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

1. INTRODUCTION. The Commissioner of Insurance (Commissioner) adopts amendments to §7.402, concerning risk-based capital and surplus requirements for insurers and health maintenance organizations (HMOs). The amendments are adopted without changes to the proposed text published in the December 30, 2011, issue of the *Texas Register* (36 TexReg 9177).

2. REASONED JUSTIFICATION. The amendments to §7.402 are necessary to implement and update the year-end 2011 risk-based capital and surplus requirements for property and casualty insurers, including county mutual insurance companies that do not meet the express criteria contained in the Insurance Code §912.056(f); life insurance companies, including limited purpose subsidiary life insurance companies; HMOs and insurers filing the National Association of Insurance Commissioners (NAIC) Health blank; and fraternal benefit societies by (i) clarifying the scope of the §7.402 risk-based capital and surplus requirements; (ii) adopting by reference the 2011 NAIC risk-based capital formulas and instructions to be used for year-end 2011; and (iii) specifying the filing requirements for the 2011 risk-based capital reports and supplemental reports and forms.

In particular, the amendments to §7.402 are necessary to require each domestic or foreign fraternal benefit society to file, for the first time, an electronic version of the 2011 fraternal risk-based capital report and any supplemental forms and reports with the NAIC. The amendments to §7.402 are further necessary to subject each domestic and foreign fraternal benefit society to a trend test. Additionally, the amendments to §7.402 are necessary to implement changes enacted by the 82nd Legislature, Regular Session, in House Bill (HB) 3161, effective June 17, 2011, by adding limited purpose subsidiary life insurance companies to the list of defined "carriers" that must comply with the section. Insurers and HMOs subject to §7.402 are referred to collectively in this proposal as "carriers."

The following paragraphs provide a brief summary and analysis of the reasons for the adopted amendments.

The amendments to §7.402 are necessary to regulate risk-based capital and surplus requirements for insurers and HMOs. The risk-based capital requirement is a method of ensuring that an insurer or HMO 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 provide the Department with a widely used regulatory tool to identify the minimum amount of capital or surplus appropriate for an insurer or HMO to support its overall business operations in consideration of its size and risk exposure.

The amendments to §7.402(b) and (e) are necessary to specify the 2011 risk-based capital reporting requirements for insurers subject to §7.402. Specifically, the amendments clarify that fraternal benefit societies, stipulated premium companies, and county mutual insurance companies that do not meet the express criteria contained in the Insurance Code §912.056(f) are required to file electronic versions of the 2011 risk-based capital reports and any supplemental risk-based capital forms and reports with the NAIC in accordance with and by the due dates specified in the risk-based capital instructions promulgated by the NAIC.

Under the previous version of §7.402, stipulated premium companies doing business only in Texas and county mutual insurance companies were required, for the first time, to file electronic versions of the 2010 risk-based capital reports with the NAIC by March 1, 2011. Under the amendments to §7.402(b) and (e), fraternal benefit societies are required, for the first time, to file electronic versions of the 2011 risk-based capital reports with the NAIC in accordance with and by the due date specified in the risk-base capital instructions promulgated by the NAIC.

The amendments to §7.402(b), (d), (e), and (g) further expand the risk-based capital requirements for domestic and foreign fraternal benefit societies. Specifically, the amendments to §7.402 add new subsection (g)(8), which imposes new substantive trend test requirements for fraternal benefit societies for year-end 2011, and each calendar year thereafter. New subsection (g)(8) subjects a 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. In that case, and if any fraternal benefit society trends below 190 percent of total adjusted capital to authorized control level risk-based capital, it will be subject to the company action level requirements and will need to file additional reporting with the Department as a result of the trend test. This new requirement is necessary because it will allow early identification of a fraternal benefit society that is likely to reach a company action level in the following year. By triggering a company action level sooner, a fraternal benefit society can better plan for its capital needs, and the Department will receive information necessary to regulate solvency and protect the public interests.

The amendments to §7.402(b), (d), and (e) also are necessary to implement HB 3161, by specifying risk-based capital requirements for limited purpose subsidiary life insurance companies. HB 3161 added a new Subchapter I to Chapter 841 of the Insurance Code to authorize the establishment of domestic limited purpose subsidiary life insurance companies to enable those companies to support excess reserves for certain life insurance policies. Under the amendments to §7.402(b), (d), and (e) as adopted, each limited purpose subsidiary life insurance company is subject to the section's risk-based capital requirements for life insurers and will be required to file an electronic version of the 2011 risk-based capital report and any supplemental forms and reports with the NAIC in accordance with and by the due date specified in the risk-based capital instructions promulgated by the NAIC.

Under the amendments to §7.402(b), (d), and (e), a limited purpose subsidiary life insurance company is also subject to a trend test under §7.402(g)(5) if its total adjusted capital to authorized control level risk-based capital is between 200 percent and 250 percent. In that case, and if a limited purpose subsidiary life insurance company trends below 190 percent of total adjusted capital to authorized control level risk-based capital, it will be subject to the company action level requirements and will need to file additional reporting with the Department as a result of the trend test. This new requirement is necessary because it will allow for early identification of a limited purpose subsidiary life insurance company that is likely to reach a company action level in the following year. By triggering a company action level sooner, a limited purpose subsidiary life insurance company can plan better for its capital needs, and the Department will receive information necessary to regulate solvency and protect the public interests.

The amendments to §7.402(d) are also necessary to adopt by reference the 2011 NAIC risk-based capital formulas to be used for year-end 2011. These adopted formulas include the 2011 NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies, the 2011 NAIC Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies, the 2011 NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies, and the 2011 NAIC Health Risk-Based Capital Report including Overview and Instructions for Companies.

Copies of the documents 2011 NAIC risk-based capital formulas adopted by reference in §7.402(d) 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. The 2011 NAIC formulas and instructions adopted and published by the NAIC may be obtained from the NAIC, and the 2011 NAIC RBC reports can be filed electronically using software available from vendors.

3. HOW THE SECTIONS WILL FUNCTION. The amendments to §7.402(b) expand the scope of the risk-based capital requirements for domestic and foreign fraternal benefit societies and add limited purpose subsidiary life insurance companies to the list of defined carriers that must comply with the section.

The amendments to §7.402(d) adopt by reference the 2011 NAIC risk-based capital formulas, replacing the year-end 2009 formulas and year-end 2010 formulas.

The amendments to §7.402(e) update the risk-based capital filing requirements for the various types of carriers. Specifically, under the amendments to §7.402(e), fraternal benefit societies are required, for the first time, to file electronic versions of the 2011 risk-based capital reports with the NAIC in accordance with and by the due date specified in the risk-base capital instructions promulgated by the NAIC.

The amendment to §7.402(g) updates the remedial actions that the Commissioner of Insurance may take against fraternal benefit societies depending on the results computed by the risk-based capital formula. New subsection (g)(8) subjects a 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. In that case, and if any fraternal benefit society trends below 190 percent of total adjusted capital to authorized control level risk-based capital, it will be subject to the company action level requirements and will need to file additional reporting with the Department as a result of the trend test.

4. SUMMARY OF COMMENTS. The Department did not receive any comments on the published proposal.

5. STATUTORY AUTHORITY. The amendments are adopted under the Insurance Code Chapters 404 and 441 and the Insurance Code §§822.210, 822.211, 841.205, 841.410(b) and (c), 841.414(c), 841.420, 843.404, 884.054, 884.206, 885.401, 982.105, 982.106, and 36.001.

Chapter 404 addresses the duties of the Department when an insurer's solvency is impaired. 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.

Chapter 441 addresses the prevention of insurer delinquencies and insolvencies. 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.

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.

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 841.420 requires the Commissioner to prescribe accounting and financial reporting requirements with regard to the limited purpose subsidiary life insurance company and any insurer as defined by §841.402 that organizes a limited purpose subsidiary life insurance company.

Section 843.404 authorizes the Commissioner to adopt rules to require a health maintenance organization to maintain a specific net worth based on factors listed in the statute 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.

6. TEXT.

SUBCHAPTER D. Risk-based Capital and Surplus and Other Requirements

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

(a) Purpose. The purpose of implementing a risk-based capital and surplus provision is to require a minimum level of capital and surplus to absorb the financial, underwriting, and investment risks assumed by an insurer or a health maintenance organization.

(b) Scope.

(1) Life companies. This section applies to any insurer authorized to do business in Texas as an insurance company that writes or assumes a life insurance or annuity contract or assumes liability on or indemnifies one person for any risk under an accident and health insurance policy, or any combination of these policies, in an amount that exceeds $10,000 including: capital stock companies, mutual life companies, limited purpose subsidiary life insurance companies, and stipulated premium insurance companies.

(2) Property and casualty companies. This section applies to all domestic, foreign, and alien property and casualty companies subject to the provisions of Insurance Code §822.210 and §982.106, including county mutual insurance companies that do not meet the express criteria contained in the Insurance Code §912.056(f), but excluding monoline financial guaranty insurers, monoline mortgage guaranty insurers, title insurers and those insurers subject to the Insurance Code §822.205.

(3) Health Maintenance Organizations. This section applies to all domestic and foreign health maintenance organizations subject to the provisions of Insurance Code Chapter 843 and insurers that file the NAIC Health Annual Statement Blank with the department under department filing requirements.

(4) Fraternal benefit societies. This section applies to all domestic and foreign fraternal benefit societies.

(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 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 2011 NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

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

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

(4) The 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 are required to file electronic versions of the 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 shall take precedence and in all respects 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 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 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 is required to perform any examinations or analyses to the insurer's business and operations that is deemed necessary. The commissioner may issue orders specifying corrective actions to be taken or may require other appropriate action.

(3) An insurer reporting total adjusted capital of 70 percent to 100 percent of authorized control level risk-based capital triggers an authorized control level. In addition to the remedies available at the higher action levels, the commissioner may take other action deemed necessary, including initiating a regulatory intervention to place an insurer under regulatory control.

(4) An insurer reporting total adjusted capital of less than 70 percent of authorized control level triggers a mandatory control level which subjects the insurer to one of the following actions:

(A) being placed in supervision or conservation;

(B) being determined to be in hazardous financial condition as provided by the Insurance Code Chapter 404 and §8.3 of this title (relating to Hazardous Conditions) regardless of percentage of assets in excess of liabilities;

(C) being determined to be impaired as provided by the Insurance Code §§404.051 and 404.052 or 841.206; or

(D) any other applicable sanctions under the Texas Insurance Code.

(5) A life insurer subject to this section is subject to a trend test described in the RBC formula, if its total adjusted capital to authorized control level risk-based

capital is between 200 percent and 250 percent. Any life insurer that trends below 190 percent of total adjusted capital to authorized control level risk-based capital triggers the company action level.

(6) A property and casualty insurer subject to this section is subject to a trend test if its total adjusted capital to authorized control level risk-based capital is between 200 percent and 300 percent. If the result of the trend test as determined by the formula is "YES", the insurer triggers regulatory attention at the company action level.

(7) A health insurer subject to this section is subject to a trend test if its total adjusted capital to authorized control level risk-based capital is between 200 percent and 300 percent and triggers the trend test determined in accordance with the trend test calculation included in the Health RBC instructions. If the result of the trend test as determined by the formula is "YES", the insurer triggers regulatory attention at the company action level.

(8) A fraternal benefit society subject to this section is subject to a trend test described in the RBC formula, if its total adjusted capital to authorized control level risk-based capital is between 200 percent and 250 percent. Any fraternal benefit society that trends below 190 percent of total adjusted capital to authorized control level risk-based capital triggers the company action level.

(h) Prohibition on announcements. Except as otherwise required under the provisions of this section, the making, publishing, disseminating, circulating or placing before the public, or causing, directly or indirectly to be made, published, disseminated, circulated or placed before the public, in a newspaper, magazine or other publication, or in the form of a notice, circular, pamphlet, letter or poster, or over any radio or television station, or in any other way, an advertisement, announcement or statement containing an assertion, representation or statement with regard to any component derived in the calculation, by any insurer, agent, broker or the person engaged in any manner in the insurance business would be misleading and is, therefore, prohibited. Any violation of this subsection may be considered a violation of Insurance Code Chapter 541, regulating unfair methods of competition and unfair or deceptive acts or practices.

(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 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. In no event shall the requirements of this section 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.

CERTIFICATION. This agency certifies that the adopted amendments have been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority.

12-0120

Issued at Austin, Texas on February 9, 2012.

Sara Waitt
General Counsel

IT IS THEREFORE THE ORDER of the Commissioner of Insurance that the amendments to §7.402 specified herein, concerning risk-based capital and surplus for insurers and health maintenance organizations, are adopted.

AND IT IS SO ORDERED.

ELEANOR KITZMAN
COMMISSIONER OF INSURANCE

ATTEST:

Sara Waitt
General Counsel

COMMISSIONER'S ORDER NO. 12-0120
FEB 09 2012