

## **SUBCHAPTER A. Examination and Financial Analysis**

### **28 TAC §7.18**

**1. INTRODUCTION.** The Texas Department of Insurance (Department) proposes amendments to §7.18, concerning Statements of Statutory Accounting Principles (SSAPs). SSAPs provide guidance to insurers and health maintenance organizations (HMOs), including accountants employed or retained by these entities, on how to properly record business transactions for the purpose of accurate statutory reporting. These insurers and HMOs are referred to collectively as “carriers” in this proposal. SSAPs provide a nationwide standard method of accounting, which most carriers are required to use for statutory financial reporting guidance. Therefore, SSAPs provide for a more consistent reporting of financial information from carriers. However, SSAPs do not preempt individual state legislative or regulatory authority. SSAPs are adopted by the National Association of Insurance Commissioners (NAIC) through its maintenance of statutory accounting principles process, which involves the developing and proposing of new SSAPs, providing the opportunity for public comment, and adoption by the NAIC in a series of public meetings with the opportunity for public comment. The Accounting Practices and Procedures Manual (Manual), published and issued by the NAIC, is a comprehensive guide to statutory accounting principles and includes the SSAPs that have been adopted by the NAIC. SSAPs provide the source of statutory accounting principles for the Department when analyzing financial reports and for conducting statutory examinations and rehabilitation of carriers licensed in Texas, except where otherwise provided by law.

The proposed amendments are necessary to adopt by reference the March 2010 version of the Manual, as well as substantive and non-substantive updates to this version of the Manual issued by the NAIC in calendar year 2010. Except for new SSAP Nos. 5R and 35R, the March 2010 version of the Manual and the updates to it must be used to prepare all financial statements filed with the Department for reporting periods ending on or after December 31, 2010. SSAP Nos. 5R and 35R must be used to prepare all financial statements filed with the Department for reporting periods beginning on or after December 31, 2011, and January 1, 2011, respectively.

Amendments are proposed to §7.18(a) to replace the reference to the March 2008 Manual with the reference to the March 2010 Manual and to replace the word “additions” with the word “modifications.” These amendments are necessary to clarify that the March 2010 version of the Manual, including the exceptions and modifications specified in §7.18(c) and (d), will be utilized as the guideline for statutory accounting principles in Texas to the extent the Manual does not conflict with provisions of the Insurance Code or Department rules of the Department.

Under the proposed amendments to §7.18(b), the Commissioner adopts by reference the March 2010 version of the Manual, with the exceptions and modifications specified in subsections (c) and (d), as the source of accounting principles for the Department when analyzing financial reports and for conducting statutory examinations and rehabilitations of insurers and HMOs licensed in Texas, except where otherwise provided by law. Amendments are also

proposed to §7.18(b) to provide that except for new SSAP Nos. 5R and 35R, the March 2010 version of the Manual, as well as the exceptions and modifications specified in subsections (c) and (d), are required to be (i) applied to examinations conducted as of December 31, 2010, and thereafter; and (ii) used to prepare all financial statements filed with the Department for reporting periods ending on or after December 31, 2010. Under the proposed amendments to §7.18(b), SSAP Nos. 5R and 35R must be (i) applied to examinations conducted as of December 31, 2011, and January 1, 2011, respectively, and thereafter; and (ii) used to prepare all financial statements filed with the Department for reporting periods beginning on or after December 31, 2011, and on or after January 1, 2011, respectively. These proposed amendments are necessary to clarify the purpose and application of the updated Manual.

Under the proposed amendments to §7.18(c), the Commissioner adopts the exceptions and modifications to the Manual that are specified in §7.18(c)(1) and (2). The proposed amendments provide that except for new SSAP Nos. 5R and 35R, these exceptions and modifications must be (i) applied to examinations conducted as of December 31, 2010, and thereafter, and (ii) used to prepare all financial statements filed with the Department for reporting periods ending on or after December 31, 2010. Under the amendments to §7.18(c)(1)(A), the following substantively revised SSAPs are proposed to be adopted by reference: SSAPs Nos. 5R, 35R, and 91R. SSAP No. 5R, which was adopted by the NAIC in October 2010, was revised to include guidance for accounting guarantees that are issued to other entities. SSAP No. 5R is adopted to be effective on

December 31, 2011, and must be used to prepare all financial statements filed with the Department for reporting periods beginning on or after December 31, 2011. SSAP No. 35R, which was adopted by the NAIC in October 2010, was revised to eliminate the non-admission criteria for accrued guaranty fund assessments, to incorporate new disclosures for assets, and to include transition guidance for assets. SSAP No. 35R was adopted by the NAIC to be effective on January 1, 2011, and must be used to prepare all financial statements filed with the Department for reporting periods beginning on or after January 1, 2011. SSAP No. 91R, which was adopted by the NAIC in August 2010, specifies updated securities lending accounting, reporting, and disclosures. SSAP No. 91R is effective on December 31, 2010, and must be used to prepare all financial statements filed with the Department for reporting periods beginning on or after December 31, 2010. The amendments to §7.18(c)(1)(A) also propose to delete references to SSAP Nos. 98 and 99 because SSAP Nos. 98 and 99 are included in the March 2010 version of the Manual. Additionally, a non-substantive amendment to §7.18(c)(1)(A) is needed to delete the redundant phrase “filed with the Department” in the sentence that begins “SSAP Nos. [No.] 5R and 35R [98] shall be applied to examinations conducted as of. . . .” Under amendments to §7.18(c)(1)(B), the Department is proposing to adopt by reference non-substantive modifications to SSAP Nos. 9, 43R, 90, 100, and 10R, and Issue Paper No. 99 issued by the NAIC in calendar year 2010. These non-substantive modifications clarify language or change disclosures, appendices, or other material referenced in SSAPs already included in the March 2010 version of the

Manual. The proposed amendments to §7.18(c)(1)(B) also delete references to the non-substantive modifications to SSAP Nos. 5, 15, 21, 22, 26, 30, 32, 40, 41, 43, 48, 52, 54, 55, 63, 65, 68, 86, and 91, and to the Preamble section of the Manual because the March 2010 version of the Manual includes all of these with the non-substantive modifications. The proposed amendments to §7.18(c)(1)(C) delete references to Actuarial Guidelines 43, 44, and 45, and revisions to Actuarial Guidelines 34 and 39 because these guidelines are included in the March 2010 version of the Manual.

Amendments are also proposed to §7.18(a), (b), (c), and (c)(2) to replace the word “additions” with the word “modifications.” These proposed amendments are necessary to classify more accurately the provisions adopted under §7.18(a), (b), (c), and (c)(2). An amendment is also proposed to §7.18(c)(1) to replace the words “additions and exceptions” with the word “modifications.” This proposed amendment is necessary to classify more accurately the provisions adopted under §7.18(c)(1).

Additionally, amendments are proposed to §7.18(e) to add the phrases “and obtain approval prior to using the accounting deviation in a financial statement” and “that is proposed to be.” These proposed amendments are necessary to clarify that a domestic insurer must both timely file a written request for a permitted practice and receive the Department’s approval prior to using the accounting deviation in a financial statement. The proposed amendments to §7.18(e) also add the phrase “of the Financial Program.” These proposed amendments are necessary to clarify that written requests for a permitted

practice must be filed with the Senior Associate Commissioner of the Financial Program.

**2. FISCAL NOTE.** Danny Saenz, Senior Associate Commissioner, Financial Program, has determined that, for each year of the first five years the amended section is in effect, there will be no fiscal implications for state or local government as a result of enforcing or administering the amended section, and there will be no effect on local employment or the local economy.

**3. PUBLIC BENEFIT/COST NOTE.** Mr. Saenz also has determined that for each year of the first five years the amended section is in effect, the public benefit will be the adoption of an updated Accounting Practices and Procedures Manual (Manual) that will enable the Department to continue efficient financial solvency regulation of insurance in general and the decrease in costs to carriers that are required to comply with accounting requirements in multiple states. In particular, adoption of the March 2010 version of the Manual, and substantive and non-substantive updates to it, will enable the Department to continue efficient and effective utilization of existing resources in the analysis and examination of the financial condition of carriers to better ensure financial solvency. Additionally, the adoption and use of the updated Manual will continue to support a more consistent regulatory environment and to provide a central source for accounting guidance. The Department does not anticipate that any of the proposed amendments, including the proposed adoption by reference of the 2010 Manual, will result in additional costs to those costs that are required of carriers, regardless of size, under the existing rules.

**§7.18(c)(1)(A).** The proposed amendments to §7.18(c)(1)(A) adopt by reference three substantively revised Statements of Statutory Accounting Principles (SSAPs): SSAP No. 5R, which was revised to include guidance for accounting guarantees that are issued to other entities; SSAP No. 35R, which was revised to eliminate the non-admission criteria for accrued guaranty fund assessments, to incorporate new disclosures for assets, and to include transition guidance for assets; and SSAP No. 91R, which specifies updated securities lending accounting, reporting, and disclosures, effective December 31, 2010. None of these substantively revised SSAPs will result in additional costs to those costs that are required of carriers, regardless of size, under the existing rules.

**§7.18(c)(1)(B).** The proposed amendments to §7.18(c)(1)(B) adopts by reference non-substantive modifications to SSAP Nos. 9, 10R, 43R, 90, and 100 and Issue Paper No. 99. The proposed non-substantive modifications clarify language or update reference materials, including disclosures and appendices, to SSAPs already included in the March 2010 version of the Manual as adopted by the NAIC and proposed for adoption by reference in this proposal. None of these non-substantive modifications will result in additional costs to those costs that are required of carriers, regardless of size, under the existing rules.

**4. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY ANALYSIS FOR SMALL AND MICRO BUSINESSES.** In accordance with the Government Code §2006.002, the Department has determined that the proposed amendments will not result in any additional costs to those costs that are required of small and micro business carriers under the existing rules for the

reasons specified in the Public Benefit/Cost Note part of this proposal. Nevertheless, the rule exempts certain carriers that have historically accounted for their business on a cash basis and have historically posed relatively insubstantial insolvency-related risk to consumers, other carriers, and the state's general economic welfare from compliance with the Manual. Section 7.18(d) exempts any farm mutual insurance company, statewide mutual assessment company, local mutual aid association, or mutual burial association with less than \$6 million in annual direct written premiums from compliance with the Manual. Because of the types or methods of operations of these types of carriers, they are more likely to be small or micro business carriers.

Under the Government Code §2006.002(c), before adopting a rule that may have an adverse economic effect on small or micro businesses, an agency is required to prepare in addition to an economic impact statement a regulatory flexibility analysis that includes the agency's consideration of alternative methods of achieving the purpose of the proposed rule. The Department has determined that the routine costs to comply with this proposal, i.e., compliance with the Manual in financial filings, will not have an adverse economic effect on small or micro business carriers. Therefore, the Department is not required to consider alternative methods of achieving the purpose of these requirements in the proposed rule as required by the Government Code §2006.002(c).

**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 November 29, 2010. All comments should be submitted to Gene C. Jarmon, General Counsel and Chief Clerk, Texas Department of Insurance, Mail Code 113-2A, P. O. Box 149104, Austin, Texas 78714-9104. An additional copy of the comments should be submitted simultaneously to Danny Saenz, Senior Associate Commissioner, Financial Program, Texas Department of Insurance, Mail Code 305-2A, P.O. Box 149104, Austin, Texas 78714-9104. Any request for a public hearing on the proposal should be submitted separately to the Office of the Chief Clerk before the close of the public comment period. If a hearing is held, written and oral comments presented at the hearing will be considered.

**7. STATUTORY AUTHORITY.** The amendments are proposed under the Insurance Code Chapters 32, 401, 404, 421, 425, 426, 441, 802, 823, 841, 843, 861, and 862, and §36.001. Sections 401.051 and 401.056 mandate that the Department examine the financial condition of each carrier organized under the laws of Texas or authorized to transact the business of insurance in Texas and adopt by rule procedures for the filing and adoption of examination reports. Section 404.005(a)(2) authorizes the Commissioner to establish standards for evaluating the financial condition of an insurer. Section 421.001(c) requires the Commissioner to adopt each current formula recommended by the NAIC for establishing reserves for each line of insurance. Section 425.162 authorizes the

Commissioner to adopt rules, minimum standards, or limitations that are fair and reasonable as appropriate to supplement and implement the Insurance Code Chapter 425, Subchapter C. Section 426.002 provides that reserves required by §426.001 must be computed in accordance with any rules adopted by the Commissioner to adequately protect insureds, secure the solvency of the workers' compensation insurance company, and prevent unreasonably large reserves. Section 441.005 authorizes the Commissioner to adopt reasonable rules as necessary to implement and supplement Chapter 441 of the Insurance Code (Supervision and Conservatorship). Section 32.041 requires the Department to furnish to the companies the required financial statement forms. Section 802.001 authorizes the Commissioner, as necessary, to obtain an accurate indication of the company's condition and method of transacting business, to change the form of any annual statement required to be filed by any kind of insurance company. Section 823.012 authorizes the Commissioner to issue rules and orders necessary to implement the provisions of Chapter 823 of the Insurance Code (Insurance Holding Company Systems). Section 843.151 authorizes the Commissioner to promulgate rules that are necessary and proper to implement the provisions of Chapter 843 of the Insurance Code (Health Maintenance Organizations). Section 843.155 requires HMOs to file annual reports with the Commissioner, which include a financial statement of the HMO, certified by an independent public accountant. Sections 841.004(b), 861.255(b) and 862.001(c) authorize the Commissioner to adopt rules defining electronic machines and systems, office equipment, furniture, machines and labor saving

devices, and the maximum period for which each such class may be amortized. Section 36.001 provides that the Commissioner of Insurance may adopt any rules necessary and appropriate to implement the powers and duties of the Department under the Insurance Code and other laws of this state.

**8. CROSS REFERENCE TO STATUTE.** The following statutes are affected by this proposal: Insurance Code Chapters 32, 401, 404, 421, 425, 426, 441, 802, 823, 841, 843, 861, and 862.

**9. TEXT.**

**§7.18. National Association of Insurance Commissioners Accounting Practices and Procedures Manual.**

(a) The purpose of this section is to adopt statutory accounting principles, which will provide insurers and health maintenance organizations, including accountants employed or retained by these entities, guidance as how to properly record business transactions for the purpose of accurate statutory reporting. The March 2010 [~~2008~~] version of the *Accounting Practices and Procedures Manual* (Manual) published by the National Association of Insurance Commissioners (NAIC), with the exceptions and modifications [~~additions~~] set forth in subsections (c) and (d) of this section, will be utilized as the guideline for statutory accounting principles in Texas to the extent the Manual does not conflict with provisions of the Insurance Code or rules of the department. The Commissioner reserves all authority and discretion to resolve any accounting issues in Texas. When making a determination on the proper accounting treatment for an insurance or health plan transaction, the Commissioner shall refer to the sources in

paragraphs (1) - (6) of this subsection in the respective order of priority listed. The sources in paragraphs (1) – (3) of this subsection preempt any contrary provisions in the Manual. The department rules that preempt any contrary provisions in the Manual, include, but are not limited to: §§3.1501 - 3.1505, 3.1601 - 3.1608, 3.4505(f), 3.6101, 3.6102, 3.7001 – 3.7009, 3.9101 - 3.9106, 3.9401 – 3.9404, 7.7, 7.85 and 11.803 of this title (relating to Annuity Mortality Tables; Actuarial Opinion and Memorandum Regulation; General Calculation Requirements for Basic Reserves and Premium Deficiency Reserves; Policy Reserves; Claims Reserves; Minimum Reserve Standards for Individual and Group Accident and Health Insurance; 2001 CSO Mortality Table; Preferred Mortality Tables; Subordinated Indebtedness, Surplus Debentures, Surplus Notes, Premium Income Notes, Bonds, or Debentures, and Other Contingent Evidences of Indebtedness; Audited Financial Reports; and Investments, Loans, and Other Assets).

(1) - (6) (No change.)

(b) The Commissioner adopts by reference the March 2010 [~~2008~~] version of the Manual, with the exceptions and modifications [~~additions~~] set forth in subsections (c) and (d) of this section, as the source of accounting principles for the department when analyzing financial reports and for conducting statutory examinations and rehabilitations of insurers and health maintenance organizations licensed in Texas, except where otherwise provided by law. Except as provided in subsection (c)(1)(A) of this section concerning Statement of Statutory Accounting Principles (SSAP) Nos. 5R and 35R, this [~~This~~] Manual

that is adopted [~~adoption~~] by reference with the exceptions and modifications specified in subsections (c) and (d) of this section shall be applied to examinations conducted as of December 31, 2010, [~~January 1, 2009~~] and thereafter, and also shall be used to prepare all financial statements filed with the department for reporting periods beginning on or after December 31, 2010 [~~January 1, 2009~~].

(c) The Commissioner adopts the exceptions and modifications [~~additions~~] to the Manual specified in paragraphs (1) and (2) of this subsection. Except as provided in paragraph (1)(A) of this subsection concerning SSAP Nos. 5R and 35R [~~Statement of Statutory Accounting Principles No. 98 (SSAP No. 98) and in paragraph (1)(C) of this subsection concerning Actuarial Guideline 43~~], these exceptions and modifications [~~additions~~] shall be applied to examinations conducted as of December 31, 2010, [~~January 1, 2009~~] and thereafter, and also shall be used to prepare all financial statements filed with the department for reporting periods beginning on or after December 31, 2010 [~~January 1, 2009~~].

(1) In addition to the statements of statutory accounting principles in the Manual, the following modifications [~~additions and exceptions~~] are adopted by reference:

(A) Statements [~~Statement~~] of Statutory Accounting Principles (SSAP) Nos. 5R, adopted by the NAIC in calendar year 2010, and effective December 31, 2011; 35R, adopted by the NAIC in calendar year 2010, and effective January 1, 2011; and 91R [~~and 99~~], adopted by the NAIC in calendar year 2010 [~~2008~~] and effective December 31, 2010 [~~January 1, 2009~~,

~~and SSAP No. 98, adopted by the NAIC in calendar year 2008 and effective September 30, 2009]. SSAP Nos. [No.] 5R and 35R [98] shall be applied to examinations conducted as of December 31, 2011, and January 1, 2011, respectively [September 30, 2009], and thereafter, and also shall be used to prepare all financial statements filed with the department [filed with the Department] for reporting periods beginning on or after December 31, 2011, and on or after January 1, 2011, respectively [after September 30, 2009, beginning with the third quarter 2009 financial statements].~~

(B) Nonsubstantive modifications to SSAP Nos. 9, 43R, 90, 100, and 10R, and Issue Paper No. 99 [~~5, 15, 21, 22, 26, 30, 32, 40, 41, 43, 48, 52, 54, 55, 63, 65, 68, 86, and 91~~] and to the ~~Preamble section of the Manual~~ made by the NAIC in calendar year 2010 [~~2008~~], as follows:

(i) Ref. No. 2010-07: ASU 2010-09, Subsequent Events - Amendments to Certain Recognition and Disclosure Requirements [~~2008-25: FSP FAS 133-1 and FIN 45-4: Disclosures about Credit Derivatives and Certain Guarantees, Amendments of FAS 133 and FIN 45, and Clarification of the Effective Date of FAS 161~~];

(ii) Ref. No. 2010-01: AVR and IMR Guidance within SSAP No. 43R and SSAP No. 7 [~~2008-22: Disclosures for Funding Agreements Issued to a Federal Home Loan Bank~~];

(iii) Ref. No. 2010-02: Clarification of SSAP No. 90 - Accounting for the Impairment or Disposal of Real Estate Investments, paragraph 6 [~~2007-32: EITF 06-5: Accounting for Purchases of Life Insurance~~];

~~Determining the Amount That Could be Realized in Accordance with FASB Technical Bulletin 85-4 and INT 07-05: Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements];~~

(iv) Ref. No. 2010-05: ASU 2010-06, Fair Value Measurements and Disclosures - Improving Disclosures about Fair Value Measurements [~~2008-05: FSP FAS 13-2: Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction];~~

(v) Ref. No. 2010-09: Income Taxes [~~2008-08: Methods Used to Determine and Report Fair Value of Securities];~~

(vi) Ref. No. 2009-20: ASU 2009-02, Omnibus Update – Amendments to Various Topics for Technical Corrections; and 2010-04: ASU 2010-03, Extractive Activities - Oil and Gas; and Ref. No. 2010-04: ASU 2010-03, Extractive Activities – Oil and Gas [~~2007-21: SOP 97-1: Accounting by Participating Mortgage Loan Borrowers];~~

~~[(vii) Ref. No. 2008-12: Clarification of Accounting for Capital Notes Held as Investments];~~

~~[(viii) Ref. No. 2002-20: Valuation and Reporting of Residential Interests];~~

~~[(ix) Ref. No. 2007-34: Use of Audited Tax Basis Financial Statements];~~

~~[(x) Ref. No. 2007-30: Remove Reference to Health Reserves Guidance Manual;]~~

~~[(xi) Ref. No. 2008-06: Clarification of SSAP No. 63 Regarding Intercompany Pooling Arrangements;]~~

~~[(xii) Ref. No. 2008-03: Discounting of Loss Adjustment Expense Reserves;]~~

~~[(xiii) Ref. No. 2007-36: Goodwill in a Merged Subsidiary;]~~

~~[(xiv) Ref. No. 2008-17: FSP FAS 142-3, Determination of the Useful Life of Intangible Assets;]~~

~~[(xv) Ref. No. 2008-14: Measurement of Sufficient Collateralization for Securities Lending Transactions;]~~

~~[(xvi) Ref. No. 2005-02: Amendment to the Permitted Practices Notice Requirement; and]~~

~~[(xvii) Ref. No. 2008-19: FAS 162, The Hierarchy of Generally Accepted Accounting Principles;] and~~

~~[(C) [Actuarial Guidelines 43, 44, and 45, and revised Actuarial Guidelines 34 and 39, issued by the NAIC in calendar year 2008. Actuarial Guideline 43 shall be applied to examinations conducted as of January 1, 2010 and thereafter, and also shall be used to prepare all financial statements filed with the department for reporting periods beginning on or after January 1, 2010.]~~

(2) In addition, the following exceptions and modifications ~~additions~~ are adopted:

(A) – (E) (No change.)

(d) (No change.)

(e) In the event a domestic insurer desires to deviate from the accounting guidance in a Texas statute or any applicable regulation, the insurer shall file a written request for a permitted accounting practice and obtain approval prior to using the accounting deviation in a financial statement. Such filing shall be made with the Senior Associate Commissioner of the Financial Program, Texas Department of Insurance, Mail Code 305-2A, P.O. Box 149104, Austin, Texas 78714-9104 at least 30 days before filing the financial statement that is proposed to be affected by the deviated accounting practice. Insurers shall not use deviated accounting practice without the department's prior approval.

(f) (No change.)