SUBCHAPTER D. RISK-BASED CAPITAL AND SURPLUS AND OTHER REQUIREMENTS
28 TAC §7.402

1. INTRODUCTION. The Texas Department of Insurance proposes amendments to §7.402, concerning risk-based capital and surplus requirements for insurers and health maintenance organizations (HMOs).

The proposed amendments to §7.402 adopt by reference the 2012 National Association of Insurance Commissioners (NAIC) risk-based capital formulas and instructions in order to implement and update the risk-based capital and surplus requirements for year-end 2012 for property and casualty insurers, life insurance companies, HMOs and insurers filing the NAIC Health Annual Statement Blank, and fraternal benefit societies. Specifically, proposed amended §7.402(d) adopts by reference (1) the 2012 NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies; (2) the 2012 NAIC Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies; (3) the 2012 NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies; and (4) the 2012 NAIC Health Risk-Based Capital Report including Overview and Instructions for Companies. Proposed amended §7.402(d) also deletes reference to the 2011 versions of these documents.

The proposed amendments to §7.402 are necessary to regulate risk-based capital and surplus requirements for insurers and HMOs subject to §7.402 (collectively referred to as “carriers” in this proposal). The risk-based capital requirement is a method of ensuring that a carrier has an appropriate level of policyholder surplus after taking into account the underwriting, financial, and investment risks of a carrier. The updated NAIC risk-based capital formulas listed above provide the department with a widely used regulatory tool to identify the minimum amount of capital and surplus appropriate for a carrier to support its overall business operations in consideration of its size and risk exposure.

The 2012 NAIC risk-based capital formulas and instructions largely do not vary from the 2011 NAIC risk-based capital formulas and instructions though the 2012 version does contain minor changes, including new requirements for all carriers regarding deferred tax assets. The department also notes that the NAIC amended its Risk-Based Capital for Insurers Model Act in November 2011 to adjust the threshold at which a trend test applies to fraternal benefit societies and life insurers from 2.5 times the authorized control level to 3.0 times the authorized control level. Pursuant to this change, the NAIC has included a dual reporting presentation in its 2012 Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies and 2012 Life Risk-Based Capital Report Including Overview and Instructions for Companies that, respectively, requires fraternal benefit societies and life insurers to show whether 2.5 or 3.0 is the regulatory basis of their domiciliary state and to show what level of action would be indicated based on the two levels. Importantly, while the department by adopting by reference the 2012 Fraternal and Life risk-based capital formulas and instructions is requiring fraternal benefit societies and life insurers to comply with this dual reporting requirement, the department is not proposing to modify the trend test requirements provided in §7.402(g)(5) or §7.402(g)(8) for life insurers or fraternal benefit societies. Specifically, §7.402(g)(5) and §7.402(g)(8) will still, respectively, subject a life insurer or fraternal benefit society to a trend test if its total adjusted capital to authorized control level risk-based capital is between 200 percent and 250 percent, not 300 percent. However, for consistency with the NAIC Model Act, the department may explore adjusting these thresholds to 300 percent for year-end 2013 or later in a subsequent rulemaking proposal.

The department has also proposed several non-substantive amendments to §7.402 to conform to current agency style and nomenclature.

Copies of the documents proposed in §7.402 for adoption by reference are available for inspection in Financial Analysis, Financial Regulation Division, Texas Department of Insurance, William P. Hobby Jr. State Office Building, Tower Number III, Third Floor, Mail Code 303-1A, 333 Guadalupe, Austin, Texas 78701.

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

3. PUBLIC BENEFIT/COST NOTE. Mr. Saenz also has determined that for each year of the first five years the proposed amended section is in effect, the anticipated public benefit will be that the department will be able to more effectively utilize existing resources in the review of the operations and financial condition of carriers, to more efficiently monitor solvency of the carriers subject to the proposal, and to implement the most current risk-based capital requirements. The amended section will enable the department to administer appropriate and proactive regulatory actions to protect the interests of the public against carriers whose financial condition may potentially be hazardous.

The proposed amendments to §7.402 contain the same substantive risk-based capital and surplus requirements of existing §7.402 for year-end 2011 except that §7.402 as proposed requires use of the 2012 NAIC risk-based capital formulas and instructions. But, as described above, the 2012 risk-based formulas and instructions have only minor variations from 2011 risk-based formulas and instructions, so carriers previously subject to the rule will incur the same types of costs for year-end 2012 to comply with these requirements that were incurred for year-end 2011. The department also does not anticipate that any new, incremental costs will be incurred by carriers that were previously subject to §7.402 as a result of the proposed amendments. The proposed amendments also subject no new classes of carriers to the requirements of §7.402, and so the proposed amendments do not impose costs on any new classes of carriers.

4. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY ANALYSIS FOR SMALL AND MICRO-BUSINESSES. Government Code §2006.002(c) requires that if a proposed rule may have an adverse economic impact on small and micro-businesses, state agencies must prepare as part of the rulemaking process an economic impact statement that assesses the potential impact of the proposed rule on small businesses and a regulatory flexibility analysis that considers alternative methods of achieving the purpose of the rule.

As detailed above, the department does not anticipate that the proposed amendments to §7.402 will impose any new costs on carriers subject to its requirements, regardless of the carrier's size, so Government Code §2006.002 does not require the department to prepare an economic impact statement and regulatory flexibility analysis because the proposed amendments to §7.402 will not have an adverse economic impact on small or micro-businesses.

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, therefore, 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 March 11, 2013, to Sara Waitt, General Counsel, Mail Code 113-2A, Texas Department of Insurance, P. O. Box 149104, Austin, Texas 78714-9104. An additional copy of the comments must be simultaneously submitted to Danny Saenz, Deputy Commissioner, Financial Regulation

Division, Mail Code 305-2A, P. O. Box 149104, Austin, Texas 78714-9104. Any request for a public hearing should be submitted separately to the Office of the Chief Clerk, Mail Code 113-2A, Texas Department of Insurance, P. O. Box 149104, Austin, Texas 78714-9104, 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 amendments are proposed under the Insurance Code §§404.004, 404.005, 441.005, 441.051, 822.210, 822.211, 841.205, 841.410(b) and (c), 841.414(c), 843.404, 884.054, 884.206, 885.401, 982.105, 982.106, and 36.001. Section 404.004 provides that the commissioner's authority to increase any capital and surplus requirements prevails over the general provisions of the Insurance Code relating to specific companies, and §404.005 authorizes the commissioner to set standards for evaluating the financial condition of an insurer. Under §441.005, the commissioner may adopt reasonable rules as necessary to implement and supplement the purposes of Chapter 441. Section 441.051 specifies "the circumstances in which an insurer is considered insolvent, delinquent, or threatened with delinquency" and includes certain statutorily specified conditions, including if an insurer's required surplus, capital, or capital stock is impaired to an extent prohibited by law. Section 822.210 authorizes the commissioner to adopt rules or guidelines to require an insurer to maintain capital and surplus levels in excess of statutory minimum levels to assure financial solvency of insurers for the protection of policyholders and insurers. Section 822.211 specifies the actions the commissioner may take if an insurance company does not comply with the capital and surplus requirements of Chapter 822. Section 841.205 authorizes the commissioner to adopt rules or guidelines to require an insurer that writes life or annuity contracts or assumes liability on or indemnifies one person for any risk under an accident and health insurance policy, or a combination of these policies, in an amount that exceeds $10,000 to maintain capital and surplus levels in excess of statutory minimum levels to assure financial solvency of insurers for the protection of policyholders and insurers. Section 841.410(b) and (c) require a limited purpose subsidiary life insurance company to comply with the risk-based capital requirements adopted by the commissioner by rule, and maintain risk-based capital in an amount that is at least equal to 300 percent of the authorized control level of risk-based capital adopted by the commissioner. Section 841.414(c) requires a limited purpose subsidiary life insurance company annually to file with the commissioner a report of the limited purpose subsidiary life insurance company's risk-based capital level as of the end of the preceding calendar year containing the information required by the risk-based capital instructions adopted by the commissioner. Section 843.404 authorizes the commissioner to adopt rules to require a health maintenance organization to maintain capital and surplus levels in excess of statutory minimum levels to ensure financial solvency of health maintenance organizations for the protection of enrollees. Section 884.054 specifies the capital stock and surplus requirements for stipulated premium insurance companies. Section 884.206 authorizes the commissioner to adopt rules to require an insurer that writes or assumes life insurance, annuity contracts or accident and health insurance for a risk to one person in an amount that exceeds $10,000 to maintain capital and surplus levels in excess of statutory minimum levels to assure financial solvency of insurers for the protection of policyholders and insurers. Section 885.401 requires each fraternal benefit society to file an annual report on the society's financial condition, including any information the commissioner considers necessary to demonstrate the society's business and method of operation, and authorizes the department to use the annual report in determining a society's financial solvency. Section 982.105 specifies the capital, stock, and surplus requirements for foreign or alien life, health, or accident insurance companies. Section 982.106 specifies the capital, stock, and surplus requirements for foreign or alien insurance companies other than life, health, or accident insurance companies. Section 36.001 authorizes the commissioner to 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 this state.

8. CROSS REFERENCE TO STATUTES. This proposal affects the following statutes:

Rule	Statute
§7.402	Insurance Code §§404.004, 404.005, 441.005, 441.051, 822.210, 822.211, 841.205, 841.410(b) and (c), 841.414(c), 843.404, 884.054, 884.206, 885.401, 982.105, and 982.106

9. TEXT.

§7.402. Risk-Based Capital and Surplus Requirements for Insurers and HMOs.

(a) – (b) (No change.)

(b) (No change.)

(c) Definitions. The following words and terms, when used in this section, [~~shall~~] have the following meanings, unless the context clearly indicates otherwise.

(1) Annual financial statement--The annual statement blank to be used by insurance companies, as promulgated by the NAIC and as adopted by the commissioner.

(2) Authorized control level--The result determined under the RBC formula in accordance with the RBC instructions.

(3) NAIC--National Association of Insurance Commissioners.

(4) RBC--Risk-based capital.

(5) RBC formula--NAIC risk-based capital formula.

(6) RBC instructions--NAIC Risk-Based Capital Report Including Overview and Instructions for Companies.

(7) Total adjusted capital--An insurer's adjusted statutory capital and surplus as determined under the RBC formula in accordance with the RBC instructions.

(d) Adoption of RBC formula by reference. The commissioner adopts by reference the following, which are available for inspection in the Financial Regulation [~~Analysis~~] 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:

(1) The 2012 [~~2011~~] NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(2) The 2012 [~~2011~~] NAIC Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(3) The 2012 [~~2011~~] NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(4) The 2012 [~~2011~~] NAIC Health Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(e) Filing requirements. All companies subject to this section must [~~are required to~~] file electronic versions of the 2012 [~~2011~~] RBC reports and any supplemental RBC forms and reports with the NAIC in accordance with and by the due dates specified in the RBC instructions.

(f) Conflicts. In the event of a conflict between the Insurance Code, any rule of the department or any specific requirement of this section, and the RBC formula and/or the RBC instructions, the Insurance Code, rule or specific requirement of this section takes [~~shall take~~] precedence and in all respects controls [~~control~~]. It is the express intent of this section that the adoption by reference of the NAIC Risk-Based Capital Reports Including Overview and Instructions for Companies does not repeal or modify or amend any rule of the department or any provision of the Insurance Code.

(g) Actions of commissioner. The level of risk-based capital is calculated and reported annually. Depending on the results computed by the risk-based capital formula, the commissioner of insurance may take a number of remedial actions, as considered necessary. The ratio result of the total adjusted capital to authorized control level risk-based capital requires the following actions related to an insurer within the specified ranges:

(1) An insurer reporting total adjusted capital of 150 percent to 200 percent of authorized control level risk-based capital institutes a company action level under which the insurer must prepare a comprehensive financial plan that identifies the conditions that contribute to the company's financial condition. The plan must contain proposals to correct areas of substantial regulatory concern and projections of the company's financial condition, both with and without the proposed corrections. The plan must list the key assumptions underlying the projections and identify the concerns associated with the insurer's business. The RBC plan is to be submitted within 45 days of filing the RBC report with the NAIC. After review, the commissioner will notify the company if the plan is satisfactory or not satisfactory. In the event the commissioner notifies the company that the plan is not satisfactory, the company must [~~shall~~] prepare a revised plan and submit it to the commissioner. Failure to file this comprehensive financial plan triggers the next lower action level described in this subsection.

(2) An insurer reporting total adjusted capital of 100 percent to 150 percent of authorized control level risk-based capital triggers a regulatory action level initiative. At this action level, an insurance company must [~~is also required to~~] file an RBC plan or revised RBC plan within 45 days of filing the RBC report with the NAIC, and the commissioner must [~~is required to~~] perform any examinations or analyses to the insurer's business and operations that are [~~is~~] deemed necessary. The commissioner

may issue orders specifying corrective actions to be taken or may require other appropriate action.

(3) – (8) (No change.)

(h) (No change.)

(i) Prohibition on use in ratemaking. The RBC instructions and any related filings are intended solely for use by the commissioner in monitoring the solvency of insurers subject to this section and in taking corrective action with respect to insurers and must [~~shall~~] not be used by the commissioner for ratemaking nor considered or introduced as evidence in any rate proceeding nor used by the commissioner to calculate or derive any elements of an appropriate premium level or rate of return for any line of insurance that an insurer or any affiliate is authorized to write.

(j) Limitations. The [~~In no event shall the~~] requirements of this section do not reduce the amount of capital and surplus otherwise required by the Insurance Code, Department rules, or by authority of the commissioner of insurance as provided by law.

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

Issued at Austin, Texas on January 22, 2013.

Sara Waitt

Sara Waitt
General Counsel
Texas Department of Insurance