

SUBCHAPTER A. Examination and Financial Analysis
28 TAC §7.18

1. INTRODUCTION. The Texas Department of Insurance proposes amendments to §7.18, concerning the National Association of Insurance Commissioners Accounting Practices and Procedures Manual. These proposed amendments primarily seek to adopt by reference the National Association of Insurance Commissioners' (NAIC) substantive and other updates to the March 2012 version of *The Accounting Practices and Procedures Manual* (Manual) adopted by the NAIC in calendar year 2012. The proposed amendments also delete or modify three existing Texas exceptions to the Manual. Additionally, the proposed amendments make conforming changes to §7.18 to reflect these proposed changes.

The Manual, published and issued by the NAIC, incorporates the statements of statutory accounting principles (SSAPs) adopted by the NAIC and various other appendices, including actuarial guidelines adopted by the NAIC. The SSAPs provide a national standard for insurers and health maintenance organizations (collectively referred to as "carriers" in this order) on how to properly record business transactions for the purpose of statutory reporting. The NAIC adopts these SSAPs through its maintenance of statutory accounting principles process, which includes a series of open meetings that offer the public the opportunity to comment on the proposed SSAPs. The NAIC annually updates the Manual to reflect any changes to the SSAPs made through this process or other changes to the Manual.

The department uses the Manual, including its appendices, as its source of statutory accounting principles and actuarial guidelines when analyzing financial reports and conducting statutory examinations and rehabilitations of carriers licensed in Texas unless a department rule or other state law provides otherwise. The department periodically adopts the Manual by reference, with certain modifications and exceptions, in §7.18 of this title to codify this usage. Most recently, on October 12, 2012, the department amended §7.18 of this title to adopt by reference the March 2012 version of the Manual to apply to all examinations conducted on or after December 31, 2011, and all financial statements filed with the department for reporting periods beginning on or after December 31, 2011.

The department now proposes to amend §7.18 of this title to adopt by reference the substantive and other updates to the March 2012 version of the Manual issued by the NAIC during calendar year 2012. The department proposes that these updates will be used to prepare all financial statements required to be filed with the department on or after January 1, 2013, and will be applied to all examinations of those financial statements. These amendments are necessary to ensure that all applicable examinations conducted and statements filed comply with these NAIC updates, which, combined with the March 2012 version of the Manual, effectively constitute the March 2013 version of the Manual.

The department also proposes to amend three existing exceptions to the Manual and to make other conforming changes to §7.18 of this title to account for

the deleted exceptions and addition of the NAIC updates. The department provides a full description of these changes below.

The department also notes that copies of the documents proposed in newly designated §7.18(c)(1) are available for inspection in the Financial Regulation Division of the Texas Department of Insurance, William P. Hobby Jr. State Office Building, Tower Number III, Third Floor, Mail Code 303-1A, 333 Guadalupe, Austin, Texas.

Proposed amended subsection (c) provides that the adopted exceptions and modifications under this subsection must be used to prepare all financial statements required to be filed with the department on or after January 1, 2013, and will be applied to all examinations of those financial statements. This change is necessary to comply with the analogous effective dates of the NAIC updates adopted by reference in subparagraph (c)(1).

Proposed amended §7.18(c)(1)(A) lists the SSAPs proposed to be adopted by reference. Specifically, it proposes to adopt by reference: (i) SSAP No. 94, which adopts, with modification, *FAS 123(R): Share-Based Payment*; (ii) SSAP Nos. 92 and 102, which adopts, with modification, *FAS 158: Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements Nos. 87, 88, 106, and 132(R)*; and (iii) SSAP No. 103, which adopts, with modification, *ASU 2009-16: Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*. SSAP No. 92 supersedes SSAP No. 14. SSAP No. 102 supersedes SSAP No. 89, and SSAP No. 103 supersedes SSAP No. 91R. SSAPs Nos. 92, 102, 103, and 104 must

be used to prepare all financial statements required to be filed with the department on or after January 1, 2013 and will be applied to all examinations of those financial statements.

Proposed new subparagraph §7.18(c)(1)(B) adopts by reference a placement revision to SSAP Nos. 40 and 77. Specifically, this placement revision nullifies SSAP No. 77 and includes the real estate guidance, related effective dates, and adopted General Accepted Accounting Principles (GAAP) references in SSAP No. 40.

Proposed amended §7.18(c)(1)(C) adopts by reference several non-substantive revisions to the SSAPs adopted by the NAIC in calendar year 2012 that do not modify the intent of a SSAP. The SSAPs specifically addressed by these modifications include SSAP Nos. 1, 11, 26, 27, 36, 35R, 48, 57, 68, 90, 95, 97, and 101 QA – Clean and 101 QA – Tracked.

Proposed amended §7.18(c)(1)(D) adopts by reference Actuarial Guideline 38 (AG 38) adopted by the NAIC in calendar year 2012. AG 38 sets forth reserve requirements for all universal life products that employ secondary guarantees with or without shadow account funds. This revision to AG 38 provides clarification of certain ambiguities used by sophisticated shadow fund designs, and this revision to AG 38 provides different requirements for in force business and business issued on or after January 1, 2013. The department has also determined that this adoption by reference of AG 38 will impose a minor cost on some carriers as described below in the public benefit/cost note section of this preamble.

Proposed amended §7.18(c)(2) adopts several amendments to existing Texas exceptions to the Manual. Specifically, this proposed paragraph redesignates current paragraphs (c)(2) and (c)(3) of this section as new §7.18(c)(2)(B) and §7.18(c)(2)(C), respectively, and removes unnecessary portions of these exceptions relating to property acquired before January 1, 2001, because the amortization period in these provisions has expired. Additionally, proposed amended §7.18(c)(4) of this title deletes existing paragraph (c)(4) of this section because this exception now conforms with the current SSAPs.

The proposed amendments also make nonsubstantive changes to §7.18 of this title that are necessary for the section to conform to current nomenclature, for reformatting, consistency, clarity, or editorial reasons, and to correct typographical and grammatical errors.

2. FISCAL NOTE. Danny Saenz, deputy commissioner of the Financial Regulation Division, has determined that, for each of the first five years the amended section is in effect, there will be no fiscal implications for state or local government as a result of enforcing or administering the amended section, and there will be no effect on local employment or the local economy.

3. PUBLIC BENEFIT/COST NOTE. Mr. Saenz also has determined that for each of the first five years the amended section is in effect, the public benefit will be the adoption of an updated Manual that will enable the department to continue

efficient financial solvency regulation of insurance in general and the decrease in costs to carriers that are required to comply with accounting requirements in multiple states. In particular, the adoption of the NAIC calendar year 2012 updates to the March 2012 version of the Manual will permit the department to continue to effectively analyze and examine the financial condition of carriers. Additionally, the adoption and use of the updated Manual will continue to support a more consistent regulatory environment for carriers and to provide a central source for accounting guidance. The department believes that deleting or modifying the existing Texas exceptions to the Manual in paragraph §7.18(c)(2) will reduce costs for carriers that write insurance in multiple states by reducing the variation in Texas accounting requirements from those of other states.

The department does not anticipate that any of the proposed amendments, including the proposed adoption by reference of the NAIC calendar year 2012 updates to the Manual, will result in additional costs to those costs that are already required of carriers, regardless of size, under the existing rules except for the adoption by reference of AG 38. Specifically, the AG 38 changes require an actuarial opinion and company representation to support compliance for new business for universal life insurance products with secondary guarantees (ULSG) sold on and after January 1, 2013. These AG 38 changes also provide for a demonstration of reserve adequacy for certain in force ULSG business. The department estimates, however, that the costs of compliance due to these AG 38 requirements are small relative to overall costs of business of the larger insurers that are primarily impacted by these AG 38 changes. The department

also estimates that these costs of compliance will be offset by savings due to the uniformity and more reasonable reserve impact than would have occurred without these changes.

4. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY

ANALYSIS FOR SMALL AND MICRO BUSINESSES. In accordance with the Government Code §2006.002, the department has determined that the proposed amendments will not result in any additional costs to those costs that are already required of small and micro business carriers under the existing rules for the reasons specified in the public benefit/cost note section of this proposal.

Additionally, the department notes that the costs of compliance due to AG 38 discussed in the public benefit/cost note should not impact small and micro businesses because these changes should only apply to larger carriers. Small and micro businesses do not provide the product subject to AG 38, universal life insurance business with secondary guarantee, because this type of business is more complex and typically involves greater costs for product development, sales, and ongoing support than simpler products. The department anticipates no other costs as a result of these amendments.

Nevertheless, the rule exempts certain carriers that have historically accounted for their business on a cash basis and have historically posed relatively insubstantial insolvency-related risk to consumers, other carriers, and the state's general economic welfare from compliance with the Manual.

Specifically, §7.18(d) of this title exempts any farm mutual insurance company,

statewide mutual assessment company, local mutual aid association, or mutual burial association with less than \$6 million in annual direct written premiums from compliance with the Manual. Because of the types or methods of operations of these types of carriers, they are more likely to be small or micro business carriers.

Under the Government Code §2006.002(c), before adopting a rule that may have an adverse economic effect on small or micro businesses, an agency is required to prepare, in addition to an economic impact statement, a regulatory flexibility analysis that includes the agency's consideration of alternative methods of achieving the purpose of the proposed rule. The department has determined that the routine costs to comply with this proposal, i.e., compliance with the NAIC updates to the Manual in financial filings, will not have an adverse economic effect on small or micro business carriers. Therefore, the department is not required to consider alternative methods of achieving the purpose of these requirements in the proposed rule as required by the Government Code §2006.002(c).

5. TAKINGS IMPACT ASSESSMENT. The department has determined that no private real property interests are affected by this proposal and that this proposal does not restrict or limit an owner's right to property that would otherwise exist in the absence of government action and so does not constitute a taking or require a takings impact assessment under the Government Code §2007.043.

6. REQUEST FOR PUBLIC COMMENT. To be considered, written comments on the proposal must be submitted no later than 5:00 p.m. on January 7, 2013. All comments should be submitted to Sara Waitt, General Counsel, Texas Department of Insurance, Mail Code 113-2A, P. O. Box 149104, Austin, Texas 78714-9104. An additional copy of the comments should be submitted simultaneously to Danny Saenz, Deputy Commissioner, Financial Regulation Division, Texas Department of Insurance, Mail Code 305-2A, P.O. Box 149104, Austin, Texas 78714-9104. Any request for a public hearing on the proposal should be submitted separately to the Office of the Chief Clerk before the close of the public comment period. If a hearing is held, written and oral comments presented at the hearing will be considered.

7. STATUTORY AUTHORITY. The department proposes these amendments under the Insurance Code Chapters 32, 401, 404, 421, 425, 426, 441, 802, 823, 841, 843, 861, and 862, and §36.001. Sections 401.051 and 401.056 mandate that the department examine the financial condition of each carrier organized under the laws of Texas or authorized to transact the business of insurance in Texas and adopt by rule procedures for the filing and adoption of examination reports. Section 404.005(a)(2) authorizes the commissioner to establish standards for evaluating the financial condition of an insurer. Section 421.001(c) requires the commissioner to adopt each current formula recommended by the NAIC for establishing reserves for each line of insurance. Section 425.162 authorizes the commissioner to adopt rules, minimum standards, or limitations

that are fair and reasonable as appropriate to supplement and implement the Insurance Code Chapter 425, Subchapter C. Section 426.002 provides that reserves required by §426.001 must be computed in accord with any rules adopted by the commissioner to adequately protect insureds, secure the solvency of the workers' compensation insurance company, and prevent unreasonably large reserves. Section 441.005 authorizes the commissioner to adopt reasonable rules as necessary to implement and supplement Chapter 441 of the Insurance Code (Supervision and Conservatorship). Section 32.041 requires the department to furnish to the companies the required financial statement forms. Section 802.001 authorizes the commissioner to obtain an accurate indication of the company's condition and method of transacting business, as necessary, to change the form of any annual statement required to be filed by any kind of insurance company. Section 823.012 authorizes the commissioner to issue rules and orders necessary to implement the provisions of Chapter 823 of the Insurance Code (relating to Insurance Holding Company Systems). Section 843.151 authorizes the commissioner to promulgate rules that are necessary and proper to implement the provisions of Chapter 843 of the Insurance Code (Health Maintenance Organizations). Section 843.155 requires HMOs to file annual reports with the commissioner, including a financial statement of the HMO, certified by an independent public accountant. Sections 841.004(b), 861.255(b), and 862.001(c) authorize the commissioner to adopt rules defining electronic machines and systems, office equipment, furniture, machines, and labor saving devices, and the maximum period for which each

class may be amortized. Section 36.001 provides that the commissioner may adopt any rules necessary and appropriate to implement the powers and duties of the department under the Insurance Code and other laws of this state.

8. CROSS REFERENCE TO STATUTE. The following statutes are affected by this proposal: Insurance Code Chapters 32, 401, 404, 421, 425, 426, 441, 802, 823, 841, 843, 861, and 862.

9. TEXT.

§7.18. National Association of Insurance Commissioners Accounting Practices and Procedures Manual.

(a) (No change.)

(b) (No change.)

(c) The adopted exceptions and modifications under this subsection must be used to prepare all financial statements required to be filed with the department on or after January 1, 2013, and will be applied to all examinations of those financial statements. [~~The commissioner adopts the following exceptions and modifications to the Manual.~~]

(1) The commissioner adopts by reference the following modifications to the Manual:

(A) Statement of Statutory Accounting Principles (SSAP) Nos. 92, 102, 103, and 104 adopted by the NAIC in calendar year 2012.

(B) Placements revisions to nullify SSAP No. 77 and include

real estate sales guidance, related effective dates, and adopted Generally Accepted Accounting Principles references in SSAP No. 40.

(C) The following modifications made by the NAIC in calendar year 2012 to SSAP Nos. 1, 11, 26, 27, 36, 35R, 48, 57, 68, 90, 95, 97, and 101 QA – Clean and 101 QA – Tracked, that do not modify the intent of those or any other SSAP Numbers.

(i) Ref. No. 2004-27: Fund Demand Disclosures for Institutional Business;

(ii) Ref. No. 2011-19: ASU 2010-11: Derivatives and Hedging (Topic 815) – Scope Exception Related to Embedded Credit Derivatives;

(iii) Ref. No. 2011-25: ASU 2011-02, Receivables – A Creditors' Determination of Whether a Restructuring is a Troubled Debt Restructuring;

(iv) Ref. No. 2011-38: ASU 2011-06, Fees Paid to the Federal Government by Health Insurers;

(v) Ref. No. 201142: SSAP No.1 Implementation Guide;

(vi) Ref. No. 2012-01: EITF 06-2: Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FAS No. 43;

(vii) Ref. No. 2012-02: EITF 07-1, Accounting for Collaborative Arrangements;

(viii) Ref. No. 2012-03: Clarifications to SSAP No.

57—Title Insurance;

(ix) Ref. No. 2012-05: Clarification on the Amortization

of the Basis Difference;

(x) Ref. No. 2012-07: Adopt EAIW Proposed

Revisions to SSAPs – 2000 INTs;

(xi) Ref. No. 2012-08: Paragraph Placement in SSAP

No. 86;

(xii) Ref. No. 2012-09: Move Guidance from SSAP

No. 95 and Incorporate into SSAP No. 90;

(xiii) Ref. No. 2012-12: Credit for Reinsurance;

(xiv) Ref. No. 2012-13: Reference to Credit Tenant

Loans within SSAP No. 26;

(xv) Ref. No. 2012-21: Adopt EAIWG Proposed

Revisions to SSAPs – 2001 INTs;

(D) Actuarial Guideline 38 adopted by the NAIC in calendar

year 2012.

(2) In addition, the following exceptions and additions are adopted:

(A) [(1)] Settlement requirements for intercompany

transactions are subject to the accounting treatment in Statement of Statutory Accounting Principles (SSAP) No. 25 (previously SSAP No. 96 located in Appendix H), except that amounts owed to the reporting entity must [~~shall~~] be settled by the due date in accord [~~accordance~~] with the written agreement and

the requirements of §7.204 of this title (relating to Commissioner's Approval Required). Intercompany balances must ~~[shall]~~ be settled within 90 days of the period for which the amounts are being billed; otherwise the balances will ~~[shall]~~ be nonadmitted.

~~(B)(2)~~ Electronic machines, constituting a data processing system or systems and operating systems software used in connection with the business of an insurance company acquired after December 31, 2000, may be an admitted asset as permitted by Insurance Code §§841.004, 861.255, 862.001, and any other applicable law and must ~~[shall]~~ be amortized as provided by the Manual. ~~[Property acquired prior to January 1, 2001, may be an admitted asset as permitted by Insurance Code §§841.004, 861.255, 862.001, and any other applicable law, and shall be amortized in full over a period not to exceed ten years.]~~

~~(C)(3)~~ Furniture, labor-saving devices, machines, and all other office equipment may be admitted as an asset as permitted by the Insurance Code §§841.004, 861.255, 862.001, and any other applicable law and, for property acquired after December 31, 2000, depreciated in full over a period not to exceed five years. ~~[Property acquired prior to January 1, 2001, may be an admitted asset as permitted by Insurance Code §§841.004, 861.255, 862.001, and any other applicable law, and shall be depreciated in full over a period not to exceed ten years]~~

~~[(4) All certificates of deposit, of any maturity, may be classified as cash and are subject to the accounting treatment contained in SSAP No. 2, notwithstanding the provisions of SSAP No. 26.]~~

(d) (No change.)

(e) (No change.)

(f) (No change.)

10. CERTIFICATION. This agency certifies that legal counsel has reviewed the proposal and found it to be within the agency's authority to adopt.

Issued at Austin, Texas on November ²⁶~~XX~~, 2012.



Sara Waitt
General Counsel
Texas Department of Insurance