Texas Department of Insurance
Biennial Report to the 84th Legislature

Texas Department of Insurance

December 2014

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Texas Department of Insurance

Commissioner of Insurance

December 30, 2014

The Honorable Rick Perry, Governor
The Honorable David Dewhurst, Lieutenant Governor
The Honorable Joe Straus, Speaker of the House

Dear Governors and Speaker:

In accordance with Texas Insurance Code, Section 32.002, I am pleased to submit the biennial report of the Texas Department of Insurance (TDI). As required by law, the report summarizes needed changes in the laws relating to regulation of the insurance industry.

The changes requested in TDI's biennial report to the 84th Texas Legislature cover a vast spectrum of insurance issues in Texas, including fraud prevention, consumer protection, financial solvency, and accounting methods. The recommendations also seek to address the significant growth in the Texas insurance market and the increased demand for TDI's services. Over the last two years, the Texas insurance market grew by 18 percent as a result of a growing economy and population, pushing it from the world's 12th largest insurance market in 2011 to the 10th largest in 2013. This economic and population boom provides numerous benefits to the state and its residents, but also creates regulatory challenges for TDI. The recommendations in this report seek to address those challenges in a manner that allows for effective regulation without inhibiting the growth and vibrancy of the Texas insurance market.

The report also highlights additional funding requests submitted in TDI's Legislative Appropriations Request (LAR) for the 2016-17 biennium. In the LAR, TDI submitted exceptional item requests for a 3 percent increase in agency funding, a modest request compared to the 18 percent increase in the industry TDI regulates.

In addition to the items mentioned above, TDI is seeking limited supplemental appropriation authority to spend funds it already holds. Last session, the Legislature directed funds from the Texas Health Insurance Pool to the Healthy Texas Program, a program required under Chapter 1508, in which TDI contracted with carriers to expand small employer health insurance coverage in Texas. The legislation, however, did not provide appropriation authority for those funds. Therefore, TDI was directed to spend approximately $5.3 million for specific obligations, but did not have the authority to access the account that holds those funds. In order to avoid defaulting on its contractual obligations to the Healthy Texas carriers, TDI reallocated funds from across the agency that were intended for other purposes, and to date, has paid $1.7 million of the $5.3 million due. Accordingly, TDI is asking for authority to spend the existing funds for the purpose for which they were intended.

Thank you for the opportunity to provide this information and for your consideration of this report. Please contact me or Melissa Hamilton, Director of Government Relations, at (512) 676-6605 with any questions or if you need additional information.

Sincerely,

Julia Rathgeber

Julia Rathgeber
Commissioner of Insurance

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The Texas Department of Insurance (TDI) biennial report is submitted in accordance with Texas Insurance Code Section 32.022, and summarizes recommended legislative changes relating to Texas insurance industry regulation.

Working Together to Protect Consumers and Promote Competition

In preparing this report to the 84th Texas Legislature, agency staff solicited input from a large number of stakeholder groups to ensure an open and collaborative process while developing legislative recommendations. The goal was to develop a set of consensus recommendations that align with the agency's mission to protect insurance consumers by regulating the industry fairly and diligently, promoting a stable and competitive market, and providing information that makes a difference.

Texas as a Global Market: Top 10 and Growing

The U.S. insurance market is the largest in the world with nearly $1.8 trillion in premium value and a 34.6 percent market share, and Texas, with $127.2 billion in premium value, boasts the world's 10th largest insurance market. Over the last two years, Texas' insurance market grew by 18 percent as a result of a growing economy and population, pushing it from the 12th largest insurance market in 2011 to the 10th largest market at the end of 2013.

Figure 1: 2013 Global Insurance Ratings by Premium Volume, in Millions of U.S. Dollars

2013 Premium Volume - Worldwide			
Rank	**Country**	**Premium Volume**	**Percent of Market**
1	United States	$ 1,786,753	34.57
2	Japan	531,506	10.28
3	United Kingdom	329,643	6.38
4	China	277,965	5.38
5	France	254,754	4.93
6	Germany	247,162	4.78
7	Italy	168,554	3.26
8	South Korea	145,427	2.81
9	Canada	125,344	2.43
10	The Netherlands	101,140	1.96

2013 Premium Volume - Worldwide (with U.S. States)			
Rank	**Jurisdiction**	**Premium Volume**	**Percent of Market**
1	Japan	$ 531,506	10.28
2	United Kingdom	329,643	6.38
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5	Germany	247,162	4.78
6	California	240,978	4.66
7	Italy	168,554	3.26
8	South Korea	145,427	2.81
9	New York	135,297	2.62
10	Texas	127,173	2.46

Source: NAIC Financial Data Repository, NAIC IID Filings, U.S. residual market mechanisms, health insurers or captives not filing to FDR, and SwissRe Sigma No. 3/2013 for the remainder. (Note: U.S. state totals do not include deposit-type contract funds.) www.naic.org/documents/cipr_stats_top_50_worldwide_insurance_markets.pdf

Growing Pains and Opportunities

While the economic and population boom is good for Texas and its insurance market, the substantial and rapid market growth impacts TDI's ability to provide certain core regulatory services. In particular, the agency has faced a significant increase in agent license applications, consumer complaints, and suspected insurance fraud reports. This report includes several legislative recommendations to help address the increased demand for these, and other, services.

TDI also included exceptional items in its fiscal year (FY) 2016-17 Legislative Appropriations Request (LAR) to address the strain placed on the agency from the increased demand and improve the agency's ability to serve the people of Texas.

It is important to note that none of the following exceptional items adversely impact the state's general revenue (GR) because of the self-leveling nature of TDI's funding. While insurers pay premium taxes, which are deposited into the state's GR Fund, TDI receives very little funding from GR. TDI is primarily funded by a maintenance tax paid by the insurance industry. As a result, the insurance industry would ultimately fund these requests via the maintenance tax.

Increased Demand for TDI Services

TDI requested $4.6 million and an additional 28 full-time equivalent (FTE) employees for the biennium to help address the increased demand for information technology, consumer protection, agent and adjuster licensing, state fire marshal's office services, and fraud investigations. TDI has analyzed its needs and believes the additional FTEs and operational expenses in these areas reflect the agency's critical staffing needs.

Regulatory Response Rider

The regulatory response rider is contingent upon a disaster or insurance crisis, and allows TDI the flexibility to add up to $2.2 million and 40 FTEs. TDI has not used this rider in the past and would only use this rider to respond to a critical need.

Data Center Services

TDI worked closely with the Texas Department of Information Resources (DIR) to project expenditures for data center services. The agency's LAR contains an exceptional item to increase the Data Center Services capital budget project by $1.9 million for the biennium.

Enhanced Cyber Security

DIR studied cyber security at state agencies and provided agencies with improvement recommendations. TDI has been working on these recommendations and is seeking $556,000 and one FTE for the biennium to implement additional recommendations.

As previously noted, the Texas insurance market grew 18 percent during the last biennium. The exceptional items above would increase TDI's biennial budget and funded FTE positions by approximately 3 percent and 2 percent respectively.[1] Therefore, TDI's regulatory costs are growing at a slower rate than the industry it regulates. These additional funding requests do not change that, and will preserve the state's pro-business climate for insurers, while also closing the gap between market growth and regulatory resources.

1 These percentages exclude the Regulatory Response Rider, as it is a contingency rider.

In addition, TDI is seeking limited supplemental appropriations authority to spend existing funds it already holds. Senate Bill (SB) 1367 of the 83rd Legislative Session directed funds from the Texas Health Insurance Pool to the Healthy Texas Program, a program required under Chapter 1508 of the Insurance Code in which TDI contracted with carriers to expand small employer health insurance coverage in Texas. TDI, however, did not receive appropriation authority for those funds. Therefore, TDI was directed to spend funds for specific obligations, which total approximately $5.3 million, but did not have the authority to access the account that holds those funds. In order to avoid defaulting on its contractual obligations to the Healthy Texas carriers, TDI reallocated funds from across the agency, and to date, has paid $1.7 million of the estimated $5.3 million due. TDI had intended to spend those funds for other purposes: agent licensing and consumer protection. TDI is seeking appropriation authority for the approximately $5.3 million in Healthy Texas payments, including a reimbursement to TDI of the approximately $1.7 million that TDI paid in September 2013.

The Federal Government's Increased Interest in Regulating Insurance

State-based insurance regulation dates back to the mid-1800s, and a state's authority to regulate insurance was codified by the McCarran Ferguson Act of 1945. The federal government, however, is showing renewed interest in regulating insurance. This interest is evidenced in many ways, such as the federal Affordable Care Act, as well as in reports issued by the new Federal Insurance Office (FIO) created by the Dodd-Frank Wall Street Reform and Consumer Protection Act. A report issued in September 2014 by the FIO reflects the office's intent to preempt the states' authority to regulate reinsurance.

The federal versus state insurance regulation debate is a debate between a centralized approach versus a local, customized approach. TDI believes Texas policymakers are more responsive and better attuned to issues and concerns raised by Texans. This report contains recommendations to maintain and strengthen Texas' regulatory authority over insurance, including the implementation of an Own Risk Solvency Assessment requirement for insurers to create and use, a modernization of reinsurance accounting requirements, and changes to the method certain companies use to calculate their reserves. All of these recommendations improve market efficiency while mitigating the threat of potential federal preemption.

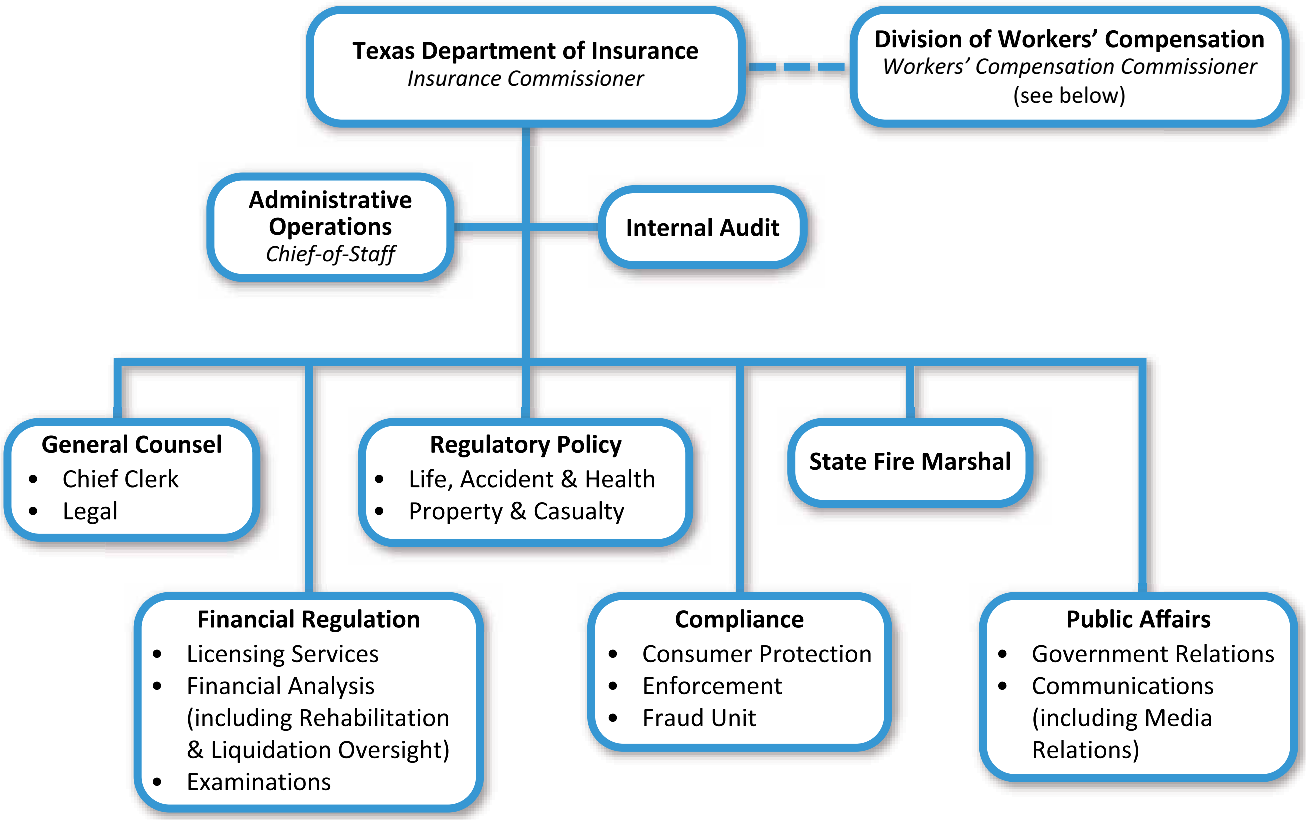
Stakeholder Input Project

Agency staff solicited extensive stakeholder input in developing the legislative recommendations in this report. TDI met with consumer advocates, industry trade associations, professional groups, and other stakeholders and invited each one to submit ideas on ways to improve the Texas regulatory framework. Agency staff followed up with individual stakeholders for more in-depth discussions about their suggestions. As a result, this report includes several recommendations received directly from stakeholders.

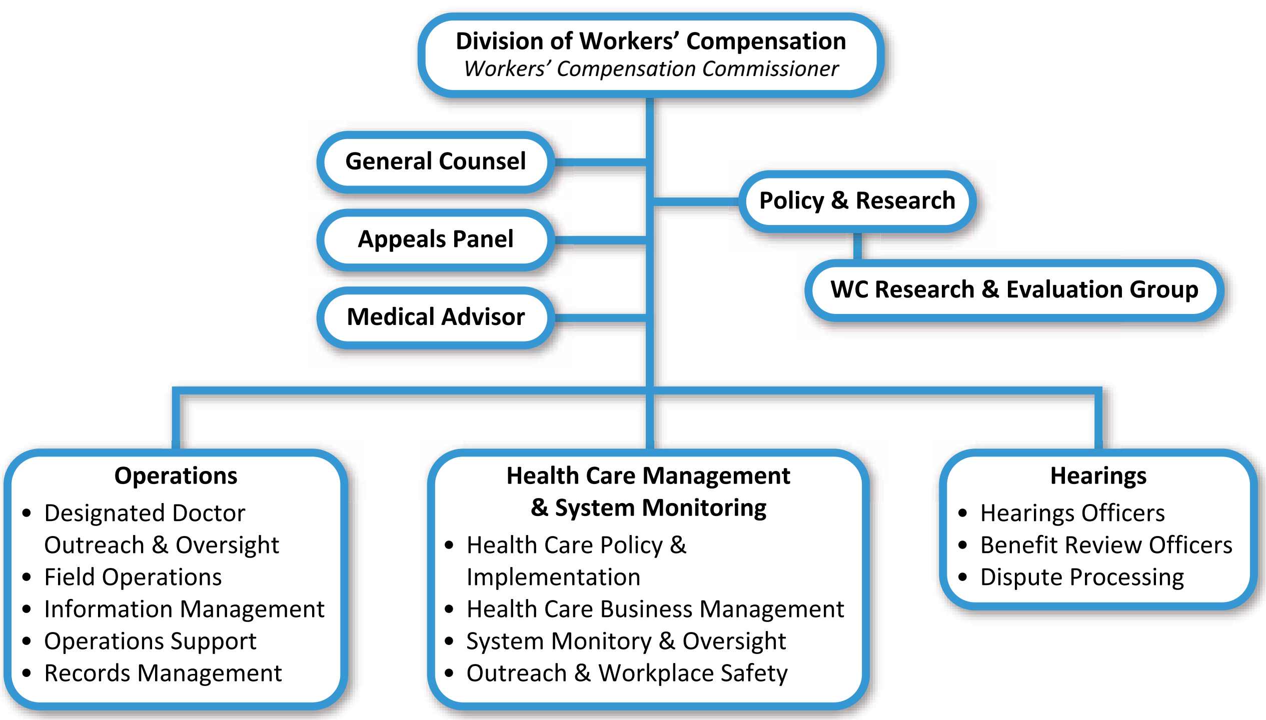
Figure 2: TDI Functional Organizational Chart

TDI's functional organization is illustrated below.

Texas Department of Insurance



Division of Workers' Compensation



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Data Calls and Certain Required Reports

A data call is one of TDI's commonly used information-gathering tools. A data call is a mandatory request to insurers for specific information with a timeline for completion. A good example of a data call is a survey TDI conducts following catastrophic losses, such as a hurricane, that requires insurers to submit information about the estimated amount of their insured losses.

Texas law mandates certain data calls, some of which are required to prepare reports, conduct hearings, monitor the insurance market, and fulfill information requests. Other data calls are not mandated by law but are part of the agency's regulatory processes. An insurer's failure to comply with a data call may result in sanctions by TDI.

Over time, some data calls used by TDI, whether required by law or developed as part of agency practice, have become outdated or duplicative and are no longer necessary to effectively regulate insurance. Unnecessary data calls result in inefficiencies for TDI and the insurance industry by consuming valuable time and resources.

Issue

TDI conducted an internal analysis and identified a number of data calls that can be eliminated, or required less frequently, without impacting the agency's ability to effectively protect consumers or perform other core functions. It is important to note, however, that some of the data calls listed below relate to legislatively required reports. In an effort to be thorough, TDI included legislatively mandated reports and their accompanying data calls as part of the review, but the agency recognizes that the Legislature's perspective is much broader than that of a state agency and understands that certain identified reports may have value and may need to be continued.

Recommendations

Repeal or amend data calls contained in the Insurance Code:

Repeal:

- Section 32.0221: Requires TDI to prepare a one-time report related to copayments of oral and intravenous chemotherapies. TDI delivered the report to the Legislature in 2010.
- Chapter 38, Subchapter C: Requires a data call for information pertaining to HIV and AIDS coverage and an annual report.
- Chapter 38, Subchapter D: Requires a data call and on closed claims and an annual report.
- Chapter 38, Subchapter I: Requires an annual data call for aggregate personal automobile insurance and residential property insurance claims information.
- Section 425.107: Requires a data call for certain Texas life insurers to report investment information and requires TDI to prepare the Community Investment Report for the Legislature each even-numbered year.
- Section 542.006(c): Requires a data call for grievance information and requires TDI to prepare a statistical report.
- Section 1501.056(c): Requires health insurance cooperatives and coalitions to file an annual Statement of Amounts Collected and Expenses Incurred.
- Section 1501.101(a): Requires health insurance geographic service areas to be filed with TDI.
- Section 4201.204(c): Requires a data call for utilization review agents to submit summary reports of all complaints.

Amend

- ★ Section 2053.056: Requires a data call for workers' compensation and employers' liability rate filings for a public rate hearing. The recommended amendment would change the mandatory data call requirement to be required at the commissioner's discretion. (Page 28 of this report provides a related recommendation that would change a mandatory biennial hearing requirement to be required at the commissioner's discretion.)
- ★ Section 2251.008: Requires a quarterly data call for changes in losses, premiums, and market share and requires TDI to prepare a Quarterly Market Condition Report for the Legislature. TDI recommends changing this section to require an annual data call and report rather than quarterly.
- ★ Section 2251.101: TDI recommends removing the requirement for commercial lines to report disallowed expenses.

Additional conforming amendments would be required to implement the changes summarized above.

Commercial Group Property Insurance

Chapter 2171 of the Texas Insurance Code authorizes insurers to write commercial group property insurance for a group of businesses or an association that constitutes a “large risk.” A “large risk” is defined in the Insurance Code. The Insurance Code does not, however, require these groups and associations to register with TDI, so the agency cannot easily confirm if a group or association complies with the requirements in Chapter 2171.

Commercial group property insurance policies include both a “per-occurrence” limit and “an annual aggregate” limit. The per-occurrence limit is the maximum amount the insurer pays for a single loss event. Once that limit is reached, the insurer is not required to pay additional claims related to that loss event, even if some members’ claims go unpaid. The annual aggregate limit is the maximum amount the insurer will pay during the entire policy period for all claims related to all loss events. Once that amount has been reached, the insurer is not required to pay any additional claims. Chapter 2171 of the code, however, does not require insurers to provide a copy of the policy or a certificate of coverage to each member, or to otherwise inform each individual member of these limits.

In addition, the group’s total insured property values may exceed the available coverage limits provided under the insurance policy. For example, if a single event, such as a hailstorm or hurricane, damages several properties in a group, the per-occurrence limit may not be enough to cover all of the damaged properties. Likewise, damages paid for a single event also reduce the policy’s aggregate limits, so multiple events and claims can quickly deplete coverage. In particular, when many of the insured properties are concentrated in an area prone to catastrophes, and are damaged by the same loss event, or events, some members’ claims may not be paid if the total damage exceeds these limits. Accordingly, some members, and their lenders, may not have the full extent of insurance coverage they believe has been purchased.

Moreover, the Insurance Code does not define an insurer in the commercial group property context. Determining which insurers are subject to Chapter 2171 is important because different insurers have different regulatory requirements. For example, surplus lines insurers are typically exempt from rate and form filings that admitted insurers must make with TDI, unless they are made expressly subject to a chapter of the Insurance Code.

Issues

In some cases, an agent sells commercial group property insurance to multiple apartment complexes or condominium associations. The agent creates a corporation, or what is statutorily known in some states as a “fictitious group,” created solely for the purpose of buying commercial group property insurance. This fictitious group is the insured named on a surplus lines policy. Each apartment complex or condominium association is added to the group as an additional member, but is not individually named on the policy. Since Chapter 2171 does not require insurers to provide a copy of the policy or certificate of coverage to each member, the members and their lenders may not be aware of the policy’s limitations. TDI also has limited knowledge about these fictitious groups and therefore, cannot provide adequate consumer protections to the members.

Recommendation

Allow TDI to better protect Texas consumers by amending Chapter 2171 of the Texas Insurance Code to:

- prohibit fictitious groups;
- require groups and associations to register with TDI;
- require that each group or association member receive a copy of the certificate of coverage and policy;
- require that each group or association member and lender receive disclosures for each policy’s limits, along with the total insured property values and the total number of properties insured under the policy;
- require updated disclosures each time the ratio of total insured values to policy limits is increased to the group’s or association members’ disadvantage;
- clarify whether Chapter 2171 applies to surplus lines insurers; and
- provide TDI with express rulemaking authority to facilitate effective enforcement.

Fraud Prevention Education Grants

Insurance fraud is a multi-billion dollar problem in the U.S., and the costs of fraud are borne by policyholders through premium increases. According to the FBI, the total cost of non-health related insurance fraud is estimated to be over $40 billion per year, costing the average U.S. family between $400 and $700 per year in increased premiums.

The Texas Legislature created Chapter 701 of the Texas Insurance Code to address insurance fraud and identity theft. The Fraud Unit is a law enforcement entity established under this chapter and housed at TDI to protect Texans from insurance fraud. The Fraud Unit consists of 28 investigators, including 26 commissioned peace officers. The investigators are divided into three sections that investigate (i) consumer and provider fraud, (ii) insurer fraud, and (iii) workers' compensation fraud. TDI's Fraud Unit investigates criminal cases throughout the state and when necessary, refers cases to district and county attorneys for prosecution. Additionally, the Fraud Unit employs three attorneys that serve as assistant district attorneys in the Bexar, Dallas, and Harris counties' district attorney offices.

Over the past three years, the TDI Fraud Unit has helped secure millions of dollars in restitution for insurance fraud victims in Texas. In FY 2014, the Fraud Unit referred 188 criminal cases for prosecution, including over $9 million in alleged fraudulent criminal activity, and as a result of their investigative and prosecutorial efforts, courts ordered more than $24 million in restitution to be repaid to victims.

Despite these successes, insurance fraud continues to grow at an alarming rate. In FY 2014, TDI's Fraud Unit opened 728 cases, resulting in 858 active investigations, a 55 percent increase from three years ago.

There is good news, though. Education and improvements in technology have proven to be effective tools in combating insurance fraud. Public education about insurance fraud helps Texans identify fraud and protect themselves from becoming victims. Similarly, improvements in crime-fighting technology help TDI's Fraud Unit and local law officials detect and investigate fraudulent insurance activity and take appropriate action quickly.

Issue

Although the TDI Fraud Unit has been successful, the growth of insurance fraud has created a situation in which the funding available to combat fraud has not kept pace with the fraudulent activity in the state. TDI's LAR requested additional Fraud Unit funding as one method for addressing this trend, but TDI is also looking for other sources of revenue to complement that request. Grants are one possible source of additional funding.

Texas law, however, does not currently permit the Fraud Unit to seek or accept grant funds. If the Fraud Unit is given authority by the Legislature to accept grants, the unit can better meet its statutory obligations. With these additional resources, the Fraud Unit can also obtain better crime-fighting technologies and enhance its annual educational conference. The funds will additionally support the Fraud Unit's other educational goals, improve prevention and deterrence of fraudulent crimes, and promote public awareness about insurance crimes in Texas.

Recommendation

Add a provision to Texas Insurance Code, Chapter 701 authorizing the TDI Fraud Unit to seek and accept grants. The new provision would prohibit receiving grants from the insurance industry.

Fraud Attorneys and Investigations

Chapter 701 of the Texas Insurance Code gives TDI authority to investigate insurance fraud and aid in enforcing laws related to fraudulent insurance acts. Under Section 701.101, the TDI Fraud Unit helps enforce insurance fraud laws by investigating complaints and providing assistance to governmental agencies prosecuting laws related to fraudulent insurance acts. Section 701.102, however, includes an outdated reference to investigate the offense of fraud under Penal Code Section 35.02(a). Penal Code Section 35.02 was amended in 2005 to reflect the increasingly sophisticated and complex fraudulent insurance activity, but the Insurance Code has not been updated and many times offenses are investigated and prosecuted under other sections of the Penal Code.

While TDI does not need the Penal Code reference to investigate fraudulent insurance acts, the specific reference to Subsection 35.02(a) creates an inconsistency between the Insurance Code and the Penal Code and requires amendments to two statutes for any future legislation.

Issue

TDI is authorized to investigate and aid in enforcing laws for all fraudulent insurance acts under the Insurance Code. Accordingly, the reference to the outdated Penal Code provision in Section 701.102 is unnecessary. Additionally, due to the specialized nature of insurance fraud investigation and criminal prosecution, Section 701.102 needs to reflect the technical and legal assistance provided throughout the investigative and prosecutorial processes.

Recommendation

Amend Insurance Code, Section 701.102 to remove the reference to Penal Code Section 35.02(a) and amend Subparagraph (2) to include providing technical or litigation assistance to governmental agencies.

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Burial Reimbursement Benefits

- A Division of Workers' Compensation Recommendation

The Texas Workers' Compensation Act provides for various types of indemnity benefits payable to injured employees and their beneficiaries in the case of a compensable occupational injury, illness, or death. One of these types of indemnity benefits, burial benefits, is designed to compensate the person who pays for the burial costs for the deceased employee.

Currently, the statute allows for burial expense compensation up to $6,000 per workers' compensation claim, or the actual costs incurred for reasonable burial expenses, whichever is less. This burial benefit has not increased since the passage of House Bill 2510, 76th Legislature, Regular Session, and effective September 1, 1999, when the burial benefit increased from $2,500 to $6,000.

Issue

According to the National Funeral Directors Association the national median cost of an adult funeral in 2012 was $8,343 (most current data available). This cost estimate does not take into account crematory fees, cemetery, obituaries, and monument or marker costs. Over the past decade, the median cost of an adult funeral in the United States has increased approximately 35.2 percent.[2]

As a result, current compensation of burial benefits have not kept up with increased costs associated with burial expenses in today's market, which places undue economic pressure on family and friends of deceased employees to make certain burial decisions in order to stay within the burial benefit amount designated by statute, or to pay the remaining burial expenses out of their own pocket.

Twenty-nine states currently provide burial benefits in amounts that exceed $6,000 and sixteen states currently provide at least $10,000 or more in burial benefits in the case of a compensable death.[3]

Recommendation

Amend Section 408.186(a), Texas Labor Code to increase the maximum reimbursement for burial benefits payable under the Workers' Compensation Act from $6,000 to $10,000.

2 National Funeral Directors Association, Funeral Service Trends and Statistics, (April 12, 2013) available at www.nfda.org/about-funeral-service-/trends-and-statistics.html.

3 Workers' Compensation Research Institute and International Association of Industrial Accident Boards and Commissions, Workers' Compensation Laws as of January 1, 2014, available at www.crinet.org/studies/public/books/wclaws_2014_book.html.

Small Employer Safety Program

- A Division of Workers' Compensation Recommendation

Section 402.021 of the Texas Labor Code outlines the legislative intent for the Texas workers' compensation system and includes, as part of that intent, that the workers' compensation system "must promote safe and healthy workplaces through appropriate incentives, education, and other actions." The best possible outcome for Texas employers and employees is to prevent unnecessary workplace injuries and illnesses, and to "reduce, and to every reasonable extent, eliminate the causes of loss of production, reduction of work hours, temporary and permanent incapacity of workers, and increases in certain insurance rates."[4]

As part of its statutory duty to administer the workers' compensation system, the Division of Workers' Compensation (DWC) provides numerous free safety resources for Texas employers, including customized onsite workplace safety and health training; the Occupational Safety and Health Consultation (OSHCON) Program, an extensive library of safety publications and safety DVDs for employer use; the US Department of Labor's Occupational Safety and Health Administration (OSHA) 10-hour construction classes; and safety and health newsletters. DWC also hosts an annual safety and health conference for Texas employers, which focuses on accident prevention issues such as transportation safety, workplace violence prevention, effective safety management processes, and regulatory compliance.

Building on the existing safety resources for Texas employers, DWC has recently expanded its efforts to promote workplace safety and health issues. These efforts include publicly recognizing employers with exemplary safety programs who qualify for the DWC Peer Review Safety award and the DWC OSHCON Safety and Health Recognition Program (SHARP) awards. Additionally, DWC is focusing more attention on transportation safety issues through industry roundtables and educational outreach, because transportation incidents remain the leading cause of workplace fatalities in Texas.

Issue

While Texas has consistently seen lower non-fatal occupational injury and illness rates compared to the national average for years, Texas has a higher number of workplace fatalities than most states, primarily due to the size of the state and the state's industry mix. Generally speaking, small employers (i.e. employers with fewer than 50 employees) often do not have the resources available to purchase necessary safety equipment or provide additional safety training to reduce or eliminate workplace hazards. As a result, these smaller employers are at a disadvantage compared to larger employers who can employ risk management or loss control personnel for this purpose.

Although DWC provides numerous safety resources to Texas employers, they also recognize that smaller employers and employers in high-risk industries could benefit from a safety reimbursement program, similar to an existing program for return-to-work issues under Section 413.022, Labor Code. Other states, including Wyoming, Ohio, Minnesota, and Washington offer similar employer safety reimbursement programs to their employers.

Recommendation

Amend Chapter 411 of the Labor code to add a new Section 411.111 to establish a pilot safety reimbursement program for small employers (i.e., employers with fewer than 50 employees) and employers in certain high-risk industries through FY 2019. This program would provide reimbursements to employers with workers' compensation coverage who incur allowable expenses to improve workplace safety (e.g., workplace modifications, purchase safety equipment, provide additional safety training). Reimbursements would be available on a first-come, first-serve basis, up to a $100,000 per year. Individual employer reimbursements would not exceed $5,000 per year.

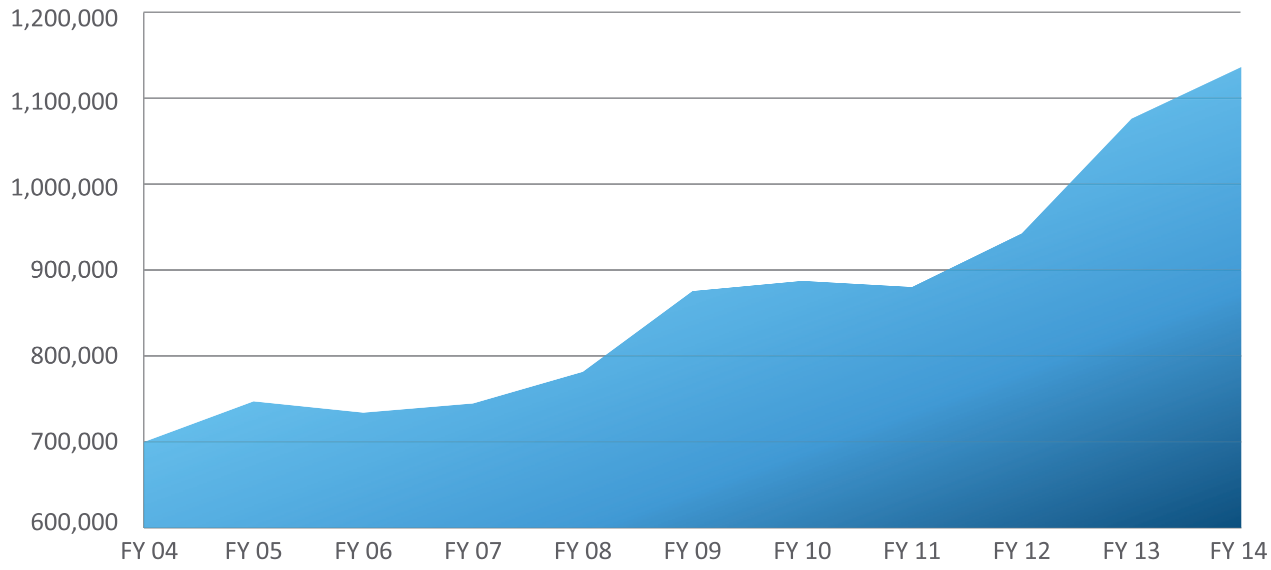
By December 1, 2018, DWC would include, as part of its biennial report to the Legislature, an analysis detailing the results of the program with a recommendation on whether the Legislature should continue the safety reimbursement program beyond FY 2019 in its biennial report.

4 Texas Labor Code, Section 411.101

Agent and Adjuster Licensing

TDI processes requests for 23 individual insurance licenses and 22 business entity licenses. Over the last decade, the agency experienced an unprecedented 60 percent increase in insurance agent and adjuster license requests, as shown in Figure 3 below.

Figure 3: Total Filings Processed, FY 2004-2014



Issues

The increased demand for agent and adjuster licenses in Texas, and the greater complexity of certain filings, has strained agency resources and its ability to deliver licensing services in a timely manner, while providing quality customer service. As part of TDI's continual efforts to improve the agency's procedures and processes, TDI recognized that licensing activities required more attention than in previous years and sought to address deficiencies in the system.

After a thorough review, TDI identified three changes needed in order for the agency to provide timely and accurate licensing services and quality customer service: (i) improve existing staff levels, processes, and procedures; (ii) increase funding; and (iii) change laws regarding agent and adjuster licensing.

TDI addressed the first item in 2014 by devoting additional staff and resources to agent licensing, and by implementing improved processes and procedures. While these changes decreased the amount of time applicants had to wait between submitting their applications and receiving their licenses, TDI realized that for meaningful, long-term improvements, the agency would need both additional funding, which has been submitted to the Legislature for its consideration in the agency's LAR, and changes to the laws governing agent and adjuster licensing in the state.

Recommendations

Amend the Insurance Code to implement the following agent and adjuster licensing requirements:

Align Agent and Adjuster License Renewal Dates

It is common for an agent or adjuster to hold several different licenses, and many times each license has a different renewal date. The different renewal dates make it difficult for licensees to keep all of their licenses current and to comply with continuing education (CE) requirements. Aligning individual license renewal dates for the same date every two years removes an unnecessary regulatory burden on Texas agents and adjusters, as well as the insurers and agencies who employ them. It would also simplify fees and CE requirements for subsequent new licenses.

Align CE Requirements for License Renewal with National Standards

Texas currently requires resident insurance agents to complete 30 CE hours every two years. The majority of states, however, only require resident agents to complete 24 CE hours, which is the standard set by state insurance commissioners through the National Association of Insurance Commissioners (NAIC). This means Texas' resident agents bear a greater regulatory burden than agents in other states.

By reducing the required CE hours, TDI aligns its CE requirements with the majority of the country. With this modification, Texas resident agents will have the same renewal requirements as nonresident agents operating in Texas, creating a level playing field for all agents that compete in Texas.

Modify the CE Noncompliance Penalty

Current law requires agents to pay a $50 fine for each uncompleted CE hour, but they are not required to make up the deficient hours. Fines for failure to complete CE requirements can reach as much as $1,500, an insurmountable fine for some agents. Moreover, the lack of a requirement to make up deficient hours means that certain agents do not have the training they need to ensure adequate consumer protection. TDI recommends limiting the maximum fine to $500 while also requiring agents to complete all deficient hours within a grace period or risk license revocation. This change will allow TDI to streamline its CE enforcement and ensure that appropriately trained agents are serving Texas consumers.

Make Temporary License Requirements More Flexible

In addition to traditional licenses, TDI issues temporary licenses to agents who have not yet passed the exam required for their permanent licenses. Temporary licenses provide an expedited method for agent applicants to begin working as agents under the supervision of license holders while preparing for their exam. Temporary license authority can be used within eight days after an applicant submits an application for a temporary license to TDI and is good for 90 days. Temporary license holders are limited to marketing the products of the sponsor.

To qualify for a temporary license, an applicant must submit an application; a nonrefundable filing fee; and a certification from a sponsoring agent, insurer, or HMO indicating they are being considered for full-time agent appointment, that the sponsor supports issuing a temporary license, and that the applicant will complete required training under the sponsor's supervision. Training includes 40 hours of instruction not later than 14 days after the day the temporary license application is sent to TDI.

Sponsors willing to vouch for a temporary licensee must (i) ensure that at least 70 percent of their temporary appointees take the licensing examination and at least 50 percent of those pass, and (ii) may not appoint more than 500 temporary license holders in a calendar year.

The one-size-fits-all temporary license requirements have become outdated and no longer reflect the realities of today's insurance market. By raising or revising the 500 temporary license holders per company cap, TDI can better address the complexities of the insurance market.

Allow TDI to Authorize Provisional Work Authority

As mentioned above, Texas law sets forth temporary license requirements. The current temporary license provisions, however, do not work well for certain license types. TDI recommends creating a new provisional work authority for certain license types to provide short-term authority to act as an agent until an applicant receives their permanent license.

Provisional work authority would allow certain segments of the insurance industry to respond quickly to emerging market trends by authorizing applicants to act as agents using a process similar to what has been established for temporary licenses. TDI recommends adding a provision to the Texas Insurance Code to allow the agency to recognize provisional work authority for certain types of agents waiting for their permanent licenses.

Close the Nonresident Agent Relocation Loophole

Nonresident agents, or agents from other states, are not subject to background checks required for Texas resident agents. Background checks on agents, who handle customers' monies and private financial information, are important for protecting Texas policyholders. Other states' background checks are not as thorough as TDI's process. Under the current framework, a nonresident agent can "game the system" by seeking a license in another state with less complete background requirements than Texas, and then, after acquiring that license, simply file an address change to become a Texas resident. To ensure TDI is aware of the backgrounds of all of its license holders, nonresidents seeking a resident license should be required to file an abbreviated application with fingerprints, allowing TDI to complete its background process. This process will also allow TDI to be informed of any potential criminal activity that occurs after the individual becomes a resident agent. Without processing the individual's fingerprints, TDI would not be notified of any future criminal conduct automatically, which is the case for resident agents.

Issue a Single License to All Title Escrow Officers

Currently, all escrow officer licenses associated with a title agent renew when the title agent's license renews, meaning that there is a spike in demand in certain months when large title agencies renew. It also results in certain escrow officers having multiple licenses. Switching to a single license system will create a consistent process for TDI, simplify the requirements for license holders, and spread the renewal workload more evenly throughout a year, making the license renewal process less burdensome for both licensees and TDI.

Own Risk Solvency Assessment

TDI regulates insurance carriers and the relationships between insurance companies and their affiliates. The agency also strives to monitor the financial condition and risk profiles of holding company systems, which refers to a group of affiliated insurance carriers or other entities under common ownership or control. As an illustration, a single group of affiliates may be engaged in a variety of activities including insurance, banking, real estate, and securities. In fact, a holding company has become the most common business structure through which an entity owns an insurance company.

TDI monitors the financial condition and risk profiles of holding company systems because risks posed by noninsurance operations can potentially spread within a group and negatively impact the financial condition of affiliated insurance companies. For example, financial harm caused by a group's banking, real estate, or securities activities may negatively impact the financial health of its affiliated insurers.

In response to lessons learned from the global financial crisis that started in 2008, insurance commissioners from each state adopted the Own Risk Solvency Assessment (ORSA) model act through the NAIC. An ORSA is an insurer's evaluation of the risks associated with their current business model and an assessment of its ability to cover those risks. Insurers then file an ORSA summary report with the state's regulator since the regulator is tasked with monitoring the solvency of insurers writing in their state.

To date, 20 other states have enacted ORSA legislation based on the NAIC model act.

Issues

TDI lacks sufficient information about the financial risks faced by insurers and their noninsurance affiliates that may potentially result in financial harm to insurance policyholders in Texas. TDI similarly lacks sufficient information about the steps taken by holding company systems to mitigate those risks, such as capital allocation strategies. Since Texas law charges TDI with the responsibility of making sure insurers are solvent and able to both quickly and fully pay Texans' claims, TDI wants to work with insurers via an ORSA to gain a better understanding of their financial condition and to help guard against potential financial hazards.

Moreover, if Texas does not adopt ORSA, insurance companies domiciled in Texas will find themselves subject to ORSA filing requirements in one or more other states, which means Texas-based insurers will be subject to additional filings and scrutiny from non-Texas regulators. Texas insurers can be sheltered from multiple filing requirements by enacting ORSA legislation in Texas.

Recommendation

Amend the Insurance Code by adding a new chapter based on the NAIC Risk Management and ORSA model act.

TDI recommends the model act to ensure uniformity and consistency in regulatory requirements from state to state, which is important for insurance carriers with multi-state operations. Adding a requirement for certain insurance carriers to file ORSA summary reports with TDI will also improve the agency's understanding of large insurance carriers and their holding company systems, which will provide the agency with a group-level perspective on risk and capital. Most importantly, the ORSA summary reports will provide TDI with a vital tool for protecting Texas policyholders by allowing the agency to better evaluate the financial condition of the largest insurance companies and their ability to pay claims.

The recommended new chapter should:

- require large insurers and insurance groups to maintain a risk management framework, regularly perform an ORSA, and file an annual ORSA summary report with the insurance commissioner, which should also be available upon request;
- address the confidentiality of the ORSA summary report; and
- provide an exemption from the requirements for smaller insurers and groups.

Reinsurance Accounting Modernization

Individuals and businesses typically manage their risks by buying insurance and transferring certain liabilities to insurance companies. Similarly, insurance companies manage their risks by buying reinsurance[5] and transferring certain liabilities to other insurance companies known as reinsurers.

TDI, like other state regulators across the country, enforce laws that require insurers to maintain a certain level of reserves to pay claims and related obligations arising from insurance policies. An insurer, however, may reduce the amount of reserves required by purchasing reinsurance. The amount of the reserve reduction allowed depends upon the amount of money the insurer can collect from the reinsurer. The amount the insurer can collect is determined by a reinsurance contract between the insurer and the reinsurer. The reserve-reduction is called "credit for reinsurance."

The four types of reinsurers operating in Texas are those: (i) domiciled, or headquartered, in Texas or another state and licensed by TDI; (ii) domiciled in another state and accredited by TDI; (iii) domiciled outside the U.S. but meeting Texas Insurance Code requirements and having assets in a U.S. trust to cover their obligations (these are commonly referred to as "trusteed" reinsurers); and (iv) all other reinsurers. Texas law requires certain reinsurers to collateralize, or secure, their obligations. Reinsurers licensed or accredited by TDI do not have to provide collateral. Trusteed and all other reinsurers, however, must provide collateral to secure their financial obligations incurred in a reinsurance contract.

This system worked well at one time, but today, most reinsurers, including the majority of the world's most prestigious and financially secure reinsurers, are located outside the U.S. This means some of the world's most financially stable reinsurers must produce large amounts of capital as collateral, reducing the capital they have on hand to support additional insurance sales to consumers and/or to invest in the U.S. and other economies. At the same time, a financially weaker reinsurer may be exempt from the collateral requirements based solely on its licensing status and location.

Insurance commissioners from various states have sought to address this conundrum, and working together via the NAIC, the states' commissioners developed a new model law to reduce unnecessary regulatory requirements that trap valuable capital from being utilized to the greatest extent possible. The new model, which has been adopted by 23 states, provides insurance commissioners with discretion to index, or set, the amount of required reinsurance collateral based on a reinsurer's financial strength rating. In other words, commissioners can customize reinsurance requirements to reflect a reinsurer's financial strength relative to their risk, instead of using an arbitrary, one-size-fits-all system.

Issues

Texas' current regulatory framework does not take into account the financial stability of a reinsurer when determining the amount of collateral that must be posted by that reinsurer. Reinsurers not licensed or accredited in Texas must use capital to collateralize their reinsurance obligations. Because this capital is no longer available to support additional insurance sales and/or for other transactions and investments, reinsurers include these opportunity costs in the reinsurance premium they charge to Texas insurance companies. As a result, the costs of regulatory compliance are higher in Texas than in those states that have adopted the new model, and these costs are passed on to Texas consumers. Moreover, reinsurers will likely seek to do business in other states that have enacted the new model because of lower compliance costs. Not only does the current Texas law create these issues, the proposed change to the law will benefit Texans by ensuring that the collateral required to cover a risk accurately reflects the financial condition of the reinsurer and by making more capital available for additional insurance sales and for infusion into the state's economy.

Finally, the new Federal Insurance Office created by the Dodd-Frank Wall Street Reform and Consumer Protection Act has stated its intent to preempt state's authority to regulate reinsurance requirements because an insufficient

5 Reinsurance is essentially insurance for insurance companies. Insurance companies buy this protection from other insurers, who are called reinsurers.

number of states have modernized their requirements. If Texas can craft its own version of reinsurance accounting modernization, it is likely the state can stave off federal preemption and implement a Texas-specific version of the modernized process to best meet the needs of Texans and Texas-based companies.

Recommendation

Amend the Texas Insurance Code by adopting the following changes:

- provide the insurance commissioner with discretion to index the amount of required reinsurance collateral to a reinsurer's financial strength rating;
- provide for stronger communication between TDI and the domiciliary jurisdiction of "trusteed/certified reinsurers";
- provide financially strong reinsurers with the ability to more efficiently deploy their capital and provide more capacity to sell insurance; and
- allow Texas-based insurers to negotiate the terms of reinsurance agreements, including acceptable collateral levels.

Standard Valuation Law and Principle-Based Reserves

Life insurance companies must hold funds, known as reserves, to pay insurance policy benefits. The benefits represent the value of the insurance policy. Current Texas law requires companies to use a prescriptive formula, provided in the Standard Valuation Law, to calculate the reserves needed for life insurance policies.

Innovations in life insurance products through the years have provided consumers with a greater variety of products tailored to meet their needs. This increase in available options, however, makes it difficult to calculate the associated reserves with simple formulas established years ago. Innovations in the life insurance market have also created a constant need for flexibility in the formulas used to calculate reserves.

In 2009, state insurance commissioners, via the NAIC, adopted a revised model Standard Valuation Law. The revised model introduced a new method for calculating life insurance policy reserves called principle-based reserves. Principle-based reserves are designed to allow a company's reserves to be "right-sized" by reducing reserves that are too high for some products while increasing reserves that are too low for others. Principle-based reserves adapt easily to new requirements and evolving products and allow an insurer's actuary to utilize professional judgment and historical experience to calculate reserves. These new reserve requirements are, however, subject to rigorous and ongoing oversight by insurance regulators to ensure accuracy and adequate consumer protection.

Principle-based reserves' more flexible approach replaces the current formulaic approach to determining policy reserves with one more closely reflecting the risks of highly complex products. Similar to reinsurance accounting modernization, this issue is about removing outdated legal restrictions that result in higher compliance costs and trapped capital. The overarching objective is to account for changes in the market and ensure that the reserves required by law accurately reflect the risk being borne.

The revised model law would authorize the creation of a valuation manual that contains reserve requirements. The state insurance regulators at NAIC recommend the manual be effective once a minimum of 42 states, representing 75 percent of the country's premium, adopt the revisions. Once adopted, life insurance principle-based reserves will be implemented, and companies can then use principle-based reserves in any state they sell insurance.

An insurer will be subject to the principle-based reserves laws enacted by each state in which the company does business. Given the fact that 18 states have already adopted principle-based reserves, one state has legislation pending, and 19 to 25 states are expected to introduce legislation in 2015, it may be possible the U.S. will reach the premium threshold during 2015 to fully implement principle-based reserves in 2016. If Texas wants to craft its own principle-based reserves law and stay ahead of the market curve, the state needs to enact the appropriate legislation in a timely manner.

Issues

Archaic and prescriptive reserve requirements like those currently in law result in higher compliance costs and trapped capital, and fail to keep pace with the ever-evolving insurance market. The current system needs to be replaced with a system that more accurately reflects the risks being borne by insurers and that can respond to ongoing product innovation in the industry.

The current requirements also produce reserves beyond what is necessary to ensure financial solvency and the policy payment for some products. This results in capital being unnecessarily tied up and unable to be used in the economy. Ultimately, this inefficient use of capital leads to higher costs for consumers.

Recommendation

Amend the Texas Insurance Code to enable the valuation manual to become operative, which in turn will begin the new principle-based reserve life insurance requirements.

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Amusement Rides

Under current law, TDI administers the Amusement Ride Safety Inspection and Insurance Act (Texas Occupations Code, Chapter 2151) to regulate amusement rides in Texas. In order to legally operate an amusement ride in Texas, an owner or operator must fulfill three statutory requirements: (i) purchase an insurance policy with a certain amount of liability coverage for persons using the ride and file it with TDI; (ii) receive an annual amusement ride safety inspection certificate from TDI along with a sticker showing compliance; and (iii) submit a $40 filing fee per amusement ride. There are no other regulatory requirements.

The Amusement Ride Safety Inspection and Insurance Act encompasses a broad spectrum of rides—from mobile carnival rides and theme park rides to mechanical bulls and bounce-house rentals. Over the last decade, TDI has seen a steady increase in the number of amusement rides operating in the state.

TDI has a limited ability to monitor these amusement rides' compliance with the law and, perhaps more importantly, the agency does not have enforcement authority when non-compliance is identified. In fact, TDI must rely on competitors reporting noncompliant owners or operators; online search comparisons of amusement ride businesses with the agency's amusement ride database; and consumer injury inquiries to identify noncompliant rides. If TDI becomes aware of a noncompliant ride, the agency will send the owner or operator a notice of noncompliance and request that the owner or operator comply with the statute. If they do not comply, TDI notifies the Texas Attorney General's Office, the owner or operator, and local law enforcement.

Issue

TDI does not have an effective and efficient means of monitoring amusement ride compliance or an effective means of recourse when it identifies noncompliance. At the same time, the number of amusement rides in Texas has significantly increased. TDI has seen a 570 percent increase in the number of applications filed since 2004, largely due to public-use amusement ride rentals like bounce houses and rock climbing walls, which are the most difficult type of amusement rides to monitor. Additionally, the ultimate enforcement authority lies with the Attorney General's Office and local law enforcement officials, and it is up to law enforcement's discretion to charge owners or operators with a Class B misdemeanor if they are found operating a noncompliant amusement ride.

Recommendation

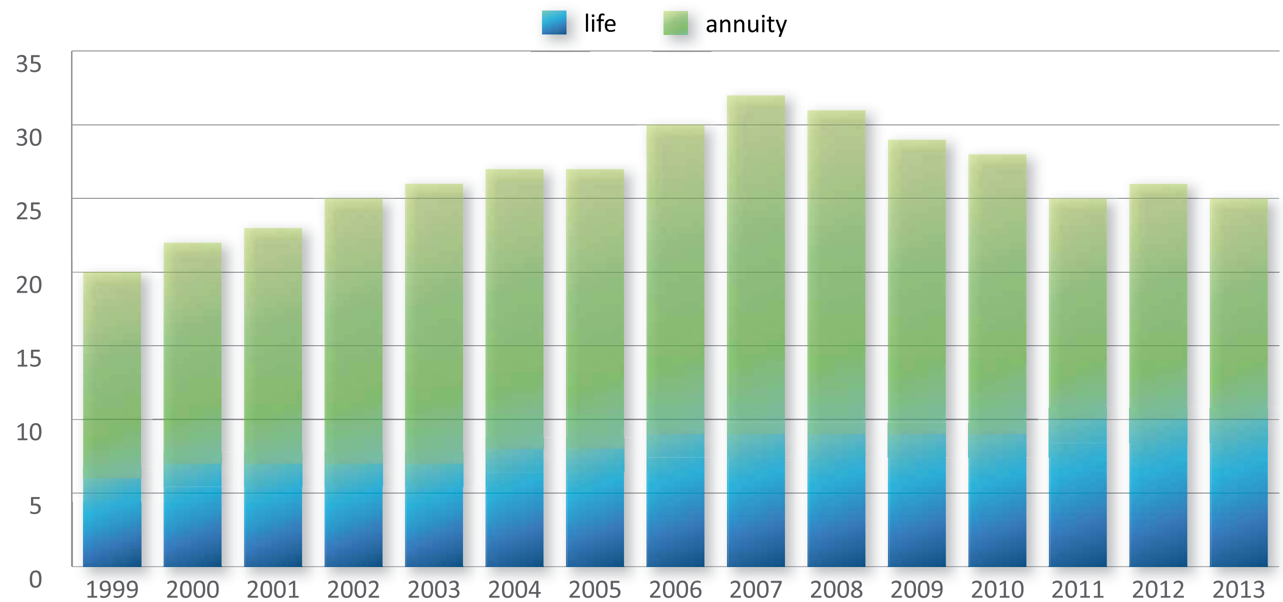
Amend Occupations Code Chapter 2151, to transfer amusement ride regulation to another state agency better suited to regulating the amusement ride industry, and provide appropriate enforcement authority for the regulatory agency responsible for administering the Amusement Ride Safety Inspection and Insurance Act.

Annuities

The Texas Insurance Code requires insurance carriers to file most insurance policies and contracts with TDI, including annuities. Specific authority in the Insurance Code to regulate annuities, however, has not kept pace with this growing market.

As shown in Figure 4 below, annuity premium volume in Texas has consistently exceeded premium volume for life insurance, yet the Insurance Code provides a much more robust regulatory framework for life insurance regulation than it does for annuity regulation. For instance, approximately 50 sections of the Insurance Code address the regulation of policy provisions for life insurance contracts, but just two address annuity regulation.

Figure 4: Annuity and Life Insurance Premiums, 1999-2013 (in billions)



Issue

TDI's current authority to regulate annuity contracts results in an incomplete regulatory framework that cannot respond well to market changes and cannot adequately protect consumers, who increasingly choose to purchase annuity products over life insurance products. This is especially true in the context of new and unique annuity product designs, such as contingent deferred annuities and indexed annuities that replicate investment market returns. Carriers continue to develop new and innovative products to respond to market demand from consumers by addressing longevity and investment risk or offering alternative investment options that compete with non-insurance products. The current regulatory framework does not give TDI latitude to approve these types of products.

Recommendation

Amend Chapter 1116 of the Texas Insurance Code to provide TDI with authority to adopt minimum standards for annuity contracts and provide for innovative annuity product review through rulemaking.

Commercial Policies

Businesses traditionally obtain their insurance coverage through commercial insurance policies. Commercial policies are different from personal policies, like homeowners and auto insurance policies, purchased by individuals. Most commercial policies, however, are subject to the same prior approval filing requirements as personal policies, meaning carriers writing commercial insurance must file their policies with TDI and receive the agency's approval prior to selling them.

Certain commercial policy provisions are largely standardized, and commercial insurers serve a different customer than the personal insurers. Commercial insurers, which often interact with sophisticated companies, need to quickly respond to marketplace changes. Therefore, other, more flexible, policy regulation methods, such as file-and-use, use-and-file, or exemption from filing may be appropriate for certain commercial policies.

Issue

The insurance commissioner has authority under the Insurance Code to adopt rules governing the manner in which certain commercial policies are regulated. By allowing the commissioner to exempt or limit the review of additional commercial lines policies, agency staff can focus the agency's limited resources on crucial policy reviews like homeowners and automobile policies, thereby increasing efficiency and improving consumer protection.

Recommendation

Amend Texas Insurance Code Chapter 2301 to allow the insurance commissioner to establish filing requirements for certain commercial insurance policies.

Required Workers’ Compensation Biennial Rate Hearing

Section 2053.056 of the Texas Insurance Code requires the insurance commissioner to conduct a public hearing each biennium to review the impact of reforms enacted by House Bill (HB) 7, 79th Legislature, on workers’ compensation rates and premiums. Prior to the hearing, each insurer must file its rates and other information with TDI. Agency staff compiles and analyzes this information and subsequently presents its findings to the insurance commissioner at the required public hearing.

At the same time, Section 2053.012 of the Texas Insurance Code and Section 405.0025 of the Texas Labor Code require the agency to prepare a more exhaustive biennial report on the impact of the HB 7 reforms on the workers’ compensation market, which includes the same rate information as the required rate hearing. The biennial report also includes analysis on other issues including the affordability and availability of workers’ compensation insurance for employers in Texas and the impact of certified workers’ compensation health care networks on return-to-work outcomes, medical costs, quality of care issues, and medical dispute resolution.

Issue

Substantial time and resources are expended by agency staff and insurers to prepare for the rate hearing under Section 2053.056. This hearing has not been well attended and public input has been minimal or non-existent for several years. Moreover, the process that culminates in the required rate hearing is duplicative of the process required to prepare a portion of the HB 7 biennial report.

Recommendation

Amend Section 2053.056 of the Texas Insurance Code to remove the requirement for a biennial rate hearing and instead allow the commissioner to conduct a hearing at his or her discretion. TDI will continue to obtain and report the rate information as part of the HB 7 biennial report process.

Personal Auto Insurance Standard Rate Index

SB 14, 78th Legislature, Regular Session (2003), substantially revised the framework for regulating rates that insurers charge consumers for personal lines of insurance, which includes automobile and homeowners insurance. Prior to SB 14, insurers were required to charge consumers a promulgated rate. SB 14 replaced the promulgated rate with a file-and-use system that allows insurers to charge new rates without prior approval from the insurance commissioner. Insurers are still required, however, to submit their rates and supporting statistical information to TDI so the agency can review them for compliance with applicable statutory provisions.

SB 14 also added Section 2251.202 to the Texas Insurance Code, which requires the insurance commissioner to annually compute and publish a statewide standard rate index for personal auto insurance. This index theoretically allows comparisons of an insurer's rate to the rate index, but since the 2003 legislation also allows insurers to file their own rating plans, it is difficult to provide a meaningful comparison for rates via the auto index. In other words, as SB 14 took effect, the market changed and the overall usefulness of the rate index diminished.

Issue

TDI believes the index is rarely used and that the state resources required to annually compute and publish the standard rate index could be reallocated to more pressing regulatory tasks, such as actuarial analyses of homeowners and personal auto rate filings.

Recommendation

Repeal Insurance Code Chapter 2251, Subchapter E, Sections 2251.201 – 2251.204, which requires a standard rate index for personal automobile insurance, and amend Section 2251.205 to remove the reference to Section 2251.204.

Timely Policy Delivery

Insurance companies routinely issue insurance policies, including personal automobile and homeowners insurance policies. Texas law, however, does not create a deadline by which the insurers must provide copies of those policies to their customers. As a result, some insurers do not deliver insurance policies to their policyholders within a reasonable amount of time.

Issue

Without a statutory deadline, some insurers have little incentive to deliver policies to policyholders in a timely manner, leaving them, and potential lenders, without the ability to thoroughly review a policy and confirm adequate insurance coverage.

Recommendation

Require insurers to deliver personal automobile and homeowners insurance policies to policyholders within 30 business days after issuance.

Underinsured Motorists Coverage: Stracener Case

Texas drivers can buy underinsured motorist coverage to protect themselves against other drivers who are at-fault in an automobile accident but do not have enough insurance to pay for all damage the injured driver sustained during the accident. Underinsured motorist coverage protects a driver when the other driver has some insurance, but not enough to pay for all of the damages and/or injuries sustained in an accident.

For a time, Texas courts disagreed about the point at which a driver qualified as "underinsured." This disagreement occurred because the sections of the Texas Insurance Code that address this issue could be interpreted in different ways. Determining if underinsured motorist coverage applies is important because it determines whether the injured driver can recover under his or her own underinsured motorist coverage.

In the case of Stracener v. United Services Automobile Association[6], the Texas Supreme Court resolved the issue. The court held that the injured driver can collect payment under underinsured motorist coverage if their damages exceed the at-fault driver's coverage limits. The court also clarified that the injured driver can be compensated for the full extent of his or her damages, up to the limits of both policies. The injured driver is not prevented from collecting from underinsured motorist coverage if the at-fault driver's insurer paid part of the damages.

In other words, the governing law in Texas is that, no matter how much coverage the at-fault driver has purchased, the injured driver can collect payment under his or her own underinsured motorist coverage if the damages suffered exceed the at-fault driver's coverage limits. This interpretation of the law allows injured drivers to be compensated for all of their damages, up to the limits of both policies.

Issue

Sections 1952.103 and 1952.106 of the Texas Insurance Code have not been updated to reflect the Texas Supreme Court's decision. As a result, insurers and consumers could interpret the statute in a manner that is inconsistent with the court's decision.

Recommendation

Amend Sections 1952.103 and 1952.106 of the Texas Insurance Code to clearly reflect current law, under the Texas Supreme Court's 1989 decision in Stracener.

6 777 S.W.2d 378 (Tex. 1989).

Uninsured/Underinsured Motorist Coverage

Texas Insurance Code, Section 1952.105 requires insurers to offer bodily injury coverage and property damage coverage as part of a person's uninsured/underinsured motorist insurance coverage. The statute does not specify whether insurers must offer bodily injury and property damage coverages separately or whether they may offer them together.

TDI has changed its interpretation of the Insurance Code requirements at different points in time, which has led to confusion about the statute's requirements and acceptable market practices. TDI considered rulemaking to end the confusion and clarify the statutory requirements. During that process, TDI discovered some legislative history that appeared to indicate that the Texas Legislature intended for policyholders to have the option to purchase either bodily injury coverage, property damage coverage, or both. The Insurance Code, however, is not clear on this point.

Issue

As a result of ambiguity in the statute and changes in TDI's position on bodily injury and property damage coverages, confusion exists in the market about whether Section 1952.105 of the Insurance Code requires the coverages to be offered separately, or whether an insurer may sell them only together.

Recommendation

Amend Section 1952.105 to clarify whether insurers must offer bodily injury and property damage coverages separately or may offer them only together as a package.

Inspection Authority

The State Fire Marshal's Office (SFMO) helps protect public safety on state-owned property. In 2011, SFMO initiated an inspection program to periodically inspect all 16,000 state-owned buildings. Local fire code and building ordinances typically do not apply to state buildings.

Issues

Government Code Section 417.0081 provides for SFMO fire safety inspections in facilities owned and leased by the Texas Facilities Commission, which only accounts for an estimated 6 percent of state-owned and leased buildings, and 4 percent of all state-owned and leased square footage. SFMO has also conducted inspections of other state-owned facilities where fire and public safety violations and concerns were documented. However, current Texas law lacks clarity regarding SFMO's role as the authority with jurisdiction for all state-owned buildings.

Recommendations

- ✯ Clarify that SFMO is the chief fire marshal related to fire protection and fire safety for all state-owned and operated buildings.
- ✯ Amend Government Code Section 417.0081 to include inspection findings for all state-owned and leased buildings.

Investigation Authority

Texas Government Code Chapter 417 states that SFMO is the chief investigator for arson and suspected arson investigations in the state. This authority was established in 1910 and the investigative function of that authority has not been significantly amended since 1913. Chapter 417 also directs SFMO to investigate when a firefighter dies in the line of duty or if the firefighter's death occurs in connection with an on-duty incident. Once SFMO has concluded the firefighter fatality investigation, it must submit a detailed report of the findings. The firefighter fatality report is prepared to address needed corrections relating to any contributing factors related to the death in an effort to reduce loss of life for future on-duty incidents and is submitted to the insurance commissioner.

Issues

Fire Investigations

As a part of its investigative function, SFMO must conduct interviews, which may involve persons reluctant to provide information. Current statute provides SFMO with the power to compel individuals to serve as witnesses and requires them to provide statements; however, the statute is outdated and could benefit from modernizing language to reflect current standards, similar to the authority provided to county fire marshals in the Local Government Code. Moreover, the statute lacks clarity with respect to crime scenes involving vehicle fires.

Firefighter Fatality Investigations

Government Code Section 417.0075 states that SFMO "shall investigate circumstances surrounding the death of the firefighter," but it does not provide clear direction for how the office should proceed in investigating and reporting factors surrounding the death of a firefighter. Additional provisions are needed in the statute to allow for appropriate coordination and communication between all governmental entities during an investigation to ensure all contributing factors are properly investigated and fully reported.

Recommendations

Fire Investigations

- Amend Government Code Section 417.007 to update the existing SFMO fire investigation authority as it relates to the privacy of interviews and examinations. Additional language is needed for fire investigation authority similar to the authority provided to county fire marshals in Chapter 352 of the Local Government Code.
- Amend fire investigation authority to specifically include vehicle fire investigations.

Firefighter Fatality Investigations

- Amend SFMO investigation authority in Government Code Section 417.0075 to include necessary provisions for increased coordination between governmental entities when investigating a firefighter fatality.
- Amend firefighter fatality investigation authority to clarify that an investigation should consider whether culpable criminal conduct occurred.

Texas Windstorm Insurance Association

The Texas Windstorm Insurance Association (TWIA) is one of the more than 2,000 insurance carriers that TDI regulates. The Texas Legislature created TWIA in 1971 to provide wind and hail insurance coverage for Texas Gulf Coast property owners who might otherwise be left uninsured. TWIA functions as the insurer of last resort for wind and hail coverage in Texas' 14 coastal counties listed in the Texas Insurance Code, and portions of Harris County.

TDI Administrative Oversight

"Administrative oversight" refers to a regulatory tool TDI uses to exercise enhanced regulatory oversight over an insurer. TDI placed TWIA under administrative oversight after TWIA's financial resources were challenged following losses from Hurricane Ike and Dolly and the high volume of litigation that followed those storms. In a letter to TWIA on February 28, 2011, former Insurance Commissioner Mike Geeslin notified TWIA of TDI's increased regulatory oversight and set forth the terms of that oversight.

Although TDI's administrative oversight of TWIA was initially quite expansive, over time TDI has somewhat reduced its review of TWIA operations to reflect improvements TWIA made to its processes and procedures. Under the most recent letter describing the scope of TDI's administrative oversight, dated March 14, 2014, TDI requires that TWIA:

- submit executive-level personnel decisions to TDI for objection or non-objection before finalization;
- submit non-standard contracts, as well as reinsurance and reinstatement arrangements, to TDI for objection or non-objection before execution;
- develop and maintain communications plans with TWIA's board of directors and the Legislature;
- provide financial, operating, and litigation reports to TDI on a monthly basis; and
- participate in quarterly financial and operational update meetings with TDI.

TWIA's Financial and Operational Condition

Changes made to TWIA's funding structure by the Texas Legislature in House Bill 4409 (81R) 2009, along with a lack of significant hurricanes since 2008, have improved TWIA's financial stability. TWIA advises it can now pay claims for an estimated 1 in 70-year storm or in other words, a storm that causes no more than $3.85 billion in losses.

In the event of a catastrophe, TWIA expects to fund claim payments from the following sources in this order:

- approximately $400 million from available premiums and the catastrophe reserve trust fund;
- up to $500 million from class 1 public securities (which have already been issued);
- up to $1 billion from the proceeds of class 2 public securities (to be issued after the catastrophe);
- up to $1.45 billion from reinsurance payments (to be issued after the catastrophe); and
- up to $500 million from class 3 public securities (to be issued after the catastrophe).

Despite improvements in TWIA's financial condition, however, long-term challenges remain. TWIA indicates that its policyholders' rates are below actuarial soundness. It should also be noted that while TWIA has the authority to issue an additional $500 million from class 1 public securities after an event, there are no assurances that these securities will be issued due to market conditions. Accordingly, TWIA has disregarded these securities in determining its sources of payment for potential claims. There is also no guarantee TWIA will be able to sell all of its remaining public securities following a catastrophe, and TWIA has not identified a source of payment for potential claims in excess of $3.5 billion. These uncertainties regarding TWIA's funding create concerns about TWIA's long-term viability.

Matters Reported to Texas Board of Professional Engineers

Section 2210.2551(e) of the Texas Insurance Code requires TDI's biennial report to the Legislature to include the number of matters reported to the Texas Board of Professional Engineers regarding qualified windstorm inspectors. From September 28, 2011, to August 31, 2014, TDI reported 35 matters to the board. The outcome of those matters is summarized below:

Outcome	TBPE
Action on Appointment and/or License	14
Voluntary Compliance	-
Warning Letter	9
Pending	4
No Action/No Case Opened	8

* *For purposes of this report, "Action on Appointment and/or License" includes a qualified inspector's appointment and/or engineering license being canceled, voluntarily surrendered, reprimanded, probated, suspended, or revoked through an order or less formal disciplinary tool.*

TWIA's financial stability and its role in the Texas insurance market present challenges to legislators and regulators alike. TDI stands ready to serve as a resource for the Texas Legislature as it addresses these many challenging issues throughout the upcoming session and following interim.

Uncompensated Auto Accident Damages

Texas law requires motorists to establish financial responsibility — the ability to pay for damages when the motorist is at-fault. The law requires motorists to meet this financial obligation so that, if necessary, they can compensate other motorists for losses they cause. Sometimes, however, injured parties discover they do not receive compensation for all, or even some, of their damages, regardless of whether they were at-fault in the accident. The uninsured or underinsured motorist issue is gaining greater attention at the state and national level. It is a challenging and multifaceted problem, which can be the result of several factors and for which a clear-cut solution has been difficult to identify.

Financial Responsibility

Current law requires minimum liability limits of $30,000 for bodily injury to, or death of, one person in one accident; $60,000 for bodily injury to, or death of, two or more persons in one accident; and $25,000 for property damage in one accident. Many people carry higher limits; however, most maintain a minimum level of auto liability insurance coverage. Others satisfy the financial responsibility requirement with surety bonds or deposits of cash or securities.

Although owners must show proof of financial responsibility when they register vehicles, they can present a policy that does not cover all of the individuals who could potentially drive their automobile. If a person not covered by the policy drives the car, the policy will not pay for damages caused by that person. In contrast, if financial responsibility is established using methods other than insurance, such as deposits or surety bonds, then damages would be paid regardless of who was driving.

A driver may have to pay for damages caused by another driver in the following scenarios:

- No Insurance (uninsured motorist): If a vehicle owner does not have insurance coverage for the vehicle, or the owner has coverage that applies only to certain drivers (named driver or limited coverage policies).
- Not Enough Insurance (underinsured motorist): If the at-fault driver's insurance coverage limits are too low to pay for all the damages from a particular accident.
- Problems with Claims (third-party claims): If the at-fault driver has insurance, but the insurer does not pay the claim, or does not do so promptly, whether for lack of response from the at-fault driver or for some other reason.

Not All Policies Provide the Same Coverage:

Standard Personal Auto Policies

Policy forms, such as the promulgated Texas Auto Policy and the Insurance Services Office policy, are generally referred to as standard policies and typically provide coverage for everyone who drives a vehicle with the owner's permission. Family members are presumed to have permission.

Standard personal auto policies may mitigate some of the problems relating to uninsured motorists; however, third-party claimants can encounter the same problems whether a policy has standard or limited coverage.

Third-Party Auto Issues

A personal auto insurance policy is a contract between the insurance company and the policyholder. Accordingly, the insurer must meet certain obligations to the policyholder and vice versa. For example, insurers are required to pay their policyholders' claims (first-party claims) within a certain amount of time, and policyholders must cooperate with their insurers after a loss by providing information. The policyholder must also take steps to mitigate, or lessen, the amount of a loss, such as covering a broken window with plastic to reduce water damage from rain.

In contrast, there is no statute setting a specific timeframe for an insurance company to handle third party claims. Third party claims are claims made by a person injured by the insurance company's policyholder (the negligent driver). The third-party claimant has no contract with the negligent driver's insurer.

Problems can arise when a third-party driver or passenger is injured by another driver and then seeks to be paid for their injuries and damages under the at-fault driver's auto liability insurance policy. In that scenario, no statute sets a timeline for handling or paying claims and the third party must rely on the at-fault driver and their insurer to communicate with each other, establish who is at-fault, determine the claim amount, and pay the claim to the third party. Sometimes the at-fault driver or the insurer, or both, fail to communicate with each other. As a result, the injured third-party's claim may not get paid in a timely manner, or may not get paid at all.

From July 2011 to June 2014, TDI received 5,288 complaints about third-party auto claims. Of those complaints, 5,007 complained about claim-handling delays, and 1,100 mentioned uncooperative insured drivers. There is some overlap in these two groups. When a policyholder does not cooperate in the claim investigation or the insurer cannot locate the policyholder, the insurer sometimes either refuses to pay a third-party claim or delays payment of the claim. In either situation, the injured third-party often must make a claim under his or her own uninsured or underinsured motorist coverage, must pay for the damages up front while waiting indefinitely for reimbursement, or must pay out of pocket for the damages.

Limited Coverage and Monthly Auto Policies

Since 2003, Texas has allowed insurers to develop and file their own forms, subject to TDI approval.[7] While some auto insurers match the coverage in standard personal auto policies, others offer limited coverage in various ways. Some of those limited coverage policies are discussed below.

Named Driver Policies

Named driver policies have been characterized both as part of the uninsured motorist problem and part of the solution. A named driver policy does not cover every household resident—even if they are driving with permission—but only those named or described in the policy itself. As a result, a vehicle covered by a named driver policy may be uninsured when driven by a person not named on the policy. In contrast, a standard auto insurance policy typically covers everyone who drives a vehicle with the owner's permission, both those residing in and outside the household. Many companies selling named driver policies, however, maintain that because named driver policies may be less expensive than standard policies, they actually reduce the uninsured motorist rate.

30-Day Policies

Some companies sell 30-day policies instead of a traditional six-month or one-year policy. The frequent renewals for 30-day policies increase the probability that a policyholder will not pay a renewal premium when due, essentially canceling the policy and resulting in a coverage gap. Additionally, a policyholder may or may not renew that policy after showing proof of insurance to get the vehicle registered or inspected. Coverage gaps may leave other drivers without compensation for their damages after an accident.

Other Coverage Limitations

Some insurers' forms exclude coverage for frequent users, punitive damages, unlicensed drivers, incidental business use, and so forth, which can result in the policy not providing coverage when the policyholder injures someone.

7 See SB 14, 78th Leg., R.S. (2003).

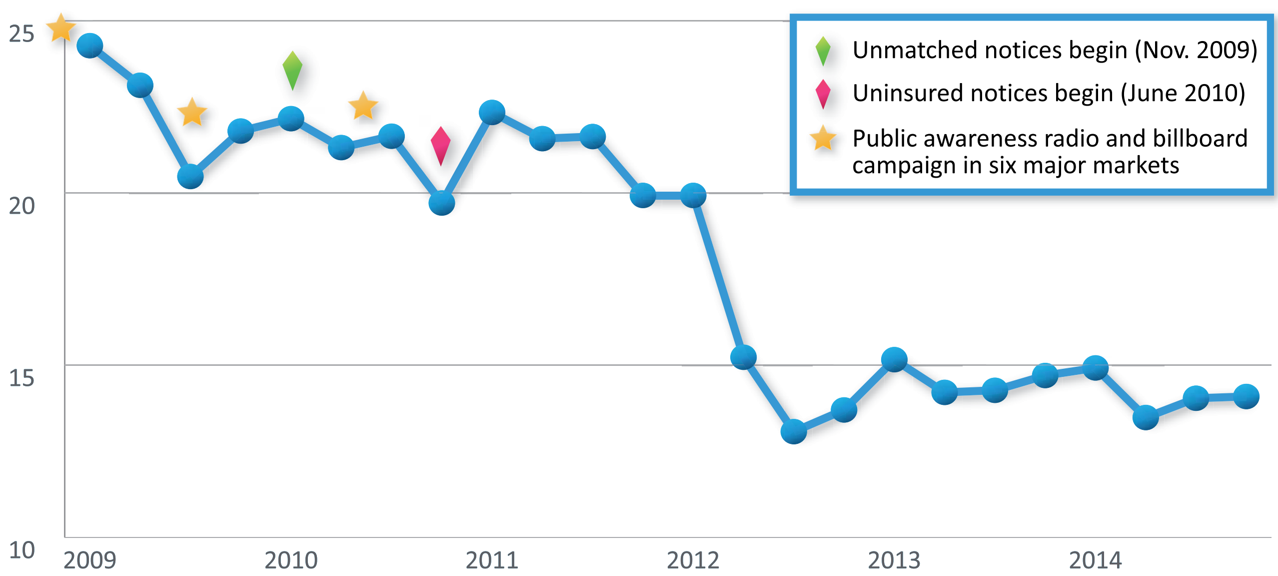
TexasSure Verification Program

In an effort to reduce the number of uninsured motorists in Texas, the 79th Texas Legislature enacted SB 1670, which amended the Texas Transportation Code by adding Chapter 601, creating the Financial Responsibility Verification Program. The statute required the Texas Department of Insurance, Texas Department of Motor Vehicles (TxDMV), Texas Department of Public Safety (DPS), and Department of Information Resources to establish a verification program, branded TexasSure, to determine whether motor vehicle owners have established financial responsibility. The TexasSure database was created by a vendor and made available to law enforcement and Texas' 254 county tax assessor-collectors.

On a weekly basis, the vendor compares and matches the TxDMV registered vehicle database to insurance companies' full book of personal auto business and self-insureds reported by DPS. Reporting commercial policies is optional. TexasSure sends 25,000 notices to consumers weekly, with most sent to registered owners of vehicles not matched to an insurance policy. There are no requirements for consumers to respond to these notices and TexasSure does not send follow-up notices. Moreover, the only enforcement authority lies with DPS and local law enforcement agencies, who can issue a citation for a person's failure to meet the financial responsibility requirement after a driver has been stopped for a traffic violation or other violation, or is in an accident.

Before TexasSure, the uninsured motorist rate was estimated to be 25 percent. Current estimates are 14 percent or approximately 2.7 million vehicles. While Texas appears to have experienced a reduction in the number of uninsured motorists, the percentage of vehicle registrations not matched to insurance has remained stagnant since March 2013 as shown in Figure 5 below.

Figure 5: Percent of Registered Vehicles Not Matched to Insurance, 2009-2014



* *In February 2012, the TexasSure vendor performed data cleansing activities necessary to purge obsolete records from the TexasSure database. This resulted in a drop in the percentage of unmatched vehicles. Steps are now in place to prevent future accumulation of obsolete records.*

According to the Insurance Research Council's report, Uninsured Motorists, 2014 Edition, there are five types of verification programs in the U.S.: (1) web services, (2) database, (3) a combination of web services and database, (4) random audits, and (5) accident report verification.

Most states, including Texas, use the database approach in addition to mailing notifications to uninsured motorists. These notices do not require a response or penalize the vehicle owner for not responding. From the inception of the program, it appears TexasSure has been successful in reducing the uninsured motorist rate; however, as mentioned above, the uninsured motorist rate has remained stagnant at approximately 14.2 percent.

Some states, such as Alabama and Delaware, perform random audits in addition to their web services or database programs. This approach is similar to the TexasSure notice campaign, except the notices generally require the owner of the registered vehicle to provide certification of coverage without a lapse from the date of the letter; otherwise, the motorist is subject to fines and/or license and registration suspensions. Delaware's uninsured motorist rate is 11.5 percent and Alabama's is 19.6 percent.

Eight states use the accident report verification approach, where the state verifies financial responsibility after reviewing an accident report. The uninsured motorist rate among these states ranges from 8.5 to 14.7 percent.

California utilizes the database approach in addition to accident report verification and has a 14.7 percent uninsured motorist rate. Texas utilizes the database approach.

In Texas, the penalty for driving without auto insurance is a $175 to $300 fine for first time offenders and a $350 to $2,000 fine for repeat offenders. Nationwide, penalties for the first offense of driving without auto insurance range from a $100 to $200 fine to jail time up to one year; however, these penalties do not appear to directly affect the uninsured motorist rate. For example, 16 states include a jail penalty, but seven of those states are ranked higher than the median and have some of the highest uninsured motorist rates in the nation.

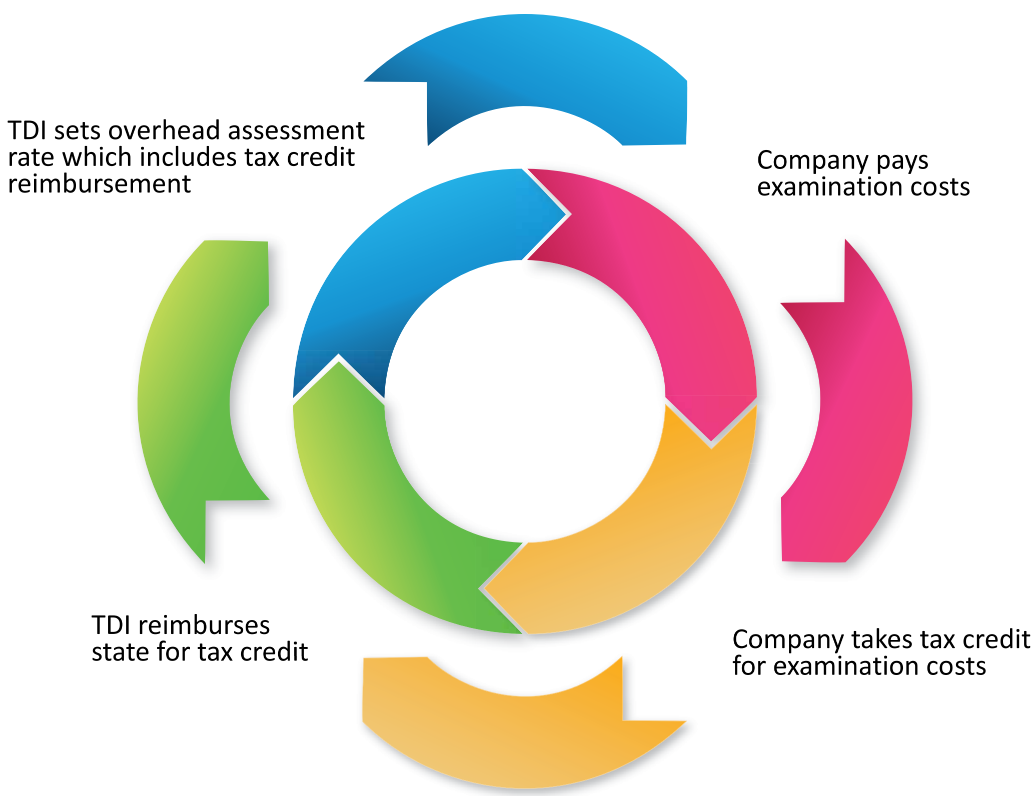
Snowball Effect of Examination Premium Tax Credits and General Revenue Reimbursement

TDI conducts financial and market conduct examinations on insurers to ensure they are financially stable and are being good actors in the insurance market. Texas law allows insurance companies to take premium tax credits for fees they pay when TDI conducts these on-site financial and market conduct examinations. These premium tax credits historically meant the examination function was ultimately funded by general revenue, which created an advantage for Texas insurers, since insurers not domiciled in Texas are usually examined by their states' regulators and not TDI. These premium tax credits have been part of Texas law for at least five decades.

During the budget shortfall in the 2011 session, and again in the 2013 legislative session, the framework for this reimbursement methodology was changed by adding a rider to the General Appropriations Act. The rider required TDI to reimburse the state's General Revenue Fund for these premium tax credits. TDI levies assessments on insurers in order to obtain the funds to make the reimbursements required by the rider. As a result, Texas insurers ultimately fund their own premium tax credits by paying the assessments. Moreover, these new assessments are also eligible for premium tax credits.

As shown in Figure 6 below, the current framework is inherently circular: examination premium tax credits lead to assessments…and these assessments lead to additional premium tax credits…and these additional premium tax credits lead to larger assessments…and the cycle repeats itself while the assessments grow ever larger.

Figure 6: Snowball Chart



Thus, the rider in the General Appropriations Act results in a circular process that snowballs into continually larger assessments levied on Texas insurers. The current framework places a burden on Texas insurers, and runs counter to TDI's objective of attracting additional insurers and capital to Texas. The Texas Legislature may wish to consider removing this rider from the appropriations act and return the law back to its original framework, which was in effect for at least 50 years and provided an advantage to Texas-based insurers.

Captive Insurance Companies

Captive insurance companies are a unique type of insurance company that typically provide a means for an entity to self-insure its own risks. Captives are subject to reduced regulation, including reduced capital and taxation requirements, and enjoy broad exemptions from many statutory requirements that apply to traditional insurers.

Last session, the Legislature enacted SB 734 to allow TDI to license "pure" captives, which is the most traditional type of captive. A pure captive is formed by a parent corporation for the exclusive purpose of self-insuring the risks of its parent company and affiliates. Under this model, the parent company provides capital in order to adequately fund the captive and, like a traditional insurance company, determines what risks will be insured. Through implementation of SB 734, TDI has learned that no two captive situations are identical, as each applicant's business model is intended to address the applicant's own unique business needs. TDI continues to work with the industry to license pure captives under the current law.

There are a wide range of other types of captives, including some with less traditional and established business models, such as rent-a-captives and special purpose captives, which pose a number of uncertain risks. In addition, certain other types of captives may compete directly with traditional insurance companies, which are highly regulated, creating a competitive disadvantage.

TDI is aware that certain stakeholders may be motivated to expand the type of captives licensed in Texas and/or to reduce regulatory requirements even further. While TDI appreciates these stakeholder's views, TDI is recommending no change to the current statutory limits on the types of captives that can be formed in Texas.

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