

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

1. INTRODUCTION. The Texas Department of Insurance (Department) proposes amendments to §7.402, concerning risk-based capital and surplus requirements for insurers and health maintenance organizations (HMOs).

The proposed amendments to §7.402 are necessary to implement and update the risk-based capital and surplus requirements for year-end 2011 for property and casualty insurers, including county mutual insurance companies that do not meet the express criteria contained in the Insurance Code §912.056(f); life insurance companies, including limited purpose subsidiary life insurance companies and stipulated premium insurance companies; HMOs and insurers filing the National Association of Insurance Commissioners (NAIC) Health blank; and fraternal benefit societies, by (i) adopting the 2011 NAIC risk-based capital formulas and instructions to be used for year-end 2011; and (ii) specifying the filing requirements for 2011 risk-based capital reports and supplemental reports and forms. The proposed amendments to §7.402 are necessary to require domestic and foreign fraternal benefit societies to file an electronic version of the 2011 fraternal risk-based capital report and any supplemental forms and reports with the NAIC and to subject fraternal benefit societies to a trend test. The proposed amendments to §7.402 also are necessary to implement changes enacted by the 82nd Legislature, Regular Session, in House Bill (HB) 3161, effective June 17, 2011, by adding limited purpose subsidiary life insurance companies to the list of defined

“carriers” that must comply with the section. Insurers and HMOs subject to §7.402 are referred to collectively in this proposal as “carriers.”

The proposed amendments to §7.402 are necessary to regulate risk-based capital and surplus requirements for carriers. The risk-based capital requirement is a method of ensuring that a carrier has an appropriate level of policyholder surplus after taking into account the underwriting, financial, and investment risks of a carrier. The updated NAIC risk-based capital formulas provide the Department with a widely used regulatory tool to identify the minimum amount of capital and surplus appropriate for a carrier to support its overall business operations in consideration of its size and risk exposure. The proposed amendments are necessary to adopt by reference the 2011 NAIC risk-based capital formulas to be used for year-end 2011. These formulas include the 2011 NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies, the 2011 NAIC Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies, the 2011 NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies, and the 2011 NAIC Health Risk-Based Capital Report including Overview and Instructions for Companies. Specifically, the proposed amendments to §7.402(d), in paragraphs 1 – 4, replace the date “2009” with “2011,” and delete paragraphs 5 - 8. Additionally, the proposed amendments to §7.402(e) are necessary to specify the 2011 risk-based capital reporting requirements: (i) by deleting the phrase “except fraternal benefit societies, stipulated premium companies doing business only in Texas, and county mutual insurance companies that do not meet the express criteria contained in the Insurance Code

§912.056(f),” and replacing the phrase “2009 and the 2010” with the word “2011” from paragraph (1); and (ii) deleting paragraphs (2), (3), and (4). These proposed changes clarify that fraternal benefit societies, stipulated premium companies, and county mutual insurance companies that do not meet the express criteria contained in the Insurance Code §912.056(f) are required to file electronic versions of the 2011 RBC reports and any supplemental RBC forms and reports with the NAIC in accordance with and by the due dates specified in the RBC instructions. By March 1, 2011, stipulated premium companies doing business only in Texas and county mutual insurance companies were required, for the first time, to file electronic versions of the 2010 RBC reports with the NAIC. By March 1, 2012, fraternal benefit societies will be required, for the first time, to file electronic versions of the 2011 RBC reports with the NAIC.

Additionally, the proposed amendments to §7.402 expand the risk-based capital requirements for domestic and foreign fraternal benefit societies. Under the amendments to §7.402(b), (d), (e), and (g), as proposed, domestic and foreign fraternal benefit societies will be subject to the section’s risk-based capital requirements for fraternal benefit societies and, for the first time, will be required to file an electronic version of the 2011 risk-based capital report and any supplemental forms and reports with the NAIC in accordance with and by the due date specified in the RBC instructions. Specifically, the proposed amendments to §7.402(b): (i) revise paragraph (1) to delete the sentence “Fraternal benefit societies are subject to their own separate risk-based capital instructions as provided in subsection (d)(2) of this section.”; and (ii) add a new paragraph (4) to specify that “This section does apply to domestic and foreign benefit

societies.” The proposed amendment to §7.402(d)(2) adopts by reference the 2011 risk based capital formulas and instructions adopted by the NAIC this year for fraternal benefit societies. Additionally, the proposed amendments to §7.402 add new subsection (g)(8) which imposes new substantive trend test requirements for fraternal benefit societies, for year-end 2011, and each calendar year thereafter. New subsection (g)(8), as proposed, subjects a fraternal benefit society to a trend test if its total adjusted capital to authorized control level risk-based capital is between 200 percent and 300 percent. In that case, and if the result of the trend test as determined by the formula is "YES," the fraternal benefit society will be subject to the company action level requirements and will need to file additional reporting with the Department as a result of the trend test. This new requirement is necessary because it will allow for early identification of a fraternal benefit society that is likely to reach a company action level in the following year. By triggering a company action level sooner, a fraternal benefit society can plan better for its capital needs and the Department will receive information related to its solvency regulatory duties which is necessary to protect the interests of the public.

The proposed amendments to §7.402 also are necessary to implement HB 3161. HB 3161 added a new Subchapter I to Chapter 841 of the Insurance Code to authorize the establishment of domestic limited purpose subsidiary life insurance companies to enable those companies to support excess reserves for certain life insurance policies. New Insurance Code §841.410(b) and (c) require a limited purpose subsidiary life insurance company to comply with the risk-based capital requirements adopted by the

Commissioner by rule, and to maintain risk-based capital in an amount that is at least equal to 300 percent of the authorized control level of risk-based capital adopted by the Commissioner. New §841.414(c) requires a limited purpose subsidiary life insurance company annually to file with the Commissioner a report of the limited purpose subsidiary life insurance company's risk-based capital level as of the end of the preceding calendar year containing the information required by the risk-based capital instructions adopted by the Commissioner. Under the amendments to §7.402(b), (d), and (e), as proposed, each limited purpose subsidiary life insurance company will be subject to the section's risk-based capital requirements for life insurers and will be required to file an electronic version of the 2011 risk-based capital report and any supplemental forms and reports with the NAIC in accordance with and by the due date specified in the RBC instructions. Under the amendments to §7.402(b), (d), and (e), as proposed, a limited purpose subsidiary life insurance company also will be subject to a trend test under §7.402(g)(5) if its total adjusted capital to authorized control level risk-based capital is between 200 percent and 250 percent. In that case, and if a limited purpose subsidiary life insurance company trends below 190 percent of total adjusted capital to authorized control level risk-based capital, it will be subject to the company action level requirements and will need to file additional reporting with the Department as a result of the trend test. This new requirement is necessary because it will allow for early identification of a limited purpose subsidiary life insurance company that is likely to reach a company action level in the following year. By triggering a company action level sooner, a limited purpose subsidiary life insurance company can plan better for its

capital needs and the Department will receive information related to its solvency regulatory duties which is necessary to protect the interests of the public.

Copies of the documents proposed in §7.402 for adoption by reference are available for inspection in Financial Analysis, Financial Regulation Division, Texas Department of Insurance, William P. Hobby Jr. State Office Building, Tower Number III, Third Floor, Mail Code 303-1A, 333 Guadalupe, Austin, Texas 78701.

2. FISCAL NOTE. Mr. Danny Saenz, Deputy Commissioner, Financial Regulation Division, has determined that, for each year of the first five years the proposed amended section will be in effect, there will be no fiscal implications for state or local government as a result of enforcing or administering the section. The amended section will have no effect on local employment or local economy.

3. PUBLIC BENEFIT/COST NOTE. Mr. Saenz also has determined that for each year of the first five years the proposed amended section is in effect, the anticipated public benefit will be that the Department will be able to more effectively utilize existing resources in the review of the operations and financial condition of carriers, to more efficiently monitor solvency of the carriers subject to the proposal, and to implement the most current risk-based capital requirements. The amended section will enable the Department to administer appropriate and proactive regulatory actions to protect the interests of the public against carriers whose financial condition may potentially be hazardous. The risk-based capital requirements are methods of ensuring carrier

solvency for the benefit of policyholders and others conducting business with insurers. The risk-based capital requirement ensures that a carrier has an appropriate level of policyholders' surplus after taking into account the underwriting, financial, and investment risks of a carrier. The NAIC risk-based capital formulas provide the Department with a widely used regulatory tool to identify the minimum amount of capital and surplus appropriate for a carrier to support its overall business operations considering its size and risk exposure. The new minimum capital and surplus requirements similarly require carriers to maintain minimum amounts of net assets to safely operate and pay policyholder claims.

With the exception of amended subsection (e), as proposed, and new subsection (g)(8) related to fraternal benefit societies, the proposed amendments to §7.402 contain the same substantive risk-based capital and surplus requirements of existing §7.402 for year-end 2010 but the compliance with the requirements will be based on the use of the 2011 NAIC risk-based capital formulas. Therefore, carriers previously subject to the rule will incur the same types of costs for year-end 2011 to comply with these requirements that were incurred for year-end 2010. The Department does not anticipate that any new, incremental costs will be incurred by carriers that were previously subject to §7.402 as a result of the proposed amendments.

However, because the scope of proposed §7.402(b) is expanded to also include fraternal benefit societies and limited purpose subsidiary life insurance companies, all of the costs for these specific carriers to now comply with the rule are set out below.

Section 7.402.

The Department has determined that the requirements of §7.402, which are proposed to be expanded to apply to limited purpose subsidiary life insurance companies and to fraternal benefit societies, contain two separate sets of requirements that must be analyzed in order to determine costs to carriers required to comply with the proposal. The two sets of requirements that may result in costs to carriers relate to (i) §7.402(b), (d), and (e) concerning risk based capital reports; and (ii) §7.402(g)(1) - (7), and proposed new (8), concerning additional reporting requirements.

Section 7.402(b), (d), and (e) concern, respectively, the scope of §7.402, the adoption of the risk-based capital formulas by reference, and the filing requirements for the subject carriers. Section 7.402(b), (d), and (e) require, regardless of size, certain property and casualty insurers; certain life insurance companies, including but not limited to, stipulated premium insurance companies and limited purpose subsidiary life insurance companies; fraternal benefit societies; and HMOs and insurers filing the National Association of Insurance Commissioners (NAIC) Health blank (the term “carriers” refers to all of these entities) to complete a risk-based capital report and reflect the results of that report in their financial statements filed with the Department. Section 7.402 does not apply to certain types of specified insurers and certain specified insurers with limited operations. Specifically, §7.402(b)(1) provides that §7.402 does not apply to any insurance company that writes or assumes a life insurance or annuity contract or assumes liability on or indemnifies one person for any risk under an accident and health insurance policy, or any combination of these policies, in an amount that is \$10,000 or less. Further, the scope indicated in §7.402(b)(1) does not include certain

carriers regulated by the Department, such as a statewide mutual assessment association, a local mutual aid association, a mutual burial association and an exempt association.

Certain carriers that have business subject to §7.402(d)(1) are also required to perform risk-based capital calculations pursuant to the 2011 life risk-based capital C-3 Phase II instructions. This requirement relates to certain unique types of annuity business that is generally written only by large carriers. The C-3 Phase II calculations are considered a more appropriate measure of the capital requirement for the interest rate risks and market risks associated with this type of annuity business, by requiring carriers to evaluate how various guarantees react to changes in equity markets and interest rates. The less than 10 large domestic carriers expected to be affected by the 2011 life risk-based capital C-3 Phase II instructions will incur ongoing annual actuarial and computer personnel costs to perform the C-3 Phase II calculations. The Department estimates that these actuarial personnel costs will range from \$25 per hour to approximately \$300 per hour. Computer personnel costs are estimated to range from \$25 per hour to approximately \$150 per hour. The annual costs for each of these few large domestic carriers in Texas are estimated to range from one-half of one percent to one percent of the annual costs of administering each of the carrier's business affected by the C-3 Phase II requirements. The Department anticipates that such annual costs per carrier are believed to be similar for each foreign carrier in Texas with business subject to these requirements. The Department's estimations are based upon discussions with industry representatives familiar with resources and costs needed for

these computations. Discussions with industry representatives involved several of the large domestic carriers in Texas estimated to have over half of the domestic carrier variable annuity business in Texas as measured on the basis of accumulation value for this business. Also, regardless of size, carriers specified in §7.402(b) that fail to maintain capital and surplus in accordance with the specified levels in §7.402(g)(1), (2), (5), (6), (7), and proposed new (8) are required to prepare and implement a comprehensive financial plan under §7.402(g)(1), (2), (5), (6), (7), and proposed new (8).

Any carrier specified in §7.402(b) is required to comply with the requirements in §7.402(d) and (e) to prepare a risk-based capital report and reflect the results of the report in the carrier's financial statements filed with the Department. These costs will vary from carrier to carrier based on various factors, which include the size and type of the carrier, the character of its investments, the kinds and nature of the risks insured, the type of software used by the carrier to complete its annual statement, and employee compensation expenses. Under §7.402, each carrier subject to §7.402(b), (d), and (e), regardless of size, is required to acquire NAIC risk-based capital software at a cost of approximately \$650 per entity for each carrier. The labor cost to transfer the information from a carrier's records to the applicable report will vary depending on the size of the carrier and the character of its investments; the transfer by larger carriers and carriers with more complex investments will generally take longer. If a carrier uses the annual statement software that conforms to NAIC specifications provided by authorized vendors to prepare its annual report, and if that software is linked to the risk-based

capital formula software, the Department estimates that the information can be transferred and the formula completed in four hours or less. If the annual statement software is not linked to the risk-based capital formula, the Department estimates that a carrier will be able to transfer the information from its records to the risk-based formula in eight to 16 hours. The Department's estimations are based upon discussions with industry representatives who are responsible for maintaining accounting records for carriers. It is anticipated that a carrier, regardless of size, will utilize an employee who is familiar with the accounting records of the carrier and accounting practices in general. The Department estimates that the compensation for this employee will range from approximately \$20 to \$40 an hour. After the completion of the transfer of information, the resulting risk-based capital report will likely be reviewed by an officer of the carrier who is responsible for the preparation of the financial reports of the carrier. The Department estimates that such officers are compensated at a range from approximately \$40 per hour to approximately \$100 per hour, or more. The Department also estimates that large carriers generally will compensate these officers at the higher end of the salary range. Therefore, based on the Department's experience, the cost of review of the risk-based capital report for small carriers will typically be less than the cost for large carriers.

Section 7.402(g)(1), (2), (5), (6), (7), and proposed new (8) concern reporting requirements for certain carriers and certain remedial actions the Commissioner is authorized or required to take based upon a carrier's specific risk-based capital calculations. A few carriers (estimated to be less than one percent of the total carriers

doing business in Texas) may need to prepare and file additional reporting with the Department at the company action level, as provided in §7.402(g)(1), (2), (5), (6), (7), and proposed new (8). The costs of this reporting will vary by company size and complexity, as well as the amount of risk that each company assumes, but will generally involve an employee who is familiar with the accounting records of the carrier and is compensated at an estimated rate from \$20 to \$40 per hour. Assistance from actuarial staff may be required, and actuarial personnel costs is estimated to range from \$25 per hour to approximately \$300 per hour. The additional reporting requirements typically will involve the chief financial officer or other similar officer responsible for preparing the financial reports; such officers are generally compensated at hourly rates that may range from \$40 per hour to approximately \$300 per hour. The Department also estimates that large carriers generally will compensate these officers at the higher end of the salary range. Therefore, based on the Department's experience, the costs of preparation and filing of the additional reporting to the Department at the company action level are estimated to be relatively less for small and micro business carriers compared to large business carriers. Company action level reporting and its associated costs are intended to stave off other, higher costs that impacted carriers will likely incur absent their timely action to address the underlying concerns. Company action level reporting enables the Department to administer appropriate and proactive regulatory actions in order to protect the interests of the public against carriers whose financial condition may potentially be hazardous.

The Department does not anticipate any new, incremental costs as a result of the adoption of the 2011 risk-based capital formulas to require a level of capital that is significantly different from the capital requirements for 2010. A relatively large percentage of carriers have been required by the Department to comply with the risk-based capital requirements for several years. For fraternal benefit societies and limited purpose subsidiary life insurance companies now required to comply with additional 2011 filing and other risk-based capital requirements due to the proposed expansion of the scope of §7.402, the costs associated with compliance will be that same as that for other carriers as set out herein. However, the function of the risk-based capital formula is to protect policyholders from the effects of insolvency, which may require some carriers to increase their capital and/or surplus, or otherwise reduce the amount of risk that the carriers assume to ensure they have an adequate amount of capital. To the extent any carrier must increase its capital and/or surplus or as a result of the risk-based capital requirements, that cost is the amount of capital and/or surplus or other action required and is a result of the statutory requirements in the Insurance Code Chapter 404 and §§441.001, 441.005, 441.051, 441.052, 822.210, 822.211, 841.205, 841.206, 841.410(b) and (c), 841.414(c), 843.404, 884.206, 885.401, 982.105, and 982.106. Moreover, as limited purpose subsidiary life insurance companies and fraternal benefit societies were not previously subject to some or all of the filing and other risk-based capital requirements, the Department anticipates that these specific carriers will be more likely to be required to increase their capital and/or surplus or take other action as a result of the application of the proposed amendments when compared

to carriers that were previously subject to risk-based capital requirements. To the extent that additional capital and/or surplus or other action may be required, the exact cost of compliance will vary significantly between carriers based upon a number of factors, which include: (1) the amount of capital and/or surplus currently maintained by the carrier; (2) the amount of capital and/or surplus required based upon the application of the risk-based capital requirements under the proposed new section; (3) the size and complexity of the carrier; and (4) the amount and complexity of the underwriting, financial, and investment risks that are assumed by the carrier.

4. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY ANALYSIS

FOR SMALL AND MICRO BUSINESSES. The Government Code §2006.002(c) 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 small 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 §2006.002(f) requires a state agency to adopt provisions concerning micro businesses

that are uniform with those provisions outlined in the Government Code §2006.002(b) - (d) for small businesses.

As required by the Government Code §2006.002(c), the Department has determined that the proposed amendments to §7.402, with the exception of amended subsection (e), as proposed, and new subsection (g)(8), related to fraternal benefit societies, contain the same requirements also applicable to the risk-based capital and surplus requirements for year-end 2010 but now using the 2011 risk-based capital formulas. Therefore, the same types of costs that were incurred for year-end 2010 to comply with these requirements will also be incurred for year-end 2011. The Department does not anticipate any new, incremental costs as a result of the proposed amendments for carriers that are subject to the existing requirements of §7.402. As previously detailed, however, the scope of the proposed new requirements in §7.402 for 2011 has been expanded to include domestic and foreign fraternal benefit societies and limited purpose subsidiary life insurance companies and, therefore, the Department provides the following analysis of the economic impact on the domestic and foreign fraternal benefit societies and limited purpose subsidiary life insurance companies that must now comply with §7.402.

Section 7.402.

The Department has determined that §7.402 contains two separate sets of requirements which will now apply to all carriers, unless they are expressly exempted, including domestic and foreign fraternal benefit societies and limited purpose subsidiary life insurance companies that are also small and micro business carriers. The two sets

of requirements that may result in costs to carriers relate to (1) §7.402(b), (d), and (e); and (2) §7.402(g)(1), (2), (5), (6), (7), and proposed new (8). As previously stated in the Public Benefit/Cost Note part of this proposal, all of the requirements in the existing §7.402 continue to apply, but the compliance with the requirements will be based on the use of the 2011 risk-based capital formulas and instructions for domestic and foreign fraternal benefit societies and limited purpose subsidiary life insurance companies. Therefore, the same types of costs that were incurred by small and micro business carriers for year-end 2010 to comply with these requirements would be incurred by domestic and foreign fraternal benefit societies and limited purpose subsidiary life insurance companies for year-end 2011.

Section 7.402(b), (d), and (e) require carriers specified in §7.402(b), regardless of size, to complete a risk-based capital report and reflect the results of that report in their financial statements filed with the Department. Separate and apart from any requirements of the Government Code §2006.002(c), §7.402(b)(1) excludes certain insurers from compliance with the §7.402 requirements. These insurers are more likely to be small or micro business carriers because of the insurers' types or methods of operation. Under §7.402(b)(1), the risk-based capital requirements in §7.402 do not apply to any insurance company that writes or assumes a life insurance or annuity contract or assumes liability on or indemnifies one person for any risk under an accident and health insurance policy, or any combination of these policies, in an amount that is \$10,000 or less. Further, under §7.402(b)(1), certain insurers are excluded entirely from compliance with the §7.402 requirements. These include statewide mutual assessment

associations, local mutual aid associations, mutual burial associations, and exempt associations. Section 7.402(d) and (e) require carriers specified in §7.402(b), regardless of size, to maintain capital and surplus in accordance with the specified levels. The failure to do so triggers the requirements in §7.402(g) that the carrier prepare and implement a comprehensive financial plan. Certain carriers that have annuity business subject to §7.402(d)(1) are required to perform risk-based capital calculations pursuant to the proposed 2011 life risk-based capital C-3 Phase II instructions. The C-3 Phase II requirement relates to certain unique types of annuity business that are generally written only by large carriers. As required by the Government Code §2006.002(c), the Department has determined that §7.402(d)(1) will not have an adverse economic effect on any small or micro businesses, including the domestic and foreign fraternal benefit societies and limited purpose subsidiary life insurance companies added to the list of carriers subject to §7.402. The Department does not anticipate that any small or micro business carriers will have business subject to §7.402(d)(1). Therefore no small or micro business will be required to perform risk-based capital calculations pursuant to the 2011 life risk-based capital C-3 Phase II instructions.

As required by the Government Code §2006.002(c), the Department has determined that approximately 50 to 100 of the carriers specified in §7.402(b), including, but not limited to, domestic and foreign fraternal benefit societies and limited purpose subsidiary life insurance companies, are small or micro-business carriers that will be required to comply with the requirements in §7.402(d) and (e) to prepare a risk-based

capital report and reflect the results of the report in the carrier's financial statements filed with the Department. These small or micro business carriers will incur routine costs associated with completing the risk-based capital report and reflecting the results in their financial statements filed with the Department. Also, as required by the Government Code §2006.002(c), the Department has determined that these routine costs will not have an adverse economic effect on the approximately 50 to 100 small or micro business carriers. These routine costs of compliance will vary between large business carriers and small or micro-business carriers based upon the carrier's type and size and other factors, including the character of the carrier's investments, the kinds and nature of the risks insured, the type of software used by the carrier to complete its annual statement, and employee compensation expenses. The Department's cost analysis and resulting estimated routine costs for carriers in the Public Benefit/Cost Note portion of this proposal are equally applicable to small and micro-businesses. As indicated in the Public Benefit/Cost Note analysis, these routine costs will be less for small or micro business carriers. This is primarily because small or micro business carriers will incur less labor costs in transferring information from their records to the risk-based capital reports due to their smaller and less complex investment portfolios than large business carriers. Also, small or micro business carriers may compensate officers who review risk-based capital reports at a lower salary than large 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. Because the Department has determined that the routine costs to comply with this amendment, i.e., completing the risk-based capital report and reflecting the results in the carrier's financial statements filed with the Department, will not have an adverse economic effect on small or micro businesses, the Department is not required to consider alternative methods of achieving the purpose of these requirements in the proposed rule.

§7.402(g)(1), (2), (5), (6), (7), and proposed new (8). As required by the Government Code §2006.002(c), the Department has determined that the costs to comply with §7.402(g)(1), (2), (5), (6), (7), and proposed new (8) may have an adverse economic effect on an estimated one or two small or micro-business carriers (i.e., all carriers subject to §7.402 including domestic and foreign fraternal benefit societies and limited purpose subsidiary life insurance companies). Such costs will only be incurred by these relatively few small or micro-business carriers because of the failure of the individual carrier to maintain capital and surplus in accordance with the levels required in §7.402(g)(1), (2), (5), (6), (7), and proposed new (8). This failure will trigger the requirement in §7.402(g)(1), (2), (5), (6), (7), and proposed new (8) that the carrier prepare and implement a comprehensive financial plan. This plan will be necessary to identify the conditions that contribute to the carrier's financial condition. The plan must contain proposals to correct areas of substantial regulatory concern and projections of the carrier's financial condition, both with and without the proposed corrections,

including plans to restore its capital and surplus to acceptable levels. The total cost of compliance with §7.402(g)(1), (2), (5), (6), (7), and proposed new (8) for preparing and implementing comprehensive financial plans will depend on the size and type of the small or micro-business carrier and several other factors. The other factors will vary by company size and complexity, as well as the amount of risk that each company assumes. The Department's cost analysis and resulting estimated costs for carriers who will be required to prepare and implement a comprehensive financial plan in the Public Benefit/Cost Note portion of this proposal are equally applicable to small or micro-businesses. As indicated in the Public Benefit/Cost Note analysis, these costs will be less for small or micro-business carriers, primarily because small or micro business carriers will incur less labor costs in transferring information from their records to the risk-based capital reports due to their smaller and less complex investment portfolios than large business carriers and because small or micro business carriers may compensate officers that review risk-based capital reports at a lower salary than large business carriers. The function of the risk-based capital formulas in §7.402(d) is to protect policyholders, enrollees, and carriers from the effects of carrier insolvency. Therefore, carriers, regardless of size, that are required to submit comprehensive financial plans may also be required to increase their capital. To the extent any carrier must increase its capital as a result of the risk-based capital requirements, that cost is the amount of capital required and is a result of the statutory requirements in the Insurance Code Chapter 404 and §§441.001, 441.005, 441.051, 441.052, 822.210, 822.211, 841.205, 841.206, 841.410(b) and (c), 841.414(c), 843.404, 884.206. 885.401,

982.105, and 982.106. These statutes authorize or require the Commissioner to order carriers that are operating in a potentially hazardous manner to take action to remedy such hazardous condition, which may include the requirement that the carriers increase their capital and surplus and take other remedial action.

In accordance with the Government Code §2006.002(c-1), the Department has determined that even though §7.402(g)(1), (2), (5), (6), (7), and proposed new (8) may have an adverse economic effect on small or micro-businesses that are required to comply with these proposed requirements, the Department is not required to prepare a regulatory flexibility analysis as required in §2006.002(c)(2) of the Government Code. Section 2006.002(c)(2) requires a state agency, before adopting a rule that may have an adverse economic effect on small businesses, to prepare a regulatory flexibility analysis that includes the agency's consideration of alternative methods of achieving the purpose of the proposed rule. Section 2006.002(c-1) of the Government Code requires that the regulatory flexibility analysis ". . . consider, if consistent with the health, safety, and environmental and economic welfare of the state, using regulatory methods that will accomplish the objectives of applicable rules while minimizing adverse impacts on small businesses." Therefore, an agency is not required to consider alternatives that, while possibly minimizing adverse impacts on small and micro-businesses, would not be protective of the health, safety, and environmental and economic welfare of the state.

Section 7.402(g)(1), (2), (5), (6), (7), and proposed new (8) are authorized by the following Insurance Code statutes: Chapter 404 and §§441.001, 441.005, 441.051,

441.052, 822.210, 822.211, 841.205, 841.410(b) and (c), 841.414(c), 843.404, 884.206, 885.401, 982.105, and 982.106. The primary purpose of Chapter 404 and §§441.001, 441.005, 441.051, 441.052, 822.210, 822.211, 841.205, 841.410(b) and (c), 841.414(c), 843.404, 884.206, 885.401, 982.105, and 982.106 is to require a carrier to maintain capital and surplus in amounts that exceed the minimum amounts required by statute because of (i) the nature and kind of risks the carrier underwrites or reinsures; (ii) the premium volume of risks the carrier underwrites or reinsures; (iii) the composition, quality, duration, or liquidity of the carrier's investments; (iv) fluctuations in the market value of securities the carrier holds; or (v) the adequacy of the carrier's reserves. These statutes further require that a rule adopted by the Commissioner be designed to ensure the financial solvency of a carrier for the protection of policyholders, enrollees, creditors, or the general public from the harmful effects of carrier insolvency. Additionally, the primary purpose of Chapters 404 and 441 is to protect insureds, enrollees or creditors, and the public against an insurer or HMO becoming insolvent, delinquent, or in a condition that renders the continuance of its business hazardous to its insureds, enrollees or creditors, or to the public. Chapter 404 permits the Commissioner to take various actions against an insurer upon a finding of impairment or hazardous condition, including a requirement that the capital and surplus of an insurer be increased. Section 441.001(g) provides that for the reasons stated in §441.001, the substance and procedures relating to insurer delinquencies and insolvencies in Insurance Code Chapter 441 are the public policy of the State of Texas and are necessary to the public welfare. Section 441.001(a) states that insurer delinquencies

destroy public confidence in the state's ability to regulate insurers and an insurer delinquency affects other insurers by creating a lack of public confidence in insurance and insurers. Section 441.001(b) states that placing an insurer in receivership often destroys or diminishes, or is likely to destroy or diminish, the value of the insurer's assets. Further, the purpose of Insurance Code §§441.051, 822.211, and 841.206 is to prohibit the impairment of a carrier's minimum required capital or surplus, and these statutes require that the Commissioner take action to remedy the impairment. Sections 441.051, 822.211, and 841.206 further provide that the failure of a carrier to maintain its required capital or surplus at levels required by the Commissioner by rule is considered a prohibited impairment.

The purpose of §7.402(g)(1), (2), (5), (6), (7), and proposed new (8) is to protect the economic welfare of (i) carriers; (ii) consumers that purchase insurance policies, annuities and other contracts issued by property and casualty insurers; life insurance companies, including, but not limited to stipulated premium insurance companies and limited purpose subsidiary life insurance companies; health insurance companies; fraternal benefit societies; and HMOs and insurers filing the NAIC Health blank; (iii) other persons and entities that would be adversely affected by a carrier insolvency against the risk that a carrier may become insolvent and unable to pay its insureds' claims and other obligations as they become due; and (iv) the public and the state of Texas generally.

The requirements in §7.402(g) that carriers maintain capital and surplus at acceptable levels or prepare a comprehensive financial plan to restore their capital and

surplus to acceptable levels are consistent with and necessary to implement the legislative intent of Chapter 404 and §§441.001, 441.005, 441.051, 441.052, 822.210, 822.211, 841.205, 841.410(b) and (c), 841.414(c), 843.404, 884.206, 885.401, 982.105, and 982.106 of the Insurance Code. This intent is to ensure the financial solvency of a carrier, regardless of size, for the protection of the economic interests of all policyholders and not just the economic interests of those policyholders insured by large carriers.

Therefore, the Department has determined, in accordance with §2006.002(c-1) of the Government Code, that because the purpose of §7.402(g)(1), (2), (5), (6), (7), and proposed new (8) and the authorizing statutes of the Insurance Code is to protect carrier and consumer economic interests and the state's economic welfare, there are no additional regulatory alternatives to the required comprehensive financial plans and increased capital required as a result of the risk-based capital requirements that will sufficiently protect the economic interests of carriers and consumers and the economic welfare of the state.

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 January 30, 2012, to Sara Waitt, Acting General Counsel, Mail Code 113-2A, Texas Department of Insurance, P. O. Box 149104, Austin, Texas 78714-9104. An additional copy of the comments must be simultaneously submitted to Danny Saenz, Deputy Commissioner, Financial Regulation Division, Mail Code 305-2A, P. O. Box 149104, Austin, Texas 78714-9104. Any request for a public hearing should be submitted separately to the Office of the Chief Clerk, Mail Code 113-2A, Texas Department of Insurance, P. O. Box 149104, Austin, Texas 78714-9104, 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 404 and 441 and §§822.210, 822.211, 841.205, 841.410(b) and (c), 841.414(c), 843.404, 884.054, 884.206, 885.401, 982.105, 982.106, and 36.001. Chapter 404 addresses the duties of the Department when an insurer's solvency is impaired. Section 404.004 provides that the Commissioner's authority to increase any capital and surplus requirements prevails over the general provisions of the Insurance Code relating to specific companies, and §404.005 authorizes the Commissioner to set standards for evaluating the financial condition of an insurer. Chapter 441 addresses the prevention of insurer delinquencies and insolvencies. Under §441.005, the Commissioner may adopt reasonable rules as necessary to implement and supplement the purposes of Chapter 441. Section 441.051 specifies "the circumstances in which an

insurer is considered insolvent, delinquent, or threatened with delinquency” and includes certain statutorily specified conditions, including if an insurer’s required surplus, capital, or capital stock is impaired to an extent prohibited by law. Section 822.210 authorizes the Commissioner to adopt rules or guidelines to require an insurer to maintain capital and surplus levels in excess of statutory minimum levels to assure financial solvency of insurers for the protection of policyholders and insurers. Section 822.211 specifies the actions the Commissioner may take if an insurance company does not comply with the capital and surplus requirements of Chapter 822. Section 841.205 authorizes the Commissioner to adopt rules or guidelines to require an insurer that writes life or annuity contracts or assumes liability on or indemnifies one person for any risk under an accident and health insurance policy, or a combination of these policies, in an amount that exceeds \$10,000 to maintain capital and surplus levels in excess of statutory minimum levels to assure financial solvency of insurers for the protection of policyholders and insurers. Section 841.410(b) and (c) require a limited purpose subsidiary life insurance company to comply with the risk-based capital requirements adopted by the Commissioner by rule, and maintain risk-based capital in an amount that is at least equal to 300 percent of the authorized control level of risk-based capital adopted by the Commissioner. Section 841.414(c) requires a limited purpose subsidiary life insurance company annually to file with the Commissioner a report of the limited purpose subsidiary life insurance company’s risk-based capital level as of the end of the preceding calendar year containing the information required by the risk-based capital instructions adopted by the Commissioner. Section 843.404

authorizes the Commissioner to adopt rules to require a health maintenance organization to maintain capital and surplus levels in excess of statutory minimum levels to ensure financial solvency of health maintenance organizations for the protection of enrollees. Section 884.054 specifies the capital stock and surplus requirements for stipulated premium insurance companies. Section 884.206 authorizes the Commissioner to adopt rules to require an insurer that writes or assumes life insurance, annuity contracts or accident and health insurance for a risk to one person in an amount that exceeds \$10,000 to maintain capital and surplus levels in excess of statutory minimum levels to assure financial solvency of insurers for the protection of policyholders and insurers. Section 885.401 requires each fraternal benefit society to file an annual report on the society's financial condition, including any information the Commissioner considers necessary to demonstrate the society's business and method of operation, and authorizes the Department to use the annual report in determining a society's financial solvency. Section 982.105 specifies the capital, stock, and surplus requirements for foreign or alien life, health, or accident insurance companies. Section 982.106 specifies the capital, stock, and surplus requirements for foreign or alien insurance companies other than life, health, or accident insurance companies. Section 36.001 authorizes the Commissioner to adopt any rules necessary and appropriate to implement the powers and duties of the Texas Department of Insurance under the Insurance Code and other laws of this state.

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

<u>Rule</u>	<u>Statute</u>
§7.402	Insurance Code Chapters 404 and 441 and §§822.210, 822.211, 841.205, 841.410(b) and (c), 841.414(c), 843.404, 884.054, 884.206, 885.401, 982.105, and 982.106

9. TEXT.

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

(a) (No change.)

(b) Scope.

(1) Life companies. This section applies to any insurer authorized to do business in Texas as an insurance company that writes or assumes a life insurance or annuity contract or assumes liability on or indemnifies one person for any risk under an accident and health insurance policy, or any combination of these policies, in an amount that exceeds \$10,000 including: capital stock companies, mutual life companies, limited purpose subsidiary life insurance companies, and stipulated premium insurance companies. [~~Fraternal benefit societies are subject to their own separate risk-based capital instructions as provided in subsection (d)(2) of this section.~~]

(2) – (3) (No change.)

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

(c) (No change.)

(d) Adoption of RBC formula by reference. The commissioner adopts by reference the following, which are available for inspection in the Financial Analysis Division of the Texas Department of Insurance, William P. Hobby Jr. State Office Building, Tower Number III, Third Floor, Mail Code 303-1A, 333 Guadalupe, Austin, Texas:

(1) The 2011 [2009] NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(2) The 2011 [2009] NAIC Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(3) The 2011 [2009] NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(4) The 2011 [2009] NAIC Health Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

~~[(5) The 2010 NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.]~~

~~[(6) The 2010 NAIC Fraternal Benefit Societies Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.]~~

~~[(7) The 2010 NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.]~~

~~[(8) The 2010 NAIC Health Risk Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.]~~

(e) Filing requirements.

~~[(1)] All companies subject to this section [except fraternal benefit societies, stipulated premium companies doing business only in Texas, and county mutual insurance companies that do not meet the express criteria contained in the Insurance Code §912.056(f),] are required to file electronic versions of the 2011 [2009 and the 2010] RBC reports and any supplemental RBC forms and reports with the NAIC in accordance with and by the due dates specified in the RBC instructions.~~

~~[(2) Fraternal benefit societies shall prepare, maintain, and file a paper copy of the 2009 RBC report and any supplemental RBC forms and reports with the department whenever requested by the department. Fraternal benefit societies shall prepare and maintain a paper copy of the 2010 RBC report and any supplemental RBC forms and reports by March 1, 2011, and make the reports and forms available for review whenever requested by the department. The 2009 and 2010 RBC reports and any supplemental RBC forms and reports shall be completed in accordance with the respective calendar-year RBC instructions.]~~

~~[(3) Stipulated premium insurance companies only doing business in Texas are not required to file the 2009 RBC report, but shall file an electronic version of the 2010 RBC report and any supplemental RBC forms and reports with the NAIC in accordance with and by the due date specified in the RBC instructions.]~~

~~[(4) County mutual insurance companies that do not meet the express criteria contained in the Insurance Code §912.056(f) are not required to file the 2009 RBC report but shall file an electronic version of the 2010 RBC report and any supplemental RBC forms and reports with the NAIC in accordance with and by the due date specified in the RBC instructions.]~~

(f) (No change.)

(g) Actions of commissioner. The level of risk-based capital is calculated and reported annually. Depending on the results computed by the risk-based capital formula, the commissioner of insurance may take a number of remedial actions, as considered necessary. The ratio result of the total adjusted capital to authorized control level risk-based capital requires the following actions related to an insurer within the specified ranges:

(1) – (7) (No change.)

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

(h) – (j) (No change.)