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

1. INTRODUCTION. The commissioner of insurance adopts amendments to 28 Texas Administrative Code §7.402, concerning risk-based capital and surplus requirements for insurers and health maintenance organizations (HMOs). Amended §7.402 is adopted with nonsubstantive grammatical changes to the proposed text published in the December 20, 2013, issue of the *Texas Register* (38 TexReg 9202) and to the existing text that was not published. The changes, however, do not introduce new subject matter, create additional costs, or affect persons other than those previously on notice from the proposal.

2. REASONED JUSTIFICATION. The adopted sections amend §7.402(d) to adopt by reference: 1) the 2013 NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies; 2) the 2013 NAIC Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies; 3) the 2013 NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies; and 4) the 2013 NAIC Health Risk-Based Capital Report including Overview and Instructions for Companies. References to the 2012 versions of these documents are removed.

The amendments to §7.402 address risk-based capital and surplus requirements for insurers and HMOs subject to §7.402 (collectively referred to as "carriers"). 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 considering its size and risk exposure.

The 2013 NAIC risk-based capital formulas and instructions for life and fraternal carriers contain changes, including new requirements regarding commercial mortgage loans. Otherwise, the 2013 NAIC risk-based capital formulas and instructions are substantially similar to the 2012 versions.

The 2013 NAIC risk-based capital formulas and instructions for property and casualty carriers contain a significant change requiring catastrophe risk (hurricane and earthquake components), to be reported on an information-only basis. Property and casualty carriers are also required to report additional catastrophe loss data. These new requirements will not impact the risk-based capital result for 2013, but the NAIC has included a dual reporting presentation of risk-based capital results exclusive and inclusive of the new catastrophe charge to allow for a testing period and further refinements before the charge impacts capital requirements.

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. NAIC included a dual reporting presentation in its 2012 Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies and in its 2012 Life Risk-Based Capital Report Including Overview and Instructions for Companies, which require fraternal benefit societies and life insurers to show: 1) whether 2.5 or 3.0 is the regulatory basis of their domiciliary state, 2) what level of action would be indicated based on the two levels, and 3) to specify what threshold is required by the domiciliary state. Amended §7.402(g)(5) and §7.402(g)(8) modify the trend test threshold from 2.5 to 3.0 times the authorized control level for life insurers and fraternal benefit societies.

Amendments to §7.402(g)(1) and (3) clarify existing requirements by replacing the terms “higher” and “lower” with the name of the action level that a company will be subject to under these paragraphs.

The proposed text has been changed to remove the comma in the first sentence of §7.402(g)(8). The department has made a change to §7.402(f) and (g)(4), which had been marked as “no change.” In §7.402(f), the department removed the first word “or” from the first series in the first sentence and added commas to both series in the first sentence. In §7.402(g)(4), the department replaced the existing word “which” with the word “that.” These changes were necessary to conform to agency style guidelines. The changes, however, do not introduce new subject matter, create additional costs, or affect persons other than those previously on notice from the proposal.

Copies of the 2013 documents adopted by reference in §7.402 are available for inspection in the Financial Analysis section of the Financial Regulation Division, Texas Department of Insurance, William P. Hobby Jr. State Office Building, Tower Number III, Third Floor, 333 Guadalupe, Austin, Texas 78701.

3. HOW THE SECTIONS WILL FUNCTION. Section 7.402 addresses risk-based capital and surplus requirements for insurers and HMOs subject to §7.402 (collectively referred to as "carriers"). 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 in the adopted section provides 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 considering its size and risk exposure.

4. SUMMARY OF COMMENTS AND AGENCY RESPONSE. The department received no public comments on the proposed amendments.

5. STATUTORY AUTHORITY. The amendments are adopted under Insurance Code §§404.004, 404.005, 441.005, 441.051, 822.210, 822.211, 841.205, 841.206, 841.410, 841.414, 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 ensure financial solvency of insurers for the protection of policyholders and insurers. Section 841.206 authorizes the commissioner to take regulatory action if the commissioner determines that a life, accident, or health insurance company's capital or surplus is impaired in violation of §841.206.

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 to file an annual report with the commissioner 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 HMO to maintain capital and surplus levels in excess of statutory minimum levels to ensure financial solvency of HMOs 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 department under the Insurance Code and other laws of this state.

6. TEXT.

§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 Insurance Code §912.056(f), but excluding monoline financial guaranty insurers, monoline mortgage guaranty insurers, title insurers, and those insurers subject to 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, 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 accord 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 accord with the RBC instructions.

(d) Adoption of RBC formula by reference. The commissioner adopts by reference the following:

(1) The 2013 NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies, which includes the RBC formula.

(2) The 2013 NAIC Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies, which includes the RBC formula.

(3) The 2013 NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies, which includes the RBC formula.

(4) The 2013 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 file electronic versions of the 2013 RBC reports and any supplemental RBC forms and reports with the NAIC in accord 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, any specific requirement of this section, and the RBC formula or the RBC instructions, the Insurance Code, rule, or specific requirement of this section takes precedence and in all respects controls. It is the intent of this section that the adoption by reference of the NAIC Risk-Based Capital Reports Including Overview and Instructions for Companies 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 must 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. If the commissioner notifies the company that the plan is not satisfactory, the company must prepare a revised plan and submit it to the commissioner. Failure to file this comprehensive financial plan triggers the regulatory 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 file an RBC plan or revised RBC plan within 45 days of filing the RBC report with the NAIC, and the commissioner must perform any examinations or analyses to the insurer's business and operations that are 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 company and regulatory action levels described in this subsection, 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 that 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 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 Insurance Code §§404.051 and 404.052 or 841.206; or

(D) any other applicable sanctions under the 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 300 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 accord 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 300 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, 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, poster, 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 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 must 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 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.

7. CERTIFICATION. This agency certifies that legal counsel has reviewed the adopted section and finds it to be a valid exercise of the agency's legal authority

Issued at Austin, Texas on February 19, 2014.

Sara Waitt
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The commissioner adopts §7.402.

Julia Rathgeber
Commissioner of Insurance