SUBCHAPTER E. TEXAS WINDSTORM INSURANCE ASSOCIATION
DIVISION 3. LOSS FUNDING, INCLUDING CATASTROPHE RESERVE TRUST FUND, FINANCING ARRANGEMENTS, AND PUBLIC SECURITIES
28 TAC §§5.4101, 5.4102, 5.4121, 5.4123 - 5.4128, 5.4133, 5.4135, 5.4136, 5.4141 - 5.4147, 5.4148, 5.4149, and 5.4164

1. INTRODUCTION. The Texas Department of Insurance adopts new 28 TAC §§5.4123 - 5.4128, 5.4135, 5.4136, 5.4148, and 5.4149, and amendments to 28 TAC §§5.4101, 5.4102, 5.4121, 5.4133, 5.4141 - 5.4147, and 5.4164, to implement HB 3, 82nd Legislature, 1st Called Session, 2011. Sections 5.4101, 5.4102, 5.4121, 5.4123 - 5.4128, 5.4133, 5.4135, 5.4136, 5.4141 - 5.4147, 5.4148, 5.4149, and 5.4164 are adopted with changes to the proposed text in the February 14, 2014, issue of the *Texas Register* (39 TexReg 867).

2. REASONED JUSTIFICATION. The amendments and new sections are necessary to implement HB 3 to provide loss funding for the Texas Windstorm Insurance Association in the event of a catastrophe. These sections concern funding losses and operating expenses in excess of the association's premium and other revenue under Insurance Code Chapter 2210, Subchapters B-1, J, and M. These sections will be incorporated into the association's plan of operation. Matters addressed in the plan of operation amendments include: (i) the catastrophe reserve trust fund; (ii) financing arrangements; (iii) issuance of public securities; (iv) use of public securities proceeds; and (v) payment of public security obligations. In conjunction with this adoption, the

department is also adopting the repeal of 28 TAC §5.4131 and §5.4132 separately and also published in this issue of the *Texas Register*.

The department accepted written comments on the loss funding and premium surcharge rule proposals from February 14, 2014, through March 10, 2014, and heard testimony at three public hearings in Beaumont, Austin, and Corpus Christi. During the comment period, the department received approximately 340 comments, both in writing and at the public hearings.

In considering all of the comments and in adopting the rules, the department is constrained by two things: 1) the association's funding structure under existing law; and 2) the Legislature's finding in Insurance Code §2210.001 that, "the provision of adequate windstorm and hail insurance is necessary to the economic welfare of this state, and without that insurance, the orderly growth and development of this state would be severely impeded."

The association is the insurer of last resort for windstorm and hail insurance coverage in the catastrophe area along the coast. The association provides insurance coverage to those who are unable to obtain wind and hail insurance in the private market. The catastrophe area includes the 14 first-tier coastal counties and parts of Harris County. The association's largest risk exposure is catastrophic losses from hurricanes.

The Texas Legislature enacted HB 4409, 81st Legislature, Regular Session, 2009, which substantially changed how the association paid for losses that exceeded its premium, other revenue, and amounts available in the catastrophe reserve trust fund

(CRTF). HB 4409 amended Insurance Code Chapter 2210 to provide for three classes of public securities to pay for excess losses in the event of a catastrophe. In 2011, HB 3 amended the association's loss funding provisions to authorize the association to request the issuance of class 1 public securities prior to a catastrophic event, and to permit the association to request the issuance of class 2 and class 3 public securities if the Texas Public Finance Authority (TPFA) is unable to issue all or any portion of the class 1 public securities. Class 1 public securities must be issued when losses in a catastrophe year exceed the association's premium, other revenue, available reserves, and amounts in the CRTF. Class 1 public securities are to be paid with the association's net premium and other revenue. Losses not paid by class 1 public securities are to be paid by the proceeds of class 2 and class 3 public securities.

Insurance Code §2210.613 describes how the association must pay class 2 public securities. HB 4409 required that class 2 public securities be paid with member insurer assessments and a premium surcharge on coastal policyholders. Thirty percent of the cost of class 2 public securities was to be paid by member insurer assessments. Seventy percent of the cost of class 2 public securities was to be paid by premium surcharges assessed on all policyholders who resided or had operations in, or whose insured property was located in the catastrophe area. HB 3 amended Insurance Code §2210.613 so that 70 percent of the cost of class 2 public securities is to be paid by premium surcharges assessed on all policyholders of policies that cover insured property located in the catastrophe area, including automobiles principally garaged in the catastrophe area. Member insurer assessments must still pay 30 percent of the

cost of class 2 public securities. HB 3 also amended Insurance Code §2210.613 to specify the lines of insurance to which the premium surcharges apply. Before the enactment of HB 3, the premium surcharges in Insurance Code §2210.613 applied to "all property and casualty lines of insurance, other than federal flood insurance, workers' compensation insurance, accident and health insurance, and medical malpractice insurance." After HB 3, Insurance Code §2210.613 states that the premium surcharge applies to "all policies of insurance written under the following lines of insurance: fire and allied lines, farm and ranch owners, residential property insurance, private passenger automobile liability and physical damage insurance, and commercial automobile liability and physical damage insurance."

If the comments are any indication, the adopted rules will displease many, and for different reasons. Coastal residents, businesses, and local governments expressed concern over premium surcharges. Some who have no connection to the association wondered why they might have to pay surcharges on their property and casualty insurance premiums to pay for the association's losses. Many on the coast asked why the cost of windstorm insurance on the coast cannot be shared with the rest of the state. In addressing these comments, the department is constrained by the association's funding structure under existing law.

Since HB 4409 was enacted in 2009, Texas law has stated that if the association cannot pay its policyholders' claims from its premium and other revenue, and amounts in the CRTF, the association must issue public securities that are paid for, in part, by premium surcharges on coastal property and casualty insurance policies, including auto

policies. The department adopted rules on premium surcharges consistent with HB 4409. The enactment of HB 3 made the department's rules implementing the premium surcharge required under Insurance Code §2210.613 obsolete. The adopted amendments conform the premium surcharge rules to the current §2210.613. Premium surcharges make up part of the association's funding structure, regardless of the department's rules. The department's rules are necessary to enable the association to effectively implement the funding structure it is given under statute to pay its policyholders' claims.

The insurance industry and other observers expressed concern that the loss funding rules are without statutory authority. Some industry members wrote of the costs they will incur in repaying premium surcharges to policyholders. In addressing these comments, the department is constrained by the need to implement Insurance Code §2210.6136 so that the association can pay claims, while still paying for its share of public securities under that statute. The adopted rules implement §2210.6136 so that the association can issue marketable public securities with which it can pay claims. Leaving the association unable to pay claims does not comport with the Legislature's intent that the Texas coast have adequate windstorm and hail insurance. The repayment requirements the industry objects to in comments about the rules comply with the Legislature's intent that the association, and not all coastal property and casualty insurance policyholders, pay for a specified portion of the public securities issued under §2210.6136.

Where possible, the department changed the proposed rules in response to comments to make them friendlier to consumers and less cumbersome for insurers. For example, the adopted rules require insurers to collect premium surcharges from policyholders in the manner that the insurer collects premium. This gives policyholders the same flexibility in paying premium surcharges that they have in paying premium. The adopted rules contain several changes in consideration of the characteristics of the surplus lines industry.

This order summarizes all of the comments the department received on the proposed rules. Although the department is constrained in the actions it may take to address the comments, the Legislature does not have the same limitations. The comments are presented here in the hope that the Legislature will consider them should it revisit the statutes these adopted rules implement.

In response to comments on the published proposal, the department has adopted changes to the proposed text in §§5.4102, 5.4125, 5.4126, and 5.4127. The department has adopted nonsubstantive changes to the proposed text in §§5.4101, 5.4102, 5.4121, 5.4123 - 5.4128, 5.4133, 5.4135, 5.4136, 5.4141 - 5.4147, 5.4148, 5.4149, and 5.4164 to conform to agency style guidelines. The changes do not introduce new subject matter, create additional costs, or affect persons other than those previously on notice from the proposal.

The following explains adopted §§5.4101, 5.4102, 5.4121, 5.4123 - 5.4128, 5.4133, 5.4135, 5.4136, 5.4141 - 5.4147, 5.4148, 5.4149, and 5.4164 in greater detail.

§5.4101. Applicability. As previously discussed, the association operates under a plan of operation. Section 5.4101(a) has been amended to provide that the adopted new sections in this division will be part of the association's plan of operation, and will control over any conflicting provision in §5.4001 of this title. Section 5.4001 contains the association's plan of operation, but over time that plan has been augmented by the adoption of other sections. The department also made nonsubstantive changes to the proposed text to conform to agency style.

§5.4102. Definitions. Amended §5.4102 defines terms used in this division. The defined terms are derived from Insurance Code Chapter 2210 and information and terminology that TPFA provided to the department. New terms that are defined in this section include: class 1 payment obligation, earned premium, member assessment trust fund, net premium, obligation revenue fund, premium, premium surcharge and member assessment repayment obligation, premium surcharge trust fund, public security administrative expenses, and repayment obligation trust fund. Other terms are amended based on changes in the statute as a result of HB 3, and nonsubstantive changes have been made to the text in the proposal for clarity and to conform to agency style.

§5.4121. Financing Arrangements. Insurance Code §2210.072 and §2210.612 provide that the association may enter into financing arrangements directly with a market source to enable the association to pay losses or obtain public securities under Insurance Code §2210.072. Amended §5.4121(b)(1) provides that the association may pay for the financing arrangement with net premium that is not required for the payment

of class 1 public securities, or the repayment of premium surcharge or member assessment repayment obligations. HB 3 revised Insurance Code §2210.612 to define the revenue stream available to fund class 1 public security obligations and public security administrative expenses as “net premium” rather than “premium.” Insurance Code §2210.609 establishes a priority for the use of net premium to fund class 1 public security obligations and public security administrative expenses. Section 5.4121(b)(1) reflects that the use of net premium and other revenue for the payment of financing arrangements is subordinate to the payment of class 1 public security obligations under §5.4126 and §5.4141 and Insurance Code §2210.612 and §2210.6136. The amendment to §5.4121(c) states the collateral assignment applies to “any class of public security issued under Insurance Code Chapter 2210” rather than listing each class.

§5.4123. Public Securities Request, Approval, and Issuance. Before public securities may be issued, Insurance Code §2210.604 requires the association to submit a request for the issuance of public securities. The commissioner must approve that request before TPFA may issue public securities on behalf of the association. Under the statute, class 1 public securities may be issued before or after a catastrophic event, and class 2 and class 3 public securities may be issued only after a catastrophic event.

This section allows the association to request public securities as often as necessary and at any time. This means that the association can submit a request for the issuance of post-event public securities to the commissioner for approval prior to a catastrophe, but the public securities may be issued only after a catastrophe occurs.

The department drafted this provision to allow TPFA the opportunity to review and prepare for the issuance of public securities prior to an event without actually issuing the securities. TPFA has informed the department that it cannot begin preparation for the issuance of public securities until it has a request for issuance from the association that is approved by the commissioner. By allowing the association to submit requests for commissioner approval prior to a catastrophe, TPFA can prepare for the issuance of public securities so that, in the event of a catastrophe, TPFA can more expediently issue public securities.

The adopted rule establishes the supporting documentation that must be included in the association's request and provides that the commissioner may request additional information. The association must provide to the department any requested information concerning public securities or the pending issuance of public securities. It is important that this information be accessible to maintain effective regulation of the association. The commissioner may deny the association's request. If a request is denied, the association may submit another request for the commissioner's consideration. When the association's request is approved, the department must provide the commissioner's written approval to the association and the TPFA.

The procedures established by this section apply to the issuance of public securities and the reissuance and refinancing of public security obligations.

§5.4124. Issuance of Class 1 Public Securities Before a Catastrophic Event. HB 3 amended Insurance Code §2210.072 to authorize the issuance of class 1 public securities before a catastrophic event. The association's board of directors must

request the issuance of the public securities, and the commissioner must approve the board's request before TPFA can issue the class 1 public securities. This rule establishes specific requirements for a request to issue class 1 public securities before a catastrophic event. This rule establishes the method for calculating the amount of class 1 public securities issued before a catastrophic event that the association may request. This rule also details the information the association must submit with its request to the commissioner, including a cost-benefit analysis required by Insurance Code §2210.604(a) for all public security requests. The contents of the cost-benefit analysis are set out in §5.4135 of this proposal. Additionally, the association must submit a three-year pro forma financial statement reflecting the financial impact to the association if class 1 public securities are issued before a catastrophic event.

The association may submit one or more requests to issue class 1 public securities before a catastrophic event under this section. Section 5.4124(d) establishes the method of calculating the amount of class 1 public securities issued before a catastrophic event that the association may request. Insurance Code §2210.072(b) limits the amount of outstanding class 1 public securities issued before a catastrophic event to $1 billion, regardless of the calendar year when the class 1 public securities were issued. Insurance Code §2210.072(e) states that the association must deplete the proceeds of outstanding class 1 public securities issued before a catastrophic event before the proceeds of class 1 public securities issued after a catastrophic event may be used. Insurance Code §2210.072(f) states that the proceeds of outstanding class 1 public securities issued before a catastrophic event count against the $1 billion

catastrophe year limit set out in Insurance Code §2210.072(b). These provisions authorize the association to issue class 1 public securities before a catastrophic event in an outstanding aggregate principal amount of up to $1 billion. If the proceeds of the class 1 public securities issued before a catastrophic event must be depleted, those proceeds are applied to that catastrophe year cap, but do not count against the aggregate principal amount cap for class 1 public securities issued before a catastrophic event. This will enable the association to continue to use class 1 public securities issued before a catastrophic event for liquidity in years following a catastrophic event.

§5.4125. Issuance of Public Securities after a Catastrophic Event. This section establishes specific requirements for the association's request to issue class 1, class 2, and class 3 public securities following a catastrophic event and the method for calculating the authorized principal amount of public securities that TPFA may issue. As previously discussed, the statute limits when the public securities can be issued, not when the public securities may be requested. Requests for issuance of public securities may be submitted prior to a catastrophe even though the public securities may not be issued until after a catastrophe. The association may submit a request for the issuance of public securities after a catastrophe for commissioner's approval at any time, although TPFA will not actually issue the public securities until a catastrophic event has occurred.

Section 5.4125(b) lists the information the association must provide to the commissioner to support its request, including a cost-benefit analysis. Section

5.4125(c) establishes the method of calculating the authorized principal amount of public securities that can be requested for issuance. Section 5.4125(d) clarifies that for each catastrophe year, the association must request the statutorily authorized principal amount of each class of public securities before it can request the next class of public securities. Section 5.4124(e) provides that the association may make one or more requests to issue public securities under this section and clarifies that the association need not exhaust all proceeds from a class of public securities before it requests issuance of the next class of public securities. Depending on the severity of a catastrophic event, the association may need additional loss funding from one or more classes of public securities. TPFA has informed the department that it measures the process of issuing public securities from the request to obtaining the proceeds in months. This rule section allows the association to request more than one class of public securities so the association may have adequate proceeds available as timely as possible for prompt payment of claims.

§5.4126. Alternative for Issuing Class 2 and Class 3 Public Securities. Insurance Code §2210.073 provides that class 2 public security proceeds are to pay for losses that have not been paid by class 1 public security proceeds. This raises an issue of providing adequate loss funding for the association if the entire $1 billion authorized amount of class 1 public securities cannot be issued due to market conditions. Class 1 public securities are to be repaid with the association's net premium under Insurance Code §2210.612. A catastrophic event may result in losses that exceed the association's revenue and impair its ability to repay class 1 public securities. If the

association's class 1 public securities are not marketable, Insurance Code §2210.6136 allows the commissioner to authorize the issuance of class 2 public securities. Section 5.4126 implements the procedure for the association to request issuance of class 2 and 3 public securities under Insurance Code §2210.6136 when all or any portion of class 1 public securities cannot be issued.

Section 5.4126(a) establishes that the purpose of this section is the issuance of class 2 and class 3 public securities if TPFA cannot issue on behalf of the association all or any portion of the authorized principal amount of class 1 public securities. Section 5.4126(b) lists the information that the association must provide to the commissioner in support of its request for issuance of class 2 or class 3 public securities. Section 5.4126(c) requires that the association must first request the authorized principal amount of class 1 public securities, as determined under §5.4125(c) of this title, before the association may request class 2 public securities under this alternative issuance procedure. The association is not required to have requested the maximum authorized principal amount of class 1 public securities because the catastrophic event may not reach that level of loss. The amount of the request under this section will be based on the amount of class 1 public securities that TPFA cannot issue on behalf of the association to fund the catastrophic loss.

The commissioner may issue an order authorizing TPFA to issue class 2 public securities in an amount that does not exceed the authorized principal amount as determined under §5.4125(c) of this title. The principal amount is further limited by the amount the association needs to fund the excess losses. The commissioner may rely

on information from any source in ordering the issuance of class 2 public securities. Subsection (e) sets forth the required contents of a commissioner's order authorizing the issuance of class 2 public securities under §5.4126(d). Subsection (f) allows the commissioner to revise the order as necessary because the association has paid excess amounts towards repayment of the premium surcharges and member assessments, or the association's financial situation has changed, necessitating a change in the repayment schedule. As discussed in §5.4127(d), the priority of the repayment obligation is subordinate to the payment of the class 1 public securities.

TPFA may issue the class 2 public securities authorized in the commissioner's order. TPFA may elect to issue the class 2 public securities in separate series. Section 5.4126(h) clarifies that the association may request and the commissioner may approve the issuance of class 3 public securities prior to the issuance of class 2 public securities under this section and Insurance Code §2210.6136. TPFA cannot issue the class 3 public securities until after TPFA has issued $1 billion in class 2 public securities on behalf of the association for that catastrophe year.

§5.4127. Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments. The Legislature enacted Insurance Code §2210.6136 for funding excess losses when a sufficient amount of class 1 public securities cannot be issued. HB 3 does not express any legislative intent that the association is to stop paying claims based on its inability to market class 1 public securities, which are paid from the association's net premium and other revenue. Insurance Code §2210.6136 allows TPFA to issue class 2 public

securities if it cannot issue all or any portion of the total authorized principal amount of class 1 public securities. Class 2 public securities are repaid by a combination of member assessments and premium surcharges under Insurance Code §2210.613.

Insurance Code §2210.6136 specifies that if class 2 public securities are issued under that section, then the class 2 public securities must be repaid by the association's net premium and other revenue in an amount equal to the lesser of $500 million or the portion of class 1 public securities that cannot be issued. This has the effect of treating class 2 public securities issued under Insurance Code §2210.6136 as class 1 public securities, which are repayable by premium and revenue. This is inconsistent with the purpose of Insurance Code §2210.6136 to provide for the issuance of class 2 public securities because class 1 public securities cannot be issued. If a hurricane occurs that results in excess losses, the fully authorized amount of class 1 public securities may not be available to pay for those losses because those securities are based on the association's premium and revenue. The fully authorized amount of class 1 public securities may not be marketable because the association's net premium and other revenue may not be a large enough to secure the full $1 billion in class 1 public securities. In the event of catastrophic losses, the association is obligated to pay claims. If class 1 public securities are not marketable and cannot be issued, then class 2 public securities and class 3 public securities must be issued.

This means that under Insurance Code §2210.6136, the association must then repay the principal, interest, and other costs of class 2 public securities with premium surcharges and member assessments. This is the only reasonable reading of

Insurance Code §2210.6136 that is consistent with Government Code §311.021. If a catastrophe occurs that results in losses in excess of funding authorized under Insurance Code §2210.072, and the association cannot issue all or any portion of class 1 public securities, then class 2 public securities may be issued under Insurance Code §2210.6136. Under the plain language of Insurance Code §2210.6136, the association must issue $500 million in class 2 public securities that are to be repaid by the association's premium and other revenue. Under this provision, class 2 public securities are repaid from the same source of revenue used to pay class 1 public securities. If the association can issue class 2 public securities that are to be repaid by premium, then this means the association is capable of issuing class 1 public securities. This eliminates the need for having an alternative to issuing class 2 public securities when class 1 public securities cannot be issued. It is not feasible to read the statute to require TPFA to issue all of the class 1 public securities it can based on the association's net premium and other revenue, and then expect TPFA to issue additional public securities using the same funding sources simply because the name of the public security has changed. Such a reading would render Insurance Code §2210.6136 meaningless. The statute does not require the association to borrow additional amounts. The statute requires the association to repay the costs incurred on some of the class 2 public securities. The association must repay the premium surcharges and member assessments to fulfill that requirement.

Section 5.4127 implements the repayment scheme in Insurance Code §2210.6136. Section 5.4127(a) requires the association to pay class 2 public securities

issued under §5.4126 of this title using premium surcharges and member assessments. Section 5.4127(a)(1) and (2) clarify that the definition of insurer and the procedures for collecting premium surcharges and member assessments under this section are the same as those used for class 2 public securities that will be issued under §5.4125. Section 5.4127(b) provides the method of determining the costs of the class 2 public securities that the association must repay. Section 5.4127(c) clarifies that the requirement is to repay premium surcharges and member assessments that are paid, or payable, on the total principal amount, plus any costs and contractual coverage amount associated with that amount.

Section 5.4127(d) describes the primary sources of funding for repayment of the premium surcharges and member assessments. These sources are net premium and other revenue that is not contractually pledged to class 1 payment obligations and amounts released from the obligation revenue fund as described in §5.4142. This means, as §5.4127(e) states, that the association must collect premium and other revenue in an amount sufficient to make the repayments and to pay for outstanding class 1 payment obligations. Section 5.4127(f) describes the methods the association may use to make the repayment and addresses the situation when the association has sufficient funds to pay class 2 obligations, which will eliminate or reduce the need to collect premium surcharges and member assessments. The association will make deposits necessary to make this payment in the appropriate trust funds. This may result in savings on administrative costs for the association caused by a reduction in the amount of premium surcharge repayments the association must track. Association

policyholders may also benefit from prepayment of premium surcharges, because association insurance coverage is subject to the premium surcharge. Section 5.4127(f)(2) requires the association to deposit funds in a repayment obligation trust fund to repay the premium surcharges and member assessments. The funds will later be distributed to insurers for repayment in compliance with the commissioner's order. Together, through prepayment or repayment, the association must fulfill its obligation under this section and Insurance Code §2210.6136.

Subsection (g) requires the association to track receipts of premium surcharges and member assessments. Subsection (h) provides that insurers may pay, on behalf of their policyholders, the premium surcharges that will be subject to repayment under Insurance Code §2210.6136(b)(1). The insurer will then collect the repayment when made, as described in §5.4128(c) of this division.

§5.4128. Repayment of Premium Surcharges to Policyholders and Member Assessments to Insurers. Section 5.4128 addresses the repayment procedures the association and insurers must use to repay premium surcharges and member assessments. The association must specify the surcharge and assessment period being repaid. Subsection (b) establishes when the repayments must begin, and subsection (c) establishes requirements for insurers making repayments to their policyholders. The repayment to each policyholder must be proportional to the amount the policyholder paid for that period. If an insurer paid all or a portion of the premium surcharge on behalf of its policyholders during the period, the insurer may recoup it, but may not claim a greater share of the premium surcharge than the portion it paid on

behalf of its policyholders. Member assessments will be returned to the insurer or insurance group that paid the member assessment.

§5.4133. Public Security Proceeds. The public security proceeds are held in trust with the trust company for the benefit of the association and may only be used for certain purposes specified by statute. This section establishes the procedure for the association to request that the trust company disburse funds. HB 3 amended Insurance Code §2210.608 to specifically allow two additional uses of public security proceeds and prohibit the association from using the proceeds of public securities issued before a catastrophic event to purchase reinsurance. The amendment to §5.4133 removes the reference to using public security proceeds and points to Insurance Code §2210.608 for the authorized uses of public security proceeds.

§5.4135. Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis. This section discusses the marketability of public securities and sets out factors that may be considered in determining the marketability of class 1 public securities. Subsection (a) defines “marketable public securities.” Subsection (b) establishes factors the association must consider in determining whether class 1 public securities are not marketable. This information is necessary for the determination of issuing class 2 public securities under §5.4126. Subsection (c) addresses the factors the association must consider in determining market conditions and requirements under §5.4135(b). Subsection (d) requires the association to submit a cost-benefit analysis as

required by Insurance Code §2210.604(a) and lists the information the cost-benefit analysis must include.

§5.4136. Association Rate Filings. HB 3 amended Insurance Code §2210.355 to clarify that association rates must consider class 1 public security obligations and contractual coverage amounts that the association determines to be required for the issuance of marketable public securities. This section restates the statutory requirement and clarifies that it also applies to repayment amounts owed under §5.4127(b), which are repaid from the same sources of funds as class 1 public securities. This section establishes how the association must comply with this requirement.

§5.4141. Obligation Revenue Fund for the Payment of Class 1 Public Security Obligations and Operating Reserve Fund. HB 3 amended Insurance Code §2210.609 to direct the association to deposit its net premium and other revenue collected under Insurance Code §2210.612 in the obligation revenue fund for the payment of class 1 public securities. The department amended subsection (a) of §5.4141 to be consistent with this requirement. The amendment replaces the reference to “net revenue” with “net premium and other revenue.” The association must deposit net premium in the amounts and for the periods required in the class 1 public security agreements. The intent is to allow greater flexibility in establishing payment schemes while the association continues to operate.

Insurance Code §2210.609(c) requires that all revenue collected under Insurance Code §§2210.612, 2210.613, and 2210.6135 be deposited in the appropriate public

security obligation revenue fund. The department amended subsection (b) of §5.4141 to provide the association flexibility to transfer funds from any operating reserve fund or other association held funds into the obligation revenue fund to pay class 1 public securities.

§5.4142. Excess Obligation Revenue Fund Amounts. From time to time, the association may need to disburse funds in the obligation revenue fund, including the contractual coverage amount. Section §5.4142 provides that excess revenue collected in the obligation revenue fund is an asset of the association and may be disbursed for any purpose authorized by Insurance Code §2210.056, including the repayment of premium surcharge and member assessments under §5.4127. If the association elects to repay class 1 public securities early, commissioner approval is required under Insurance Code §2210.072. Although the funds in the obligation revenue fund consist of net premium and other revenue, excess funds released under §5.4142 do not apply to class 1 public security payment obligations. Distribution of the excess revenue in the obligation revenue fund does not affect the amounts due under Insurance Code §2210.6136 or §5.4126 of this title. The distribution provides the association with additional funds that can be used for prepaying the amounts due under Insurance Code §2210.6136 or §5.4126 of this title. The proposal does not require prepayment because it is impossible to determine what the association's financial position will be at the time of the distribution or what will be the best use of the distribution.

§5.4143 and §5.4146. Trust Funds for the Payment of Class 2 and Class 3 Public Securities and Member Assessment Trust Fund for the Payment of Class 3

Public Securities. Insurance Code §2210.613 provides for the payment of class 2 public security obligations with premium surcharges on property and automobile insurance policies in the catastrophe area and member insurer assessments. Insurance Code §2210.6135 provides for the payment of class 3 public security obligations with association member insurer assessments. The procedure for establishing, assessing, collecting, reporting, accounting for, and transmitting the premium surcharges and member assessments to the association are currently set out in §§5.4161 - 5.4167, 5.4171 - 5.4173, and 5.4181 - 5.4192 of this title. HB 3 amended Insurance Code §2210.613 to specify the lines of insurance subject to the premium surcharge. Rules implementing the premium surcharge are addressed in a separate rule adoption published in this issue of the *Texas Register.*

Sections 5.4143 and 5.4146 concern how amounts collected from premium surcharges and member assessments are deposited. The association is required to deposit the collected revenue in the appropriate trust fund. The amendments to these sections reflect HB 3 changes to Insurance Code §2210.609, which created distinct revenue trust accounts for the premium surcharges and member assessments. Additionally, the proposal requires the association to transfer the collected money into the trust funds on receipt. The rules also allow the option for insurers to direct deposit the funds electronically into the appropriate funds. If insurers are required by the financial agreements to direct deposit, the association must send notice to the insurers with direct deposit information. Finally, the amended sections limit the use of these funds. The deposited funds may only be used to fund the appropriate public security

obligation or as authorized in this title, which includes the use of excess funds under §§5.4144, 5.4145, and 5.4147 as authorized by Insurance Code §2210.611.

§§5.4144, 5.4145, and 5.4147. Excess Class 2 Premium Surcharge Revenue, Excess Class 2 Member Assessment Revenue, and Excess Class 3 Member Assessment Revenue. The revenue funds may have excess funds. HB 3 amended Insurance Code §2210.611 to include procedures for handling both excess premium surcharge and member assessment revenue. The amendments to these sections conform to the existing provisions of Insurance Code §2210.611, as amended.

§5.4148 and §5.4149. Repayment Obligation Trust Fund for the Payment of Amounts Owed Under §5.4127 and Excess Repayment Obligation Trust Fund Amounts. Insurance Code §2210.6136 requires the association to collect net premium and other revenue for the repayment of premium surcharges and member assessments in the manner described by Insurance Code §2210.612, which states that the collected net premium and other revenue are to be deposited in the revenue obligation fund. Section 5.4148 creates procedures for a designated repayment obligation trust fund held by the trust fund or a trustee. Section 5.4148 provides that the purpose of these funds is the payment of class 2 public securities subject to repayment under §5.4127(b) of this title, and the repayment of all amounts owed under §5.4127(b). To the extent funds in this account are distributed, the funds must repay class 2 public securities first. Once the association has paid those amounts, excess funds will be disbursed to the association.

§5.4164. Payment of Assessment. Section 5.4164 is revised to allow insurers to deposit member assessments directly into the member assessment trust fund. The department made changes to this section to provide that insurers may be required to deposit assessments directly into the member assessment trust fund instead of remitting assessments to the association.

The department also makes nonsubstantive changes to the proposed text as a result of comments. These changes do not affect persons not previously on notice or raise new issues.

In response to comments, the department changes proposed §5.4102(35), which defines “premium surcharge and member assessment repayment obligation.” The department amends §5.4102(35) to clarify the length of time the association has to complete repayments.

In response to comments, the department changes proposed §5.4102(40), which defines “repayment obligation trust fund.” The department amends §5.4102(40) to remove the reference to the trust company.

In response to comments, the department changes proposed §5.4125. The department modifies §5.4125(c)(2) to more clearly identify the amount referred to in that paragraph.

In response to comments, the department changes proposed §5.4126. The department modifies §5.4126(e) to clarify that the subsection refers to a commissioner’s order issuing class 2 public securities under §5.4126(d).

In response to comments, the department changes proposed §5.4127. The department modifies §5.4127(h)(2) and (3) to clarify that if an insurer elects to pay, on behalf of its policyholders, all or part of a premium surcharge that is subject to repayment, the insurer must pay equally for all policyholders who are subject to that surcharge.

In response to comments, the department changes proposed §5.4148. The department modifies §5.4148 to require the association to either enter into trust agreements with the trust company or with a trustee selected by the association and approved by the commissioner.

The department makes other nonsubstantive changes to the proposed rule text for improved clarity and consistency with agency style. These changes do not affect persons not previously on notice or raise new issues.

3. HOW THE SECTIONS WILL FUNCTION.

§5.4101. Applicability. This section states the applicability of the subchapter.

§5.4102. Definitions. This section states the defined terms used in the division. Amendments change previous definitions and add new definitions for “class 1 payment obligation,” “earned premium,” “member assessment trust fund,” “net premium,” “obligation revenue fund,” “premium,” “premium surcharge and member assessment repayment obligation,” “premium surcharge trust fund,” “public security administrative expenses,” and “repayment obligation trust fund.”

§5.4121. Financing Arrangements. This section provides how the association may enter into financing arrangements directly with a market source to enable the association to pay losses or obtain public securities.

§5.4123. Public Securities Request, Approval, and Issuance. This section establishes procedures for the association to request public securities. The section also establishes the supporting documentation that must be included in the association's request and provides that the commissioner may request additional information. The procedures established by this section apply to the issuance of public securities and the reissuance and refinancing of public security obligations.

§5.4124. Issuance of Class 1 Public Securities Before a Catastrophic Event. This section establishes specific requirements for a request to issue class 1 public securities before a catastrophic event and the method for calculating the outstanding aggregate principal amount of class 1 public securities issued before a catastrophic event.

§5.4125. Issuance of Public Securities After a Catastrophic Event. This section establishes specific requirements for the association's request to issue class 1, class 2, and class 3 public securities following a catastrophic event and the method for calculating the authorized principal amount of public securities that TPFA may issue. This rule section allows the association to request more than one class of public securities so the association may have adequate proceeds available as timely as possible for prompt payment of claims.

§5.4126. Alternative for Issuing Class 2 and Class 3 Public Securities. This section establishes the requirements and procedures for the issuance of class 2 and

class 3 public securities if TPFA cannot issue on behalf of the association all or any portion of the authorized principal amount of class 1 public securities.

§5.4127. Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments. This section implements the repayment scheme in Insurance Code §2210.6136.

§5.4128. Repayment of Premium Surcharges to Policyholders and Member Assessments to Insurers. This section addresses the repayment procedures the association and insurers must use to repay premium surcharges and member assessments.

§5.4133. Public Security Proceeds. This section establishes the procedure for the association to request the trust company to disburse funds for use.

§5.4135. Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis. This section discusses the marketability of public securities and sets out factors that may be considered in determining the marketability of class 1 public securities.

§5.4136. Association Rate Filings. This section establishes how the association must comply with the statutory requirement and clarifies that it also applies to repayment amounts owed under §5.4127(b), which are repaid from the same sources of funds as class 1 public securities.

§5.4141. Obligation Revenue Fund for the Payment of Class 1 Public Security Obligations and Operating Reserve Fund. This section provides for the deposit of net premium and other revenue for the payment of class 1 public securities.

§5.4142. Excess Obligation Revenue Fund Amounts. This section provides that excess revenue collected in the obligation revenue fund is an asset of the association and may be disbursed for any purpose authorized by Insurance Code §2210.056, including the repayment of the premium surcharge and member assessments under §5.4127.

§5.4143 and §5.4146. Trust Funds for the Payment of Class 2 and Class 3 Public Securities and Member Assessment Trust Fund for the Payment of Class 3 Public Securities. These sections concern how the amounts collected from premium surcharges and member assessments are deposited.

§§5.4144, 5.4145, and 5.4147. Excess Class 2 Premium Surcharge Revenue, Excess Class 2 Member Assessment Revenue, and Excess Class 3 Member Assessment Revenue. These sections concern procedures for handling both excess premium surcharge and member assessment revenue.

§5.4148 and §5.4149. Repayment Obligation Trust Fund for the Payment of Amounts Owed Under §5.4127 and Excess Repayment Obligation Trust Fund Amounts. Section 5.4148 creates procedures for a designated repayment obligation trust fund. Section 5.4149 provides that excess amounts in the repayment obligation trust fund are disbursed to the association and become an asset of the association.

§5.4164. Payment of Assessment. This section specifies how insurers may deposit member assessments directly into the member assessment trust fund.

4. SUMMARY OF COMMENTS AND AGENCY RESPONSE.

Comment on §5.4102(40): A commenter suggests that the department confirm with the Texas Comptroller of Public Accounts that the Texas Safekeeping Trust Company has the authority to hold the repayment obligation trust fund, which is not explicitly created by statute.

Agency Response: The department has modified proposed §5.4102(40) to remove the reference to the trust company from the definition of the repayment obligation trust fund. The department has also modified proposed §5.4148 to require that the association enter into trust agreements with the trust company or with a trustee selected by the association and approved by the commissioner. The adopted §5.4148 also provides that trust agreements with the latter are subject to prior approval by the commissioner.

Comment on §5.4121(b): A commenter suggests that the department not add the term "net premium" to §5.4121(b)(1). The commenter states that the intent of the statute is to accommodate financing arrangements that are not necessarily class 1 public securities. The commenter further states that Insurance Code §2210.612(b) expressly authorizes financing arrangements to obtain public securities but does not limit those arrangements to only obtaining public securities. If commercial paper is issued before a

loss and not used to obtain class 1 public securities, the commercial paper should not be restricted to repayment from only “net premium.”

Agency Response: The department agrees that financing arrangements are not necessarily class 1 public securities and, unlike class 1 public securities, repayment of those financing arrangements is not limited to “net premium and other revenue.” However, the department disagrees with the suggestion to change “net premium” to “premium” in adopted §5.4121(b)(1).

In the context of the adopted rules, “net premium” is defined under §5.4102(28). This paragraph defines “net premium” as “gross premium less unearned premium.” Both “gross premium" and “unearned premium” are defined in the adopted rules. Section 5.4102(22) defines “gross premium” as “the amount of premium the association receives, less premium returned to policyholders for canceled or reduced policies.” Section 5.4102(45) defines “unearned premium” as “that portion of gross premium that has been collected in advance for insurance that the association has not yet earned because of the unexpired portion of the time for which the insurance policy has been in effect.” Using the word “premium” instead of “net premium” in §5.4121(b)(1) could permit the association to use funds that do not belong to the association to repay financial arrangements. Using the term “net premium” prohibits the association from repaying financing arrangements from funds owed policyholders for return premiums or from premiums that the association has not earned. Additionally, the rules do not limit the repayment of financing arrangements to “net premium and other revenue.” The association may also repay financing arrangements with: (i) reinsurance proceeds

under §5.4121(b)(2); (ii) the proceeds of any financing arrangement under §5.4121(b)(3); (iii) the proceeds of any class of public security under §5.4121(b)(4); and (iv) any other asset of the association under existing §5.4121(b)(5).

Comment on §5.4121(b)(4): A commenter writes that under §5.4124(b)(4) (initially identified as §5.4124(b)(4), later clarified as §5.4121(b)(4)), the association may pay a financing arrangement with proceeds from, among other sources, any class of public security issued under Insurance Code Chapter 2210. The commenter states that Insurance Code §2210.608(a)(6) allows public security proceeds to "pay private financial agreements entered into by the association as temporary sources of payment of losses and operating expenses of the association." The commenter states that the Texas Office of the Attorney General will need to concur with how the word "temporary" is interpreted in the future.

Agency Response: The adopted rules are intended to operate consistently with Insurance Code §2210.608. The department appreciates the comment.

Comment on §5.4126(d): A commenter asks that §5.4126(d) be amended to provide additional protections to lenders providing financing arrangements that are backed by public securities under §5.4121. Specifically, the commenter asks that §5.4126(d) be amended to require the commissioner to order the issuance of class 2 public securities when securities are necessary but class 1 public securities cannot be issued. The commenter asks that the amendment require the issuance of class 2 public securities in

an amount no less than “the lesser of the amount in which the financing arrangements are so secured” and the authorized amount of public securities as determined in §5.4125(c).

The commenter states that this amendment is justified because Insurance Code §2210.6136 states that the commissioner may cause the issuance of public securities “by rule or order,” and that an amendment requiring the issuance in certain circumstances is an example of the former. The commenter states that the requested amendment is necessary to “provide lenders the certainty they would need in order to offer a financing arrangement pursuant to §5.4121.”

Agency Response: TDI declines to make the requested amendment to §5.4126(d). The language in §5.4126(d) as proposed and adopted follows the language of Insurance Code §2210.6136(a), which provides that if all or any portion of the total principal amount of class 1 public securities authorized to be issued cannot be issued, the commissioner may cause the issuance of class 1 public securities.

Comment on §5.4126(e): A commenter suggests that §5.4126(e) be amended to clarify that the subsection refers to an order of the commissioner under §5.4126(d).

Agency Response: The department agrees with the suggested change.

Comment on §5.4126(f): A commenter notes that under §5.4126(f), the commissioner may revise the order issued under §5.4126 (relating to Alternative for Issuing Class 2 and Class 3 Public Securities). The commenter states that, “any revisions to the order

cannot affect the security provided to the owners of the class 1 and class 2 public securities as provided in the public securities financing documents." The commenter also states that, according to the commenter's prior discussions with the Texas Office of the Attorney General, the OAG prefers that any repayment obligations to nonassociation policyholders and member insurers under Insurance Code §2210.6136 be subordinate to the payment of class 1 public security obligations.

Agency Response: As proposed and as adopted, §5.4126(f) does not impair the security of owners of class 1 and class 2 public securities. Under §5.4126(f), the commissioner may revise the order to issue class 2 public securities in the event that all or a portion of the authorized amount of class 1 public securities cannot be issued. This order is described in §5.4126(d) and (e) and addresses the association's repayment of premium surcharges and member assessments under Insurance Code §2210.6136. Any revisions to this order will not change the fact that under §5.4127(a), the security for class 2 public securities issued under §2210.6136 are the premium surcharges and member assessments described in §2210.613. Further, any revisions to this order will not change the fact that under §5.4127(d), the only funds the association can use to repay the surcharges and assessments are: (1) its net premium and other revenue not pledged to class 1 payment obligations; and (2) excess amounts released from the class 1 obligation revenue fund.

Comment on §5.4126(g): A commenter suggests that §5.4126(g) be amended to state that TPFA must issue class 2 public securities authorized by the commissioner's order

under §5.4126(d), rather than that TPFA "may" issue class 2 public securities authorized by the order.

Agency Response: The department cannot adopt rules ordering another state agency to take action. Amending the rule as the commenter suggests would not provide any further assurance that TPFA would issue the class 2 public securities. Insurance Code §2210.604(a) already states that "at the request of the association and with the approval of the commissioner, the Texas Public Finance Authority shall issue class 1, class 2, or class 3 public securities." If TPFA were to refuse to issue class 2 public securities after the commissioner issued an order authorizing them, TPFA would be in violation of the Insurance Code.

Comment on §5.4127(h): Three commenters state that §5.4127(h) is confusing and ask for clarification. One of the commenters asks whether the intent of §5.4127 is to allow insurers to receive premium surcharge repayments from the association without having to return them to policyholders and, if so, whether the rest of the rules are consistent with that intent.

Two of the commenters ask for clarification on proposed §5.4127(h)(2). Section 5.4127 permits an insurer to pay on behalf of its policyholders all or part of a premium surcharge that the section requires the association to repay. As proposed, paragraph (2) required an insurer that pays on behalf of its policyholders to pay the premium surcharges for all of its policyholders "subject to the premium surcharge equally." The commenters ask whether this means an insurer that chooses to pay on behalf of one

group of policyholders must pay on behalf of all its policyholders, an “all or nothing election” as one commenter puts it, or whether the insurer must pay on behalf of all policyholders within a specific line of coverage.

One of the commenters asks how the surcharge is reflected on the policy declaration page if an insurer elects to pay all or part of a premium surcharge on behalf of its policyholders.

One of the commenters asks how an insurer’s election would be reported in quarterly and annual financial statements, in light of the fact that Insurance Code §2210.613(d) states that premium surcharges are not subject to premium tax or commissions. The commenter asks whether the association’s ability to repay would be counted as an admissible asset on the financial statements of insurers electing to pay on behalf of their policyholders.

One of the commenters asks how long the association has to make repayments, and the consequences of the association’s failure to make the repayments.

Agency Response: The intent of §5.4127(h) is to allow insurers to pay, on behalf of their policyholders, all or part of the premium surcharges that will be subject to repayment under Insurance Code §2210.6136(b), and then receive premium surcharge repayments from the association without having to return them to policyholders. Section 5.4127(h) requires an insurer that has chosen to pay the portion of the premium surcharges subject to repayment by the association (or a part of them), on behalf of its policyholders, to pay equally for all of its policyholders who are subject to the premium

surcharge. "All policyholders" is without qualification. The commenter's first interpretation is correct. The department has modified §5.4127(h)(2) and (3) in the adoption order to make this more clear. The loss funding and premium surcharge rules are consistent with the intent of §5.4127(h). For example, §5.4185(a), which originally prohibited insurers from paying premium surcharges instead of surcharging their policyholders, now permits it, as provided by §5.4127(h).

The notification insurers must give policyholders receiving a premium surcharge that their policy contains a premium surcharge, including what insurers must show on the declarations page, is addressed in §5.4189. If a policyholder will not receive a premium surcharge subject to repayment under Insurance Code §2210.6136 because his or her insurer has elected to pay all of it, the notification requirements of §5.4189 do not apply to that premium surcharge. The notification requirements of §5.4189 do apply to a premium surcharge the policyholder will receive, such as one not subject to repayment under §2210.6136, or part of a premium surcharge that is subject to repayment under §2210.6136, but that the insurer has not elected to pay on the policyholder's behalf. The language of proposed and adopted §5.4189, including the required notice language contained in §5.4189(a), addresses premium surcharges actually charged to policyholders, not premium surcharges that theoretically would have been charged to policyholders had the insurer not elected to pay a portion of the premium surcharge on the policyholders' behalf.

The NAIC has published its Accounting Practices and Procedures Manual, and with a few exceptions that manual has been adopted under §7.18. Premium surcharges

that an insurer opts to pay on behalf of its policyholders are analogous to assessments used to pay for public securities, except there would be an offsetting receivable for the amount the association must repay the insurer under adopted §5.4127(b). Statement of Statutory Accounting Principles (SSAP) No. 35 – Revised ("Guaranty Fund and Other Assessments") governs the accounting treatment for assessments. In addition, SSAP Nos. 4 and 20 govern when an insurer must consider an asset, including a "bill receivable not for premium," a nonadmitted asset.

In response to the comment on the length of time the association has to complete repayments, the department has amended proposed §5.4102(35), which defines premium surcharge and member assessment repayment obligation. The adopted paragraph makes clear that the order the commissioner issues under §5.4126 must specify the length of time the association has to repay the ordered amount of premium surcharges and member assessments. The adopted paragraph also states that the commissioner may order varying periodic payments. Like proposed §5.4126(f), adopted subsection (f) states that the commissioner may revise an order issued under §5.4126 as necessary to account for amounts the association prepays or to maintain the association's ability to fund class 1 payment obligations or other obligations, including losses.

If the association fails to make the repayments, the association will be in violation of a commissioner's order and subject to any applicable sanctions under Insurance Code Chapter 82.

Comment on §§5.4127 and 5.4128: Four commenters state that the department's interpretation of Insurance Code §2210.6136 is without statutory authority. The commenters state that the requirements of §5.4127 and §5.4128, which provide that the association must collect premium surcharges and member assessments to pay for public securities issued under §2210.6136, and then repay a statutorily prescribed amount of those surcharges and assessments to insurers, are not referenced in the Insurance Code.

Three commenters state that §2210.6136(b)(2) requires that premium surcharges and member assessments be used to pay for class 2 public securities only after the association has paid for its specified portion under §2210.6136(b)(1), using net premium and other revenue.

The commenters differ on the amount that §2210.6136 requires the association to pay from premium and other revenue. Two commenters state that the amount the association must pay first, from net premium and other revenue, is the lesser of $500 million, without any of the costs associated with it, or the amount of class 1 public securities that could not be issued, plus the costs associated with that amount. The two commenters state that the maximum amount that §2210.6136 requires the association to pay for class 2 public securities is $500 million. A third commenter states the association must pay for "no more than $500 million plus costs." The fourth commenter makes no statement on the matter.

Two of the commenters state that the department's interpretation of §2210.6136 is incorrect because it assumes that the association would not be able to repay class 2

public securities from premium and other revenue over a period of years. The commenters state that §2210.6136 does not set a deadline by which the association must repay its share of the class 2 public securities. One of the commenters states that it is unknown what interest rate would apply to those securities. This commenter states that Insurance Code §2210.611 contemplates that revenues from assessments and surcharges in a calendar year may exceed the public security obligations and expenses payable in that calendar year. Under §2210.611, the association may use those excess revenues to pay public security obligations payable in the subsequent calendar year, to redeem or purchase outstanding public securities, or deposit the excess revenues in the CRTF. The commenter states that under §2210.452(c), the "net profit," which the association may use to purchase reinsurance, deposit in the CRTF, or both, is calculated after payments of public security obligations and administrative expenses. The commenter states that these statutes show that the Legislature recognized that the association might have funds available to pay for class 2 public securities directly.

One of the commenters states that when the Legislature drafted §2210.6136, it was aware of any difficulty that the association might have in issuing class 2 public securities that would be paid back from the same source as class 1 public securities, whose unmarketability had triggered the issuance of the class 2 public securities. The commenter states that the department should bring concerns about §2210.6136 to the Legislature, and not rewrite the statute through rulemaking.

Two of the commenters state that the repayment system in §5.4128, under which insurers must return premium surcharges to policyholders, after having received them

from the association, is not mentioned in statute and not required to give effect to §2210.6136. Under §5.4128(c), insurers must return premium surcharges to policyholders within 90 days of receiving them from the association. The two commenters ask how insurers must allocate piecemeal payments from the association and what an insurer must do if it cannot relocate the recipient of a repayment. The two commenters state that locating former policyholders to return the surcharges within 90 days after the insurer receives them from the association will create expensive logistical challenges. The two commenters disagree with the department's estimate of the cost to insurers to comply with §5.4128, stating that the association's expected costs of implementation will be much lower than those of insurers writing multiple lines and types of property and casualty insurance.

One of the commenters proposes an alternate implementation of §2210.6136. The commenter proposes that on issuance of class 2 public securities under §2210.6136, the commissioner order the association to pay the lesser of the amount of authorized class 1 public securities that has not been issued, plus any costs associated with that amount, or $500 million. Based on information from TPFA on the structure of the class 2 public securities, the commissioner would determine how much the association would need to pay each year for up to 10 years. If, in a given year, the association did not have the funds it was required to pay that year, the commissioner would determine the premium surcharges and member assessments necessary in the next calendar year to make up the difference. Thus, the association's share would be secured by premium surcharges and member assessments. The commissioner would

also set premium surcharges and member assessments each year in an amount sufficient to pay all debt service and other costs not paid by the association. Under the commenter's interpretation of §2210.6136, bondholders would receive payment for the association's share of the class 2 public securities issued under §2210.6136 from the association itself, provided the association could make the payments. This interpretation eliminates the need for the association to pay its share by repaying premium surcharges and assessments to insurers. It also eliminates the need for insurers to return premium surcharges to policyholders.

One of the commenters repeats points from the loss funding rule proposal, published in the February 14, 2014, issue of the *Texas Register* (39 TexReg 867), regarding the effect of reading §2210.6136 to require that the association pay for class 2 public securities issued under that statute in the same manner as class 1 public securities. The commenter states that, "if the class 1 bonds won't sell because lenders don't trust TWIA policyholders to have the money to amortize the bonds, it is unlikely that they will trust 'Class 2 Alternative' bonds that have exactly the same payment source." The commenter calls this effect a "paradox."

The commenter states that requiring the association to pay for class 2 public securities issued under §2210.6136 in the same manner as class 1 public securities may have another effect on the association's ability to obtain funding. Under §2210.6136, TPFA, on behalf of the association, must issue $1 billion in class 2 public securities for a catastrophe year before it may issue any class 3 public securities. Thus, if class 2 public securities cannot be issued under §2210.6136 because they are not

marketable, the association will also lose access to the $500 million authorized through the sale of class 3 public securities.

The commenter states that the proposed rule amendments “potentially rescue TWIA policyholders from disaster.” The commenter states that the proposed amendments entirely undo §2210.6136. The commenter states that the Legislature was alerted to the ineffectiveness of the section and chose to do nothing about it during the 83rd Legislative Session. The commenter cites cases in which courts have insisted on interpreting statutes by their plain meaning unless the context shows a contrary intention or the plain meaning would lead to absurd results. The commenter cites a 1930 case from the U.S. Supreme Court stating that even absurd consequences do not justify a court’s changing the meaning of a statute.

The commenter states that under the rule amendments, premium surcharges may be necessary to pay for 70 percent of $1 billion in class 2 public securities issued under §2210.6136, whereas without the rule amendments they would only be necessary to pay for up to $500 million. The commenter states that the rules may face legal challenge from policyholders on the coast, and that the possibility of such a challenge may damage the marketability of any class 2 public securities under §2210.6136.

The commenter suggests that the commissioner of insurance ask the governor to call a special session of the Legislature to address §2210.6136, before the 2014 hurricane season begins.

Agency Response: The department declines to change the implementation of Insurance Code §2210.6136 described in the amended rules. The department has

reviewed §2210.6136 in the context of Insurance Code Chapter 2210 and concluded that the Legislature did not intend that the association stop paying claims if it is unable to market the fully authorized amount of class 1 public securities.

Insurance Code §2210.001(a) sets out the association's primary purpose, which is "the provision of an adequate market for windstorm and hail insurance in the seacoast territory of this state." The Legislature has determined that the provision of windstorm and hail insurance is necessary for the economic welfare of the state and its inhabitants and that the lack of such insurance in the state's seacoast territories would severely impede the orderly growth and development of the state.

Persons seeking insurance coverage from the association are unable to obtain comparable insurance coverage in the voluntary insurance market. The ability to obtain insurance coverage is crucial to the financial welfare of persons living and working in the designated catastrophe area, and its absence results in the lack of an important element for economic stability in the region.

Insurance coverage is meaningless if the insurer providing it cannot pay claims. This is why the Legislature provided a funding mechanism for the association, in the event it could not pay claims from premium and other revenue. Section 2210.6136 enables the association to access funding from the proceeds of class 2 and class 3 public securities, while still paying for those proceeds from the sources specified elsewhere in the chapter.

As noted in the rule proposal, the association may not be able to market all or part of the authorized $1 billion in class 1 public securities, which, under Insurance

Code §2210.612, the association must pay for with its net premium and other revenue. In this event, §2210.6136 enables the association to issue class 2 public securities, which, under §2210.613, are paid for with a 70/30 percent combination of premium surcharges and assessments on association member insurers. However, the association must repay up to $500 million of those class 2 public securities, plus costs, so that they return to the coastal policyholders and member insurers who initially paid for them.

Section 2210.6136 reflects the Legislature's intent that the association be responsible for repaying between $500 million and $1 billion of the first layer of public securities, whether those public securities are class 1 or class 2, even if TPFA is unable to market the fully authorized amount of class 1 public securities because the revenues described under §2210.612 are insufficient.

Contrary to one of the comments, coastal policyholders are not responsible for paying 70 percent of up to $1 billion plus associated costs through premium surcharges. Following repayment by the association, coastal policyholders are responsible for 70 percent of the difference between the amount of class 2 public securities issued under §2210.6136(a) (at most $1 billion), and the amount of class 2 public securities repaid by the association under §2210.6136(b)(1) (at most $500 million, plus associated costs). In short, following repayment by the association, coastal policyholders are responsible for 70 percent of the amount of class 2 public securities described under §2210.6136(b)(2).

If §2210.6136 means what the commenters say, the association must pay bondholders for up to $500 million in class 2 public securities from the same source of revenue as class 1 public securities. As noted in the rule proposal, if the association can do this, TPFA can issue the class 1 public securities, which eliminates the need for a statute under which TPFA can issue class 2 public securities when class 1 public securities cannot be issued. It is not feasible to read §2210.6136 to require TPFA to issue all of the class 1 public securities it can based on the association's net premium and other revenue, and then expect TPFA to issue additional public securities using the same funding source simply because the name of the public security has changed. Such a reading renders §2210.6136 meaningless. Such a reading also, as one of the commenters notes, prevents the issuance of class 3 public securities, because under §2210.6136(c), class 3 public securities may be issued only after class 2 public securities are issued in the maximum amount authorized.

Given the importance the Legislature has placed on the availability of adequate windstorm and hail insurance on the Texas coast elsewhere in Chapter 2210, it is unlikely the Legislature expected §2210.6136 to function as the commenters describe.

The department understands the commenters' concerns about the challenges insurers will face in returning premium surcharges to policyholders. The department considered the proposal for implementing §2210.6136 offered by one of the commenters, which would have spared insurers these challenges. However, the department rejects the proposal for reasons that fall into two main groups. First, the commenter's proposed implementation plan does not comply with the plain language of

the statute; and second, the realities of marketing public securities would make §2210.6136 unworkable.

The commenter's proposal states that under §2210.6136(b), the maximum amount the association must pay for class 2 public securities is $500 million, and that the phrase, "plus any costs associated with that portion," at the end of §2210.6136(b)(1)(B) refers only to the portion in that subparagraph, not to the $500 million. However, §2210.6136(b)(2) states that premium surcharges and member assessments must be used to pay the difference between the principal amount of class 2 public securities issued and the amount the association pays under §2210.6136(b)(1), "plus any costs associated with that amount." It is not clear whether this phrase refers to the difference or the amount the association pays. "That amount" is singular. If the phrase refers to the difference, then the statute does not identify who will pay the costs associated with the amount the association pays under §2210.6136(b)(1), if those costs plus the amount of class 2 public securities exceed $500 million. If the phrase refers to the amount the association pays under §2210.6136(b)(1), then the statute does not identify who will pay for costs associated with the difference. The solution is to read the phrase, "any costs associated with that amount," in §2210.6136(b)(2) as referring to the difference between the principal amount of class 2 public securities issued under §2210.6136(a) and the amount the association pays under §2210.6136(b)(1). The solution also requires reading the phrase, "any costs associated with that portion," in §2210.6136(b)(1)(B) as referring to both the $500 million in subparagraph (b)(1)(A) and the amount in subparagraph (b)(1)(B). Contrary to the commenter's proposal,

§2210.6136 does not cap the amount of class 2 public securities that the association must pay for with net premium and other revenue at $500 million.

The commenter's proposed implementation does not comply with the "after payment" language in §2210.6136(b)(2). Under the commenter's proposal, the association must attempt to pay for an ordered amount of class 2 public securities in a given year, but that amount will be paid the next year through premium surcharges and member assessments if the association does not have sufficient funds. The commenter's proposal only complies with the "after payment" language on a year-to-year basis, in that each year premium surcharges and member assessments pay what the association did not. It is not as though the association completes payment for all of its portion before assessments and surcharges are used.

Most importantly, under the commenter's proposed implementation of §2210.6136, it is possible that the association would pay less than the legally-required minimum for class 2 public securities. This would occur if the end of the ordered payment period arrived without the association having caught up for years during which it had insufficient funds to pay the required amount. Under Insurance Code §2210.611, the association controls what happens to excess premium surcharges and assessments. The association might not have the funds to pay for public securities in a given year, but could then decide to take excess premium surcharges and assessments received in a subsequent year and deposit those funds into the CRTF rather than using those funds to reduce future surcharges and assessments. Under the adopted rule amendments, this possibility does not exist.

The commenter's proposed implementation of §2210.6136 raises a second group of issues that involves public security marketability. The department consulted with TPFA on the marketability of class 2 public securities under the commenter's proposal.

Investors may not want public securities backed by the association's net premium and other revenue, even if that net premium and other revenue are combined with premium surcharges and assessments. Based on Insurance Code Chapter 2210, the bond market would expect class 1 public securities to be backed by net premium and other revenue and class 2 public securities to be backed by premium surcharges and assessments. Under the commenter's proposal, class 2 public securities could be backed by the association's net premium and other revenue, or by surcharges and assessments, or both. This could lead to confusion in the market as to which class of public securities is really being sold.

The class of public securities being sold is important not only because the source of payment might vary by class, but because the public securities' tax status does as well. It is unclear what the tax status of class 2 public securities issued under the commenter's interpretation of §2210.6136 would be.

Insurers must allocate piecemeal, or partial, repayments from the association as described in adopted §5.4128(c), which provides that "premium surcharge repayments must be proportional to the amount of premium surcharge each policyholder paid in the period the association specified in its repayment." For example, if an insurer has two policyholders, and during the period specified by the association in its repayment, one

policyholder paid $200 in premium surcharges that were subject to repayment by the association and the other policyholder paid $100, then of a repayment of $100 from the association, the first policyholder would get $66.67 and the second policyholder would get $33.33.

The adopted rules require insurers to repay premium surcharges, unless the insurers elected to pay premium surcharges on policyholders' behalf. Insurers should handle unpaid amounts belonging to policyholders whom they cannot locate as they would any other amount that statute requires them to return. The department may adopt rules if situations requiring clarification arise in the future.

The department based its estimate of the cost of compliance on the association's estimated costs, and added to the association's costs to take into account the expenses of a multi-line insurer.

Comment on §5.4135(b): A commenter suggests adding a 12th factor to those the association must consider in determining the amount of class 1 public securities that can and cannot be issued, which is "the commercial reasonableness of the terms of the class 1 public securities that could be issued." The commenter expresses concern that class 2 public securities might not be issued under §5.4126 based on "some hypothetical class 1 public securities, the terms of which the association could not reasonably approve."

Agency Response: The department declines to make the suggested changes because they do not appear to be necessary. Under the adopted rules, the association

must already consider 11 factors in determining the amount of class 1 public securities that can be issued, including “market conditions and requirements necessary to sell marketable public securities” and state debt issuance policies. It is not clear what might constitute commercially unreasonable terms and it is not clear why an investor would offer to purchase class 1 public securities at terms that the investor did not think the association could reasonably meet.

General Comments

Comment: A commenter points out that the rules are silent as to the use of proceeds from class 2 and class 3 public securities to refinance or to pay debt service on the repayment obligations for class 1 public securities.

Agency Response: Insurance Code §2210.614 allows the association to request that TPFA refinance class 1, 2, or 3 public securities, “with public securities payable from the same sources as the original public securities.” Chapter 2210 does not allow the association to use proceeds from other public securities to refinance or to pay debt service on the repayment obligations for class 1 public securities.

Comment: Many commenters state that the proposed rules are unnecessary. Several commenters suggest that the financial position of the association has improved significantly, and that the balance of the CRTF has increased. Other commenters state that premium surcharges are not necessary because there has not been a hurricane on the Texas gulf coast in four years, and no hurricane in Corpus Christi in more than 30

years. Other commenters suggest that the association has settled most of its Hurricane Ike-related claims and raised rates, and is on a positive financial path.

Agency Response: The department disagrees that the financial condition of the association eliminates the need for these adopted rule amendments. Existing Insurance Code §2210.613 already requires insurers to surcharge their coastal policyholders (and TWIA to assess its member insurers) if TWIA cannot pay its class 2 public security obligations and administrative expenses from available funds. This requirement exists even if the department does not adopt any amendments to its loss funding or premium surcharge rules. The rule amendments conform the department's premium surcharge and loss funding rules to current law, and provide an orderly process for the association to obtain public securities if it needs these funds to pay its policyholders' claims. While improvements in the association's financial condition reduces the possibility the association will have to rely on public securities to pay its policyholders' claims, it does not *eliminate* this possibility. For example, even if TWIA were to add $200 million to the CRTF through a net gain in operations, TWIA would still need to obtain public securities if a 1-in-50 year event hit the Texas coast during the 2014 hurricane season, which would cause $2.8 billion in insured property damage to TWIA's policyholders.

Comment: Several commenters suggest that the legislation, which the rules implement, is flawed and that the only authority that can address the legislation is the Texas Legislature.

Agency Response: The rule amendments reflect the Legislature's intent to create a mechanism to allow for the issuance of public securities. The purpose of Insurance Code Chapter 2210 reflects the Legislature's findings that the provision of adequate windstorm and hail insurance is necessary to the economic welfare of this state, and that without that insurance, the orderly growth and development of this state would be severely impeded. When the department first proposed the rule amendments in 2012, the department received requests to postpone adopting the amendments until the 83rd Legislature had an opportunity to address TWIA's funding. As a result, the rules were withdrawn by operation of law on December 27, 2012. Because the 83rd Legislature did not address TWIA's funding, the department resumed its proposal of these rule amendments.

The 2014 hurricane season begins June 1. The potential harm in delaying TWIA's access to additional financial resources outweighs the benefits of further study on the potential economic impact of premium surcharges created by HB 4409 and amended by HB 3. The department will monitor TWIA and will keep the Legislature informed about the impact of implementing the use of public securities required by HB 4409 and HB 3, including the impact of any premium surcharges should they become necessary.

Comment: Many commenters suggest that the statute does not set a deadline for the department to adopt rules, and that there is no reason to adopt rules at this time. One commenter asks why the rules are needed now, if the statute authorized rules several

years ago. Several commenters suggest that the rules be withdrawn so that the 84th Legislature can address TWIA in 2015. These commenters say elected officials, not a regulatory agency, should propose and adopt legislation to meet the needs of the proposed rules. Another commenter states one option is for the department to do nothing. Another commenter states that the language of the statute that relates to the implementation of the rules is permissive and not mandatory.

Agency Response: The department disagrees that the rule amendments are not needed. The department first adopted premium surcharge and loss funding rules effective February 3, 2011, to implement HB 4409. Since that time, the Legislature enacted HB 3, which amended TWIA's funding provisions. The department previously proposed amendments to its loss funding rules in the June 22, 2012, edition of the *Texas Register*. The department postponed consideration of these proposed rule amendments to give the 83rd Legislature an opportunity to address TWIA's funding. As a result, the proposed rule amendments were withdrawn by operation of law on December 27, 2012. Because the 83rd Legislature did not address TWIA's funding, the department resumed its proposal of amendments to its loss funding and premium surcharge rules.

The 2014 hurricane season begins June 1. TWIA's financial condition and that of the CRTF have improved, but catastrophic weather events could harm TWIA's ability to fulfill its obligations to policyholders. Adopting these rules provides an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims. Doing nothing could result in public securities that are not marketable, which

would deprive TWIA of the resources it needs to pay its policyholders' claims. TWIA may simultaneously pursue other funding or risk reduction strategies including procuring a line of credit, assessments, reinsurance, catastrophe bonds, and depopulation. Adopting rules will help TWIA test the marketability of any public securities authorized by Insurance Code Chapter 2210. Also, the Legislature may benefit from studying whether implementation of Chapter 2210 is successful, and how well the public securities authorized by the chapter strengthen TWIA's claims-paying ability.

Comment: A commenter states that assessing premium surcharges at this time is not actuarially necessary, and therefore discriminatory. The commenter urges TDI and TWIA to order the approximately $400 million in assessments, proposed but not approved by TWIA's board in September 2008, before considering premium surcharges.

The commenter recounts how, following Hurricane Ike, in September 2008, the TWIA board voted against assessing member insurance companies the full amount proposed under former Insurance Code §2210.058. The commenter states that since January 2009, TWIA policyholders have paid millions more in premiums than they would have had the board members representing TWIA-member insurance companies not voted against assessing the full amount proposed.

The commenter argues that imposing premium surcharges, before the possibility of assessing the insurance industry for Hurricane Ike losses has been exhausted, is discriminatory under Insurance Code §544.002. This section prohibits insurers from

discriminating against individuals on the basis of, among other factors, geographic location. The commenter advises that Insurance Code §544.003 states that an insurer does not violate §544.002 if the insurer's action is based on sound underwriting or actuarial principles reasonably related to actual or anticipated loss experience. The commenter states that imposing premium surcharges is discriminatory because, until TWIA members are assessed for Hurricane Ike losses, premium surcharges are not based on sound actuarial principles.

Agency Response: Many commenters have urged the department to assess TWIA member insurers under former Insurance Code §2210.058. However, foregoing or delaying adoption of the amendments to the premium surcharge and loss funding rules while TWIA assesses member insurers is not an option for the department, for two reasons.

First, the department does not have and never has had the authority to assess TWIA member insurance companies. Former Insurance Code §2210.058, which provided for the assessment of TWIA members when, in a calendar year, losses and operating expenses exceeded premium and other revenue, did not contemplate department assessment of TWIA member companies. Under the version of §5.4001 in effect in 2008, the TWIA board must determine the necessity of an assessment and then order TWIA to make the assessment.

Second, existing Insurance Code statutes already require insurers to surcharge their coastal policyholders (and TWIA to assess its member insurers) if TWIA cannot pay its class 2 public security obligations and administrative expenses from available

funds. This requirement exists even if the department does not adopt any amendments to its premium surcharge rules. See Insurance Code §§2210.609, 2210.613, and 2210.6136. Existing department rules provide for premium surcharges. The department adopted its current rules on loss funding and premium surcharges to implement HB 4409, 81st Legislature, 2009, which established TWIA's current funding structure. The question relevant to the adoption of the proposed amendments to the rules is not whether coastal policyholders will be subject to premium surcharges if the need arises, because current law already establishes this requirement. Instead, the question relevant to the adoption of the proposed rule amendments is whether the premium surcharges will be administered under the rules the department adopted in 2011 to implement HB 4409, or under amended rules that are consistent with current law. Note that some of the adopted amendments make the premium surcharge rules more consumer-friendly. As amended, §5.4184 requires insurers to refund premium surcharges when a midterm policy change or post-expiration policy change decreases the premium. This amendment reflects the fact that HB 3 removed the prohibition on making premium surcharges refundable.

Even if it were in the department's power to assess TWIA member insurers under former Insurance Code §2210.058, the additional funds provided to TWIA through an assessment would not eliminate the need for the department's rules to be consistent with current law. Further, while an assessment of approximately $400 million would result in an additional $400 million in the CRTF, it would not eliminate the possibility that TPFA may need to issue class 2 public securities to help TWIA pay its policyholders'

claims. Even if TWIA added $400 million to the CRTF, TPFA may still need to issue class 2 public securities in order for TWIA to have sufficient funds to cover its policyholders' claims should a major hurricane hit the Texas coast. For example, a 1-in-50 year catastrophic event for TWIA would result in approximately $2.8 billion in insured damage to TWIA's policyholders.

Finally, a discussion of unfair discrimination under Insurance Code §544.002, in the context of premium surcharges under Insurance Code §2210.613 or §2210.6136, is misplaced. Section 544.002 prohibits an insurer from, among other acts, charging an individual a rate that is different from the rate charged to other individuals for the same coverage because of the individual's geographic location. As the commenter points out, §544.003(b) provides an exception: an insurer does not unfairly discriminate if the different rate charged due to geographic location is actuarially justified. Premium surcharges are not insurance rates and cannot be judged based on standards that apply to insurance rates. Unlike insurance rates, premium surcharges are *not* designed to reflect the cost of insuring a particular risk. Instead, premium surcharges are designed to pay debt service and related expenses on public securities. See Insurance Code §2210.613(b).

Comment: Many commenters suggest that instead of adopting the proposed rules, TWIA should assess insurers for Hurricane Ike-related insurance claims. A commenter specifically asks why the department cannot require TWIA to assess insurers, if the department has oversight over TWIA. Several commenters suggest that assessments

are a faster method to improve TWIA's reserves than the bond approval process. Several commenters suggest that the TWIA board, as currently structured, makes it unlikely that the board would vote to assess.

Agency Response: The department declines to withdraw the proposed rule amendments. The department disagrees that the possibility of assessing insurers eliminates the need to adopt these rule amendments. A decision to assess insurers is not mutually exclusive with a request to issue public securities. TPFA may still need to issue class 2 public securities in order for TWIA to have sufficient funds to cover its policyholders' claims should a major hurricane hit the Texas coast, even if TWIA were to assess its member insurers for Hurricane Ike-related claims. The future financial circumstance of TWIA is unknowable, and the purpose of the rules is to conform the department's premium surcharge and loss funding rules to current law, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims.

The current administrative oversight the department has over TWIA is limited. The department does not directly manage TWIA and does not make operational decisions for TWIA. The board of directors of TWIA has the discretion to request an assessment under former Insurance Code §2210.058. Existing statute does not give the department or TWIA the authority to assess TWIA's member insurers to pay TWIA policyholder claims resulting from future catastrophic events, except to pay for class 2 and class 3 public securities as provided in §§2210.613, 2210.6135, and 2210.6136.

The department acknowledges that the bond approval process may take time. The final adoption of rules prior to a windstorm event will allow TWIA and TPFA to study and review bond issuance-related matters before public securities are required. Delaying or withdrawing the rules would increase the solvency risk to TWIA and its policyholders.

The department does not have the power to change the structure of the association's board of directors. The composition of the board is specified in Insurance Code §2210.102. The board is composed of nine voting members and one nonvoting member, four of whom are representatives of the insurance industry. The statute establishes other requirements, including a minimum number of representatives that must live in first tier coastal counties. The primary objectives of the board are specified in Insurance Code §2210.107.

Comment: Several commenters requested a hearing in Cameron County.

Agency Response: The department declines to extend the rule comment period in order to hold a rule hearing in Cameron County. The department has held hearings in Austin, Beaumont, and Corpus Christi. The department received numerous written comments from interested parties at those hearings. Because TWIA may require additional resources if the 2014 hurricane season results in a need for TWIA to obtain funds through the issuance of public securities, delaying the rules to hold more hearings may be detrimental to TWIA and its policyholders. However, in response to the comment, the commissioner did hold a meeting in Cameron County on April 16, 2014,

to allow the public and elected officials in attendance to voice concerns on TWIA and windstorm coverage, generally.

Comment: Several commenters state that the fiscal note in the proposed rules did not adequately address the true cost of the rules to state and local government. Several commenters suggest that the department was wrong to assert in the proposed rules that there will be no measureable effect on local employment or the local economy as a result of the proposal. One commenter requested that the department perform an analysis of the economic impact on the coastal counties before enacting the rule.

Agency Response: The adopted rule amendments do not create premium surcharges. The premium surcharges were created by the enactment of HB 4409. Any impact that possible premium surcharges may have on the coastal economy are a direct or indirect result of the statute and not the rule amendments. The department understands the economic concerns coastal residents and businesses have about the premium surcharges created by HB 4409, but declines to revise or withdraw its proposed rule amendments for this reason. The adopted rules do not impose any requirement on coastal policyholders that is not already required by statute, and the rules do not directly affect TWIA's rates. The department declines to perform additional economic analyses prior to adopting the proposed rule amendments. The potential harm in delaying TWIA's access to additional financial resources outweighs the benefits of further study on the potential economic impact of the law. The department will monitor TWIA and will keep the Legislature informed about the impact of implementing the use of public

securities required under HB 4409 and HB 3, including the impact of any premium surcharges should they become necessary.

Comment: Several commenters suggest that the rules would create uncertainty over future rate or surcharge increases. One commenter states that there is no way to know how much the premium surcharges would be. The commenters ask if any actuarial calculations have been made to show what the impact of the rules will be on the 14 coastal counties. Another commenter states that the rules do not specify the amount or duration of the surcharge, and create uncertainty in the affected region. Another commenter suggests that the unknown nature of the surcharge is detrimental in bringing new business and industry to the 14 coastal counties.

Agency Response: The proposed rule amendments implement the Legislature's intent in Insurance Code Chapter 2210. The department understands the concerns raised, but declines to revise or withdraw the proposed rule amendments. The calculation of the premium surcharge depends on a number of factors that neither the department, TWIA, nor TPFA will know until, and if, the class 2 public securities are issued. These factors include the amount of class 2 public securities TWIA needs to pay its policyholders' claims, the term of the public securities, the interest rate on the public securities, and other bondholder requirements necessary to sell the public securities. Because of these factors, the surcharges cannot be known precisely until the class 2 public securities are issued.

Comment: Several commenters suggest that the surcharge would be poorly timed. The surcharges would occur after a hurricane damaged property, just as policyholders would be recovering from a storm. One commenter states that the premium surcharges would compound the financial burden faced by coastal residents. Another commenter states that post-event bonds are a crippling punishment for homeowners and business owners on the coast.

Agency Response: The department declines to withdraw the proposed rule amendments. Insurance Code §2210.613 states that the commissioner must make the surcharge effective on or after the 180th day after the date the commissioner issues notice of the approval of the public securities. Statute requires at least a six-month delay after the event, before the surcharges can be collected. The timing of the premium surcharge must be within the period set by statute. The department has very limited flexibility to delay the premium surcharge for class 2 public securities.

Comment: Many commenters state that the premium surcharges are unfair to the residents of the 14 coastal counties. Several commenters suggest that the people of the 14 tier one counties are being treated differently than the people in the other 240 counties in Texas. One commenter suggests that the proposed rules effectively "redline" the 14 tier one counties. The commenter states that the premium surcharges would be predatory and discriminatory in an area that already pays more to insure their property than the rest of the state. One commenter states that the premium surcharges on the 14 tier one counties constitutes discrimination based on geographic location.

Another commenter states that because assessments may be available, the premium surcharge is not actuarially necessary and, therefore, discriminatory. One commenter suggests that the exclusion of most of Harris County illustrates how corrupt the current windstorm system is.

Several commenters suggest that the proposed rules may be discriminatory on racial grounds. The commenters suggest that the effect of the proposed rules would be harshest toward minorities and others who live and work along the Texas coast. One commenter states that they believe that the premium surcharges are contrary to the principles of the United States Constitution and the Texas Constitution. Another commenter states that the proposed rules are discriminatory under Texas Insurance Code Chapters 544 and 560.

Agency Response: The department understands the concerns but declines to revise or withdraw the proposed rule amendments. The adopted rule amendments conform the department's premium surcharge and loss funding rules to current law, and they provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims. The adopted rule amendments do not impose any requirement on coastal policyholders that is not already required by the statute, and the amendments do not directly affect TWIA's rates.

A discussion of unfair discrimination under Insurance Code §544.002, in the context of premium surcharges under Insurance Code §§2210.613 or 2210.6136, is misplaced. Section 544.002 prohibits an insurer from, among other acts, charging an individual a rate that is different from the rate charged to other individuals for the same

coverage because of the individual's geographic location. As another commenter points out, §544.003(b) provides an exception: an insurer does not unfairly discriminate if the different rate charged due to geographic location is actuarially justified. But premium surcharges are not rates and cannot be judged by whether they are actuarially justified. Premium surcharges are, unlike rates, *not* designed to reflect the cost of insuring a particular risk, premium surcharges are designed to pay debt service and related expenses on public securities. See Insurance Code §2210.613(b).

Comment: One commenter states that the surcharge contradicts the legislative intent that rates not increase by more than 5 percent per year. Section 32 of HB 4409, codified as §2210.351, states that TWIA may use a filed rate without prior approval if it does not exceed 105 percent of the existing rate. Section 33 of the bill has a similar limitation for the required annual manual rate filings. The commenter suggests that premium surcharges would increase rates by more than 5 percent.

Agency Response: The department declines to revise or withdraw the proposed rule amendments. The premium surcharges required under Insurance Code §2210.613 are distinct from TWIA's rates. TWIA's premium rates are designed to cover TWIA's cost to insure a particular risk. Unlike TWIA's rates, the premium surcharges are designed to pay debt service and related expenses on public securities. In addition, Insurance Code §2210.613 requires that the commissioner set the surcharge in an amount sufficient to pay, for the duration of the public securities, 70 percent of all debt service not already covered by TWIA's available funds.

Comment: Many commenters suggest that the proposed rules are illogical in their application. One commenter states that those with second homes on the coast may benefit, while coastal residents may have to pay for premium surcharges. A commenter also asks how commercial fleet vehicles or rental car companies will be impacted. Several commenters suggest those businesses may relocate to areas outside the premium surcharge area.

Agency Response: The department understands the concerns but declines to revise or withdraw the rule amendments. The statute provides that the premium surcharges would apply to policies insuring second homes that are located in the catastrophe area but that may be owned by non-coastal residents. Premium surcharges would also apply to policies covering automobiles principally garaged in the catastrophe area. The adopted rules conform the department's premium surcharge and loss funding rules to current law, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims. Insurance Code §2210.613, as created by HB 4409 and amended by HB 3, states that the premium surcharges "… shall be assessed on *all* policyholders of policies that cover insured property that is *located in a catastrophe area, including automobiles principally garaged in a catastrophe area*." (emphasis added). The adopted rules do not impose any requirement on coastal policyholders that is not already required by the statute, and the rules do not directly affect TWIA's rates. The department will monitor complaints and insurer compliance, and it will keep the Legislature informed about the impact of

implementing the use of public securities required by HB 4409 and HB 3, including the impact of any premium surcharges should they become necessary.

Comment: Many commenters suggest that premium surcharges on automobile insurance are not fair. Several commenters suggest that automobile coverage is not logically related to TWIA. One commenter states that connecting premium surcharges for TWIA to automobiles creates a bad precedent. Another commenter states the automobile insurance premium surcharge is illogical because coastal residents would not drive their personal automobiles during a storm. Another commenter states that TWIA does not pay for automobile claims, and suggests that it is inappropriate to assess windstorm related claims to automobile policies. One commenter suggests that the premium surcharges are a transparent ploy to make money for rich insurance companies.

Agency Response: The department understands the concerns but declines to revise or withdraw the rule amendments. The adopted rule amendments conform the department's premium surcharge and loss funding rules to changes made by HB 3, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims. HB 3 amended Insurance Code §2210.613 to provide that the premium surcharges "… shall be assessed on *all* policyholders of policies that cover insured property that is located in a catastrophe area, *including automobiles principally garaged in a catastrophe area.*" (emphasis added). The adopted amendments do not impose requirements on coastal policyholders that are not already required by the

statute and the amendments do not directly affect TWIA's rates. The premium surcharges are not designed to reflect the cost of insuring a particular risk. Instead, the premium surcharges are designed to pay debt service and related expenses on public securities. The department will monitor complaints and insurer compliance, and it will keep the Legislature informed about the impact of implementing the use of public securities required by HB 4409 and HB 3, including the impact of any premium surcharges should they become necessary.

Comment: One commenter suggests that the detrimental impact of the proposed rules would have negative geopolitical implications. The commenter explains that Texas coastal exports of natural gas can help western Europe reduce its reliance on Russian natural gas. The commenter states that the premium surcharges would cripple the ability for coastal industry to expand the supply and export of liquid natural gas.

Agency Response: The department understands the concerns but declines to revise or withdraw the proposed rule amendments. Existing Insurance Code §2210.613 already requires insurers to surcharge their coastal policyholders (and TWIA to assess its member insurers) if TWIA cannot pay its class 2 public security obligations and administrative expenses from available funds. This requirement exists even if the department does not adopt any amendments to its loss funding or premium surcharge rules. The adopted rule amendments conform the department's premium surcharge and loss funding rules to changes made by HB 3, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims.

The department will monitor complaints and insurer compliance, and it will keep the Legislature informed about the impact of implementing the use of public securities required by HB 4409 and HB 3, including the impact of any premium surcharges should they become necessary.

Comment: Many commenters state that the rules will harm the coastal economy. Several commenters suggest that the rules will have an adverse economic impact on the state as a whole. Many commenters suggest that the proposed rules will increase the cost of doing business in Texas. Many commenters explain how critical the economic contribution of the coast is to Texas, stating that the coast is home to key industries, it facilitates trade, and it provides goods and energy necessary for commerce.

Many commenters express concern over the impact of the rules on the state's workforce. Several commenters suggest that the premium surcharges will drive away workers. One commenter states that the rule would cut off coastal business from its most important resource: people. Several commenters suggest that industrial development in the coastal region depends on workers who must pay for TWIA insurance. If workers leave the coastal area, the remaining workforce would be insufficient to support industry. Several commenters suggest that the high cost of insurance negatively impacts the real estate market. One commenter states that home buyers already experience sticker shock for insurance costs. Several commenters suggest that coastal communities will be at a disadvantage when competing against

noncoastal communities. Other commenters suggest that coastal communities in other states may compete for and attract business away from the area, and that the proposed rules may place Texas coastal communities at a disadvantage. Another commenter suggests the uncertainty of the additional costs is a negative impact for economic competition. Another commenter suggests that it will be difficult to explain to relocating persons that property in addition to their home may face premium surcharges. Another commenter states that in commercial real estate, increased costs are difficult to incorporate due to the long lease terms.

Several commenters state that they live on a fixed income and cannot afford increased insurance costs. Many commenters suggest that insurance costs in coastal communities are already too high. Several commenters state that the 14 tier one coastal counties are some of the nation's poorest, and they are home to people who can least afford to pay premium surcharges.

Agency Response: The department understands the concerns but declines to revise or withdraw the proposed rule amendments. Existing Insurance Code §2210.613 already requires insurers to surcharge their coastal policyholders (and TWIA to assess its member insurers) if TWIA cannot pay its class 2 public security obligations and administrative expenses from available funds. This requirement exists even if the department does not adopt any amendments to its loss funding or premium surcharge rules. The adopted rule amendments conform the department's premium surcharge and loss funding rules to changes made by HB 3, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims.

The rules do not impose any requirement on coastal policyholders that is not already required by the statute, and the rules do not directly affect TWIA's rates. The department will monitor complaints and insurer compliance, and it will keep the Legislature informed about the impact of implementing the use of public securities required by HB 4409 and HB 3, including the impact of any premium surcharges should they become necessary.

The purpose of Insurance Code Chapter 2210 reflects the Legislature's findings that the provision of adequate windstorm and hail insurance is necessary to the economic welfare of this state, and without that insurance the orderly growth and development of this state would be severely impeded. Insurance Code Chapter 2210 provides a method to obtain adequate windstorm and hail insurance. Subchapter B-1 of Chapter 2210 provides that TWIA must pay its policyholders' claims in part through the issuance of class 1, class 2, and class 3 public securities. Subchapter M of Chapter 2210 provides that if TWIA cannot pay its class 2 public security obligations and administrative expenses from available funds, then 70 percent of those obligations must be paid through coastal premium surcharges and the remaining 30 percent paid through assessments to TWIA's insurer members.

Comment: Several commenters suggest that the premium surcharges will harm local governments. Several commenters suggest that the proposed rules will make it more difficult for local governments to fund services. One commenter states that the proposed rules would kill any reason to build or keep property in the 14 tier one

counties. Another commenter states that economic diversity is required for a community to exist. One commenter gave the example of the increasing costs of premium depreciating the value of a home from $200,000 to $150,000. Another commenter states that municipalities may be negatively impacted twice: first by the extra premiums, and then by the reduced ad valorem tax base. The net result is that tax revenues would decline, jeopardizing communities' ability to provide transportation, safety, emergency response, and public water infrastructure.

Agency Response: The department understands the concerns but declines to revise or withdraw the proposed rules. Existing Insurance Code §2210.613 already requires insurers to surcharge their coastal policyholders (and TWIA to assess its member insurers) if TWIA cannot pay its class 2 public security obligations and administrative expenses from available funds. This requirement exists even if the department does not adopt any amendments to its loss funding or premium surcharge rules. The adopted rule amendments conform the department's premium surcharge and loss funding rules to changes made by HB 3, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims. The adopted rules do not impose any requirement on coastal policyholders that is not already required by the statute, and the rules do not directly affect TWIA's rates. The department will keep the Legislature informed about the impact of implementing the use of public securities required by HB 4409 and HB 3, including the impact of any premium surcharges should they become necessary.

Comment: Many commenters suggest that coastal residents already pay high insurance premiums. One commenter states that not only have windstorm insurance costs increased in many areas, but flood insurance premiums have increased. Many commenters suggest that the high and rising costs of insurance may force them to relocate.

Agency Response: The department understands the concerns but declines to revise or withdraw the proposed rule amendments. Existing Insurance Code §2210.613 already requires insurers to surcharge their coastal policyholders (and TWIA to assess its member insurers) if TWIA cannot pay its class 2 public security obligations and administrative expenses from available funds. This requirement exists even if the department does not adopt any amendments to its loss funding or premium surcharge rules. The adopted rule amendments conforms the department's premium surcharges and loss funding rules to changes made by HB 3, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims. The adopted rules do not impose any requirement on coastal policyholders that is not already required by the statute, and the rules do not directly affect TWIA's rates. The department will keep the Legislature informed about the impact of implementing the use of public securities required by HB 4409 and HB 3, including the impact of any premium surcharges should they become necessary.

Comment: Several commenters suggest that premium surcharges on automobile insurance may increase the number of uninsured motorists on Texas roads.

Commenters state that the additional cost of insurance will cause motorists to drop their insurance because they may be unable to afford the premiums.

Agency Response: The department understands the concerns but declines to revise or withdraw the proposed rule amendments. Insurance Code §2210.613, as created by HB 4409 and amended by HB 3, states that the premium surcharges " … shall be assessed on all policyholders of policies that cover insured property that is located in a catastrophe area, *including automobiles principally garaged in a catastrophe area.*" (emphasis added). The adopted rule amendments conform the department's premium surcharge and loss funding rules to changes made by HB 3, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims. The adopted rules do not impose any requirement on coastal policyholders that is not already required by the statute, and the rules do not directly affect TWIA's rates. The department will keep the Legislature informed about the impact of implementing the use of public securities required by HB 4409 and HB 3, including the impact of any premium surcharges should they become necessary.

Comment: Several commenters suggest that the expiration of WPI-8 certificates will harm coastal residents. One commenter expressed frustration with their problems in getting a WPI-8 certificate, and the process for engineering oversight. Several commenters state that the lack of grandfathering provisions or full disclosures negatively impacts persons affected by storms.

Agency Response: The department understands the concerns but declines to revise or withdraw the proposed rule amendments. The adopted rule amendments conform the department's premium surcharge and loss funding rules to changes made by HB 3, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims. The rule amendments do not address WPI-8 certificates or provisions related to grandfathering WPI-8 certificates.

Comment: Several commenters suggest that the potential for premium surcharges is unfair because TWIA's problems are the result of mismanagement by TWIA. One commenter suggests that the premium surcharges, including surcharges on automobile policies, are intended to shore up the state-run financial mismanagement of TWIA. Another commenter suggests that it should not be coastal residents who have to pay for the mismanagement of TWIA.

Agency Response: The department understands concerns relating to TWIA management, but declines to revise or withdraw the proposed rule amendments. The adopted rule amendments conform the department's premium surcharge and loss funding rules to changes made by HB 3 and provide an orderly process for TWIA to obtain public securities should they be needed. The need to conform the department's rules to existing statute and to provide an orderly process for TWIA to obtain funds should they become necessary exists regardless of TWIA's financial condition. Delay or withdrawal of the proposed rules could harm TWIA's policyholders. The department will monitor complaints and insurer compliance.

Comment: Several commenters suggest that coastal windstorm coverage should be available through other insurers. One commenter states that the department can get insurance companies to return to selling windstorm coverage.

Agency Response: The department understands concerns relating to competition in the property market along the coast, but declines to revise or withdraw the proposed rule amendments. Implementing statutes designed to ensure funding for TWIA's policyholders is a separate issue from that of the availability of private market insurance along the coast. The adopted rule amendments conform the department's premium surcharge and loss funding rules to changes made by HB 3, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims. The rules do not impose any requirement on coastal policyholders that is not already required by the statute, and the rules do not directly affect insurance market competition. The department will keep the Legislature informed about the impact of implementing the use of public securities required by HB 4409 and HB 3, including the impact of any premium surcharges should they become necessary.

Comment: Many commenters suggest that the department needs to explore alternate funding sources to spread the cost and risk of a catastrophic event across the state. One commenter states that the department should study what other states have done to address coastal windstorm coverage. Many commenters state that residents across

Texas should contribute to the cost of windstorm insurance on the coast. Commenters suggest that the purpose of insurance is to pool risks.

Agency Response: The department understands the concerns but declines to revise or withdraw the proposed rule amendments. The adopted rule amendments conform the department's premium surcharge and loss funding rules to changes made by HB 3, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims. The Insurance Code does not authorize the department to require insurers to surcharge statewide policyholders. Insurance Code §2210.613, as created by HB 4409 and amended by HB 3, requires that the premium surcharges "… be assessed on all policyholders of policies that cover insured property that *is located in a catastrophe area*, including automobiles principally garaged *in a catastrophe area."* (emphasis added). The department will keep the Legislature informed about the impact of implementing the use of public securities required by HB 4409 and HB 3, including the impact of any premium surcharges should they become necessary.

Comment: Many commenters suggest that coastal residents are subsidizing other parts of the state. Several commenters suggest that recent property losses from wildfires, tornados, hailstorms, and severe freezes have been paid for by coastal policyholder premiums. Several commenters suggest that the insurance risks for coastal property is not different than the risks faced in other parts of the state.

Agency Response: The department understands the concerns but declines to revise or withdraw the rules. The adopted rule amendments conform the department's premium surcharge and loss funding rules to changes made by HB 3. The Insurance Code does not authorize the department to require insurers to surcharge statewide policyholders. Insurance Code §2210.613, as created by HB 4409 and amended by HB 3, requires that the premium surcharges "… be assessed on all policyholders of policies that cover insured property that *is located in a catastrophe area*, including automobiles principally garaged *in a catastrophe area."* (emphasis added). The department will keep the Legislature informed about the impact of implementing the use of public securities required by HB 4409 and HB 3, including the impact of any premium surcharges should they become necessary.

Comment: Many commenters suggest alternative funding methods. One commenter states that the easiest way to do that is to ask the insurance companies to purchase the bonds in the event of a storm. Several commenters suggest that residents in all of the United States should contribute to the costs of insuring risks anywhere in the United States. Another commenter suggests a similar federal mechanism involving other states that share coastal windstorm risks. Another commenter suggests that the funding for the public securities should come from the insurance premium taxes that are based on the admitted and nonadmitted carriers operating in Texas. One commenter suggests that insurance companies should be asked to fund the cost of reinsurance and let them spread those costs throughout the state. Another commenter suggests that

funding should come from forcing all home and building owners to pay a prorated premium rate that is based on the value of the homes or buildings. One commenter suggests that if TWIA needs more money, it ought to raise the rates of current TWIA policyholders. Another commenter suggests an additional hotel tax on visitors to the coastal areas.

Many commenters suggest other methods to insure the coast or to mitigate the need for TWIA. Many commenters state that the premium surcharge should apply statewide. One commenter states that the solution to the TWIA problem is the removal of all new homes and homes built to code from the TWIA pool. Another commenter states that if the Uniform Building Codes were enforced across the state, property damage would be mitigated. Several commenters state that the department should require insurance companies to write insurance in all of Texas. One commenter suggested that all property and casualty insurance companies that do business in Texas offer windstorm coverage statewide, at a rate not to exceed 1 percent of the insured value of the property. One commenter suggests that tort reform would be helpful. Another suggests a consumer and user tax on products specifically earmarked for the windstorm fund. One commenter suggests that the department look to federal flood insurance for a viable funding method. Another commenter suggests that the department require better underwriting rules, adequate rates, liability limits, other funding strategies, and encourage the private insurance market. Another commenter suggests encouraging underwriting flexibility to encourage insurance companies to write coverage on the coast. One commenter suggests that TWIA policies should only cover

named storms. One commenter states that the premium surcharge should be 3 percent on the coast and 1 percent everywhere else. One commenter suggests that rates should vary by wind maps and that the department should conduct further study to produce wind maps that provide a reasonable measure of the degree of risk across Texas. Another commenter states that all beach property and property within two miles of the beach should pay the premium surcharge. Another commenter suggests expanding the list of counties to any county where the wind speed maps show that wind may exceed 90 miles an hour. The commenter states that expanding the coastal zone would include 50 more counties than the 14 specified tier one counties. One commenter suggests that TWIA coverage should be more like flood insurance, and premium should be 100 percent earned when written. Then the only way a policy can be canceled is if the homeowner sells their property.

Several commenters suggest funding solutions relating to imposing a tax or surcharge on goods that are produced or transported from the coast to other areas of the state. Another commenter suggests that the state should cover any shortcomings in the association's ability to pay claims. Several commenters suggest that the state's rainy day funds be available for windstorm costs.

Agency Response: The department declines to revise or withdraw the proposed rule amendments. The adopted rule amendments conform the department's premium surcharge and loss funding rules to changes made by HB 3, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims. The statute prescribes the method for financing public securities.

The department will keep the Legislature informed about the impact of implementing the use of public securities required by HB 4409 and HB 3, including the impact of any premium surcharges should they become necessary. The authority of the department is limited to the statutory methods that the Legislature has created. The department will continue to do what it can to encourage authorized insurers to write insurance on a voluntary basis and to minimize the use of TWIA as a means to obtain insurance, as required by Insurance Code §2210.009. During the next legislative session, the department will serve as a resource for the Legislature, should the Legislature address TWIA's funding structure.

Comment: One commenter suggests that residents on the coast should not have two different deductibles, and that the standard TWIA policy should cover all hazards the same way.

Agency Response: The department understands the concerns but declines to revise or withdraw the proposed rule amendments. The rule amendments conform the department's premium surcharge and loss funding rules to changes made by HB 3, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims. The authority of the department is limited to the regulatory authority specified in Chapter 2210, TWIA's governing statute. Chapter 2210 prescribes the type of coverage that TWIA may provide. The adopted rules do not address the type of coverage that TWIA may provide or the contractual language in a TWIA policy.

Comment: Several commenters suggest TWIA should depopulate and cover less property in order to remove some of the risk. One commenter suggests that the statutory language imposes a requirement on the department to develop incentives. The commenter states that the department should push incentives even if insurance companies do not like the incentives. Another commenter suggests that TWIA is not interested in depopulation.

Agency Response: The department agrees that reducing TWIA's risk, including TWIA depopulation strategies, should be pursued. However, the department declines to revise or withdraw the proposed rule amendments. The adopted rule amendments conform the department's premium surcharge and loss funding rules to changes made by HB 3, and provide an orderly process for TWIA to obtain public securities if it needs these funds to pay its policyholders' claims. The department is continuing its administrative oversight of TWIA. The department will continue to do what it can to encourage authorized insurers to write insurance on a voluntary basis and to minimize the use of TWIA as a means to obtain insurance, as required by Insurance Code §2210.009.

Comment: One commenter states that the department should look into dissolving TWIA. The commenter states that TWIA should not be allowed to continue making mistakes that cost taxpayers and citizens.

Agency Response: The department understands the concerns but declines to revise or withdraw the rule amendments. The department does not have authority to change

TWIA's statutory structure, which the Legislature enacted. The department is continuing its administrative oversight of TWIA.

Comment: Several commenters suggest that they support the proposed rules in general. Supportive commenters also offer similar constructive comments to those suggested by commenters not in support of the rules.

Agency Response: The department appreciates the supportive comments.

5. NAMES OF THOSE COMMENTING FOR AND AGAINST THE PROPOSAL.

For: Two individuals.

For with changes: American Insurance Association, Association of Fire and Casualty Companies of Texas, Bank of America Merrill Lynch, Insurance Council of Texas, JP Morgan Chase, Texas Public Finance Authority, Texas Surplus Lines Association.

Against: One U.S. congressman; three state senators; 11 state representatives; five mayors; four county commissioners; one city secretary; 13 city councilpersons; three county judges; Associated General Contractors of Southeast Texas; Beaumont Board of Realtors; Beaumont Chamber of Commerce; Braselton Homes; Brownsville Chamber of Commerce; Builders Association of Corpus Christi; Catholic Charities of Southeast Texas; Coastal Windstorm Task Force; Corpus Christi Association of Realtors; Corpus Christi Chamber of Commerce; Del Mar College; Hamilton Real Estate; Island Retreat Condominiums; League of United Latin American

Citizens of Corpus Christi; Mr. Sidings, Windows, and Sunrooms; Padre Island Chamber of Commerce; Padre Isles Property Owners Association; Port Aransas Chamber of Commerce and Tourist Bureau; Port of Corpus Christi Authority; Port Royal Ocean Resort; Regional Economic Development Initiative; Salter Insurance Agency; South Padre Island Chamber of Commerce; Southeast Texas Plan Managers Forum; Terry Cauthen Insurance; Texas Association of Realtors; Texas Watch; Thurmen-Fonden Glass; TPCO America Corporation; and 238 individuals.

6. STATUTORY AUTHORITY. The amendments and new sections are adopted under Insurance Code §§36.001, 2210.008, 2210.056, 2210.071, 2210.072, 2210.073, 2210.074, 2210.151, 2210.152, 2210.604, 2210.608, 2210.609, 2210.611, 2210.612, 2210.613, 2210.6135, and 2210.6136.

Section 36.001 provides that the commissioner may adopt any rules necessary and appropriate to implement the powers and duties of the Texas Department of Insurance under the Insurance Code and other laws of the state.

Section 2210.008(b) authorizes the commissioner to adopt reasonable and necessary rules in the manner prescribed by Insurance Code Chapter 36, Subchapter A.

Section 2210.056 establishes the allowable uses for the association’s assets. Section 2210.071 provides that if an occurrence or series of occurrences in a catastrophe area results in insured losses and operating expenses of the association in excess of premium and other revenue of the association, the excess losses and

operating expenses must be paid as provided by Insurance Code Chapter 2210, Subchapter B-1.

Section 2210.072 authorizes the association to use the proceeds of class 1 public securities before, on, or after an occurrence or series of occurrences and establishes the maximum principal amount of class 1 public securities that may be issued before, on, or after an occurrence or series of occurrences to pay losses not paid under Insurance Code §2210.071. Section 2210.072 also authorizes the association to enter into financing arrangements with any market source so that the association can pay losses and obtain public securities.

Section 2210.073 authorizes the association to use the proceeds of class 2 public securities issued after an occurrence or series of occurrences to pay for losses not paid under §2210.072, and establishes the maximum principal amount of class 2 public securities. Section 2210.074 authorizes the association to use the proceeds of class 3 public securities issued after an occurrence or series of occurrences to pay for losses not paid under §2210.073, and establishes the maximum principal amount of class 3 public securities.

Section 2210.151 authorizes the commissioner to adopt the association's plan of operation to provide Texas windstorm and hail insurance coverage in the catastrophe area by rule. Section 2210.152 requires that the association's plan of operation provide for the efficient, economical, fair, and nondiscriminatory administration of the association and include both underwriting standards and other provisions that the

department considers necessary to implement the purposes of Insurance Code Chapter 2210.

Section 2210.604 requires commissioner approval of the association's request to TPFA to issue class 1, class 2, or class 3 public securities prior to issuance. Section 2210.608 provides for how the association may use public security proceeds and excess public security proceeds.

Section 2210.609 provides that the association must repay all public security obligations from available funds, and if those funds are insufficient, from revenue collected under Insurance Code §§2210.612, 2210.613, 2210.6135, and 2210.6136. Section 2210.609 further provides that the association must deposit all revenue collected under §§2210.612, 2210.613, and 2210.6135 in the obligation revenue fund, premium surcharge obligation revenue fund, and the member assessment obligation revenue fund.

Section 2210.611 establishes that for class 2 public securities, the association may use premium surcharge revenue and member assessment revenue, collected under Insurance Code §2210.613, in any calendar year that exceeds the amount of the class 2 public security obligations and public security administrative expenses payable in that calendar year, and interest earned on those funds to: (i) pay the applicable public security obligations payable in the subsequent year; (ii) redeem or purchase outstanding public securities; or (iii) make a deposit in the CRTF. Section 2210.611 further establishes that the association may handle member assessment revenue collected under Insurance Code §2210.6135 in any calendar year that exceeds the

amount of the class 3 public security obligations and public security administrative expenses payable in that calendar year, and interest earned on those funds in the same manner as the excess class 2 amounts.

Section 2210.612 provides that the association must pay class 1 public securities issued under §2210.072 from its net premium and other revenue. Section 2210.613 provides that the association must collect premium surcharges and member assessments to pay class 2 public securities issued under §2210.073. Section 2210.6135 provides that the association collect member assessments to pay class 3 public securities issued under Section 2210.074.

Section 2210.6136 provides that if all or any part of the class 1 public securities cannot be issued, the commissioner may order the issuance of class 2 public securities. Section 2210.6136 further provides that the commissioner will order the association to repay the premium surcharges and member assessments used to pay the cost of a portion of the class 2 public securities issued under this section.

7. TEXT.

§5.4101. Applicability.

(a) Sections 5.4101, 5.4102, 5.4111 - 5.4114, 5.4121, 5.4123 - 5.4128, 5.4133 - 5.4136, and 5.4141 - 5.4149 of this division are a part of the Texas Windstorm Insurance Association’s plan of operation and will control over any conflicting provision in §5.4001 of this subchapter (relating to Plan of Operation). If a court of competent jurisdiction holds that any provision of this division is inconsistent with any statutes of

this state, is unconstitutional, or is invalid for any reason, the remaining provisions of the sections in this division will remain in effect.

(b) Notwithstanding any provision in this subchapter, the department retains regulatory oversight of the association as required by Insurance Code Chapter 2210, including periodic examinations of the accounts, books, and records of the association, and no provision in this subchapter should be interpreted as negating or limiting the department regulatory oversight of the association.

§5.4102. Definitions. The following words and terms when used in this division will have the following meanings unless the context clearly indicates otherwise:

(1) Association--Texas Windstorm Insurance Association.

(2) Association program--The funding of any or all of the purposes authorized to be funded with the Public Securities under Insurance Code Chapter 2210, Subchapter M.

(3) Authorized representative of the department--Any officer or employee of the department, empowered to execute instructions and take other necessary actions on behalf of the department as designated in writing by the commissioner.

(4) Authorized representative of the trust company--Any officer or employee of the comptroller or the trust company who is designated in writing by the comptroller as an authorized representative.

(5) Budgeted operating expenses--All operating expenses as budgeted for and approved by the association's board of directors, excluding expenses related to catastrophic losses.

(6) Catastrophe area--A municipality, a part of a municipality, a county, or a part of a county designated by the commissioner under Insurance Code §2210.005.

(7) CRTF-- Catastrophe Reserve Trust Fund. A statutorily-created trust fund established with the trust company under Insurance Code Chapter 2210, Subchapter J.

(8) Catastrophic event--An occurrence or a series of occurrences in a catastrophe area resulting in insured losses and operating expenses of the association in excess of premium and other revenue of the association.

(9) Catastrophic losses--Losses resulting from a catastrophic event.

(10) Class 1 payment obligation--The contractual amount of net premium and other revenue that the association must deposit in the obligation revenue fund at specified periods for the payment of class 1 public security obligations, public security administrative expenses, and contractual coverage amount as required by class 1 public security agreements**.**

(11) Class 1 public securities--A debt instrument or other public security that TPFA may issue as authorized under Insurance Code §2210.072 and Insurance Code Chapter 2210, Subchapter M.

(12) Class 2 public securities--A debt instrument or other public security that TPFA may issue as authorized under Insurance Code §2210.073 and Insurance Code Chapter 2210, Subchapter M.

(13) Class 3 public securities--A debt instrument or other public security that TPFA may issue as authorized under Insurance Code §2210.074 and Insurance Code Chapter 2210, Subchapter M.

(14) Commercial paper notes--A debt instrument that the association may issue as a financing arrangement or that TPFA may issue as any class of public security.

(15) Commissioner--Commissioner of Insurance of the State of Texas.

(16) Comptroller--Comptroller of the State of Texas.

(17) Contractual coverage amount--Minimum amount over scheduled debt service that the association is required to deposit in the applicable public security obligation revenue fund, premium surcharge trust fund, or member assessment trust fund as security for the payment of debt service on the public securities, administrative expenses on public securities, or other payments the association must pay in connection with public securities.

(18) Credit agreement--An agreement described by Government Code Chapter 1371 that TPFA may issue as authorized under Insurance Code Chapter 2210, Subchapter M.

(19) Department--Texas Department of Insurance.

(20) Earned premium--That portion of gross premium that the association has earned because of the expired portion of the time for which the insurance policy has been in effect.

(21) Financing arrangement--An agreement between the association and any market source under which the market source makes interest-bearing loans or provides other financial instruments to the association to enable the association to pay losses or obtain public securities under Insurance Code §2210.072.

(22) Gross premium--The amount of premium the association receives, less premium returned to policyholders for canceled or reduced policies.

(23) Investment income--Income from the investment of funds.

(24) Letter of instruction--The commissioner's or authorized department representative's signed written authorization and direction to an authorized representative of the trust company.

(25) Losses--Amounts paid or expected to be paid on association insurance policy claims, including adjustment expenses, litigation expenses, other claims expenses, and other amounts that are incurred in resolving a claim for indemnification under an association insurance policy.

(26) Member assessment trust fund--A dedicated trust fund established by TPFA and held by the trust company in which the association or assessed insurers must deposit member assessments collected under Insurance Code §2210.613 and §2210.6135. The member assessment trust fund may be segregated into separate

funds, accounts, or subaccounts, including for the purpose of segregating class 2 and class 3 public security member assessments.

(27) Net gain from operations--Net income reported during a calendar year equal to the amount of all earned premium, other revenue of the association, and distributions of excess revenues from the obligation revenue fund and the repayment obligation trust fund that are in excess of incurred losses, operating expenses, reinsurance premium, current year financial arrangement obligations, current year class 1 payment obligations, current year public security administrative expenses, and premium surcharge and member assessment repayment obligations.

(28) Net premium--Gross premium less unearned premium. Following the issuance of public securities, net premium is pledged for the payment of class 1 payment obligation.

(29) Net revenues--Net premium plus other revenue, less scheduled policy claims, less budgeted operating expenses, less class 1 payment obligation for that calendar year, less premium surcharge and member assessment repayment obligation for that calendar year, and less amounts necessary to fund or replenish any operating reserve fund.

(30) Obligation revenue fund--The dedicated trust fund established by TPFA and held by the trust company in which the association must deposit net premium and other revenue for the payment of class 1 payment obligation.

(31) Operating reserve fund--Association or trust company held fund for the payment of budgeted scheduled policy claims and budgeted operating expenses.

(32) Other revenue--Revenue of the association from any source other than premium. Other revenue includes investment income on association assets. Other revenue does not include premium surcharges and member assessments collected under Insurance Code §§2210.259, 2210.613, 2210.6135, and 2210.6136 and interest income on those amounts.

(33) Plan of operation--The association's plan of operation as adopted by the commissioner under Insurance Code §2210.151 and §2210.152.

(34) Premium--Amounts received in consideration for the issuance of association insurance coverage. The term does not include premium surcharges collected by the association under Insurance Code §§2210.259, 2210.613, and 2210.6136.

(35) Premium surcharge and member assessment repayment obligation--The amount of premium surcharge and member assessment that the commissioner has ordered the association to repay over a specified number of years under §5.4126 of this division (relating to Alternative for Issuing Class 2 and Class 3 Public Securities). This may involve varying periodic payments equaling the total required repayment amount.

(36) Premium surcharge trust fund--The dedicated trust fund established by TPFA and held by the trust company in which the association or insurers must deposit premium surcharges collected under Insurance Code §2210.613.

(37) Public securities--Collective reference to class 1 public securities, class 2 public securities, and class 3 public securities.

(38) Public security administrative expenses--Expenses incurred by the association, TPFA, or TPFA consultants to administer public securities issued under Insurance Code Chapter 2210, including fees for credit enhancement, paying agents, trustees, attorneys, and other professional services.

(39) Public security obligations--The principal of a public security and any premium and interest on a public security issued under Insurance Code Chapter 2210, Subchapter M, together with any amount owed under a related credit agreement.

(40) Repayment obligation trust fund--The dedicated trust fund into which the association deposits, in amounts necessary to comply with the commissioner's order under §5.4126 of this division for payment of the premium surcharge and member assessment repayment obligation, net premium and other revenue that is not contractually required for the class 1 payment obligation.

(41) Scheduled policy claims--That portion of the association's earned premium and other revenue expected to be paid in connection with the disposition of losses that do not result from a catastrophic event.

(42) Trust company--The Texas Treasury Safekeeping Trust Company managed by the comptroller under Government Code §404.101, *et seq*.

(43) Trust company representative--Any individual employed by the trust company who is designated by the trust company as its authorized representative for purposes of any agreement related to the CRTF or the public securities.

(44) TPFA--Texas Public Finance Authority.

(45) Unearned premium--That portion of gross premium that has been collected in advance for insurance that the association has not yet earned because of the unexpired portion of the time for which the insurance policy has been in effect.

§5.4121. Financing Arrangements.

(a) The association may enter into financing arrangements. The financing arrangement must:

(1) enable the association to:

(A) pay losses under Insurance Code §2210.072; or

(B) obtain public securities under Insurance Code §2210.072;

(2) be approved by the association's board of directors before the association enters into the financing arrangement.

(b) The association may pay a financing arrangement with any or all:

(1) net premium and other revenue of the association that is not required for payment of class 1 payment obligations or premium surcharge and member assessment repayment obligations;

(2) reinsurance proceeds;

(3) the proceeds of any financing arrangement;

(4) the proceeds of any class of public security issued under Insurance Code Chapter 2210; or

(5) any other association asset.

(c) As collateral security for such financial arrangements, including interest bearing loans or other financial instruments, the association may grant in favor of the applicable market source a collateral assignment and security interest in and to all or any portion of the association's assets, including without limitation, all or any portion of the association's right, title, and interest in and to all proceeds of any class of public security issued under Insurance Code Chapter 2210.

§5.4123. Public Securities Request, Approval, and Issuance.

(a) The association's board of directors must request the issuance of public securities as prescribed in §§5.4124 - 5.4126 of this division (relating to Issuance of Class 1 Public Securities Before a Catastrophic Event; Issuance of Public Securities After a Catastrophic Event; and Alternative for Issuing Class 2 and Class 3 Public Securities).

(1) The request must be submitted to the commissioner for approval with all required supporting documentation prescribed in §§5.4124 - 5.4126 of this division.

(2) The association's board of directors may request public securities as often as necessary.

(3) If multiple classes of public securities are combined into a single request, the request must separately identify and provide supporting documentation for the issuance of each class of public securities.

(4) The association's board of directors may submit a request for the issuance of public securities to be issued after a catastrophic event at any time. If the

request for the issuance of public securities after a catastrophic event is submitted before a catastrophic event, the association's request must specify that the requested public securities may only be issued after a catastrophic event.

(b) The commissioner must approve the request before TPFA may issue the requested public securities.

(1) If the supporting documentation is incomplete, the commissioner or the department may request additional documentation without rejecting the request.

(2) In considering the association's request, the commissioner may rely on any statements or notifications of definitive or estimated losses, association revenue, reinsurance proceeds, and any other related or supporting information from any source, including from the general manager of the association and from TPFA and its consultants and legal counsel.

(3) If the commissioner disapproves the request, the association's board of directors may reconsider the matter and submit another request under subsection (a) of this section.

(4) The department must provide the commissioner's written approval of the request to the association and TPFA.

(c) Following the commissioner's written approval of the request, TPFA may issue public securities and credit agreements on behalf of the association, as authorized in Insurance Code Chapter 2210 and §§5.4124 - 5.4126 of this division, for the issuance, reissuance, refinancing, and payment of public security obligations and public security administrative expenses.

(d) The association must provide to the department and the commissioner any requested information concerning public securities or the pending issuance of public securities, including information TPFA, a TPFA consultant, or TPFA legal counsel provides to the association.

(e) A request for issuance of public securities under subsection (a) of this section includes a request for the reissuance and refinancing of public security obligations.

§5.4124. Issuance of Class 1 Public Securities before a Catastrophic Event.

(a) The association's board of directors may request that TPFA issue class 1 public securities before a catastrophic event, if the association's board of directors determines that class 1 public security proceeds may become necessary and the commissioner approves the request.

(b) The association must submit its board of directors' written request under subsection (a) of this section to the commissioner. The request must include the following information:

(1) the reason why the requested class 1 public securities may become necessary;

(2) the amount of premium and other revenue that the association expects will be available to pay loss claims in the current calendar year;

(3) reinsurance coverage that the association expects will be available to pay claims in the current calendar year;

(4) the amount in the CRTF that the association expects will be available to pay loss claims in the current calendar year;

(5) the principal amount of class 1 public securities that are authorized and available to be issued before a catastrophic event, and that are requested;

(6) the estimated amount of debt service for the public securities, including any contractual coverage amount and public security administrative expenses;

(7) the structure and terms of the public securities, including any terms that may change as a result of a catastrophic event or the use of any proceeds of class 1 public securities issued before a catastrophic event;

(8) market conditions and requirements necessary to sell marketable public securities;

(9) a cost-benefit analysis as described in §5.4135 of this division (relating to Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis);

(10) a three-year pro forma financial statement consisting of a balance sheet, income statement, and a statement of cash flows, reflecting the financial impact of issuing class 1 public securities before a catastrophic event that assumes the proceeds will be used in the event of a catastrophe; and

(11) any other relevant information requested by the commissioner.

(c) The association may make one or more requests under this section.

(d) The association may request class 1 public securities up to an aggregate principal amount not to exceed $1 billion outstanding at any one time, regardless of the

calendar year or years in which the securities are issued, except that class 1 public securities that are issued before a catastrophic event and that have been used to pay for insured losses or expenses will not continue to count against the combined $1 billion aggregate limit described in this subsection. This section does not authorize the association to request class 1 public securities in an amount in excess of the catastrophe year limit prescribed in §5.4125(c) of this division (relating to Issuance of Public Securities after a Catastrophic Event).

§5.4125. Issuance of Public Securities after a Catastrophic Event.

(a) As provided in §5.4123 of this division (relating to Public Securities Request, Approval, and Issuance) and subject to the commissioner's approval, the association's board of directors may request that TPFA issue public securities after a catastrophic event has occurred. The association's board of directors may make the request:

(1) after the catastrophic event if the association's board of directors determines that actual catastrophic losses are estimated to exceed available money in the CRTF and available reinsurance proceeds, and that the public security proceeds are necessary to fund the catastrophic losses; or

(2) before the catastrophic event if the association's board of directors determines that public security proceeds may become necessary to fund potential catastrophic losses. This paragraph does not affect the requirements for issuing public securities that are issued after a catastrophic event or the use of proceeds from public securities issued after a catastrophic event.

(b) The association must submit its board of directors' written request under subsection (a) of this section to the commissioner. The request must include the following information:

(1) an estimate of the actual or potential losses and expenses from the catastrophic event;

(2) the association's current premium and other revenue;

(3) the association's current net revenues;

(4) the sources and amount of loss funding other than public securities, including:

(A) the amount of the loss paid from premium and other revenue;

(B) the amount requested from the CRTF;

(C) amounts available from other financing arrangements, and the association's obligations for other financing arrangements, including whether such amounts must be repaid from public security proceeds or from other means; and

(D) available reinsurance proceeds;

(5) the principal amount of each requested class of public securities that is authorized and available to be issued and that is requested;

(6) the estimated costs associated with each requested amount and class of public securities under this section, including any contractual coverage requirement and public security administrative expenses;

(7) the structure and terms of the public securities;

(8) market conditions and requirements necessary to sell marketable public securities;

(9) a cost-benefit analysis as described in §5.4135 of this division (relating to Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis); and

(10) any other relevant information requested by the commissioner.

(c) For each class of public securities requested under this section, the association must determine and submit as part of its request the authorized amount of public securities. This amount must be the lesser of:

(1) the statutorily authorized principal amount for that class, less any principal amount of that class of public security that was issued in the catastrophe year, less, in the case of class 1 public securities, the proceeds of class 1 public securities issued under §5.4124 of this division (relating to Issuance of Class 1 Public Securities before a Catastrophic Event) that were available for a catastrophic event at the beginning of the catastrophe year for which the class 1 public securities are requested under this section; or

(2) the amount of the estimated loss payable from proceeds of that particular class, and estimated costs including the costs associated with the issuance of that class of public security.

(d) The association must request, in aggregate for each catastrophe year:

(1) the statutorily authorized principal amount of class 1 public securities before class 2 public securities may be requested; and

(2) the statutorily authorized principal amount of class 2 public securities before class 3 public securities may be requested.

(e) The association:

(1) may make one or more requests under this section;

(2) may, following a catastrophic event, request the issuance of class 1 public securities under this section, before the exhaustion of any remaining proceeds from class 1 public securities issued before a catastrophic event;

(3) must deplete the proceeds of any outstanding class 1 public securities issued before a catastrophic event before using the proceeds of class 1 public securities requested under this section; and

(4) may request the issuance of class 2 and class 3 public securities under this section, before the exhaustion of all class 1 or class 2 public security proceeds.

§5.4126. Alternative for Issuing Class 2 and Class 3 Public Securities.

(a) If all or any portion of the authorized principal amount of class 1 public securities requested under §5.4125 of this division (relating to Issuance of Public Securities after a Catastrophic Event) cannot be issued based on the factors described in §5.4135 of this division (relating to Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and

Cost-Benefit Analysis), the commissioner may order the issuance of class 2 and class 3 public securities as provided in this section.

(b) In its request to the commissioner to order issuance of public securities under this section, the association must submit the following information:

(1) the information required by §5.4125(b) of this division; and

(2) information based on the analyses described in §5.4135 of this division;

(3) the amount of class 1 public securities that can be issued;

(4) the amount of class 1 public securities that cannot be issued; and

(5) the specific reasons, market conditions, and requirements that prevent TPFA from issuing all or any portion of the authorized principal amount of class 1 public securities. The association may rely on information and advice provided by TPFA, TPFA consultants, TPFA legal counsel, and third parties retained by the association for this purpose.

(c) The association must request that TPFA issue the authorized principal amount of class 1 public securities that can be issued under §5.4125(c) of this division before class 2 public securities may be issued under this section.

(d) The commissioner may rely on information provided to the commissioner under this section, §5.4125 of this division, and from any other source, including information and advice provided by the association, TPFA, TPFA consultants, and TPFA legal counsel. If the commissioner finds that all or any portion of the authorized amount of class 1 public securities cannot be issued, the commissioner may order the

issuance of class 2 public securities in an amount that does not exceed the authorized principal amount of class 2 public securities as determined in §5.4125(c) of this division.

(e) An order of the commissioner issued under subsection (d) of this section must specify:

(1) the maximum principal amount of class 2 public securities that are to be issued;

(2) the information and amount required under §5.4127(b) of this division (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments);

(3) the maximum term of the class 2 public securities;

(4) when the association is to begin collecting funds under this section for deposit in the repayment obligation trust fund;

(5) the premium surcharge and member assessment repayment obligation; and

(6) the year repayment begins under §5.4128 of this division (relating to Repayment of Premium Surcharges to Policyholders and Member Assessments to Insurers).

(f) The commissioner may revise an order issued under this section as necessary if the association prepays amounts due or to maintain the association's ability to fund the class 1 payment obligations or other association obligations, including losses.

(g) TPFA may issue the class 2 public securities authorized by the commissioner's order under this section. TPFA may issue the class 2 public securities that are subject to §5.4127(b) of this division as a separate series from other class 2 public securities.

(h) If class 2 public securities are issued in the manner authorized under this section, class 3 public securities may be issued only after class 2 public securities have been issued in the statutorily-authorized principal amount of $1 billion for that catastrophe year. Despite the restriction on issuing class 3 public securities in this subsection, the association may request, the commissioner may approve, and TPFA may prepare for the issuance of class 3 public securities before the issuance of all class 2 public securities. Class 3 public securities must be requested as provided in §5.4123 of this division (relating to Public Securities Request, Approval, and Issuance) and §5.4125 of this division.

§5.4127. Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments.

(a) All public security obligations and public security administrative expenses for class 2 public securities issued under §5.4126 of this division (relating to Alternative for Issuing Class 2 and Class 3 Public Securities) must be paid 30 percent from member assessments and 70 percent from premium surcharges on those catastrophe area insurance policies subject to premium surcharge under Insurance Code §2210.613.

(1) For purposes of the premium surcharge, in this section and §5.4128 of this division (relating to Repayment of Premium Surcharges to Policyholders and Member Assessments to Insurers), the term “insurer” has the meaning that is defined in §5.4172 of this division (relating to Premium Surcharge Definitions).

(2) The association must collect and deposit the member assessments and premium surcharges as directed in §§5.4143 - 5.4146 of this division (relating to Trust Funds for the Payment of Class 2 Public Securities; Excess Class 2 Premium Surcharge Revenue; Excess Class 2 Member Assessment Revenue; and Member Assessment Trust Fund for the Payment of Class 3 Public Securities).

(b) The commissioner’s order described in §5.4126(d) and (e) of this division must require the association to repay the cost of the class 2 public securities issued under subsection (a) of this section in an amount equal to the lesser of:

(1) $500 million total principal amount, plus any costs associated with that amount; or

(2) that portion of the total principal amount of class 1 public securities authorized to be issued as described in §5.4125 of this division (relating to Issuance of Public Securities after a Catastrophic Event) that cannot be issued, plus any costs associated with that portion.

(c) The association must repay the costs under subsection (b) of this section by repaying the amount of premium surcharges and member assessments that are paid, or payable, on the total principal amount, plus any costs and contractual coverage amount associated with that amount.

(d) The sources of funds for the repayment required under subsection (b) of this section include:

(1) the association's net premium and other revenue that is not contractually pledged to class 1 payment obligations; and

(2) excess amounts released from the obligation revenue fund that are released as described in §5.4142 of this division (relating to Excess Obligation Revenue Fund Amounts).

(e) In addition to premium and other revenue amounts that the association must collect to pay for outstanding class 1 payment obligations, the association must collect premium and other revenue in an amount sufficient to repay the premium surcharge and member assessment repayment obligation owed under the commissioner's order in subsection (b) of this section.

(f) Using either or both of the following methods, the association must repay the amounts required under the commissioner's order in subsection (b) of this section.

(1) To reduce the need for collecting premium surcharges and member assessments, the association may deposit funds described in subsection (d) of this section in the premium surcharge trust fund, member assessment trust fund, or both funds, before the collection of any premium surcharges or member assessments.

(2) The association may deposit funds described in subsection (d) of this section in the repayment obligation trust fund for repayment of class 2 premium surcharges and member assessments already collected.

(g) For each year in which the association owes funds to repay member assessments or premium surcharges used to pay debt service for public securities described under subsection (b) of this section, the association must record the following information:

(1) the amount of premium surcharges the association owes to each insurer for that year; and

(2) the amount of member assessments the association owes to each insurer for that year.

(h) Despite any other requirement in this division, an insurer may pay on behalf of its policyholder all or any part of a premium surcharge that is subject to repayment under this section. If the insurer makes the payment under this subsection, the insurer is entitled to repayment of that amount when the association repays it. The insurer:

(1) may only pay the premium surcharge to pay the amounts owed for the payment of class 2 public security obligations and public security administrative expenses associated with the amount to be repaid under the commissioner's order in subsection (b) of this section;

(2) must pay the premium surcharges equally for all policyholders of that insurer who are subject to the premium surcharge; and

(3) must maintain records that track the amount of premium surcharges paid to their policyholders and the amount not paid.

§5.4128. Repayment of Premium Surcharges to Policyholders and Member

Assessments to Insurers.

(a) When providing a repayment to insurers for amounts paid for class 2 premium surcharges and member assessments, the association must specify the surcharge and assessment period being repaid.

(b) Beginning with the year designated in the commissioner's order described in §5.4126 of this division (relating to Alternative for Issuing Class 2 and Class 3 Public Securities), not later than March 1 of each year, the association must direct payment of the funds held in the repayment obligation trust fund to the insurer or insurance group to which the funds are owed for repayment of premium surcharges or member assessments.

(c) Within 90 days of receipt of a premium surcharge repayment from the association, insurers must repay to the policyholders who made the payments all amounts received from the association. Premium surcharge repayments must be proportional to the amount of premium surcharge each policyholder paid in the period the association specified in its repayment. To the extent that the insurer paid all or any portion of the premium surcharge for its policyholders as provided under §5.4127 of this division (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments), the insurer may recoup the amount it paid for the period refunded from the association repayment as if the insurer were the policyholder to whom the repayment was owed.

§5.4133. Public Security Proceeds.

(a) As necessary, the association must make written requests to TPFA for the disbursement of public security proceeds for the association program, including:

(1) for the payment of incurred claims and operating expenses of the association; or

(2) other amounts as authorized in Insurance Code §2210.608.

(b) The association's written request must specify:

(1) the amount of the request; and

(2) the purpose of the request.

(c) To facilitate timely payment of losses, the association may request funds to be disbursed to the association before the settlement of incurred claims.

(d) The association must account for the receipt and use of public security proceeds separately from all other sources of funds. The association may hold public security proceeds in the manner authorized by the association's plan of operation or as required by agreement with TPFA.

§5.4135. Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis.

(a) Marketable public securities under this division are public securities that the association in consultation with TPFA determines:

(1) are consistent with state debt issuance policy requirements; and

(2) achieve the goals of the association.

(b) In determining the amount of class 1 public securities that can and cannot be issued, the association must consider:

(1) the association's current premium and net revenue;

(2) the estimated amount of debt service for the public securities, including any contractual coverage amount;

(3) the association's obligations for outstanding class 1 public securities, including contractual coverage requirements and public security administrative expenses;

(4) the estimated premium surcharge and member assessment repayment obligations;

(5) the association's outstanding premium surcharge and member assessment repayment obligations;

(6) the association's obligations for other financing arrangements;

(7) any conditions precedent to issuing class 1 public security obligations contained in any applicable public security financing documents;

(8) TPFA administrative rules;

(9) applicable State of Texas debt issuance policies;

(10) administrative rules of the Office of the Attorney General of Texas that require evidence of debt service and other obligation coverage; and

(11) market conditions and requirements necessary to sell marketable public securities, including issuing classes in installments.

(c) The association may rely on the advice and analysis of TPFA, TPFA consultants, TPFA legal counsel, and third parties the association has retained for this purpose in determining "market conditions and requirements" under subsection (b) of this section. The association's determination may include consideration of the following factors:

(1) interest rate spreads;

(2) municipal bond ratings of the public securities;

(3) prior issuances of catastrophe related public securities in Texas or any other state;

(4) similar financings in the market within the preceding 12 months;

(5) news or other publications relating to the association or the issuance of catastrophe-related public securities;

(6) a nationally-recognized investment banking firm's confidence memorandum;

(7) legal and regulatory conditions; and

(8) any other market conditions and requirements that the association deems necessary and appropriate.

(d) As part of each request for public securities, the association must submit to the commissioner a cost-benefit analysis of the various financing methods and funding structures that are available to the association. A cost-benefit analysis must include:

(1) for public securities requested under §5.4124 of this division (relating to Issuance of Class 1 Public Securities before a Catastrophic Event):

(A) estimates of the monetary costs of issuing public securities, including issuance costs, debt service costs, and any contractual coverage requirement;

(B) the benefits associated with issuing public securities, including benefits to the association's claim-paying capabilities, liquidity position, and other benefits associated with issuing public securities before a catastrophic event; and

(C) estimates of the monetary costs, benefits associated with, and the availability of funding alternatives, such as:

(i) purchasing additional reinsurance for similar funding at a similar level;

(ii) providing financing arrangements, or additional financing arrangements, that provide similar funding and at a similar layer; or

(iii) other alternative risk transfer arrangements, such as catastrophe bonds, that provide similar funding and at a similar layer;

(2) for public securities requested under this division following a catastrophic event:

(A) estimates of the monetary costs of issuing public securities, including issuance costs, debt service costs, and any contractual coverage requirement;

(B) the benefits associated with issuing public securities, including benefits to the association's claim-paying capabilities and other benefits associated with issuing public securities; and

(C) the availability of alternative funding arrangements, if any, including the monetary costs and benefits associated with any available alternative funding arrangements.

§5.4136. Association Rate Filings.

While there are outstanding class 1 public securities, or there are repayment obligations under §5.4127(b) of this division (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments), the association:

(1) must consider its obligations for the payment of class 1 public securities and the repayment of class 2 public securities, including the additional amount of any debt service coverage that the association determines is required for the issuance of marketable public securities in developing its rates;

(2) must include in a rate filing submitted to the department an analysis that demonstrates that the filed rates produce premium sufficient to provide for at least:

(A) the expected operating costs of the association, including expected nonhurricane wind and hail losses and loss adjustment expenses; and

(B) the expected payment of class 1 public security obligations and the expected repayment of class 2 public securities, including any contractual coverage amount the association determines is required for the issuance of marketable public securities, during the period in which the rates will be in effect; and

(3) must include a cost component in the rates sufficient to at least provide for the expected payment of class 1 payment obligations and the expected repayment of premium surcharge and member assessment repayment obligations during the period in which the rates will be in effect.

§5.4141. Obligation Revenue Fund for the Payment of Class 1 Public Security Obligations and Operating Reserve Fund.

(a) While class 1 public securities are outstanding, the association must deposit net premium and other revenue in the obligation revenue fund at periods and in amounts as required by the class 1 public security agreements to fund the class 1 payment obligation.

(b) Without limiting other options, the class 1 public security agreements may include an operating reserve fund. If the class 1 public securities obligation revenue fund does not contain sufficient money to pay debt service on the class 1 public securities, administrative expenses on the class 1 public securities, or other class 1 public security obligations, the association must transfer sufficient money from any operating reserve fund or other association held funds to the obligation revenue fund to make the payment.

§5.4142. Excess Obligation Revenue Fund Amounts.

(a) Excess revenue collected in the obligation revenue fund that is disbursed to the association is an asset of the association and may be used for any purpose

authorized in Insurance Code §2210.056, including as provided in §5.4127 of this division (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments), or deposited in the CRTF.

(b) As specified in Insurance Code §2210.072(a), class 1 public securities may be repaid before their full term if the association's board of directors elects to do so and the commissioner approves it.

§5.4143. Trust Funds for the Payment of Class 2 Public Securities.

(a) As required by any agreements between the association, TPFA, and the trust company, insurers may be required to deposit premium surcharges and member assessments directly into the premium surcharge trust fund and member assessment trust fund, respectively.

(b) If insurers are required to direct deposit under subsection (a) of this section, then the association must provide notice to the commissioner and insurers:

(1) for premium surcharges, no later than 60 days before the insurers must implement the surcharge; and

(2) for member assessments, with the notice required under §5.4163 of this division (relating to Notice of Assessments).

(c) The notice under subsection (b) of this section must include all applicable deposit instructions, including any required routing information and account numbers.

(d) Insurers must deposit the funds into the appropriate accounts on the date the funds must otherwise be remitted to the association under §5.4164 of this division (relating to Payment of Assessment) and §5.4186 of this division (relating to Remittance of Premium Surcharges).

(e) If insurers are not required to direct deposit under subsection (a) of this section, then the association must deposit the collected premium surcharges and association member assessments on receipt into the appropriate accounts as required under agreements with TPFA and the trust company. The association may not directly or indirectly use, borrow, or in any manner pledge or encumber premium surcharges and association member assessments collected, or to be collected, by the association under Insurance Code §2210.613, except for the payment of class 2 public security obligations and as otherwise authorized in this title.

(f) The trust company must deposit any investment income earned on the premium surcharges or member assessments into the appropriate trust fund accounts while these amounts are on deposit.

§5.4144. Excess Class 2 Premium Surcharge Revenue.

(a) Revenue collected in any calendar year from premium surcharges under Insurance Code §2210.613 that exceeds the amount of class 2 public security obligations and class 2 public security administrative expenses payable in that calendar year from premium surcharges and interest earned on the premium surcharge trust fund deposits may, at the discretion of the association, be:

(1) used to pay class 2 public security obligations payable in the following calendar year, offsetting the amount of the premium surcharge that would otherwise be required to be levied for the year under Insurance Code Chapter 2210, Subchapter M;

(2) used to redeem or purchase outstanding class 2 public securities; or

(3) deposited in the CRTF.

(b) As specified in Insurance Code §2210.073(a), class 2 public securities may be repaid before their full term if the association's board of directors elects to do so and the commissioner approves it.

§5.4145. Excess Class 2 Member Assessment Revenue.

(a) Revenue collected in any calendar year from a member assessment under Insurance Code §2210.613 that exceeds the amount of class 2 public security obligations and class 2 public security administrative expenses payable in that calendar year from member assessments and interest earned on the member assessment trust fund created for class 2 public securities deposits may, at the discretion of the association, be:

(1) used to pay class 2 public security obligations payable in the following calendar year, offsetting the amount of the member assessment that would otherwise be required to be levied for the year under Insurance Code Chapter 2210, Subchapter M;

(2) used to redeem or purchase outstanding class 2 public securities; or

(3) deposited in the CRTF.

(b) As specified in Insurance Code §2210.073(a), class 2 public securities may be repaid before their full term if the association's board of directors elects to do so and the commissioner approves it.

§5.4146. Member Assessment Trust Fund for the Payment of Class 3 Public Securities.

(a) As required by any agreement between the association, TPFA, or the trust company, insurers may be required to direct deposit member assessments into the member assessment trust fund.

(b) If insurers are required to direct deposit under subsection (a) of this section, then the association must provide notice of the direct deposit requirement to the commissioner and insurers with the notice required under §5.4163 of this division (relating to Notice of Assessments).

(c) If insurers are not required to direct deposit under subsection (a) of this section, then the association must deposit the collected member assessments on receipt in the member assessment trust fund. The deposits must be made as required under agreements with TPFA and the trust company.

(d) The trust company must deposit in that member assessment trust fund any investment income earned on the member assessments while these amounts are held on deposit in the member assessment trust fund. The association may not directly or indirectly use, borrow, or in any manner pledge or encumber association member assessments collected, or to be collected, by the association under Insurance Code

§2210.6135, except for the payment of class 3 public security obligations and as otherwise authorized by this title.

§5.4147. Excess Class 3 Member Assessment Revenue.

(a) Revenue collected in any calendar year from a member assessment under Insurance Code §2210.6135 that exceeds the amount of class 3 public security obligations and class 3 public security administrative expenses payable in that calendar year from member assessments and interest earned on the member assessment trust fund created for class 3 public securities deposits may, in the discretion of the association, be:

(1) used to pay class 3 public security obligations payable in the following calendar year, offsetting the amount of the member assessments that would otherwise be required to be levied for the year under Insurance Code Chapter 2210, Subchapter M;

(2) used to redeem or purchase outstanding class 3 public securities; or

(3) deposited in the CRTF.

(b) As specified in Insurance Code §2210.074(a), class 3 public securities may be repaid before their full term if the association's board of directors elects to do so and the commissioner approves it.

§5.4148. Repayment Obligation Trust Fund for the Payment of Amounts Owed under §5.4127.

(a) As required by the commissioner's order under §5.4126(d) of this division (relating to Alternative for Issuing Class 2 and Class 3 Public Securities), the association must deposit funds collected under §5.4127(d)(2) of this division (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments) in the repayment obligation trust fund. The association must enter into trust agreements with the trust company or with a trustee selected by the association and approved by the commissioner. The trust agreements between the association and a trustee other than the trust company are subject to prior approval by the commissioner. Any investment income earned on funds in the repayment obligation trust fund become repayment obligation trust funds.

(b) The association may not directly or indirectly use, borrow, or in any manner pledge or encumber repayment obligation trust funds held by the repayment obligation trust fund trustee except as authorized under Insurance Code Chapter 2210 and this division.

§5.4149. Excess Repayment Obligation Trust Fund Amounts. Following the payment of all class 2 public securities subject to repayment under §5.4127(b) of this division (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments) and the repayment of all amounts owed under §5.4127(b) of this division, any funds remaining in the repayment obligation trust fund must be disbursed to the association as an asset of the association and may be used for any purpose authorized in Insurance Code §2210.056.

§5.4164. Payment of Assessment. Except as provided by §5.4143 of this division (relating to Trust Funds for the Payment of Class 2 Public Securities) and §5.4146 of this division (relating to Member Assessment Trust Fund for the Payment of Class 3 Public Securities), each member must remit to the association payment in full of its assessed amount of any assessment levied by the association within 30 days of receipt of notice of assessment.

8. CERTIFICATION. This agency certifies that legal counsel has reviewed the adoption and found it to be a valid exercise of the agency's legal authority.

Issued at Austin, Texas, on May 16, 2014

Sara Waitt
General Counsel
Texas Department of Insurance

The commissioner adopts amendments to 28 TAC §§5.4101, 5.4102, 5.4121, 5.4133, 5.4141 - 5.4147, 5.4164 and new 28 TAC §§5.4123 - 5.4128, 5.4135, 5.4136, 5.4148, and 5.4149.

Julia Rathgeber
Commissioner of Insurance

COMMISSIONER'S ORDER NO. **3301**