

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

1. INTRODUCTION. The Texas Department of Insurance proposes amendments to 28 Texas Administrative Code §7.402, concerning risk-based capital and surplus requirements for insurers and health maintenance organizations (HMOs). The proposed amendments to §7.402 adopt by reference the 2013 National Association of Insurance Commissioners (NAIC) risk-based capital formulas and instructions to implement and update the risk-based capital and surplus requirements for year-end 2013 for property and casualty insurers, life insurance companies, HMOs, insurers filing the NAIC Health Annual Statement Blank, and fraternal benefit societies.

Specifically, proposed amended §7.402(d) adopts by reference: 1) the 2013 NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies, 2) the 2013 NAIC Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies, 3) the 2013 NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies, and 4) the 2013 NAIC Health Risk-Based Capital Report including Overview and Instructions for Companies. References to the 2012 versions of these documents are removed.

The amendments to §7.402 address risk-based capital and surplus requirements for insurers and HMOs subject to §7.402 (collectively referred to as “carriers” in this proposal). The risk-based capital requirement is a method of

ensuring that a carrier has an appropriate level of policyholder surplus after taking into account the underwriting, financial, and investment risks of a carrier. The updated NAIC risk-based capital formulas listed above provide the department with a widely used regulatory tool to identify the minimum amount of capital and surplus appropriate for a carrier to support its overall business operations considering its size and risk exposure.

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

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

The NAIC amended its Risk-Based Capital for Insurers Model Act in November, 2011, to adjust the threshold at which a trend test applies to fraternal benefit societies and life insurers from 2.5 times the authorized control level to 3.0

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

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

Copies of the 2013 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 reviewing operations and financial condition of carriers, more efficiently monitor solvency of carriers subject to the proposal, and 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 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 2013 risk-based formulas and instructions have minor variations from the 2012 risk-based formulas and instructions. With certain exceptions, carriers previously subject to the requirements will incur the same types of costs for year-end 2013 to comply with these requirements they incurred for year-end 2012. Additional costs may result from amendments to §7.402(g)(5) and (8) and the reporting requirements for property and casualty carriers in §7.402(d)(3) resulting from

reporting a new information only catastrophe risk charge and catastrophe loss data for 2013. Catastrophe loss data reporting is needed in order to develop premium risk factors on an ex-catastrophe basis so that catastrophe risk is not double-counted in the risk based capital formula.

The new catastrophe risk charge will require property and casualty carriers with hurricane and earthquake exposure to use software to model their losses using certain parameters as described in the instructions. Because carriers should already be modeling their losses to manage their catastrophe risk, the additional cost to comply with the reporting should be marginal. This cost will vary based on the carrier's size, organization, and ability to adapt available information to the reporting purpose. The department anticipates that these functions will require the services of actuaries, accountants, and systems software developers. While it is not feasible to determine the actual cost of any employees needed to comply with the new requirement, the United States Department of Labor, Bureau of Labor Statistics' *May 2012, Occupational Employment Statistics* report indicates that the average hourly wages for these professions in Texas are: \$52.58 for actuaries (see: <http://www.bls.gov/oes/current/oes152011.htm#st>), \$34.54 for accountants and auditors (see: <http://www.bls.gov/oes/current/oes132011.htm#nat>), and \$47.80 for systems software developers (see: <http://www.bls.gov/oes/current/oes151133.htm#st>). The method of compliance is a business decision, including a decision to employ staff or contract for these services.

Because data for reporting 2013 catastrophe losses should be readily available to property and casualty insurers, any additional cost to comply with the reporting should be marginal. The department anticipates that preparing the information will require the services of accountants. These costs will vary among carriers based on factors, including the size and type of carrier and its existing data collection procedures. While it is not feasible to determine the actual cost of any employees needed to comply with the new requirement, the United States Department of Labor, Bureau of Labor Statistics' *May 2012, Occupational Employment Statistics* report indicates that the average hourly wage for this profession in Texas is \$34.54 for accountants and auditors (see: <http://www.bls.gov/oes/current/oes132011.htm#nat>). The method of compliance is a business decision, including a decision to employ staff or contract for these services.

Section 7.402(g) establishes reporting requirements for certain carriers and certain remedial actions the commissioner is authorized or required to take based on a carrier's specific risk-based capital calculations. Amendments to §7.402(g)(5) and (8) may require some life and fraternal benefit society carriers to prepare and file additional reporting with the department at the company action level. The department anticipates that these functions will require the services of actuaries, accountants, and a corporate officer, typically the chief financial officer or other similar officer responsible for preparing the financial reports.

While it is not feasible to determine the actual cost of any employees needed to comply with the new requirement, the United States Department of Labor, Bureau of

Labor Statistics' *May 2012, Occupational Employment Statistics* report indicates that the average hourly wages for these professions in Texas are \$52.58 for actuaries and \$34.54 for accountants and auditors. The United States Department of Labor, Bureau of Labor Statistics' *May 2012, Occupational Employment Statistics* does not list the average hourly wages for the chief financial officer profession. Consistent with the 2010 and 2011 proposals implementing risk-based capital requirements under §7.402, the department has determined that the hourly rate of compensation for a chief financial officer or other similar officer responsible for preparing the financial reports ranges from \$40 per hour to approximately \$300 per hour.

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 or surplus, or otherwise reduce the amount of risk the carriers assume to ensure they have an adequate amount of capital. To the extent any carrier must increase its capital and surplus, or take other action as a result of the risk-based capital requirements, that cost is the amount of capital and 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. To the extent that additional capital or surplus or other action may be required, the exact cost of compliance will vary significantly between carriers based on 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 on

the application of the risk-based capital requirements under the proposed amended section, 3) the size and complexity of the carrier, and 4) the amount and complexity of the underwriting, financial, and investment risks assumed by the carrier.

4. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY

ANALYSIS FOR SMALL AND MICRO-BUSINESSES. Government Code §2006.002(c) requires that if a proposed rule may have an adverse economic impact on small and micro-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 department has determined that the amendments to §7.402 may result in new costs to carriers from two separate sets of requirements. The first applies to all property and casualty insurers required to submit risk-based capital reports under §7.402(d)(3). The second applies to life insurance and fraternal benefit societies required to prepare and file additional reporting with the department at the company action level under §7.402(g)(5) and (8). Both requirements ensure that the carrier has sufficient minimum capital to account for its risks and is a consideration for any insurer, regardless of size. The department has determined that approximately 50 to 100 small or micro-business carriers will be needed to comply with the requirements in §7.402.

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. 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 §§441.051, 822.210, 822.211, 841.205, 841.206, 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 the hazardous condition, which may include requiring the carriers to increase their capital and surplus and take other remedial action.

In accord with Government Code §2006.002(c-1), the department has determined that although §7.402(d)(3) and (g)(5) and (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 under §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. Government Code §2006.002(c-1) 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." 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(d)(3) and (g)(5) and (8) are authorized by Insurance Code Chapters 404 and 441 and §§822.210, 841.205, 843.404, 884.206, 885.401, 982.105, and 982.106. The primary purpose of §§822.210, 841.205, 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: 1) the nature and kind of risks the carrier underwrites or reinsures; 2) the premium volume of risks the carrier underwrites or reinsures; 3) the composition, quality, duration, or liquidity of the carrier's investments; 4) fluctuations in the market value of securities the carrier holds; 5) or the adequacy of the carrier's reserves. These statutes further require the commissioner to adopt rules 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, 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 on a finding of impairment or hazardous condition, including requiring that the insurer's capital and surplus 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 purposes of §7.402(d)(3) and (g)(5) and (8) are to protect the economic welfare of: 1) carriers; 2) consumers that purchase insurance policies, annuities, and other contracts; 3) other persons and entities that would be adversely affected by a carrier insolvency; and 4) 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 Chapters 404 and 441 and §§822.210, 841.205, 843.464, 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. The department has determined, in accord with §2006.002(c-1) of the Government Code, that because the purpose of §7.402(d)(3) and (g)(5) and (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 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, so this proposal does not constitute a taking or require a takings impact assessment under the Government Code §2007.043.

6. REQUEST FOR PUBLIC COMMENT. To have your written comments on the proposal considered, you must submit them no later than 5:00 p.m. on January 20, 2014, to the Office of Chief Clerk, Mail Code 113-2A, Texas Department of Insurance, P. O. Box 149104, Austin, Texas 78714-9104. A copy of your 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 §§404.004, 404.005, 441.005, 441.051, 822.210, 822.211, 841.205, 841.206, 841.410, 841.414, 843.404, 884.054, 884.206, 885.401, 982.105, 982.106, and 36.001. Section 404.004 provides that the commissioner's authority to increase any capital and surplus requirements prevails over the general provisions of the Insurance Code relating to specific companies, and §404.005 authorizes the commissioner to set standards for evaluating the financial condition of an insurer. Under §441.005, the commissioner may adopt reasonable rules as necessary to implement and supplement the purposes of Chapter 441.

“Section 441.051 specifies the circumstances in which an insurer is considered “insolvent, delinquent, or threatened with delinquency” and includes certain statutorily specified conditions, including if an insurer's required surplus, capital, or capital stock is impaired to an extent prohibited by law. Section 822.210 authorizes the commissioner to adopt rules or guidelines to require an insurer to

maintain capital and surplus levels in excess of statutory minimum levels to assure financial solvency of insurers for the protection of policyholders and insurers.

Section 822.211 specifies the actions the commissioner may take if an insurance company does not comply with the capital and surplus requirements of Chapter 822.

Section 841.205 authorizes the commissioner to adopt rules or guidelines to require an insurer that writes life or annuity contracts or assumes liability on or indemnifies one person for any risk under an accident and health insurance policy, or a combination of these policies, in an amount that exceeds \$10,000, to maintain capital and surplus levels in excess of statutory minimum levels to assure financial solvency of insurers for the protection of policyholders and insurers. Section 841.206 authorizes the commissioner to take regulatory action if the commissioner determines that a life, accident, or health insurance company's capital or surplus is impaired in violation of §841.206.

Section 841.410(b) and (c) require a limited purpose subsidiary life insurance company to comply with the risk-based capital requirements adopted by the commissioner by rule, and maintain risk-based capital in an amount that is at least equal to 300 percent of the authorized control level of risk-based capital adopted by the commissioner. Section 841.414(c) requires a limited purpose subsidiary life insurance company 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 HMO to maintain capital and surplus levels in excess of statutory minimum levels to ensure financial solvency of HMOs for the protection of enrollees. Section 884.054 specifies the capital stock and surplus requirements for stipulated premium insurance companies. Section 884.206 authorizes the commissioner to adopt rules to require an insurer that writes or assumes life insurance, annuity contracts, or accident and health insurance for a risk to one person in an amount that exceeds \$10,000 to maintain capital and surplus levels in excess of statutory minimum levels to assure financial solvency of insurers for the protection of policyholders and insurers.

Section 885.401 requires each fraternal benefit society to file an annual report on the society's financial condition, including any information the commissioner considers necessary to demonstrate the society's business and method of operation, and authorizes the department to use the annual report in determining a society's financial solvency.

Section 982.105 specifies the capital, stock, and surplus requirements for foreign or alien life, health, or accident insurance companies. Section 982.106 specifies the capital, stock, and surplus requirements for foreign or alien insurance companies other than life, health, or accident insurance companies. Section 36.001 authorizes the commissioner to adopt any rules necessary and appropriate to implement the powers and duties of the department under the Insurance Code and other laws of this state.

8. CROSS REFERENCE TO STATUTE. The proposal affects the following statutes:

Rule	Statute
§7.402	Insurance Code §§404.004, 404.005, 441.005, 441.051, 822.210, 822.211, 841.205, 841.206, 841.410, 841.414, 843.404, 884.054, 884.206, 885.401, 982.105, and 982.106

9. TEXT.

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

(a) - (c) (No change.)

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

(1) The 2013 [~~2012~~] NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies, which includes the RBC formula.

(2) The 2013 [~~2012~~] NAIC Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies, which includes the RBC formula.

(3) The 2013 [~~2012~~] NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies, which includes the RBC formula.

(4) The 2013 [~~2012~~] NAIC Health Risk-Based Capital Report Including Overview and Instructions for Companies, which includes the RBC formula.

(e) Filing requirements. All companies subject to this section must file electronic versions of the 2013 [~~2012~~] RBC reports and any supplemental RBC forms

and reports with the NAIC in accord with and by the due dates specified in the RBC instructions.

(f) (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) An insurer reporting total adjusted capital of 150 percent to 200 percent of authorized control level risk-based capital institutes a company action level under which the insurer must prepare a comprehensive financial plan that identifies the conditions that contribute to the company's financial condition. The plan must contain proposals to correct areas of substantial regulatory concern and projections of the company's financial condition, both with and without the proposed corrections. The plan must list the key assumptions underlying the projections and identify the concerns associated with the insurer's business. The RBC plan must ~~is to~~ be submitted within 45 days of filing the RBC report with the NAIC. After review, the commissioner will notify the company if the plan is satisfactory or not satisfactory. If the commissioner notifies the company that the plan is not satisfactory, the company must prepare a revised plan and submit it to the commissioner. Failure to

file this comprehensive financial plan triggers the regulatory [~~next lower~~] action level described in this subsection.

(2) (No change.)

(3) An insurer reporting total adjusted capital of 70 percent to 100 percent of authorized control level risk-based capital triggers an authorized control level. In addition to the remedies available at the company and regulatory [~~higher~~] action levels described in this subsection, the commissioner may take other action deemed necessary, including initiating a regulatory intervention to place an insurer under regulatory control.

(4) (No change.)

(5) A life insurer subject to this section is subject to a trend test described in the RBC formula, if its total adjusted capital to authorized control level risk-based capital is between 200 percent and 300 [~~250~~] percent. Any life insurer that trends below 190 percent of total adjusted capital to authorized control level risk-based capital triggers the company action level.

(6) - (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 300 [~~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.)

10. CERTIFICATION. This agency certifies that legal counsel has reviewed the proposal and found it to be within the agency's authority to adopt.

Issued at Austin, Texas on December 9, 2013.

A handwritten signature in black ink that reads "Sara Waitt". The signature is written in a cursive style with a horizontal line underneath it.

Sara Waitt
General Counsel
Texas Department of Insurance