Texas insurance industry and that TDI is well-positioned to ensure the availability of competitive and fair insurance products.

9.2 Update TDI's statutory duties to better reflect the agency's role in protecting consumers and encouraging a competitive insurance market in Texas.

Agency Response: TDI agrees with the recommendation to acknowledge the agency's responsibility to protect consumers and foster a competitive Texas insurance market. Our agency mission statement is instructive:

> To protect insurance consumers by
> - regulating the industry fairly and diligently
> - promoting a stable and competitive market
> - providing information that makes a difference.

Texas Department of Insurance New Issue

Expanded State Catastrophe Exposure Requires a More Comprehensive Funding Strategy for the Texas Windstorm Insurance Association (TWIA) to Better Protect the State's Revenues

Recommendations

- Change TWIA's funding structure to keep pace with its rapid growth. This new structure should focus on a system that does not excessively expose the state's general revenue to hurricane losses while at the same time allowing for strong, sustainable economic growth along the coast by making necessary insurance coverage available.

- Any new structure should expand funding sources available to TWIA to include pre-event and/or post-event bonding authority.

- These bonds should be funded by policyholder surcharges. In certain instances, it may be necessary to expand the base to include all property and casualty policyholders.

Findings

- The current funding mechanism for TWIA was developed in 1993 when the combined residential and commercial exposure was $6.5 billion. As of April 2008, TWIA's exposure was approximately $65 billion.

- The 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 $2.3 billion) is estimated to cover the probable TWIA losses from a storm that would be expected to occur every 50 years (a 2 percent chance of striking in any given year).

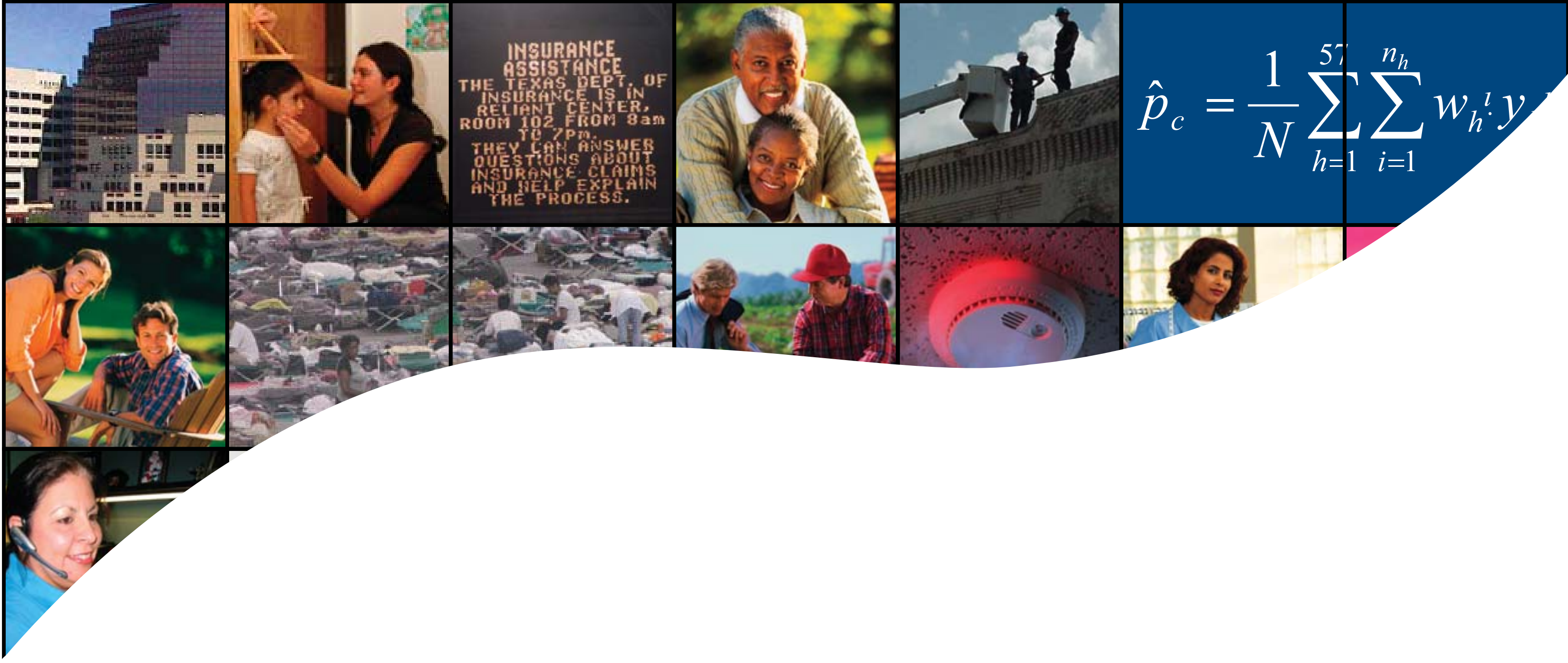
- Texas' general revenue stream would be at significant risk should a more severe storm strike the coast. For example, TWIA losses from a so-called 100-year storm (one having a 1 percent chance of striking in any given year) are estimated at about $3.6 billion, placing about $1.3 billion of state revenues at risk; a 250-year storm (one with a 0.4 percent chance of striking in any given year) would produce about $5.6 billion in losses for TWIA, jeopardizing about $3.3 billion in state revenues.

- TWIA's 2008 estimated reinsurance premium is approximately $184 million, which accounts for almost half of its total 2008 premiums.

- Concerns with an inadequate funding structure, which increases the likelihood of insurer assessments, may discourage insurers from writing more business in Texas as they weigh expanding their market share against the potential for future assessments. It may also discourage new companies from writing property insurance in the state.

Conclusion

TWIA's funding structure, which was last revised 15 years ago, has not changed. What may have been adequate then to promote the property market and protect state revenues is inadequate today. The funding structure's failure to keep pace with TWIA's ever-expanding growth increases the likelihood of assessments that would reduce the State's revenue. Bonds would provide TWIA with additional available funds to pay claims in the event of a large storm. This may lessen TWIA's reliance on reinsurance, giving TWIA the flexibility to purchase more or less reinsurance depending on market price and conditions. A sound funding structure may also encourage some insurers to expand their writings and new insurers to write in Texas.



Texas Department of Insurance Response to Sunset Advisory Commission Staff Report on the Office of Public Insurance Counsel

June 2008

Texas Department of Insurance Response to Sunset Advisory Commission Staff Report on Office of Public Insurance Counsel

Issue 1: Texas Needs Consumer Representation in Insurance Regulation, But No Longer Needs a Separate State Agency to Advocate on Behalf of Consumers.

The Texas Department of Insurance (TDI) agrees that consumer representation in insurance regulation is critical. As an independent consumer advocate, the Office of Public Insurance Counsel (OPIC) has benefited Texans by providing perspectives and input that enriches the regulatory system. Also, as directed by the Legislature, OPIC has served as a consumer education advocate by producing publications and reviewing TDI publications. Moreover, OPIC has assisted TDI in enforcement actions, negotiating on behalf of the class of Texas consumers. The Commissioner of Insurance thus strongly urges the Sunset Advisory Commission to maintain OPIC as a separate state agency. If the recommendation regarding a transfer to TDI of the responsibility for OPIC's consumer publications is adopted, then the statutory transfer should state with specificity that the OPIC public education resources would transfer to TDI's Consumer Protection Program.