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Insurance Surplus:

Why it's Critical to the Texas Marketplace

Insurance Fundamentals: Surplus requirements

- **By law, insurers are required to have a financial surplus to back their policies.** The surplus must meet the mandated ratio of \$3 of risk to \$1 of surplus. In other words, an insurance company must have \$30,000 in easily accessible money to insure a \$90,000 home. The larger the surplus, the more policies an insurer can write, therefore expanding insurance availability for Texas consumers.
- **During profitable years, as surplus grows, insurers have several options.** They can use profits to shore up the legally mandated surplus to be used in the event of a catastrophe. They can use expanded surplus to write more insurance policies and expand market share. Or insurers may use an increased surplus to absorb costs associated with lowering rates.
- **During high loss years, insurance companies are forced to spend their surplus to meet their claims obligations.** Insurance financial experts attempt to structure company risk and finances to meet the needs of their customers in high loss or catastrophic years. Insurers use excess surplus, reinsurance and other financial instruments to meet their obligations to both their customers and financial regulation. Sometimes, despite preparations, losses are so great that an insurer's surplus drops below the amount legally required to insure its customers. In such cases, an insurer must either seek additional funds or reduce its risk obligations by cancelling or non-renewing some customers. In the worst cases, insurers can become insolvent, and can be liquidated by the state.

Texas 2008: While stressed, the current competitive market structure has helped ensure that companies are solvent and able to pay claims

- **Texas suffered a series of catastrophic weather losses in 2008.** Beginning with record hail in the spring, continuing with Hurricanes Dolly and Gustav, and culminating with Hurricane Ike, Texas insured catastrophic losses exceeded \$10 billion. Not only did the marketplace pay its claims, it also paid \$530 million in assessments to the Texas Windstorm Insurance Association ("TWIA"). Insurers paid an estimated \$1.65 in claims and claims-related expenses for every \$1.00 collected in premium during the year, severely depleting the market surplus built in previous years.

Good Financial Policy: Vital to consumers and the insurance marketplace

- **The resilience of insurance in this time of financial crisis is no accident.** Insurance financial regulation has been firm, fair and focused for decades. Both regulators and insurers have embraced the idea that the most important attribute of an insurer is the ability to pay claims to its customers. The resulting body of law regulating insurer assets has led to general stability and limited insolvencies, even in these times of both financial and natural disaster.
- **Regulators and insurers need to work to ensure that companies have adequate surplus to meet their legal obligations now and in the future.** Policymakers must reject calls to pass laws that deplete surplus and could restrict availability in the marketplace. All should work to support initiatives such as competitive file and use rating, sound financial regulation, and better TWIA funding that ensure adequate surplus to fund a stable, competitive, fair marketplace.