

No. 06-1198

**Official Order
of the
Commissioner of Insurance
of the
State of Texas
Austin, Texas**

Date: November 14, 2006

Subject Considered:

**Texas Windstorm Insurance Association
2006 Manual Rate Filings for All Types and Classes of Risks**

Docket No. 2650

Docket No. 2660

General remarks and official action taken:

On this day came on for consideration by the Commissioner of Insurance (Commissioner) the matter of the 2006 manual rate filings submitted by the Texas Windstorm Insurance Association (the Association) to the Texas Department of Insurance (Department) pursuant to the TEX. INS. CODE ANN. Art. 21.49 §8(h). Notice of an open meeting concerning the 2006 manual rate filings for all types and classes of risks submitted by the Association was published in the *Texas Register* on September 1, 2006. On September 20, 2006 an open meeting was convened before the Commissioner in Room 100 of the Hobby Building to consider the Association's rate filings. All interested persons were allowed to present written and oral comments. Comments were presented by Jim Oliver, Jim Murphy, and James Elbert of the Association; Steve Alexander and Lee Otis Zapp, Jr. of the Galveston Windstorm Action Committee (GWAC); Rod Borderlon of the Office of Public Insurance Council (OPIC); and Jay Thompson of the Insurance Council of Texas (ICT) and the Association of Fire and Casualty Companies of Texas (AFACT).

On September 21, 2006, the Association filed a petition with the Texas Department of Insurance to suspend the rate change limitation of TEX. INS. CODE ANN. Art. 21.49 §8(h)(9) which provides that a rate established and authorized by the Commissioner for the Association may not reflect an average rate change that is more than 10 percent higher or lower than the rate for

commercial or 10 percent higher or lower than the rate for noncommercial windstorm and hail insurance in effect on the date the filing is made. Notice of an open meeting concerning the petition to suspend the rate change limitation was published in the *Texas Register* on October 6, 2006. On October 25, 2006 an open meeting was convened before the Commissioner in Room 100 of the Hobby Building to consider the petition to suspend the rate change limitation. All interested persons were allowed to present written and oral comments. Comments were presented by Mike Perkins, representing the Association, Lee Otis Zapp, Jr. of the Galveston Windstorm Action Committee (GWAC); Jay Thompson of the Insurance Council of Texas (ICT) and the Association of Fire and Casualty Companies of Texas (AFACT), and Rod Borderlon of the Office of Public Insurance Council (OPIC).

After considering the Association's rate filings, the submissions from OPIC and GWAC, staff's analysis, and all written and oral comments presented, the Commissioner adopts the following findings of fact and conclusions of law.

FINDINGS OF FACT

1. The Association rate filings, reference number P-0806-13, were filed with Texas Department of Insurance (Department) on August 14, 2006, and subsequently revised on August 31, 2006. After adjustment for the correction of the net cost of reinsurance as described in Findings Nos. 57 and 132, the Association's indicated rate changes for its commercial property rates are an increase of 20 percent based on the actual industry experience for hurricane losses and an increase of 37 percent based on computer simulation models for hurricane losses; and the indicated rate changes for its residential property rates are an increase of 18 percent based on the actual industry experience for hurricane losses and an increase of 80 percent based on computer simulation models for hurricane losses.
2. OPIC recommended uniform decreases of ten percent for both commercial and residential property rates based on the statutory maximum decreases for rate filings under TEX. INS. CODE ANN. Art. 21.49 §8(h)(9).
3. GWAC recommended no change for both commercial and residential property rates.
4. The Association, OPIC and GWAC did not recommend any changes in the classification relativities for the commercial and residential property rates.
5. The Association's proposed rates are based on four components: non-hurricane losses and associated loss adjustment expenses (LAE);

hurricane losses and associated LAE; expenses other than LAE; and a provision for contribution to the Catastrophe Reserve Trust Fund (trust fund).

Commercial Property

Non-hurricane Losses and Associated LAE

6. Both the Association and OPIC used ten years (1996 through 2005) of the Association's non-hurricane commercial premium and paid loss experience data to project the component of the rates intended to cover non-hurricane losses and associated LAE.
7. The Association and OPIC selected their paid loss development factors using the average of various arithmetic averages of the loss development indications ranging up to nine years of data (the 12 to 24 months' indication) to four years of data (the 72 to 84 months' indication).
8. Due to the small amount of paid losses at the 12-month valuation for 2004, the resulting loss development indication from 12 to 24 months is considerably greater than that of other years.
9. It is reasonable to use an averaging methodology that excludes the 2004 data when estimating a paid loss development factor from 12 to 24 months.
10. Because more recent development indications are likely more indicative of what can be expected in the immediate future, a reasonable way to calculate the development factors is to use the so-called "Olympic Method," wherein the highest and the lowest indications in the most recent five years are rejected and the average is based on the middle three values.
11. The Association and OPIC adjusted the premiums earned during each experience year to current rate levels by the application of current rate level factors.
12. The Association and OPIC calculated loss ratio trend factors by dividing the average loss trend for each year by the corresponding premium trend.
13. The Association and OPIC differed in their calculations of the historical premium trend for years 2000 through 2005 in that the Association used actual historical average earned premiums at present rates while OPIC used the values on a curve fitted to the actual historical average earned premiums at present rates.

14. It is reasonable to use the actual historical average earned premiums at present rates to calculate the historical premium trend for the years 2000 through 2005.
15. The Association and OPIC derived the future premium trend of 6.5 percent from six year historical changes in average earned premiums at present rates per policy and derived the future loss trend using a weighted average of four year and a quarter industry-wide coastal construction cost and five modified consumer price indices. This process creates an improper premium trend due to the incompatible matching of time periods.
16. It is reasonable to derive the future premium trend from five year historical changes in average earned premiums at present rates per policy to better match the premium trend with the loss trend described in Finding No. 15.
17. Based on Finding No. 16, the revised future premium trend is 4.5 percent.
18. The Association calculated and OPIC adopted a factor of 1.268 to include associated non-hurricane LAE based on the experience for non-hurricane years in the 30-year period from 1976 through 2005.
19. It is reasonable to apply a factor of 1.268, as recommended by the Association and adopted by OPIC, to non-hurricane losses in order to include associated LAE.
20. The Association and OPIC differed in their calculations of the average loss ratios in that the Association used a premium-weighted average while OPIC used an arithmetic average.
21. The average loss and LAE ratio calculated is 0.123 using a premium-weighted average and 0.121 using an arithmetic average based on the revised loss development factors and trend.
22. Either averaging approach described in Finding No. 21 would normally be reasonable to project non-hurricane losses and LAE, but given the large growth in the Association in recent years, the weighted average may give undue weight to the most recent experience.
23. OPIC's arithmetic average described in Finding No. 21 is a reasonable approach under the circumstances.
24. GWAC adopted the Association's originally filed non-hurricane loss and associated LAE ratio of 0.117.

25. Based on Finding Nos. 6-24, a non-hurricane loss and associated LAE ratio of 0.121 is reasonable and should be used to calculate the Association's commercial property rates.

Hurricane Losses and Associated LAE

26. The Association utilized two different estimates to project its rate needs to cover hurricane losses and associated LAE: a 36.3-year historical analysis adjusted to the actual 106-year historical hurricane frequency level and the average of projections by three computer models. The three computer models used were those by Applied Insurance Research (AIR), EQECAT, and Risk Management Solutions (RMS).
27. OPIC utilized four different estimates to project rate needs to cover hurricane losses and associated LAE: 36.3-year and 40.3-year historical analyses using arithmetic average of the hurricane loss and LAE ratios, and 36.3-year and 40.3-year historical analyses using premium-weighted average of the hurricane loss and LAE ratios. OPIC recommended using the 40.3-year historical analysis using an arithmetic average of the hurricane loss and LAE ratios.
28. GWAC projected rate needs to cover hurricane losses and associated LAE by utilizing the Association's 36.3-year historical analysis but adjusting it to the average of actual 106 year and 36.3 year historical hurricane frequency levels and removing hurricane losses and associated LAE funded by assessments against members of the Association.
29. The Association and OPIC calculated their hurricane loss ratios by taking the loss ratios for years in which there were hurricanes, subtracting their estimated average non-hurricane loss ratio, and spreading the result over the appropriate number of years.
30. Based on Finding Nos. 26-29, the projected hurricane loss ratios are 0.293 based on the 36.3-year historical analysis proposed by the Association and 0.276 based on the 40.3-year historical analysis proposed by OPIC; and the projected hurricane loss and LAE ratio is 0.141 based on the analysis proposed by GWAC.
31. The Association and OPIC estimated that the hurricane LAE factor is 1.103 based on the historical experience.
32. It is reasonable to use the LAE factor of 1.103 as proposed by the Association and adopted by OPIC.
33. The current funding mechanism of the Association in the 2006-2007 fiscal year provides that, for the loss and LAE of a hurricane, the first 100 million

- dollars is covered by an assessment of its members; the next 300 million dollars is covered by the trust fund; of the next 100 million dollars, 86.05 million dollars is covered by the reinsurance treaty and the rest is covered by the trust fund; of the next 400 million dollars, 331.2 million dollars is covered by the reinsurance treaty, 6.05 million dollars is covered by the trust fund, and the rest is covered by an assessment of its members; the next 137.25 million dollars is covered by an assessment of its members; and the rest is covered by unlimited assessment of its members, which is reimbursable via premium tax credits.
34. The projected hurricane loss ratios calculated by the Association and OPIC described in Finding No. 30 include assessments of the members of the Association as described in Finding No. 33. All those assessments should be excluded from the analysis because those portions of hurricane loss and associated LAE are not payable by, nor are they the fiscal responsibility of, the Association and its policyholders.
 35. GWAC estimated that the assessments of the members of the Association described in Finding Nos. 33 and 34 were 65.2 percent of hurricane loss and associated LAE using RMS and AIR models. It recommended excluding the assessments from the projected hurricane loss and associated LAE ratio.
 36. It is reasonable to exclude the assessments of the members of the Association for hurricane loss and associated LAE from the projected hurricane loss and associated LAE ratio since the Association and its policyholders are not liable for the amounts involved.
 37. The Association's current funding mechanism for hurricane loss and LAE is for the combined residential property risks and commercial property risks. Therefore, the combined historical experience of commercial property risks and residential property risks should be used in order to calculate the net hurricane loss and associated LAE excluding the assessments described in Finding Nos. 33-36.
 38. The Association provided the most recent 36.3-year (1970-2005) historical experience and OPIC provided the most recent 40.3-year (1966-2005) historical experience for commercial property risks. Both provided the most recent 42-year (1964-2005) historical experience for residential property risks with their filings.
 39. It is reasonable to use the most recent 42-year combined historical experience for commercial property risks and residential property risks to project hurricane loss and LAE ratio.

40. The Association proposed to adjust the projected hurricane loss ratio to reflect the actual 106-year hurricane frequency (0.406) as compared to the hurricane frequency (0.275) of the 36.3-year period.
41. GWAC proposed to adjust the hurricane loss ratio to reflect the average (0.341) of the actual 106-year hurricane frequency (0.406) and the actual 36.3-year hurricane frequency (0.275).
42. The hurricane frequency for the 42-year experience described in Finding No. 39 is 0.262. Therefore, the average of the actual 106-year hurricane frequency (0.406) and the actual 42-year hurricane frequency (0.262) is 0.334.
43. While certain groups and individuals have projected a higher than normal hurricane frequency in coming years, it is not clear that the 106-year hurricane frequency history will be entirely predictive of Texas hurricane activity during the immediate future.
44. Based on Finding Nos. 40-43, it is reasonable to adjust the hurricane loss ratio and associated LAE ratio to the average hurricane frequency of 0.334 described in Finding No. 42.
45. Based on Finding Nos. 32, 39, and 44, the combined average hurricane loss and LAE ratio is 38.6 percent before adjusting for assessable amounts.
46. Adjusting the combined average hurricane loss and LAE ratio for assessable amounts reduces the hurricane loss and LAE ratio to 20.9 percent.
47. The hurricane loss and associated LAE ratio described in Finding No. 46 is reasonable and should be used to calculate the Association's commercial property rates.

Expenses Other than LAE

48. The Association proposed, and OPIC and GWAC agreed to, the following expense provisions: 15.8 percent for commission and brokerage expenses; 4.6 percent for general expenses; and 1.8 percent for taxes, licenses and fees.
49. The general expense provision described in Finding No. 48 was calculated by dividing dollars of general expenses by earned premium.

50. The approach described in Finding No. 49 is theoretically equivalent to the assumption that such expenses are spread approximately equally throughout the life of a policy.
51. It is generally agreed that most expenses other than LAE are incurred on or around the effective date of a policy.
52. Written premiums, which generally reflect premiums at policy inception, are therefore a better measure of the level of expenses than earned premium especially when the Association is growing rapidly.
53. Using written premiums the general expense ratio is 4.4 percent.
54. It is reasonable to use expense provisions of 15.8 percent for commission and brokerage expenses; 4.4 percent for general expenses; and 1.8 percent for taxes, licenses, and fees.
55. The Association, OPIC and GWAC considered general expenses to be fixed independent of the rate change (fixed expenses). Commission and brokerage expenses and taxes, licenses and fees were considered to be expenses that vary directly with changes in premium (variable expenses).
56. For the 2006-2007 fiscal year, the Association purchased reinsurance protection to cover, in part, catastrophe claims payments and LAE in excess of 400 million dollars, with the first 100 million dollars covered by assessment of its members and the second 300 million dollars covered by the trust fund.
57. The Association included a fixed expense provision of 18.2 percent for the net cost of reinsurance in its original rate filing, which reflects the excess of the gross reinsurance premiums over the expected average loss recoveries under the reinsurance contracts. The Association later corrected the net cost of reinsurance to 16.9 percent because the reinsurance contracts also cover the associated LAE, which was omitted in the original estimation.
58. OPIC recommended a fixed provision of 7.7 percent to cover the net cost of reinsurance based on ratios of net cost of reinsurance that had been used in Department rate decisions several years ago. This analysis ignores the relationship between the current gross reinsurance premiums and the expected average loss recoveries under the current reinsurance contracts.
59. GWAC recommended that no reinsurance be purchased, thus no net cost of reinsurance would be needed.

60. It is reasonable to include a provision for the net cost of reinsurance because the current reinsurance contracts are already in place for the 2006-2007 fiscal year.
61. The Association's proposed provision for the net cost of reinsurance of 16.9 percent was based on the expected reinsurance loss and LAE recoveries estimated using the RMS model.
62. Because the projected hurricane loss and LAE ratio described in Finding No. 47 is based on historical experience, it is logically consistent to use the historical experience instead of a computer simulation model to estimate the net cost of reinsurance.
63. Based on the 42-year industry historical hurricane loss experience in Texas and the Association's current reinsurance contracts, the estimated net cost of reinsurance is 24.5 percent adjusted to the average of the 42 year and 106 year hurricane frequencies.
64. The reinsurance premiums are paid when the treaty is placed and are not directly related to the level of premiums actually written or earned during the year in which the reinsurance contracts are in effect.
65. It is reasonable to use a fixed provision of 24.5 percent for the net cost of reinsurance.

Contribution to the Catastrophe Reserve Trust Fund

66. The Association included in its rate filing a 15.0 percent variable expense provision for its contribution to the trust fund.
67. OPIC recommended a 10.0 percent provision for the contribution to the trust fund, prior to any consideration of investment income.
68. GWAC recommended a 63.1 percent provision for the contribution to the trust fund.
69. The amounts for hurricane losses that had been included in the current rates that corresponded to the assessments of members of the Association were effectively a provision for a contribution to the trust fund. Those amounts are 17.7 percent of premium, which is the difference between the hurricane loss and LAE ratio before excluding the assessments described in Finding No. 45 and the hurricane loss and LAE ratio after excluding the assessments described in Finding No. 46.
70. In recent Commissioner's Orders a ten percent contribution to the trust fund was granted.

71. Given that the amounts payable by members of the Association through assessments have been removed from the expected hurricane losses, a greater explicit contribution to the trust fund is reasonable.
72. OPIC recommended reducing the provision for the contribution to the trust fund by 3.0 percentage points to account for the Association's investment income.
73. It is well accepted that investment income be taken into account in insurance rates for coverage written by for-profit insurers.
74. The Association is not a for-profit insurer.
75. The Association's investment income is available to increase the amount in the trust fund.
76. It is desirable that the Association build up the trust fund so that the funds will be available to pay claims from future catastrophes.
77. It is not reasonable to reduce the Association's rates to account for its investment income.
78. Based on Findings Nos. 45, 46 and 69, it is reasonable that a contribution to the trust fund somewhat greater than the 10 percent granted in recent decisions be granted.
79. Based on Findings Nos. 69, 70, 71 and 78, a total contribution to the trust fund of 22.7 percent is reasonable.

Commercial Property Rates

80. Based on Finding Nos. 25, 47, 54, 65, and 79, the indicated rate change for commercial property risks and classes of commercial property risks is 3.7 percent.
81. Based on Finding No. 80, the Association's existing rates for commercial property risks and classes of commercial property risks should be increased by 3.7 percent.
82. The loss experience provided by the Association includes the amount of losses and LAE resulting from Hurricane Rita in 2005. There have been no catastrophe loss or series of occurrences resulting in losses in the catastrophe area which justify the need to suspend the ten percent cap on rate increases to assure rate adequacy.

83. The total losses and LAE sustained by the Association, including those sustained on account of Hurricane Rita, are used to project the non-hurricane loss and LAE ratio described in Finding No. 25 and the hurricane loss and LAE ratio described in Finding No. 47.

Residential Property

Non-hurricane Losses and Associated LAE

84. Both the Association and OPIC used ten years (1995-2005) of 90 percent of the industry (excluding the Association) extended coverage experience and 100 percent of the Association's experience to project the indicated non-hurricane loss and LAE ratios.
85. The Association and OPIC selected their paid loss development factors using the average of various arithmetic averages of the loss development indications ranging up to nine years of data (the 15 to 27 months' indication) to two years of data (the 99 to 111 months' indication).
86. Because more recent development indications are likely more indicative of what can be expected in the immediate future, a reasonable way to calculate the development factors is to use the so-called "Olympic Method," wherein the highest and the lowest indications in the most recent five years are rejected, and the average is based on the middle three values.
87. The Association and OPIC adjusted the premiums earned during each experience year to current rate levels by the application of current rate level factors.
88. The Association and OPIC calculated loss ratio trend factors by dividing the average loss trend for each year by the corresponding premium trend.
89. The Association and OPIC differed in their calculations of the historical premium trend for years 2000 through 2005 in that the Association used actual historical average earned premiums at present rates while OPIC used the values on a curve fitted to the actual historical average earned premiums at present rates.
90. It is reasonable to use the actual historical average earned premiums at present rates to calculate the historical premium trend for the years 2000 through 2005.

91. The Association and OPIC derived the future premium trend of 6.4 percent from six year historical changes in average earned premiums at present rates per policy and derived the future loss trend using a weighted average of four year and a quarter industry-wide coastal construction cost and five modified consumer price indices. This process creates an improper premium trend due to the incompatible matching of time periods.
92. It is reasonable to derive the future premium trend from five year historical changes in average earned premiums at present rates per policy to better match the premium trend with the loss trend described in Finding No. 91.
93. Based on Finding No. 92, the revised future premium trend is 7.3 percent.
94. The Association calculated and OPIC adopted a factor of 1.268 to include non-hurricane associated LAE based on the experience for non-hurricane years in the 30-year period from 1976 through 2005.
95. It is reasonable to apply a factor of 1.268, as recommended by the Association and adopted by OPIC, to non-hurricane losses in order to include associated LAE.
96. The Association and OPIC differed in their calculations of the average loss ratios in that the Association used a premium-weighted average while OPIC used an arithmetic average.
97. The average loss and LAE ratio is 0.120 calculated using a premium-weighted average and 0.124 using an arithmetic average based on the revised loss development factors and trend.
98. Either averaging approach described in Finding No. 97 would normally be reasonable to project non-hurricane losses and LAE, but given the large growth in the Association in recent years, the weighted average may give undue weight to the most recent experience.
99. OPIC's arithmetic average described in Finding No. 97 is a reasonable approach under the circumstances.
100. GWAC adopted the Association's originally filed non-hurricane loss and associated LAE ratio of 12.3 percent.
101. Based on Finding Nos. 84-100, a non-hurricane loss and associated LAE ratio of 0.124 is reasonable and should be used to calculate the Association's residential property rates.

Hurricane Losses and Associated LAE

102. The Association utilized two different estimates to project its rate needs to cover hurricane losses and associated LAE: a 42-year historical analysis adjusted to the actual 106-year historical hurricane frequency level and the average of projections by three computer models. The three computer models used were those by AIR, EQECAT, and RMS.
103. OPIC utilized two different estimates to project its rate needs to cover hurricane losses and associated LAE: a 42-year historical analysis using an arithmetic of the hurricane loss and LAE ratios and a 42-year historical analysis using a premium-weighted average of the hurricane loss and LAE ratios. OPIC recommended using an arithmetic average of the hurricane loss and LAE ratios.
104. GWAC projected rate needs to cover hurricane losses and associated LAE by utilizing the Association's 42-year historical analysis but adjusting it to the average of actual 106 year and 42 year historical hurricane frequency levels and removing reimbursable hurricane losses and associated LAE funded by assessments against members of the Association.
105. The Association and OPIC calculated their hurricane loss ratios by taking the loss ratios for years in which there were hurricanes, subtracting their estimated average non-hurricane loss ratio, and spreading the result over the appropriate number of years.
106. Based on Finding Nos. 102-105, the projected hurricane loss ratios are 0.267 based on the 42-year historical analysis proposed by the Association and 0.263 based on the 42-year historical analysis proposed by OPIC; and the projected hurricane loss and LAE ratio is 0.118 based on the analysis proposed by GWAC.
107. The Association and OPIC estimated that the hurricane LAE factor is 1.103 based on the historical experience.
108. It is reasonable to use the LAE factor of 1.103 as proposed by the Association and adopted by OPIC.
109. The current funding mechanism of the Association in the 2006-2007 fiscal year provides that, for the loss and LAE of a hurricane, the first 100 million dollars is covered by an assessment of its members; the next 300 million dollars is covered by the trust fund; of the next 100 million dollars, 86.05 million dollars is covered by the reinsurance treaty and the rest is covered by the trust fund; of the next 400 million dollars, 331.2 million dollars is covered by the reinsurance treaty, 6.05 million dollars is covered by the

- trust fund, and the rest is covered by an assessment of its members; the next 137.25 million dollars is covered by an assessment of its members; and the rest is covered by unlimited assessment of its members, which is reimbursable via premium tax credits.
110. The projected hurricane loss ratios calculated by the Association and OPIC described in Finding No. 106 include assessments of the members of the Association as described in Finding No. 109. All those assessments should be excluded from the analysis because those portions of hurricane loss and associated LAE are not payable by, nor are they the fiscal responsibility of, the Association and its policyholders.
 111. GWAC estimated that the assessments of the members of the Association described in Finding Nos. 109 and 110 were 65.2 percent of hurricane loss and associated LAE using RMS and AIR models. It recommended excluding the assessments from the projected hurricane loss and associated LAE ratio.
 112. It is reasonable to exclude the assessments of the members of the Association for hurricane loss and associated LAE from the projected hurricane loss and associated LAE ratio since the Association and its policyholders are not liable for the amounts involved.
 113. The Association's current funding mechanism for hurricane loss and LAE is for the combined residential property risks and commercial property risks. Therefore, the combined historical experience of commercial property risks and residential property risks should be used in order to calculate the net hurricane loss and associated LAE excluding the assessments described in Finding Nos. 109-112.
 114. The Association provided the most recent 36.3-year (1970-2005) historical experience and OPIC provided the most recent 40.3-year (1966-2005) historical experience for commercial property risks. Both provided the most recent 42-year (1964-2005) historical experience for residential property risks with their filings.
 115. It is reasonable to use the most recent 42-year combined historical experience for commercial property risks and residential property risks to project hurricane loss and LAE ratio.
 116. The Association proposed to adjust the hurricane loss ratio to reflect the actual 106-year hurricane frequency (0.406) as compared to the hurricane frequency (0.262) of the 42-year period.

117. GWAC proposed to adjust the hurricane loss ratio to reflect the average (0.334) of the actual 106-year hurricane frequency (0.406) and the actual 42-year hurricane frequency (0.262).
118. While certain groups and individuals have projected a higher than normal hurricane frequency in coming years, it is not clear that the 106-year hurricane frequency history will be entirely predictive of Texas hurricane activity during the immediate future.
119. Based on Finding Nos. 116-118, it is reasonable to adjust the hurricane loss ratio and associated LAE ratio to the average hurricane frequency of 0.334 described in Finding No. 117.
120. Based on Finding Nos. 108, 115, and 119, the combined average hurricane loss and LAE ratio is 38.6 percent before adjusting for assessable amounts.
121. Adjusting the combined average hurricane loss and LAE ratio for assessable amounts reduces the hurricane loss and LAE ratio to 20.9 percent.
122. The hurricane loss and associated LAE ratio described in Finding No. 121 is reasonable and should be used to calculate the Association's residential property rates.

Expenses Other than LAE

123. The Association proposed, and OPIC and GWAC agreed to, the following expense provisions: 15.8 percent for commission and brokerage expenses; 4.6 percent for general expenses; and 1.8 percent for taxes, licenses and fees.
124. The general expense provision described in Finding No. 123 was calculated by dividing dollars of general expenses by earned premium.
125. The approach described in Finding No. 124 is theoretically equivalent to the assumption that such expenses are spread approximately equally throughout the life of a policy.
126. It is generally agreed that most expenses other than LAE are incurred on or around the effective date of a policy.
127. Written premiums, which generally reflect premiums at policy inception, are therefore a better measure of the level of expenses than earned premium especially when the Association is growing rapidly.

128. Using written premiums the general expense ratio is 4.4 percent.
129. It is reasonable to use expense provisions of 15.8 percent for commission and brokerage expenses; 4.4 percent for general expenses; and 1.8 percent for taxes, licenses, and fees.
130. The Association, OPIC and GWAC considered general expenses to be fixed independent of the rate change (fixed expenses). Commission and brokerage expenses and taxes, licenses and fees were considered to be expenses that vary directly with changes in premium (variable expenses).
131. For the 2006-2007 fiscal year, the Association purchased reinsurance protection to cover, in part, catastrophe claims payments and LAE in excess of 400 million dollars, with the first 100 million dollars covered by assessment of its members and the second 300 million dollars covered by the trust fund.
132. The Association included a fixed expense provision of 18.2 percent for the net cost of reinsurance in its original rate filing, which reflects the excess of the gross reinsurance premiums over the expected average loss recoveries under the reinsurance contracts. The Association later corrected the net cost of reinsurance to 16.9 percent because the reinsurance contracts also cover the associated LAE, which was omitted in the original estimation.
133. OPIC recommended a fixed provision of 7.7 percent to cover the net cost of reinsurance based on ratios of net cost of reinsurance that had been used in Department rate decisions several years ago. This analysis ignores the relationship between the current gross reinsurance premiums and the expected average loss recoveries under the current reinsurance contracts.
134. GWAC recommended that no reinsurance be purchased, thus no net cost of reinsurance would be needed.
135. It is reasonable to include a provision for the net cost of reinsurance because the current reinsurance contracts are already in place for the 2006-2007 fiscal year.
136. The Association's proposed provision for the net cost of reinsurance of 16.9 percent was based on the expected reinsurance loss and LAE recoveries estimated using the RMS model.
137. Because the projected hurricane loss and LAE ratio described in Finding No. 122 is based on historical experience, it is logically consistent to use

- the historical experience instead of a computer simulation model to estimate the net cost of reinsurance.
138. Based on the 42-year industry historical hurricane loss experience in Texas and the Association's current reinsurance contracts, the estimated net cost of reinsurance is 24.5 percent adjusted to the average of the 42 year and 106 year hurricane frequencies.
 139. The reinsurance premiums are paid when the treaty is placed and are not directly related to the level of premiums actually written or earned during the year in which the reinsurance contracts are in effect.
 140. It is reasonable to use a fixed provision of 24.5 percent for the net cost of reinsurance.

Contribution to the Catastrophe Reserve Trust Fund

141. The Association included in its rate filing a 15.0 percent variable expense provision for its contribution to the trust fund.
142. OPIC recommended a 10.0 percent provision for the contribution to the trust fund, prior to any consideration of investment income.
143. GWAC recommended a 63.1 percent provision for the contribution to the trust fund.
144. The amounts for hurricane losses that had been included in the current rates that corresponded to the assessments of members of the Association were effectively a provision for a contribution to the trust fund. Those amounts are 17.7 percent of premium, which is the difference between the hurricane loss and LAE ratio before excluding the assessments described in Finding No. 120 and the hurricane loss and LAE ratio after excluding the assessments described in Finding No. 121.
145. In recent Commissioner's Orders a ten percent contribution to the trust fund was granted.
146. Given that the amounts payable by members of the Association through assessments have been removed from the expected hurricane losses, a greater explicit contribution to the trust fund is reasonable.
147. OPIC recommended reducing the provision for the contribution to the trust fund by 3.0 percentage points to account for the Association's investment income.

148. It is well accepted that investment income be taken into account in insurance rates for coverage written by for-profit insurers.
149. The Association is not a for-profit insurer.
150. The Association's investment income is available to increase the amount in the trust fund.
151. It is desirable that the Association build up the trust fund so that the funds will be available to pay claims from future catastrophes.
152. It is not reasonable to reduce the Association's rates to account for its investment income.
153. Based on Findings Nos. 120, 121 and 144, it is reasonable that a contribution to the trust fund somewhat greater than the 10 percent granted in recent decisions be granted.
154. Based on Findings Nos. 144, 145, 146 and 153, a total contribution to the trust fund of 22.7 percent is reasonable.

Residential Rates

155. Based on Finding Nos. 101, 122, 129, 140, and 154, the indicated rate change for residential property risks and classes of residential property risks is 4.2 percent.
156. Based on Finding No. 155, the Association's existing rates for residential property risks and classes of residential property risks should be increased by 4.2 percent.
157. The loss experience provided by the Association includes the amount of losses and LAE resulting from Hurricane Rita in 2005. There have been no catastrophe loss or series of occurrences resulting in losses in the catastrophe area which justify the need to suspend the ten percent cap on rate increases to assure rate adequacy.
158. The total losses and LAE sustained by the Association, including those sustained on account of Hurricane Rita, are used to project the non-hurricane loss and LAE ratio described in Finding No. 101 and the hurricane loss and LAE ratio described in Finding No. 122.

Conclusions of Law

1. The Commissioner of Insurance has jurisdiction over this matter pursuant to TEX. INS. CODE ANN. Art. 21.49.
2. TEX. INS. CODE ANN. Art. 21.49 §8(h)(6) provides that the Commissioner shall approve, disapprove, or modify the Association's rate filings in writing on or before November 15 of the year in which the filings are made, or the filings are deemed approved.
3. TEX. INS. CODE ANN. Art. 21.49 §8(h)(9) limits an average rate change to ten percent higher or lower than the rate for commercial and non-commercial windstorm and hail insurance in effect on the date the filing was made.
4. TEX. INS. CODE ANN. Art. 21.49 §8(h)(9) provides that a rate may not reflect a rate change for an individual rating class for commercial and non-commercial windstorm and hail insurance that is 15 percent higher or lower than the rate for that individual class in effect on the date the filing is made.
5. TEX. INS. CODE ANN. Art. 21.49 §8(h)(9) provides that the commissioner may, after notice and a hearing, suspend the average rate change limitation of ten percent higher or lower than the rate for commercial and non-commercial windstorm and hail insurance in effect on the date the filing was made, upon a finding that a catastrophe loss or series of occurrences resulting in losses in the catastrophe area justify a need to assure rate adequacy in the catastrophe area and also justify a need to assure availability of insurance outside the catastrophe area.
6. There are no findings that a catastrophe loss or series of occurrences resulting in losses in the catastrophe area justify a need to assure rate adequacy in the catastrophe area or justify a need to assure availability of insurance outside the catastrophe area.
7. TEX. INS. CODE ANN. Art. 21.49 §8(h)(11) requires that the catastrophe element used to develop rates applicable to risks written by the Association be uniform throughout the seacoast territory. The catastrophe element of the rates must be developed using: (a) 90 percent of both the monoline extended coverage loss experience and related premium income for all insurers, other than the Association, for covered property located in the seacoast territory, using not less than the most recent 30 years of experience available; and (b) 100 percent of both the loss experience and related premium income for the Association for covered property using not less than the most recent 30 years of experience available.

8. TEX. INS. CODE ANN. Art. 21.49 §8(h)(12) requires that the noncatastrophe element used to develop the Association's residential property rates must be developed using: (a) 90 percent of both the monoline extended coverage loss experience and related premium income for all insurers, other than the Association, for covered property located in the catastrophe area of the seacoast territory using the most recent 10 years of experience available; and (b) 100 percent of both the loss experience and related premium income for the Association for covered property using the most recent 10 years of experience available.
9. TEX. INS. CODE ANN. Art. 21.49 §8(h)(13) requires that the noncatastrophe element used to develop the Association's commercial rates must be developed using 100 percent of both the loss experience and related premium income for the Association for covered property using the most recent 10 years of experience available.

IT IS THEREFORE THE ORDER of the Commissioner of Insurance that the foregoing findings of fact and conclusions of law be adopted.

IT IS FURTHER ORDERED that the manual rate filing request for 2006 commercial rates and 2006 residential rates filed by the Association be modified consistent with the findings and conclusions set forth in this order and approved as modified.

IT IS FURTHER ORDERED that the manual rates to be charged by the Association for insurance for commercial property risks written by the Association in accordance with TEX. INS. CODE ANN. Art. 21.49 be increased by 3.7 percent from the September 1, 2006 rate level.

IT IS FURTHER ORDERED that the manual rates to be charged by the Association for insurance for residential property risks written by the Association in accordance with TEX. INS. CODE ANN. Art. 21.49 be increased by 4.2 percent from the September 1, 2006 rate level.

IT IS FURTHER ORDERED that the petition to approve a rate change that is more than 10 percent higher higher or lower than the rate for commercial or 10 percent higher or lower than the rate for non-commercial windstorm and hail insurance in effect on the date the filing is made is **DENIED**.

IT IS FURTHER ORDERED that the Association's rates adopted in this order become effective January 1, 2007.

All relief not granted herein is **DENIED**.

AND IT IS SO ORDERED.

TEXAS DEPARTMENT OF INSURANCE

MIKE GEESLIN
COMMISSIONER OF INSURANCE