

**SUBCHAPTER E. TEXAS WINDSTORM INSURANCE ASSOCIATION
DIVISION 3 LOSS FUNDING, INCLUDING CATASTROPHE RESERVE TRUST
FUND, FINANCING ARRANGEMENTS, AND PUBLIC SECURITIES [POLICY
FORMS]**

§§5.4101, 5.4102, 5.4111 - 5.4114, 5.4121, 5.4131 - 5.4134, and 5.4141 - 5.4147

1. INTRODUCTION. The Texas Department of Insurance proposes amending the title of Division 3, and adding new §§5.4101, 5.4102, 5.4111 - 5.4114, 5.4121, 5.4131 - 5.4134, and 5.4141 - 5.4147 to implement legislative changes to the Insurance Code Chapter 2210 under House Bill (HB) 4409, 81st Legislature, 2009 Regular Session, and amend the plan of operation of the Texas Windstorm Insurance Association (Association). These sections concern the funding of losses and operating expenses in excess of the Association's premium and other revenue under Subchapters B-1, J, and M, Chapter 2210, Insurance Code. Matters addressed in the proposed plan of operation amendments include: (i) the catastrophe reserve trust fund; (ii) financing arrangements; (iii) issuance of public securities; (iv) use of public securities proceeds; and (v) payment of public security obligations. In conjunction with this proposal, the Department is also proposing the repeal of existing §§5.9901 - 5.9906 of this chapter in a separate proposal also published in this issue of the *Texas Register*.

Under §2210.001 of the Insurance Code, the Legislature has determined that the provision of windstorm and hail insurance is necessary for the economic welfare of the state and its inhabitants; and that the lack of such insurance in the state's seacoast territories would severely impede the orderly growth and development of the state. The Association was created by the Legislature and serves as a residual insurer of last resort for windstorm and hail insurance coverage (insurance coverage) in the

catastrophe area designated by the Commissioner under the Insurance Code §2210.005. The catastrophe area is underserved for insurance coverage and consists of the 14 Texas coastal counties and parts of Harris County. Persons seeking insurance coverage from the Association are unable to obtain comparable insurance coverage in the voluntary insurance market. The ability to obtain insurance coverage that will provide coverage for losses resulting from windstorm and hail is crucial to the financial welfare of persons living and working in the designated catastrophe area. The absence of such coverage providing for the payment of losses results in the lack of an important element for economic stability in the region.

House Bill 4409 substantially amended how Association losses and operating expenses in excess of premium and other revenue are funded in new Subchapters B-1 and M, Chapter 2210, Insurance Code. In accordance with Chapter 2210 of the Insurance Code, compliance with these requirements is essential to assure the availability of Association insurance coverage for all eligible persons and properties. The proposed sections implement the legislative loss funding scheme. Thus, adoption of these proposed sections will affect the economic welfare of the state and its inhabitants, and positively impact the orderly growth and development of the state. Because of this need, if, prior to the adoption of these sections, an occurrence or series of occurrences is reasonably likely to impact the catastrophe area, all of these sections will be submitted for immediate effect as emergency rules.

The Association operates under a plan of operation which is adopted by rule. The Insurance Code §2210.151 provides that the Commissioner shall adopt by rule the

Association's plan of operation to provide Texas windstorm and hail insurance in the catastrophe area. The Insurance Code §2210.152(a)(1) sets out the requirements of the plan of operation and specifies that the plan of operation must provide for the efficient, economical, fair and nondiscriminatory administration of the Association. Further, the Insurance Code §2210.152(a)(2)(G) provides that the plan of operation may include other provisions considered necessary by the Department to implement the purposes of Chapter 2210.

Historically the Association's plan of operation has been specified in §5.4001 of this chapter (relating to Plan of Operation). Neither the Insurance Code §2210.151 nor §2210.152 require the Association's plan of operation to be in a single section of the Administrative Code. With the adoption of HB 4409 related requirements in §§5.4902 - 5.4908 and 5.4911 of this chapter (relating to Additional Requirements; Declination of Coverage; Flood Insurance, Minimum Retained Premium, Certificate of Compliance Approval Program, Certificate of Compliance Transition Program, Alter and Alteration; and Insurance Policy Forms, Endorsements, Manual Rules, Application Forms, and Underwriting Guidelines; respectively) the Department began to revise the format of the plan of operation into sections related to specific topics. Sections 5.4902 - 5.4908 and §5.4911 were adopted to control over conflicting provisions in §5.4001. The sections in this proposal have similar language with respect to controlling over §5.4001. However, references in this proposal to the plan of operation incorporate both §§5.4001, 5.4902 - 5.4908, and 5.4911, unless specified otherwise.

As stated, HB 4409 substantially amended how Association losses and operating expenses in excess of premium and other revenue are funded. It is necessary that these new requirements, which amend or augment the Association's existing plan of operation, be integrated into the plan of operation. In accordance with Chapter 2210 of the Insurance Code, compliance with these requirements is essential to assure the availability of Association insurance coverage for all eligible persons and properties.

Thus, it is necessary to amend the plan of operation to address the following: (i) deposits to and disbursements from the Catastrophe Reserve Trust Fund, including deposit of premium surcharges collected under the Insurance Code §2210.259; (ii) financing arrangements; (iii) issuance of public securities; (iv) use of public securities proceeds; and (v) payment of public securities.

To effect these necessary amendments, the Department proposes for adoption the following sections to become part of the Association's plan of operation: (i) §5.4101, which provides that the proposed sections in this division are part of the plan of operation and shall control over conflicting provisions in the Association's current plan of operation; (ii) §5.4102, which defines terms used in this division; (iii) §§5.4111 - 5.4114, which amend and update the procedures and requirements of existing §§5.9903 - 5.9906 related to the Catastrophe Reserve Trust Fund; (iv) §5.4121, which addresses the payment of financing arrangements, including the Association's ability to secure these funds with public security proceeds; (v) §5.4131, which establishes the procedure for the Association to obtain Commissioner approval before requesting the

issuance of public securities; (vi) §5.4133 and §5.4134, which set forth a procedure for the Association to request use of the public security proceeds for the payment of incurred claims and operating expenses of the Association, as well as the uses for excess public security proceeds; (vii) §5.4141 and §5.4142 which set forth the funding of the revenue obligation fund for class 1 public security obligations and the disposition of excess class 1 revenue obligation fund amounts; (viii) §§5.4143 - 5.4145 which set forth the funding of the revenue obligation fund for class 2 public security obligations and the disposition of excess class 2 premium surcharge and member assessment amounts; and (ix) §5.4146 and §5.4147 which set forth the funding of the revenue obligation fund for class 3 public security obligations and the disposition of excess class 3 revenue obligation fund amounts. This proposal explains in subsequent discussions each of the proposed sections in greater detail.

Additionally, the Department has decided to move existing requirements related to the Catastrophe Reserve Fund (CRTF) into this division as proposed §5.4101, §5.4102, and §§5.4111 - 5.4114. The requirements in these sections have been updated to reflect HB 4409 amendments and current statutory citations. The existing requirements related to the CRTF are set forth in §§5.9901 - 5.9906 of this chapter. Because these six sections would conflict with proposed new §5.4101, §5.4102, and §§5.4111 - 5.4114, they have been proposed for repeal in a separate proposal also published in this edition of the *Texas Register*.

§5.4101. Applicability. As previously discussed, the Association operates under a plan of operation. Proposed §5.4101(a) provides that the proposed sections in

this division shall be considered to be a part of the Texas Windstorm Insurance Association's plan of operation and shall control over any conflicting provision in §5.4001 of this title. Proposed §5.4101(b) is based on existing §5.9906(e) and provides that the Department retains regulatory oversight of the Association as required by the Insurance Code Chapter 2210, notwithstanding any provision in 28 Texas Administrative Code, Chapter 5, Subchapter E. This would include situations where the Association is required to work with the Texas Public Finance Authority (TPFA), the Comptroller of the State of Texas (Comptroller), and the Texas Treasury Safekeeping Trust Company (Trust Company).

§5.4102. Definitions. Proposed §5.4102 defines terms used in this division. The definitions are derived in part from existing §5.9902, which have been updated as necessary, the Insurance Code, Chapter 2210, and information provided to the Department from the TPFA. The proposal does not intend to substantively redefine terms used in Chapter 2210, however, the definitions have been further adapted for use in this division. For example, in §5.4102 the term "public securities" is defined as a collective reference to class 1, class 2, and class 3 public securities, while the Insurance Code definition of public security - a debt instrument or other public security issued by the Texas Public Finance Authority - has been incorporated into the definition of each class of public security. Further, to avoid confusion, commercial paper notes are defined as being a class 1 public security. Additionally, the TPFA has provided the Department with proposed definition terminology so that, to the extent possible, items may be referred to consistently in these proposed sections and documents prepared to

implement the purposes of HB 4409 and these rules by the TPFA, Comptroller, and the Trust Company.

§5.4111. Operation of the Catastrophe Reserve Trust Fund. Proposed §5.4111 reflects existing §5.9903 of this chapter. Proposed §5.4111(b)(1) has been amended to reflect that the Association no longer bases part of its contribution to the CRTF on the net equity of its members but, rather on the Association's net gain from operations, under the Insurance Code §2210.452, as amended by HB 4409. Proposed §5.4111(b)(2) has been added to address the new §2210.259, Insurance Code, which provides for a premium surcharge that is to be deposited by the Association into the CRTF. Section 5.4111(b)(2), as well as the proposed definitions of "gross premiums" in §5.4102(20) and "other revenue" in §5.4102(27), clarifies that the premium surcharge collected under Insurance Code §2210.259 is not gross premiums or other revenue of the Association.

Although the Insurance Code §2210.259 requires that the collected premium surcharge amounts are to be deposited into the CRTF, the statute does not directly include these amounts within the scope of the CRTF deposit requirement in the Insurance Code §2210.452 nor otherwise state the frequency of these deposits. The Department has determined at this time not to impose a requirement as to the frequency of when the §2210.259 premium surcharge deposits must occur. Rather the proposal provides that the Association and the Comptroller may establish an agreement as to the timing of such §2210.259 premium surcharge deposits. Finally, because these premium surcharges are not premium or other revenue of the

Association, but instead are just held by the Association pending deposit in the CRTF, §5.4111(b)(2) requires the Association to account for these funds separately and to pay all investment income earned on the funds into the CRTF.

Proposed §5.4111 further does not include existing §5.9903 references to funding the annual mitigation and preparedness plan, which was eliminated by HB 4409 amendments to the Insurance Code §2210.454. Proposed §5.4111 also makes nonsubstantive updates to statutory references and uses terminology more consistent with this proposal generally.

§5.4112 and §5.4113. Termination of Catastrophe Reserve Trust Fund and Investments of Catastrophe Reserve Trust Fund. Proposed §5.4112 is based on existing §5.9904 of this chapter. Proposed §5.4113 is based on existing §5.9905 of this chapter. The proposed sections make nonsubstantive updates to statutory references and use terminology more consistent with this proposal generally.

§5.4114. Duties and Responsibilities. Proposed §5.4114 is based on existing §5.9906 of this chapter and sets forth the duties and responsibilities of the Commissioner, the Association, the Comptroller, and the Trust Company in authorizing the release of CRTF funds. The proposed section does not change the existing rule requirement that the Association must request the CRTF funds through the use of a definitive statement. The section, however, has been amended to reflect the current order of loss funding sources set forth in the Insurance Code §2210.071, as added by HB 4409; and not the order that was required under the Insurance Code §2210.058, which was repealed by HB 4409. Instead the Association need only determine that

losses exceed the Association's premium and other revenue and available reinsurance proceeds before requesting the CRTF funds. The reference to "available reinsurance proceeds" in this section and other proposed sections should not be construed as the Department directing the Association to purchase reinsurance. Rather, it is simply a statement of what funds may potentially be available to pay claims prior to relying on the CRTF under the Insurance Code §2210.071(b) or other funding sources under the Insurance Code §2210.072 - 2210.074. The Insurance Code §2210.453 provides that the Association may purchase reinsurance that operates in addition to or in concert with the CRTF, public securities, and financial instruments authorized by Chapter 2210, Insurance Code. Even as to the CRTF, it is conceivable that in the future the CRTF might be sufficiently large that Association reinsurance purchases would be financially prudent to protect part of that reserve against a single storm eliminating the entire reserve.

Proposed §5.4114(c) is based on existing §5.9906(d), except that the proposed section provides that the Commissioner, rather than the Department, shall make the determination to release the CRTF funds, which is consistent with proposed §5.4114(b). Further, the proposed section does not restate the language in existing §5.9906(d) that could be read as limiting the Commissioner's ability to consider information in making the determination to release CRTF funds to reliance only on statements or notices of definitive or estimated losses "provided by the Association's general manager" and "made for that purpose." This language is inconsistent with the premise of "any statement" and further there is no applicable statute proscribing the Commissioner's

reliance on any statement from any source that the Commissioner determines to be persuasive. The section does not reflect existing §5.9906(e) because that provision has been restated as proposed §5.4101(b). The section also does not reflect existing §5.9906(f), because member assessments are not addressed in this section. Finally, the proposed section also makes nonsubstantive updates to statutory references and uses terminology consistent with the current statute and this proposal generally.

§5.4121. Financing Arrangements. The Insurance Code §2210.072 and §2210.612, as added by HB 4409, provide that the Association may enter into financing arrangements directly with a market source for the purpose of enabling the Association to pay losses or obtain public securities under the Insurance Code §2210.072. The Insurance Code §2210.072 and Subchapter M, of Chapter 2210, Insurance Code, also authorize the TPFA to enter into financing arrangements by issuing public securities on behalf of the Association. The proposed section relates only to the Association entering into financing directly with a market source. It is not the Department's intent that the proposed section be interpreted or construed as affecting the TPFA's ability to enter into financing arrangements by issuing public securities on behalf of the Association as authorized in Chapter 2210.

Proposed §5.4121(a) states that the Association may enter into financing arrangements. Proposed §5.4121(b) provides that in addition to other Association sources of funds, including the Association premium and other revenue, the Association may pay for a financing arrangement with the proceeds of any class of public security. This use of public security proceeds is authorized under the Insurance

Code §2210.072 and §2210.612, because the financing arrangements enable the Association to: (i) pay Association catastrophe losses under the Insurance Code §2210.072 and (ii) provide immediate loss funding enabling the Association time to continue to meet contractual obligations while obtaining public securities under the Insurance Code §2210.072.

Proposed §5.4121(c) provides that the Association may secure financing arrangements with a collateral assignment and security interest in and to all or any portion of the Association's right, title and interest in and to all proceeds of any or all class 1 public securities, class 2 public securities, and/or class 3 public securities. Such a collateral assignment and security interest is likely to be required in order to obtain a financing arrangement because the Association's net revenue may be secured to fund the class 1 obligation revenue fund, as provided in proposed §5.4141. It is probable that the Association's only source of funds for the payment of the financing arrangement that was used to promptly fund the initial catastrophic claims may be the proceeds of a public security. It is reasonable for the Association to secure proceeds to pay catastrophe claims pending the completion of the arrangement, issuing, and funding of the public securities. Therefore, the market source might reasonably request that its repayment be secured in the proceeds of the public securities that are issued to fund the catastrophic losses.

§5.4131. Issuance of Public Securities. As addressed in proposed §5.4131(g) and proposed §5.4132, the Insurance Code Chapter 2210, Subchapter M, authorizes the TPFA through its board to issue public securities to fund Association

losses that are in excess of the Association's premium, other revenue, available reinsurance proceeds, and the CRTF. The Insurance Code Chapter 2210 provides that the TPFA is responsible for setting the terms and conditions of the public securities and distributing public security proceeds as well as establishing accounts necessary to repay the public securities in a timely manner. The public security proceeds and repayment amounts are held by the TPFA in funds and accounts it shall establish with the Trust Company, which is maintained by the Comptroller. Public securities issued pursuant to Chapter 2210 by the TPFA must be approved by the Texas Attorney General.

Under Chapter 2210, the Department and the Association are directed to determine the need for public securities, request the appropriate amount of public securities, and collect amounts necessary to fund repayment of the public securities. Proposed §5.4131 addresses the procedure to determine the need for public securities and the appropriate amount of public securities to be requested. The proposed section first requires the Association to reasonably estimate whether catastrophic losses arising from a catastrophic event exceed funds in the CRTF and proceeds from available reinsurance. If the determination is made, the Association may request the Commissioner's approval for the issuance of public securities. This basic determination is similar to the Association's determination under proposed §5.4114, and as such the requests could be combined. However, the proposal should not be construed as requiring the Association to make a joint funding request. A public security funding request to the Commissioner must present the information specified in proposed

§5.4131(b). Thus, depending on the available information following a catastrophic event, the Association may prefer to make the requests separately. Likewise, as provided in proposed §5.4131(e) the Association may make multiple requests for public security funding.

The information required in the request for public securities is necessary to determine the losses that must be paid and the amount of public securities that may be issued to pay those losses. The Insurance Code §§2210.072, 2210.073, and 2210.074 each authorize the maximum amount of public securities that may be issued under each class of public securities, which are, respectively, \$1 billion dollars in class 1 public securities, \$1 billion dollars in class 2 public securities and \$500 million in class 3 public securities. However, market conditions and requirements may not allow for the TPFA to issue all authorized public securities in a particular class.

The Department has been informed that the markets will set the limit for the amount of class 1 public securities that may be issued by essentially considering the Association's current net revenue as the source of the funds to pay the class 1 public security obligation and meet the contractual coverage amount, both for the initial year and subsequent years. As defined in proposed §5.4102, the "contractual coverage amount" is the minimum amount that the Association is required to deposit into the applicable public security obligation revenue fund as security for the payment of debt service on the public securities, administrative expenses on public securities, or other payments required to be paid by the Association in connection with public securities. The contractual coverage amount secures against a drop off in amounts collected to

pay the public security. As that amount is required to secure payment, the contractual coverage amount will exceed the required payment. In the case of class 1 public securities, the contractual coverage amount may be greater than the amount owed annually to pay debt service, administrative expenses, or other required payments in connection with class 1 public security obligations.

The Association's net revenue is defined in proposed §5.4102(25) as the Association's gross premium, plus other revenue, less unearned premium, less scheduled policy claims, less budgeted operating expenses, and less amounts necessary to fund or replenish the operating reserve fund. Scheduled policy claims are defined in proposed §5.4102(31) as that portion of the Association's earned premium and other revenue expected to be paid in connection with the disposition of losses that do not result from a catastrophic event. These claims result from localized windstorm and hail events that may involve one to several hundred policyholders per event and could include losses due to straight-line winds, thunderstorms, tornados, hail, or other non-catastrophe wind and hail events. These events occur regularly throughout the catastrophe area, just as they occur regularly throughout the state, and losses related to such events are actuarially calculated into the premium collected by the Association. Budgeted operating expenses defined in §5.4102(5) as all operating expenses as budgeted for and approved by the Association's board of directors, excluding expenses related to catastrophic losses. These are the ordinary expenses of the Association to issue policies, pay agent commissions, and adjust and settle scheduled claims. The operating reserve fund, which is also defined in §5.4102(26), is established in this

proposal to allow the Association to continue to function to pay scheduled claims following a loss that requires the issuance of class 1 public securities. This operating reserve fund is further discussed in proposed §5.4141.

As discussed, the Department has been informed that the market's initial consideration of class 1 public securities would be based on the Association's current net revenue. The Department has also been informed that the market would not necessarily consider additional potential revenue with respect to the issuance of public securities, because even if the Association increased its rates, the net increase in overall gross premium, if any, from this action would not be fully achieved for approximately one year. Some policyholders would pay the increase, some would reduce coverage, and others would cancel or non-renew coverage. Thus, while a rate increase may increase gross revenues and provide an opportunity for a second issuance of class 1 public securities if the funding is needed, it would not be a guarantee that the Association could issue any remaining public securities in that class. Rather, the only definite result of delaying issuance of the next class of public securities to provide needed funding would be to delay payment of incurred claims in frustration of the Association's statutory purpose. Further, the TPFA has informed the Department that the TPFA has a public policy interest in issuing the Association public securities as investment grade. Thus, the Association could not issue securities on what would essentially be a speculative or junk bond basis.

To demonstrate this contractual coverage situation, the Association and the Department were provided estimates that \$1 billion in class one public securities could

result in first year debt service of approximately \$125 million, with debt service in subsequent years of approximately \$173 million per year. At a 1.5 times coverage rate the Association would be required to have at least \$188 million in net revenue for the first year and \$259 million for subsequent years. At a 3 times coverage rate, the net revenue amounts for these periods increase to \$376 million and \$519 million, respectively. For comparison the Association's current net revenue is approximately \$250 million. In the absence of any losses in excess of what would be described as scheduled policy claims, such net revenue would be available for transfer to the CRTF.

While the HB 4409 amendments, including the adoption of the Insurance Code §2210.072 concerning class 1 public securities, may indicate a shift to making the Association more self-reliant, nothing in HB 4409 indicates any legislative intent that the Association is to stop paying claims if the entire class of public securities cannot reasonably be sold. The legislature did not state that the authorized amount of public securities in any class had to be exhausted before the next class of security could be used. Rather, the Insurance Code §2210.073 and §2210.074 each state only that losses not paid under the preceding sections are to be paid under §2210.073 and §2210.074, as applicable. Thus, this proposal requires only that the Association request issuance of the reasonably practical maximum principal amount of a class of public security before moving on to the next numerically greater class of public security. Proposed §5.4131(c) sets out the criteria that the Association must consider in determining the reasonably practical maximum principal amount of public securities. In making its determination the Association may rely on the advice and analysis of the

TPFA. Upon making its determination the Association must submit its request for issuing the public securities to the Commissioner for approval as specified in proposed §5.4131(b). Upon receipt of the Commissioner's written approval, the Association shall request the TPFA to issue the approved requested public securities. The Association may then proceed to work with the TPFA to obtain the funds.

As previously stated, proposed §5.4131(e) provides that the Association may make multiple requests for public security funding. As further stated in that subsection, in making these requests the Association must evaluate and request the reasonably practical maximum principal amount of class 1 or class 2 public securities before moving on to the next public security class. The proposal includes class 2 public securities, because even though these public securities have a greater funding basis, market conditions and requirements, including contractual coverage requirements, might still prevent the sale of all of the securities in this class, and thus require the Association to move on to class 3 public securities before exhausting the amount of class 2 public securities authorized under the Insurance Code §2210.073. Class 3 public securities are not referenced because the statute provides for no additional funding sources beyond that class.

Because of the complexity of the public security funding arrangements, it is likely that the TPFA will have already made certain arrangements prior to the occurrence of a catastrophic event that will give rise to the need for the public securities. Nothing in this proposal should be construed as limiting the TPFA's ability to perform such actions.

§5.4132. Texas Public Finance Authority Responsibilities Concerning Issuance of Public Securities. The purpose of proposed §5.4132 is to generally inform the reader of certain functions that may be performed by the TPFA pursuant to statute. The section and this proposal are not intended to establish additional requirements for the TPFA, the Comptroller, or the Trust Company.

§5.4133. Public Security Proceeds. The Insurance Code §2210.607 provides that the public security proceeds shall be held in trust with the Trust Company for the benefit of the Association. The Insurance Code §2210.606 provides that the TPFA may make additional covenants with respect the public securities, including providing for the establishment and maintenance of funds and accounts. The Insurance Code §2210.608 sets forth how public security proceeds may be used, and these uses are incorporated into the proposed definition of the Association Program in §5.4102. Proposed §5.4133 addresses the minimum requirements on the Association related to using public security proceeds to fund Association program obligations under the Association's plan of operation. These plan of operation requirements include: (i) documenting requests for public security proceeds, (ii) accounting for the receipt and use of public security proceeds, and (iii) holding the public security proceeds.

§5.4134. Excess Public Security Proceeds. The Insurance Code §2210.608(b) provides for the use of excess public security proceeds. The Insurance Code §2210.608(b), however, does not specifically provide who would make any decision as to those funds. The Insurance Code §2210.608(a) however, vests the use of the public security proceeds in the Association. This section clarifies that the

Association shall also determine the use of excess public security proceeds pursuant to the Insurance Code §2210.608. The section also clarifies that while the Association may select from available options under the Insurance Code §2210.608, if any, §2210.608 does not confer this discretion notwithstanding the requirements specified in the Insurance Code §§2210.072(a), 2210.073(a), and 2210.074(a). Thus, public securities may be repaid before their term if the Association's board of directors elects to do so and the Commissioner approves. Neither this section nor this statement concerning the application of the Insurance Code §2210.608, is intended to imply or suggest that the Association may change, alter, or disavow any covenant or obligation in a public security or other agreement.

§5.4141. Obligation Revenue Fund for the Payment of Class 1 Public Security Obligations and Operating Reserve Fund. The Insurance Code §2210.609(a) provides that the Association and the TPFA shall provide for the payment of all public security obligations from the Association's available funds. Further, if the Association is unable to pay the public security obligations and public security administrative expenses, if any, with available funds then the Association shall pay those obligations and expenses in accordance with the Insurance Code §§2210.612, 2210.613, and 2210.6135. The Insurance Code §2210.609(c) provides that all revenue collected under the Insurance Code §§2210.612, 2210.613, and 2210.6135 shall be deposited in the public security obligation fund. Such a requirement is obvious for additional amounts specifically collected for the payment of class 2 and class 3 public

security obligations and public security administrative expenses, however, class 1 public security obligations are paid from the Association's premium and other revenue.

Proposed §5.4141 establishes the means for the Association to continue its ordinary operations while funding the obligation revenue fund for the payment of class 1 public security obligations and public security administrative expenses. Under proposed §5.4141 the Association's net revenue as defined in proposed §5.4102(25) and previously discussed in relation to proposed §5.4131 will be deposited by the Association into obligation revenue fund created for class 1 public securities. This amount will include any required contractual coverage amount, which has also been previously discussed in this proposal.

Proposed §5.4141(b) provides that the Association shall hold the operating reserve fund, which is defined in §5.4102(26) as the amount budgeted each year by the Association for the payment of scheduled policy claims and budgeted operating expenses divided by four. Thus, this fund holds funds to pay for approximately three months of scheduled claims and operating expense. The fund would be replenished throughout the year by Association premium collections, with part of the premium being deposited in the operating reserve fund and part of the premium being deposited into the obligation revenue fund. Section 5.4141 also provides that should premium collections fail to meet the needs of the obligation revenue funds, funds would be transferred from the operating reserve fund to the obligation revenue fund.

§5.4142. Excess Class 1 Public Security Obligation Revenue Fund Amounts. It is possible that, from time to time, funds in the obligation revenue fund,

including the contractual coverage amount, may need to be disbursed. Revenue related to class 1 public securities is the Association's premium and other revenue, which is otherwise an Association asset. Proposed §5.4142 provides that the Association may thus use such a disbursement as an Association asset; however, if the Association elects to redeem or purchase public securities early, Commissioner approval is required under the Insurance Code §2210.072.

§5.4143 and §5.4146. Obligation Revenue Fund for the Payment of Class 2 and Class 3 Public Securities. The Insurance Code §2210.613 provides for the payment of class 2 public security obligations with premium surcharges on most lines of property and casualty insurance policies in the catastrophe area and Association member company assessments. The Insurance Code §2210.6135 provides for the payment of class 3 public security obligations with Association member company assessments. These amounts would include any applicable contractual coverage amounts that the TPFA informs the Association and the Department are necessary. The procedure for establishing, assessing, collecting, reporting, accounting for, and transmitting the premium surcharge to the Association will be the subject of a separate proposal. The Department does not anticipate any substantive change in the procedure currently set forth in §5.4001(c)(2) for assessing and paying member assessments to the Association.

Proposed §5.4143 and §5.4146 have similar requirements. In both instances, the Association is required to deposit the collected revenue and investment income, if any, on that revenue into the appropriate obligation revenue fund. Further, as this

revenue is not an asset of the Association, the Association is required to separately account for these funds and may not otherwise use or encumber these funds. Finally, the sections provide how the Association shall hold the collected revenue funds pending transfer to the obligation revenue fund.

§§5.4144, 5.4145, and 5.4147. Excess Class 2 and Class 3 Public Security Obligation Revenue Fund Amounts. The obligation revenue funds may have significant excess funds because of potential contractual coverage amounts. The Insurance Code §2210.611 provides that if excess premium surcharge revenue is collected in any year, those funds may be used in the discretion of the Association to (i) pay public security obligations in a subsequent year; (ii) redeem or purchase outstanding public securities; or (iii) be deposited in the CRTF. Proposed §5.4144 sets out the statutory provision, and also clarifies that while the Association may select from available options under the Insurance Code §2210.611, if any, that §2210.611 does not confer this discretion notwithstanding the requirement specified in the Insurance Code §2210.073(a). Thus, public securities may be repaid before their term if the Association's board of directors elects to do so and the Commissioner approves.

The Department proposes in §5.4145 and §5.4147 that an excess member assessment be handled in a similar manner. This is not addressed in the Insurance Code Chapter 2210. Thus if excess premium surcharge revenue is collected in any year, those funds may be used in the discretion of the Association to (i) pay public security obligations in a subsequent year; or (ii) redeem or purchase outstanding public securities, subject to Commissioner approval. Proposed §5.4145 and §5.4147 only

provide for the disposition of the funds to the CRTF if all the amounts payable under the other options have been satisfied. The Department considers this structure consistent with statutory provisions indicating that the public securities be at the lowest practical cost and the authorizations in the Insurance Code §2210.073 and §2210.074 that the Association's board of directors, subject to the Commissioner's approval as required in the Insurance Code §2210.074(a), may elect to repay the public securities sooner than their full term. The Department also considered refunding any final excess member assessment, however, the Department determined that such a refund could potentially be considered participation in the profits of the Association which is not authorized under the Insurance Code Chapter 2210.

2. FISCAL NOTE. Marilyn Hamilton, Associate Commissioner of the Property and Casualty Program, has determined that for each year of the first five years the proposed sections will be in effect, there will be no fiscal impact to state and local governments as a result of the enforcement or administration of the proposal. There will be no measurable effect on local employment or the local economy as a result of the proposal.

3. PUBLIC BENEFIT/COST NOTE. Ms. Hamilton also has determined that for each year of the first five years the proposed sections are in effect, there will be public benefits resulting from the proposal and there will be costs to persons required to comply with the proposal.

Anticipated Public Benefits. The Department anticipates that a primary public benefit resulting from the proposal will be the efficient access to funding for insured losses and operating expenses exceeding the Association's premium and other revenue. Further, the proposal sets forth the various funding sources into a single division to provide interested persons with a clear overview of the various sources of loss funding available to the Association. Finally the proposal updates existing provisions related to the Catastrophe Reserve Trust Fund and incorporates those provisions into the division.

Estimated Costs for Persons Required to Comply with the Proposal. The person that will incur costs for compliance with the proposal is the Association. As provided in the Insurance Code Chapter 2210, the Association is created for the purpose of providing windstorm and hail insurance in the designated catastrophe area, and, as such, is required to comply with this proposal. It is not a business decision of the Association to choose to subject itself to these regulations by electing to write this type of coverage or comply with this proposal.

The anticipated costs to the Association result from accounting, functions under proposed §§5.4111, 5.4133, 5.4143, and 5.4146 and loss evaluation functions with respect to §5.4131. Overall the Department anticipates that these activities would involve both managerial and staff personnel, office space and equipment. Some systems, including electronic systems, may need to be developed or updated to complete these functions. The following cost estimates were provided to the Department by the Association. However, the Association indicated that the actual

costs may differ from these estimates due to unanticipated situations and expenses. While the Association indicated that the proposal would result in labor costs, the Association did not directly indicate any costs resulting from additional staff, office space, new equipment, or systems development resulting from the proposal.

Proposed §5.4111. The Insurance Code §2210.259 requires the Association to collect a 15% premium surcharge on certain residential structures and to deposit that premium surcharge into the CRTF. Proposed §5.1111(b) adds the additional requirement that the Association must account for premium surcharges collected under the Insurance Code §2210.259 separately from the Association gross premium and other revenue. The Association estimated the cost of this activity to be \$2,040 per year. It is anticipated that this cost would not change over the first five year period this proposal is to be in effect. Other costs related to proposed sections §§5.4111 - 5.4114 arise from statutory requirements on the Association or requirements under existing §§5.9901 - 5.9906 of this chapter which have not been substantively changed by this proposal.

Proposed §5.4131 and §5.4133. New Subchapter B-1 and M, Chapter 2210, Insurance Code, set forth new requirements on the Association to obtain loss funding and to use loss funding. The Insurance Code §2210.604 provides that the Association is, with approval of the Commissioner, to request the TPFA to issue public securities. Proposed §5.4131 sets forth the information that the Commissioner will require before granting the Association approval to make its request to the TPFA. The Association estimated that the cost of this activity to be \$800 per occurrence. It is anticipated that

this cost would not change over the first five year period this proposal is to be in effect. The proceeds of the public securities shall be held in trust for the benefit of the Association as set forth in the Insurance Code §2210.607 and may be used by the Association for those purposes set forth in the Insurance Code §2210.608. Proposed §5.4133 sets forth the information that the Department will require the Association to keep with respect to its requests for the use of the public security proceeds and the use of the public security proceeds. The Association estimated the cost of this activity to be between \$20,000 and \$30,000 per year depending on the overall size and scope of the catastrophic loss, and including a record of the payout of losses. The Association further estimated that this cost estimate is based on the payout of losses over five years and security payback over ten years. Thus the cost estimate would be for each year of the first five years this proposal is to be in effect.

Proposed §5.4143 and §5.4146. The Insurance Code §2210.613 and §2210.6135 requires the Association to collect premium surcharges and member assessments for the payment of class 2 public securities and class 3 public securities and then to deposit these sums into an obligation revenue fund or funds held by the Trust Company. Proposed §5.4143(b) and §5.4146(b) require the Association to hold these funds separately from all other Association funds while these funds are held by the Association pending deposit into the obligation revenue fund. The Association considered that this activity would be similar to those necessary to comply with proposed §5.4111 estimated the cost of this activity to be \$500 per year. It is

anticipated that this cost would not change over the first five year period this proposal is to be in effect.

All other costs to the Association result from the legislative enactment of the Insurance Code Chapter 2210 and the amendments to Chapter 2210 in HB 4409 and are not a result of the adoption, enforcement, or administration of this proposal.

4. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY ANALYSIS FOR SMALL AND MICRO BUSINESSES. Section 2006.002(c) of the Government Code requires that if a proposed rule may have an economic impact on small businesses, state agencies must prepare as part of the rulemaking process an economic impact statement that assesses the potential impact of the proposed rule on these businesses and a regulatory flexibility analysis that considers alternative methods of achieving the purpose of the rule. The Government Code §2006.001(2) defines “small business” as a legal entity, including a corporation, partnership, or sole proprietorship, that is formed for the purpose of making a profit; is independently owned and operated; and has fewer than 100 employees or less than \$6 million in annual gross receipts. The Government Code §2006.001(1) defines “micro business” similarly to “small business” but specifies that such a business may not have more than 20 employees. The Government Code §2006.001(1) does not specify a maximum level of gross receipts for a “micro business.”

As specified in the Public Benefit/Cost Note section of this proposal, the proposal only has an economic impact on the Association. The Association does not

meet the definition of a *small business* under Government Code §2006.001(2). The Association is an *association... composed of all property insurers authorized to engage in the business of property insurance in this state*, formed under the authority of Insurance Code §2210.051. It is not a corporation, partnership nor sole proprietorship. It is not formed for the purpose of making a profit, but to provide a method by which adequate windstorm and hail insurance may be made available in certain designated portions of this state, as mandated by Insurance Code §2210.001. Under Insurance Code §2210.056, the net earnings of the Association may not inure to the benefit of private shareholders or individuals; and the assets of the Association may not be used, except to satisfy claims on policies, make investments authorized under applicable law, pay reasonable and necessary administrative expenses, satisfy the obligations of the Association, including public securities, financial instruments and the purchase reinsurance, or prepare for or mitigate the effects of catastrophic natural events. Under Insurance Code §2210.452, the net gain from operations of the Association in excess of incurred losses and operating expenses, is paid to a catastrophe reserve trust fund or used to procure reinsurance. Further, under Insurance Code §2210.056 and §2210.452, upon dissolution of the Association, all assets revert to the state. The Association is not *independently owned and operated*. In addition to not being owned by its members, under Insurance Code §2210.101 and §2210.102, the Association operates with a board of directors, which is responsible and accountable to the Commissioner. The Association provides windstorm and hail insurance according to a plan of operation as specified by Insurance Code §2210.152 and adopted by the

Commissioner by rule pursuant to Insurance Code §2210.151. Further, the Association has approximately 150 employees (including employees who are providing services by contract to the FAIR Plan) and net receipts well over \$6 million. Therefore, based on these factors, the Association does not meet the definition of a small or micro business under the Government Code §2006.001(1) and (2), and an analysis of the economic impact of this proposal on the Association pursuant to the Government Code §2006.002(c) is not required.

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

6. REQUEST FOR PUBLIC COMMENT. To be considered, written comments on the proposal must be submitted no later than 5:00 p.m. on August 24, 2010, to Gene C. Jarmon, General Counsel and Chief Clerk, Mail Code 113-2A, Texas Department of Insurance, P. O. Box 149104, Austin, Texas 78714-9104. An additional copy of the comment must be simultaneously submitted to Marilyn Hamilton, Associate Commissioner, Property and Casualty Program, Mail Code 104-PC, Texas Department of Insurance, P.O. Box 149104, Austin, Texas 78714-9104.

The Commissioner will consider the adoption of the proposed new sections in a public hearing under Docket No. 2716, scheduled for August 24, 2010, at 9:30 a.m., in Room 100 of the William P. Hobby, Jr., State Office Building, 333 Guadalupe Street, Austin, Texas. Written and oral comments presented at the hearing will be considered.

7. STATUTORY AUTHORITY. Sections 5.4101, 5.4102, 5.4111 - 5.4114, 5.4121, 5.4131 - 5.4134, and 5.4141 - 5.4147 are proposed under the Insurance Code §§2210.008, 2210.056, 2210.071, 2210.072, 2210.073, 2210.074, 2210.151, 2210.152, 2210.259, 2210.452, 2210.453, 2210.604, 2210.608, 2210.609, 2210.611, 2210.612, 2210.613, 2210.6135, and 36.001. Section 2210.008(b) authorizes the Commissioner to adopt reasonable and necessary rules in the manner prescribed in Subchapter A, Chapter 36, Insurance Code. Section 2210.056 establishes the allowable uses for the Association's assets. Section 2210.071(a) provides that if an occurrence or series of occurrences in a catastrophe area results in insured losses and operating expenses of the Association in excess of premium and other revenue of the Association, the excess losses and operating expenses shall be paid as provided by Subchapter B-1, Chapter 2210, Insurance Code. Section 2210.071(b) provides that the Association shall pay such excess losses from available amounts in the catastrophe reserve trust fund. Section 2210.072(a) provides that losses not paid under the Insurance Code §2210.071 shall be paid as provided by this section from the proceeds from class 1 public securities. Section 2210.072(a) also authorizes the early repayment of class 1 public securities if the Association's board of directors elects to do so and the Commissioner

approves. Section 2210.072(b) authorizes class 1 public securities to be issued in a principal amount not to exceed \$1 billion per year. Section 2210.072(c) requires class 1 public securities to be repaid in the manner prescribed by Subchapter M, Chapter 2210, Insurance Code, from Association premium revenue. Section 2210.072(d) authorizes the Association to enter into financing arrangement with any market source to enable the Association to pay losses under the Insurance Code §2210.072 or to enable the Association to obtain public securities. Section 2210.073 provides that losses not paid under Insurance Code §2210.072 shall be paid as provided by this section from the proceeds from class 2 public securities issued in accordance with Subchapter M, Chapter 2210, Insurance Code. Section 2210.073(a) also authorizes the early repayment of class 2 public securities if the Association's board of directors elects to do so and the Commissioner approves. Section 2210.073(b) authorizes class 2 public securities to be issued in a principal amount not to exceed \$1 billion per year and requires class 2 public securities to be repaid in the manner prescribed by Subchapter M, Chapter 2210, Insurance Code. Section 2210.074(a) provides that losses not paid under Insurance Code §§2210.072 and 2210.073 shall be paid as provided by this section from the proceeds from class 3 public securities issued in accordance with Subchapter M, Chapter 2210, Insurance Code. Section 2210.074(a) also authorizes the early repayment of class 3 public securities if the Association's board of directors elects to do so and the Commissioner approves. Section 2210.074(b) authorizes class 3 public securities to be issued in a principal amount not to exceed \$500 million per year and requires class 3 public securities to be repaid in the manner prescribed by

Subchapter M, Chapter 2210, Insurance Code. Section 2210.151 authorizes the Commissioner to adopt the Association's plan of operation to provide Texas windstorm and hail insurance coverage in the catastrophe area by rule. Section 2210.152 provides that the Association's plan of operation provide for the efficient, economical, fair, and nondiscriminatory administration of the Association and include both underwriting standards and other provisions considered necessary by the Department to implement the purposes of this chapter. Section 2210.259 requires the Association to assess a 15% premium surcharge on a noncompliant residential structure insured by the Association as of September 1, 2009, under Section 2210.251(f) that had been approved for insurability under the approval process regulations in effect on September 1, 2009 and to deposit the premium surcharge in the CRTF. Section 2210.259 further provides that the premium surcharge is a separate nonrefundable charge in addition to the premiums collected and is not subject to premium tax or commissions. Section 2210.452 requires the Commissioner to adopt rules under which the Association makes payments to the CRTF including the net gain from operations of the Association at the end of each calendar year or policy year; and the procedure relating to the disbursement of money from the trust fund to the Association to fund the obligations of the trust fund under Subchapter B-1, Chapter 2210, Insurance Code. Section 2210.452(b) further provides that the comptroller, as custodian of the trust fund, shall administer the trust fund strictly and solely as provided by Chapter 2210, Insurance Code and Commissioner rules. Section 2210.452(d) provides that the trust fund may be terminated only by law and that on termination of the trust fund, all assets of the trust

fund revert to the state to provide funding for the mitigation and preparedness plan established under the Insurance Code §2210.454. Section 2210.453 provides that the Association may purchase reinsurance that operates in addition to or in concert with the CRTF, public securities, financial instruments, and assessments authorized by Chapter 2210, Insurance Code. Section 2210.604 requires that the Commissioner approve an Association request to the Texas Public Finance Authority for the issuance of class 1, class 2, or class 3 public securities. Section 2210.608 provides how the Association may use public security proceeds and excess public security proceeds. Section 2210.609 provides that the Association shall repay all public security obligations from available funds, and if those funds are insufficient, revenue collected in accordance with the Insurance Code §§2210.612, 2210.613, and 2210.6135. Section 2210.609 further provides that the Association shall deposit all revenue collected under §§2210.612, 2210.613, and 2210.6135 in the public security obligation revenue fund and further provide for the payment of the public security obligations and the public security administrative expenses by irrevocably pledging revenues received from premiums, premium surcharges, and amounts on deposit in the public security obligation revenue fund, together with any public security reserve fund. Section 2210.611 establishes that the Association may use premium surcharge revenue collected under the Insurance Code §2210.613 in any year that exceeds the amount of the public security obligations and public security administrative expenses payable in that year and interest earned on the public security obligation fund to (i) pay public security obligations payable in the subsequent year; (ii) redeem or purchase outstanding public securities; or (iii) make a

deposit in the catastrophe reserve trust fund. Section 2210.612 provides that the Association shall pay class 1 public securities issued under §2210.072 from its premium and other revenue. Section 2210.613 provides that the Association shall pay class 2 public securities issued under §2210.073 with premium surcharges and member assessments as provided by §2210.613. Section 2210.6135 provides that the Association shall pay class 3 public securities issued under Section 2210.074 as provided by §2210.6135 through member assessments. Section 36.001 provides that the Commissioner of Insurance may adopt any rules necessary and appropriate to implement the powers and duties of the Texas Department of Insurance under the Insurance Code and other laws of the state.

8. CROSS REFERENCE TO STATUTE. The following statutes are affected by this proposal:

<u>Rule</u>	<u>Statute</u>
§5.4101	Insurance Code §§2210.151, and 2210.152
§5.4102	Insurance Code §§2210.056, 2210.071, 2210.072, 2210.073, 2210.074, 2210.151, 2210.152, 2210.259, 2210.452, 2210.453, 2210.604, 2210.608, 2210.609, 2210.611, 2210.612, 2210.613, and 2210.6135
§§5.4111 - 5.4114,	Insurance Code 2210.056, 2210.071, 2210.259, 2210.452, and 2210.453
§5.4121,	Insurance Code §§2210.056, 2210.072, 2210.608, and 2210.612
§5.4131	Insurance Code §§2210.072, 2210.073, 2210.074, 2210.453, and 2210.604
§5.4132	Insurance Code §§2210.604, 2210.608, 2210.609, 2210.611, 2210.612, 2210.613, and 2210.6135
§5.4133 and 5.4134	Insurance Code §§2210.072, 2210.073, 2210.074, 2210.604, and 2210.608

§5.4141 and 5.4142	Insurance Code §§2210.072, 2210.604, 2210.608, 2210.609, and 2210.612
§§5.4143 - 5.4145	Insurance Code §§2210.073, 2210.604, 2210.608, 2210.609, 2210.611, and 2210.613.
§5.4146 and 5.4147	Insurance Code §§2210.604, 2210.608, 2210.609, and 2210.6135

9. TEXT.

DIVISION 3 LOSS FUNDING, INCLUDING CATASTROPHE RESERVE TRUST FUND, FINANCING ARRANGEMENTS, AND PUBLIC SECURITIES [POLICY FORMS]

§5.4101. Applicability.

(a) Sections 5.4101, 5.4102, 5.4111 - 5.4114, 5.4121, 5.4131 - 5.4134, and 5.4141 - 5.4147 of this division are a part of the Texas Windstorm Insurance Association's plan of operation and shall control over any conflicting provision in §5.4001 of this subchapter (relating to Plan of Operation). If a court of competent jurisdiction holds that any provision of this division is inconsistent with any statutes of this state, is unconstitutional, or is invalid for any reason, the remaining provisions of the sections in this division shall remain in effect.

(b) Notwithstanding any provision in this subchapter, the department retains regulatory oversight of the Association as required by the Insurance Code Chapter 2210, including periodic examinations of the accounts, books and records of the Association and no provision should be interpreted as negating or limiting the department regulatory oversight of the Association.

§5.4102. Definitions. The following words and terms when used in this division shall have the following meanings unless the context clearly indicates otherwise:

(1) Association--Texas Windstorm Insurance Association.

(2) Association program--The funding of any or all of the purposes authorized to be funded with the Public Securities under Subchapter M, Chapter 2210, Insurance Code.

(3) Authorized representative of the department--Any officer or employee of the department, empowered to execute instructions and take other necessary actions on behalf of the department as designated in writing by the commissioner.

(4) Authorized representative of the trust company--Any officer or employee of the comptroller or the trust company who is designated in writing by the comptroller as an authorized representative.

(5) Budgeted operating expenses--All operating expenses as budgeted for and approved by the Association's Board of Directors, excluding expenses related to catastrophic losses.

(6) Catastrophe area--A municipality, a part of a municipality, a county, or a part of a county designated by the commissioner under the Insurance Code §2210.005.

(7) Catastrophe Reserve Trust Fund (CRTF)--A statutorily created trust fund established with the trust company under Subchapter J of Chapter 2210, Insurance Code.

(8) Catastrophic event--An occurrence or a series of occurrences in a catastrophe area resulting in insured losses and operating expenses of the Association in excess of premium and other revenue of the Association.

(9) Catastrophic losses--Losses resulting from a catastrophic event.

(10) Class 1 public securities--A debt instrument or other security authorized to be issued by the TPFA under §2210.072 and Subchapter M of Chapter 2210, Insurance Code.

(11) Class 2 public securities--A debt instrument or other security authorized to be issued by the TPFA under the Insurance Code §2210.073 and Subchapter M of Chapter 2210, Insurance Code.

(12) Class 3 public securities--A debt instrument or other security authorized to be issued by the TPFA under the Insurance Code §2210.074 and Subchapter M of Chapter 2210, Insurance Code.

(13) Commercial paper notes--A type of class 1 public security issued by the TPFA.

(14) Commissioner--Commissioner of Insurance of the State of Texas.

(15) Comptroller--Comptroller of the State of Texas.

(16) Contractual coverage amount--Minimum amount that the Association is required to deposit into the applicable public security obligation revenue fund as security for the payment of debt service on the public securities, administrative expenses on public securities, or other payments required to be paid by the Association in connection with public securities.

(17) Credit agreement--A loan agreement, revolving credit agreement, agreement establishing a line of credit, letter of credit, reimbursement agreement, insurance contract, commitment to purchase obligations, purchase or sale agreement, interest rate management agreement, or other commitment or agreement authorized by the TPFA in anticipation of, related to, or in connection with the authorization, issuance, sale, resale, security, exchange, payment, purchase, remarketing, or redemption of some or all of its public security obligations or interest on public security obligations, or both, or as otherwise authorized by Chapter 1371 of the Government Code.

(18) Department--Texas Department of Insurance.

(19) Financing arrangement--An agreement with any market source under which the market source makes interest bearing loans or provides other financial instruments to the Association to enable the Association to pay losses or obtain public securities under the Insurance Code §2210.072.

(20) Gross premiums--The amount of premium received by the Association. The term does not include premium surcharges collected by the Association pursuant to the Insurance Code §2210.259 and §2210.613.

(21) Investment income--Income received by the Association from the investment of funds held by or for the benefit of the Association.

(22) Letter of instruction--Written authorization and direction to an authorized representative of the trust company, which is signed by the commissioner or an authorized representative of the department.

(23) Losses--Amounts paid on Association insurance policy claims, including adjustment expenses, litigation expenses, and other claims expenses.

(24) Net gain from operations--The gain from operations, for a calendar year or policy year as the case may be, including all earned premium and other revenue of the Association in excess of incurred losses, operating expenses, and amounts to satisfy in whole or in part the obligations of the Association incurred in connection with the Insurance Code Chapter 2210, Subchapters B-1, J, and M, including reinsurance, public securities and financial instruments.

(25) Net Revenues--Gross premiums received by the Association from policyholders, plus other revenue, less unearned premium, less scheduled policy claims, less budgeted operating expenses, and less amounts necessary to fund or replenish the operating reserve fund.

(26) Operating Reserve Fund--The amount budgeted each year by the Association for the payment of scheduled policy claims and budgeted operating expenses divided by four.

(27) Other Revenue--Revenue of the Association from any source other than premiums. Other revenue includes investment income on Association assets; but other revenue does not include premium surcharges collected pursuant to the Insurance Code §2210.259, premiums surcharges collected from Association policyholders and other insurers under the Insurance Code §2210.613, Association member assessments collected under the Insurance Code §2210.613 and §2210.6135, and investment

income on premium surcharges and member assessments collected under the Insurance Code §§2210.259, 2210.613, and 2210.6135.

(28) Plan of operation--The Association's plan of operation as adopted by the commissioner pursuant to §2210.151 and §2210.152 of the Insurance Code.

(29) Public Securities--Collective reference to class 1 public securities, class 2 public securities, and class 3 public securities.

(30) Public security obligations--The principal of a public security and any premium and interest on a public security issued under this subchapter, together with any amount owed under a related credit agreement.

(31) Scheduled Policy Claims--That portion of the Association's earned premium and other revenue expected to be paid in connection with the disposition of losses that do not result from a catastrophic event.

(32) Trust Company--Texas Treasury Safekeeping Trust Company managed by the comptroller pursuant to the Government Code §404.101, et seq.

(33) Trust Company Representative--Any individual employed by the Trust Company who is designated by the trust company as its authorized representative for purposes of any agreement related to the catastrophe reserve trust fund or the public securities.

(34) TPFA--The Texas Public Finance Authority.

(35) Unearned Premium--That portion of gross premiums that has been collected in advance for insurance that has not yet been earned by the Association

because of the unexpired portion of the time for which the insurance policy has been in effect.

§5.4111. Operation of the Catastrophe Reserve Trust Fund.

(a) In General.

(1) The comptroller shall administer the catastrophe reserve trust fund in accordance with Insurance Code Chapter 2210, and this subchapter.

(2) The comptroller shall ensure that all money received from the Association pursuant to subsection (b) of this section is deposited with the trust company in the catastrophe reserve trust fund.

(3) The trust company shall receive, disburse, invest, hold, and manage all money deposited in the catastrophe reserve trust fund.

(4) All money, including investment income, deposited in the catastrophe reserve trust fund is state funds to be held by the comptroller outside the state treasury on behalf of, and with legal title in, the department until disbursed as provided by the Insurance Code Chapter 2210 and this subchapter.

(b) Payment of Funds to the Catastrophe Reserve Trust Fund.

(1) On an annual basis, the Association shall pay the net gain from operations of the Association directly to the comptroller for deposit with the trust company in the catastrophe reserve trust fund.

(2) In a time period acceptable to the trust company and the comptroller, but not more frequently than monthly, the Association shall pay all premium surcharges

collected under the Insurance Code §2210.259 during the preceding period and accumulated investment income on those premium surcharges directly to the comptroller for deposit with the trust company in the catastrophe reserve trust fund. Premium surcharges collected by the Association pursuant to the Insurance Code §2210.259 and investment income on those funds are not gross premium or other revenue of the Association and must be accounted for separately from the Association's gross premium and other revenue.

(3) As necessary, the Association shall pay directly to the comptroller for deposit with the trust company in the catastrophe reserve trust fund all:

(A) excess public security proceeds resulting from the Insurance Code §2210.608;

(B) excess premium surcharges resulting from the Insurance Code §2210.611 and §5.4144 of this subchapter (relating to Excess Class 2 Premium Surcharge Revenue); and

(C) excess member assessments resulting from §5.4145 and §5.4147 of this subchapter (relating to Excess Class 2 Member Assessment Revenue; and Excess Class 3 Member Assessment Revenue).

(4) All deposits received by the trust company under this subsection shall be deposited in the catastrophe reserve trust fund immediately upon receipt.

(c) Disbursements from the Catastrophe Reserve Trust Fund.

(1) Prior to a disbursement of funds from the catastrophe reserve trust fund other than a disbursement under paragraph (3) of this subsection, the department must determine that:

(A) a catastrophic event has occurred; and

(B) the catastrophic event has resulted in losses in excess of available reinsurance proceeds.

(2) To disburse funds from the catastrophe reserve trust fund in response to a catastrophic event, the commissioner or an authorized representative of the department shall issue a letter of instruction to the trust company, specifying the amount of money to be disbursed in immediately available funds and specifying any third party payee.

(3) To disburse funds from the catastrophe reserve trust fund to pay for costs associated with maintaining or managing the catastrophe reserve trust fund, the commissioner or an authorized representative of the department shall issue a letter of instruction to the trust company specifying the amount of money to be paid and specifying any third party payee.

(d) Maintenance of the Catastrophe Reserve Trust Fund.

(1) In maintaining and managing the catastrophe reserve trust fund, the trust company shall be charged with the duty of care, which applies to the comptroller as trustee of funds in the treasury.

(2) The department shall pay the trust company an amount sufficient to reimburse the trust company for the actual monthly costs of administering and

maintaining the catastrophe reserve trust fund. The trust company shall deduct the appropriate amount directly from the earnings of the catastrophe reserve trust fund and advise the department monthly in writing of the amount of these costs.

(3) The trust company shall submit to the department a report of all transactions relating to the catastrophe reserve trust fund promptly after the end of each month. The trust company shall furnish other information relating to the catastrophe reserve trust fund as the department may reasonably request from time to time.

(4) The trust company is required to keep a book of records in which the complete and correct entries are made of all transactions relating to the receipts, disbursements, deposits, withdrawals and transfers in the catastrophe reserve trust fund in accordance with generally accepted accounting principles. The records shall be available for inspection by an authorized representative of the department at all reasonable hours of the business day and under reasonable conditions.

§5.4112. Termination of Catastrophe Reserve Trust Fund.

(a) The catastrophe reserve trust fund may be terminated only by law.

(b) On termination of the trust fund, all assets of the catastrophe reserve trust fund revert to the state and shall be used by the department to provide funding for the annual loss mitigation and preparedness plan established under the Insurance Code §2210.454.

§5.4113. Investments of Catastrophe Reserve Trust Fund.

(a) The money in the catastrophe reserve trust fund may only be invested in investments as authorized by the Government Code §404.024 and §404.106, and as amended.

(b) The Association does not have authority to direct investments or money in the catastrophe reserve trust fund.

(c) All earnings and losses from the investment of funds in the catastrophe reserve trust fund shall be credited to or charged against the catastrophe reserve trust fund. Investment income on money in the trust fund shall be maintained as part of the funds in the trust fund.

(d) The funds of the catastrophe reserve trust fund may be intermingled with other funds held by the trust company for the purposes of common investment and operational efficiency.

§5.4114. Duties and Responsibilities.

(a) In the event that the Association reasonably estimates that a catastrophic event has occurred, the general manager of the Association shall promptly notify the commissioner and the comptroller in writing of the total amount of the estimated catastrophic losses and potential reinsurance recoveries related to those losses. The general manager of the Association shall further promptly notify the commissioner and the comptroller in writing of any subsequent changes in such estimates.

(b) Upon receipt of a definitive written statement from the Association's general manager that a catastrophic event has occurred and that the catastrophic losses

exceed available reinsurance proceeds, the commissioner or an authorized representative of the department shall provide a letter of instruction to pay the Association an amount from the catastrophe reserve trust fund that is equal to the lesser of the portion of the catastrophic loss that exceeds the premium and other revenue of the Association and available reinsurance proceeds or the balance of the catastrophe reserve trust fund. The Association shall report to the department any subsequent changes in the amount of catastrophic losses and the amount due either party shall be remitted promptly. Any funds received by the Association from the catastrophe reserve trust fund but not expended for the payment of loss and loss adjustment expenses shall be remitted by the Association to the catastrophe reserve trust fund.

(c) In authorizing the release of catastrophe reserve trust funds, the commissioner may rely on any statements or notifications of definitive or estimated losses, Association revenue, reinsurance proceeds, or any other related or supporting information, from any source, including the general manager of the Association.

§5.4121. Financing Arrangements.

(a) The Association may enter into financing arrangements.

(b) The Association may pay a financing arrangement with:

(1) premiums and other revenue of the Association;

(2) reinsurance proceeds;

(3) the proceeds of any financing arrangement;

(4) the proceeds of any class of public security issued under Insurance Code Chapter 2210; and

(5) any other Association asset.

(c) As collateral security for such financial arrangements, including interest bearing loans or other financial instruments, the Association may grant in favor of the applicable market source a collateral assignment and security interest in and to all or any portion of the Association's right, title and interest in and to all proceeds of any or all class 1 public securities, including commercial paper notes, class 2 public securities, and/or class 3 public securities, with the priority of each such collateral assignment and security interest, whether first or secondary, to be determined by the Association in its discretion.

§5.4131. Issuance of Public Securities.

(a) In the event that the Association reasonably estimates that a catastrophic event has occurred and that the catastrophic losses are estimated to exceed available catastrophe reserve trust funds and available reinsurance proceeds, the Association may request the commissioner's approval for the issuance of public securities.

(b) The Association's request under subsection (a) of this section must be in writing and specify:

(1) the total estimated amount of catastrophic losses as of the date of the request;

(2) the reasonably practical maximum principal amount of public securities the Association is to request;

(3) the term of the public securities;

(4) the estimated amount of debt service for the public securities, including any contractual coverage requirement;

(5) the Association's current gross premium and other revenue; and

(6) the Association's current net revenues.

(c) In determining the reasonably practical maximum principal amount of public securities under subsection (b) of this section, the Association must consider:

(1) the Association's current gross premium and other revenue;

(2) the Association's current net revenues;

(3) the Association's obligations for outstanding public securities, including contractual coverage requirements;

(4) the Association's obligations for other financing arrangements; and

(5) market conditions and requirements necessary to sell the public securities with an investment-grade rating, including issuing classes in installments.

The Association may rely on the advice and analysis of the TPFA in determining such market conditions and requirements and in determining the reasonably practical maximum principal amount of public securities.

(d) In considering the Association's request, the commissioner may rely on any statements or notifications of definitive or estimated losses, Association revenue,

reinsurance proceeds, or any other related or supporting information, from any source, including the general manager of the Association and the TPFA.

(e) The Association may make one or more requests for funding under this section following a catastrophic event.

(1) The Association must request issuance of what has been determined to be the reasonably practical maximum principal amount of class 1 public securities before the Association may request issuance of class 2 and class 3 public securities.

(2) The Association must request issuance of what has been determined to be the reasonably practical maximum principal amount of class 2 public securities before the Association may request issuance of class 3 public securities.

(f) Upon receipt of the commissioner's written approval, the Association shall request the TPFA to issue the approved requested public securities.

(g) As provided in the Insurance Code Chapter 2210 the Association may enter into agreements as directed by the TPFA for the issuance, reissuance, refinancing, and payment of public security obligations and public security administrative expenses.

§5.4132. Texas Public Finance Authority Responsibilities Concerning Issuance of Public Securities. Pursuant to Insurance Code, Chapter 2210, Subchapter M, the TPFA has the certain statutory obligations regarding the issuance of public securities on behalf of the Association, including:

(1) determining the terms of the public securities to best achieve the goals of the Association and result in borrowing at the lowest practical cost. Within the scope

of the reasonably practical maximum principal amount, the TPFA may increase the maximum amount of the public securities to include amounts sufficient to:

(A) pay the cost of issuance;

(B) provide a public security reserve fund; and

(C) capitalize the interest on the public securities for the period

specified by the Association;

(2) complying with any credit agreement, including a liquidity agreement issued by the Comptroller;

(3) issuing the requested public securities on behalf of the Association for the purpose of financing and refinancing the Association program and to pay and refinance outstanding public securities of the same class and other financing arrangements;

(4) arranging for the issuance of commercial paper notes prior to a catastrophic event. The Association and the commissioner shall approve each tranche of commercial paper notes issued under a commercial paper program;

(5) establishing all necessary accounts with the trust company;

(6) together with the trust company and the comptroller, managing the obligation revenue fund, or funds, and the distribution of money to the various accounts in the public security obligation revenue fund, or funds, as necessary to fulfill the obligations of the TPFA and the Association under the Insurance Code Chapter 2210;

(7) informing the Association and the commissioner at least annually of the amount required to fund the outstanding public security obligations and the

estimated amount of public security administrative expenses, including any required contractual coverage amount; and

(8) causing the public security proceeds to be delivered to the trust company for deposit into such funds and accounts as are necessary to fulfill the obligations of the TPFA and the Association under the Insurance Code Chapter 2210 and this section, including to:

(A) pay the costs of issuing the public securities and any administrative expenses related to the public securities;

(B) provide a reserve fund; and

(C) pay capitalized interest on the public securities.

§5.4133. Public Security Proceeds.

(a) As necessary, the Association shall make written requests to the TPFA for the distribution of public security proceeds for the Association program, including:

(1) for the payment of incurred claims and operating expenses of the Association; or

(2) to purchase reinsurance for the Association.

(b) The Association's written request must specify:

(1) the amount of the request; and

(2) the purpose of the request.

(c) To facilitate timely payment of losses, the Association may request funds to be disbursed to the Association prior to the settlement of incurred claims.

(d) The Association shall account for the receipt and use of public security proceeds separately from all other sources of funds. The Association may hold public security proceeds in the manner authorized by the Association's plan of operation or as required by agreement with the TPFA.

§5.4134. Excess Public Security Proceeds.

(a) The Association may use any excess public security proceeds remaining after the purposes for which the public securities were issued are satisfied in accordance with the Insurance Code §2210.608.

(b) As specified in the Insurance Code §§2210.072(a), 2210.073(a), and 2210.074(a) public securities may be repaid before their full term if the Association's board of directors elects to do so and the commissioner approves.

§5.4141. Obligation Revenue Fund for the Payment of Class 1 Public Security Obligations and Operating Reserve Fund.

(a) While class 1 public securities are outstanding, all of the Association's net revenue shall be paid into the obligation revenue fund created for such class 1 public securities. The Association shall deposit the required amounts in obligation revenue fund created for class 1 public securities at such periods as required under agreements with the TPFA.

(b) The operating reserve fund shall be held by the Association. If the class 1 public securities obligation revenue fund does not contain sufficient money to pay debt

service on the class 1 public securities, administrative expenses on the class public securities, or other class 1 public security obligations, the Association shall transfer sufficient money from the operating reserve fund to the obligation revenue fund for class 1 public securities to make such payment.

§5.4142. Excess Class 1 Public Security Obligation Revenue Fund Amounts.

(a) Excess revenue collected to fund class 1 public security obligations that is disbursed to the Association shall be an asset of the Association and may be used for any purpose authorized in the Insurance Code §2210.056 or deposited into the catastrophe reserve trust fund.

(b) As specified in the Insurance Code §2210.072(a), class 1 public securities may be repaid before their full term if the Association's board of directors elects to do so and the commissioner approves.

§5.4143. Obligation Revenue Fund for the Payment of Class 2 Public Securities.

(a) The Association shall deposit collected premium surcharges and Association member assessments pursuant to the Insurance Code §2210.613 in the obligation revenue fund created for class 2 public securities. The Association shall also deposit in that obligation revenue fund any investment income earned on the premium surcharges and Association member assessments while these amounts are held by the Association. The deposits shall be made as required under agreements with the TPFA.

(b) Pending deposit as required under subsection (a) of this section, the Association shall hold such collected premium surcharges and Association member assessments as required under agreements with the TPFA, or in the absence of an agreement, as required in the Association's plan of operation, including this section. Premium surcharges and Association member assessments collected by the Association pursuant to the Insurance Code §2210.613, must be held by the Association separately from all other Association funds. The Association may not directly or indirectly use, borrow, or in any manner pledge or encumber premium surcharges and Association member assessments collected, or to be collected, by the Association pursuant to the Insurance Code §2210.613.

§5.4144. Excess Class 2 Premium Surcharge Revenue.

(a) Revenue collected in any year from a premium surcharges under the Insurance Code §2210.613 that exceeds the amount of class 2 public security obligations and class 2 public security administrative expenses payable in that year from premium surcharges and interest earned on the class 2 public security obligation fund may, in the discretion of the Association, be:

(1) used to pay class 2 public security obligations payable in the subsequent year, offsetting the amount of the premium surcharge that would otherwise be required to be levied for the year under this subchapter;

(2) used to redeem or purchase outstanding class 2 public securities; or

(3) deposited in the catastrophe reserve trust fund.

(b) As specified in the Insurance Code §2210.073(a), class 2 public securities may be repaid before their full term if the Association's board of directors elects to do so and the commissioner approves.

§5.4145. Excess Class 2 Member Assessment Revenue.

(a) Revenue collected in any year from a member assessment under the Insurance Code §2210.613 that exceeds the amount of class 2 public security obligations and class 2 public security administrative expenses payable in that year from member assessments may be:

(1) used to pay class 2 public security obligations payable in the subsequent year, offsetting the amount of the member assessment that would otherwise be required to be levied for the year under this subchapter; or

(2) used to redeem or purchase outstanding class 2 public securities.

(b) As specified in the Insurance Code §2210.073(a), class 2 public securities may be repaid before their full term if the Association's board of directors elects to do so and the commissioner approves.

(c) If options (1) and (2) of subsection (a) of this section have been fully satisfied, the excess member assessments may be deposited in the catastrophe reserve trust fund.

§5.4146. Obligation Revenue Fund for the Payment of Class 3 Public Securities.

(a) The Association shall deposit collected member assessments pursuant to the Insurance Code §2210.6135 in the obligation revenue fund created for class 3 public securities. The Association shall also deposit in that obligation revenue fund any investment income earned on the member assessments while these amounts are held by the Association. The deposits shall be made as required under agreements with the TPFA.

(b) Pending deposit as required under subsection (a) of this section, the Association shall hold such collected Association member assessments as required under agreements with the TPFA, or in the absence of an agreement, as required in the Association's plan of operation, including this section. Member assessments collected by the Association pursuant to the Insurance Code §2210.6135, must be held by the Association separately from all other Association funds. The Association may not directly or indirectly use, borrow, or in any manner pledge or encumber Association member assessments collected, or to be collected, by the Association pursuant to the Insurance Code §2210.6135.

§5.4147. Excess Class 3 Member Assessment Revenue.

(a) Revenue collected in any year from a member assessment under the Insurance Code §2210.6135 that exceeds the amount of class 3 public security obligations and class 3 public security administrative expenses payable in that year from member assessments may be:

(1) used to pay class 3 public security obligations payable in the subsequent year, offsetting the amount of the member assessments that would otherwise be required to be levied for the year under this subchapter; or

(2) used to redeem or purchase outstanding class 3 public securities.

(b) As specified in the Insurance Code §2210.074(a), class 3 public securities may be repaid before their full term if the Association's board of directors elects to do so and the commissioner approves.

(c) If options (1) and (2) of subsection (a) of this section have been fully satisfied, the excess member assessments may be deposited in the catastrophe reserve trust fund.