

SUBCHAPTER A. Examination and Financial Analysis
28 TAC §7.18

1. INTRODUCTION. The Texas Department of Insurance adopts amendments to §7.18, concerning the National Association of Insurance Commissioners Accounting Practices and Procedures Manual. These amendments are adopted without changes to the proposal published in the December 7, 2012, issue of the *Texas Register* (37 TexReg 4806) and will not be republished. These amendments primarily adopt by reference the March 2012 version of *The Accounting Practices and Procedures Manual*, published and issued by the NAIC. Additionally, the amendments make conforming changes to §7.18 to reflect the adoption of this version.

2. REASONED JUSTIFICATION. These amendments to §7.18 primarily seek to adopt by reference the National Association of Insurance Commissioners' (NAIC) substantive and other updates to the March 2012 version of *The Accounting Practices and Procedures Manual* (Manual) adopted by the NAIC in calendar year 2012. The amendments also delete or modify three existing Texas exceptions to the Manual. Additionally, the amendments make conforming changes to §7.18 to reflect these changes.

The Manual, published and issued by the NAIC, incorporates the statements of statutory accounting principles (SSAPs) adopted by the NAIC and various other appendices, including actuarial guidelines adopted by the NAIC. The SSAPs provide a national standard for insurers and health maintenance

organizations (collectively referred to as “carriers” in this order) on how to properly record business transactions for the purpose of statutory reporting. The NAIC adopts these SSAPs through its maintenance of statutory accounting principles process, which includes a series of open meetings that offer the public the opportunity to comment on the proposed SSAPs. The NAIC annually updates the Manual to reflect any changes to the SSAPs made through this process or other changes to the Manual.

The department uses the Manual, including its appendices, as its source of statutory accounting principles and actuarial guidelines when analyzing financial reports and conducting statutory examinations and rehabilitations of carriers licensed in Texas unless a department rule or other state law provides otherwise. The department periodically adopts the Manual by reference, with certain modifications and exceptions, in §7.18 to codify this usage. Most recently, on October 12, 2012, the department amended §7.18 to adopt by reference the March 2012 version of the Manual to apply to all examinations conducted on or after December 31, 2011, and all financial statements filed with the department for reporting periods beginning on or after December 31, 2011.

The department now amends §7.18 to adopt by reference the substantive and other updates to the March 2012 version of the Manual issued by the NAIC during calendar year 2012. The amendments provide that these updates will be used to prepare all financial statements required to be filed with the department on or after January 1, 2013, and will be applied to all examinations of those financial statements. These amendments are necessary to ensure that all

applicable examinations conducted and statements filed comply with these NAIC updates, which, combined with the March 2012 version of the Manual, effectively constitute the March 2013 version of the Manual. Furthermore, by adopting by reference the APPM requirements, including SSAPs and actuarial guidelines, most recently adopted by the NAIC, the department ensures that its accounting and actuarial requirements remain uniform with the accounting and actuarial requirements of other states. This uniformity is critical for insurers that operate in Texas and other jurisdictions because failure to adopt the most recent APPM requirements could result in these insurers being required to prepare multiple statements to comply with the updated APPM requirements in other states and the non-updated versions in Texas. This outcome would impose an unnecessary cost on these insurers and competitively disadvantage insurers domiciled in Texas.

The department also amends three existing exceptions to the Manual and makes other conforming changes to §7.18 to account for the deleted exceptions and addition of the NAIC updates. These amendments are necessary to update expired provisions in these exceptions or to delete provisions that now conform with the current SSAPs. The department provides a full description of these changes below.

The department also notes that copies of the documents adopted by reference in newly designated §7.18(c)(1) are available for inspection in the Financial Regulation 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.

3. HOW THE SECTION WILL FUNCTION. Amended subsection (c) provides that the adopted exceptions and modifications under this subsection must be used to prepare all financial statements required to be filed with the department on or after January 1, 2013, and will be applied to all examinations of those financial statements. This change is necessary to comply with the analogous effective dates of the NAIC updates adopted by reference in subsection (c)(1).

Amended §7.18(c)(1)(A) lists the SSAPs adopted by reference. Specifically, it adopts by reference: (i) SSAP No. 94, which adopts, with modification, *FAS 123(R): Share-Based Payment*; (ii) SSAP Nos. 92 and 102, which adopts, with modification, *FAS 158: Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements Nos. 87, 88, 106, and 132(R)*; and (iii) SSAP No. 103, which adopts, with modification, *ASU 2009-16: Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*. SSAP No. 92 supersedes SSAP No. 14. SSAP No. 102 supersedes SSAP No. 89, and SSAP No. 103 supersedes SSAP No. 91R. SSAPs Nos. 92, 94, 102, and 103 must be used to prepare all financial statements required to be filed with the department on or after January 1, 2013 and will be applied to all examinations of those financial statements.

Amended §7.18(c)(1)(B) adopts by reference a placement revision to SSAP Nos. 40 and 77. Specifically, this placement revision nullifies SSAP No.

77 and includes the real estate guidance, related effective dates, and adopted General Accepted Accounting Principles (GAAP) references in SSAP No. 40.

Amended §7.18(c)(1)(C) adopts by reference several non-substantive revisions to the SSAPs adopted by the NAIC in calendar year 2012 that do not modify the intent of a SSAP. The SSAPs specifically addressed by these modifications include SSAP Nos. 1, 11, 26, 27, 36, 35R, 48, 57, 68, 90, 95, 97, and 101 QA – Clean and 101 QA – Tracked.

Amended §7.18(c)(1)(D) adopts by reference Actuarial Guideline 38 (AG 38) adopted by the NAIC in calendar year 2012. AG 38 sets forth reserve requirements for all universal life products that employ secondary guarantees with or without shadow account funds. This revision to AG 38 provides clarification of certain ambiguities used by sophisticated shadow fund designs, and this revision to AG 38 provides different requirements for in force business and business issued on or after January 1, 2013.

Amended §7.18(c)(2) makes several changes to existing Texas exceptions to the Manual. Specifically, this paragraph redesignates subsection (c)(2) and (c)(3) of this section as new §7.18(c)(2)(B) and §7.18(c)(2)(C), respectively, and removes unnecessary portions of these exceptions relating to property acquired before January 1, 2001, because the amortization period in these provisions has expired. Additionally, amended §7.18(c)(4) deletes existing paragraph (c)(4) of this section because this exception now conforms with the current SSAPs.

The amendments also make nonsubstantive changes to §7.18 that are necessary for the section to conform to current nomenclature, for reformatting, consistency, clarity, or editorial reasons, and to correct typographical and grammatical errors.

4. SUMMARY OF COMMENTS AND AGENCY RESPONSES. The public comment period for the proposed amendments to §7.18 closed on January 7, 2013. The department received no public comments on the proposed amendments.

5. STATUTORY AUTHORITY. The department adopts these amendments 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 accord 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 to obtain an accurate indication of the company's condition and method of transacting business, as necessary, 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 (relating to 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, including 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 class may be amortized. Section 36.001 provides that the commissioner 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.

6. 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 2012 version of the *Accounting Practices and Procedures Manual* (Manual) published by the National Association of Insurance Commissioners (NAIC), with the exceptions and modifications 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 determining the proper accounting treatment for an insurance or health plan transaction, the commissioner will 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 preempting 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 (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; the 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) Texas statutes;

(2) department rules;

(3) directives, instructions, and orders of the commissioner;

(4) the Manual;

(5) other NAIC handbooks, manuals, and instructions, adopted by the department; and

(6) Generally Accepted Accounting Practices.

(b) The commissioner adopts by reference the March 2012 version of the Manual, with the exceptions and modifications 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. This Manual that is adopted by

reference with the exceptions and modifications specified in subsections (c) and (d) of this section will be applied to examinations conducted as of December 31, 2011, and thereafter, and also must be used to prepare all financial statements filed with the department for reporting periods beginning on or after December 31, 2011.

(c) The adopted exceptions and modifications under this subsection must be used to prepare all financial statements required to be filed with the department on or after January 1, 2013, and will be applied to all examinations of those financial statements.

(1) The commissioner adopts by reference the following modifications to the Manual:

(A) Statement of Statutory Accounting Principles (SSAP) Nos. 92, 102, 103, and 104 adopted by the NAIC in calendar year 2012.

(B) Placements revisions to nullify SSAP No. 77 and include real estate sales guidance, related effective dates, and adopted Generally Accepted Accounting Principles references in SSAP No. 40.

(C) The following modifications made by the NAIC in calendar year 2012 to SSAP Nos. 1, 11, 26, 27, 36, 35R, 48, 57, 68, 90, 95, 97, and 101 QA – Clean and 101 QA – Tracked, that do not modify the intent of those or any other SSAP Numbers.

(i) Ref. No. 2004-27: Fund Demand Disclosures for Institutional Business;

(ii) Ref. No. 2011-19: ASU 2010-11: Derivatives and

Hedging (Topic 815) – Scope Exception Related to Embedded Credit

Derivatives:

(iii) Ref. No. 2011-25: ASU 2011-02, Receivables – A

Creditors' Determination of Whether a Restructuring is a Troubled Debt

Restructuring:

(iv) Ref. No. 2011-38: ASU 2011-06, Fees Paid to the

Federal Government by Health Insurers;

(v) Ref. No. 201142: SSAP No.1 Implementation

Guide:

(vi) Ref. No. 2012-01: EITF 06-2: Accounting for

Sabbatical Leave and Other Similar Benefits Pursuant to FAS No. 43;

(vii) Ref. No. 2012-02: EITF 07-1, Accounting for

Collaborative Arrangements;

(viii) Ref. No. 2012-03: Clarifications to SSAP No.

57—Title Insurance;

(ix) Ref. No. 2012-05: Clarification on the Amortization

of the Basis Difference;

(x) Ref. No. 2012-07: Adopt EAIW Proposed

Revisions to SSAPs – 2000 INTs;

(xi) Ref. No. 2012-08: Paragraph Placement in SSAP

No. 86;

(xii) Ref. No. 2012-09: Move Guidance from SSAP

No. 95 and Incorporate into SSAP No. 90;

(xiii) Ref. No. 2012-12: Credit for Reinsurance;

(xiv) Ref. No. 2012-13: Reference to Credit Tenant

Loans within SSAP No. 26;

(xv) Ref. No. 2012-21: Adopt EAIWG Proposed

Revisions to SSAPs – 2001 INTs;

(D) Actuarial Guideline 38 adopted by the NAIC in calendar year 2012.

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

(A) Settlement requirements for intercompany transactions are subject to the accounting treatment in Statement of Statutory Accounting Principles (SSAP) No. 25 (previously SSAP No. 96 located in Appendix H), except that amounts owed to the reporting entity must be settled by the due date in accord with the written agreement and the requirements of §7.204 (relating to Commissioner's Approval Required). Intercompany balances must be settled within 90 days of the period for which the amounts are being billed; otherwise the balances will be nonadmitted.

(B) Electronic machines, constituting a data processing system or systems and operating systems software used in connection with the business of an insurance company acquired after December 31, 2000, may be an admitted asset as permitted by Insurance Code §§841.004, 861.255, 862.001, and any other applicable law and must be amortized as provided by the Manual.

(C) Furniture, labor-saving devices, machines, and all other office equipment may be admitted as an asset as permitted by the Insurance Code §§841.004, 861.255, 862.001, and any other applicable law and, for property acquired after December 31, 2000, depreciated in full over a period not to exceed five years.

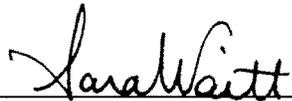
(d) A farm mutual insurance company, statewide mutual assessment company, local mutual aid association, or mutual burial association that has less than \$6 million in annual direct written premiums need not comply with the Manual.

(e) In the event a domestic insurer desires to deviate from the accounting guidance in a Texas statute or any applicable regulation, the insurer must file a written request for a permitted accounting practice and obtain approval prior to using the accounting deviation in a financial statement. The filing must be made with the deputy commissioner of the Financial Regulation Division, 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 must not use a deviated accounting practice without the department's prior approval.

(f) This section shall not be construed to either broaden or restrict the authority provided under the Insurance Code to insurers, including health maintenance organizations.

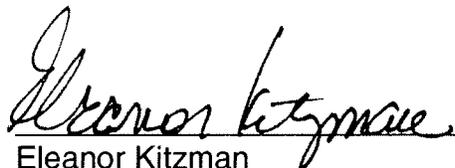
7. CERTIFICATION. This agency certifies that the adopted section has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority.

Issued at Austin, Texas, on January 22, 2013.



Sara Waitt, General Counsel
Texas Department of Insurance

The commissioner adopts that the amendments to §7.18.



Eleanor Kitzman
Commissioner of Insurance

Commissioner's Order No. **2219**