

**SUBCHAPTER E. TEXAS WINDSTORM INSURANCE ASSOCIATION
DIVISION 3. LOSS FUNDING, INCLUDING CATASTROPHE RESERVE TRUST FUND,
FINANCING ARRANGEMENTS, AND PUBLIC SECURITIES
28 TAC §§5.4101, 5.4102, 5.4121, 5.4123 - 5.4128, 5.4133, 5.4135, 5.4136,
5.4141 - 5.4147, 5.4148, 5.4149, and 5.4164**

1. INTRODUCTION. The Texas Department of Insurance proposes adding new 28 TAC §§5.4123 - 5.4128, 5.4135, 5.4136, 5.4148, and 5.4149, and amending 28 TAC §§5.4101, 5.4102, 5.4121, 5.4133, 5.4141 - 5.4147, and 5.4164 to implement HB 3, 82nd Legislature, 1st Called Session, 2011. These sections concern funding losses and operating expenses in excess of the Texas Windstorm Insurance Association's premium and other revenue under Insurance Code Chapter 2210, Subchapters B-1, J, and M. These sections will be incorporated into the association's plan of operation. Matters addressed in the proposed plan of operation amendments include: (i) the catastrophe reserve trust fund; (ii) financing arrangements; (iii) issuance of public securities; (iv) use of public securities proceeds; and (v) payment of public security obligations. In conjunction with this proposal, the department is also proposing the repeal of 28 TAC §5.4131 and §5.4132 separately and also published in this issue of the *Texas Register*.

The association is the insurer of last resort for windstorm and hail insurance coverage in the catastrophe area to those who are unable to obtain insurance in the private market. The catastrophe area includes the 14 first tier coastal counties and parts of Harris County. The association functions similar to other insurers in that it sells policies, collects premiums, and pays claims. The association's largest risk exposure is catastrophic losses from hurricanes.

In 2009, the Texas Legislature enacted HB 4409, 81st Legislature, Regular Session, which substantially changed how the association paid for catastrophic losses that exceeded its premium and other revenue, available reserves, and available amounts in the catastrophe reserve trust fund. HB 4409 amended Insurance Code Chapter 2210 to establish three classes of public securities to pay for excess losses in the event of a catastrophe. Texas Public Finance Authority (TPFA) issues public securities at the request of the association and with the approval of the commissioner. In 2011, the Texas Legislature amended the association's loss funding provisions to authorize the issuance of class 1 public securities prior to a catastrophic event and to permit the issuance of class 2 and class 3 public securities if TPFA is unable to issue all or any portion of the class 1 public securities. Insurance Code §2210.6136, enacted by HB 3, authorizes the commissioner to order the issuance of class 2 public securities if the commissioner finds that all or any portion of the total principal amount of class 1 public securities cannot be issued.

The rules currently in place regarding the issuance of public securities do not address the changes in the statute as a result of HB 3. HB 3 amended how association losses and operating expenses in excess of premium and other revenue are funded by amending Subchapters B-1 and M in Insurance Code Chapter 2210. Rules are necessary to implement HB 3 to provide loss funding in the event of a catastrophe. The proposed rules do not directly affect rates. The proposed rules implement requirements that already exist in Insurance Code Chapter 2210. HB 3 also amended Insurance Code §2210.355 to require the association to consider the payment of class 1 public security obligations in adopting its rates.

The department previously proposed rules in the June 22, 2012, edition of the

Texas Register. The department received requests to postpone adopting those rules until the 83rd Legislature had an opportunity to address the association's funding. As a result, the rules were withdrawn by operation of law on December 27, 2012. Because the 83rd Legislature did not address the association's funding, the department is resuming its proposal of these rules. The department posted an informal draft of these rules on October 14, 2013, with a comment period that ended on October 28, 2013. Based on comments, the department revised the informal draft rule for this proposal. The proposed rules address: (i) the catastrophe reserve trust fund; (ii) financing arrangements; (iii) the issuance of public securities; (iv) the use of public securities proceeds; and (v) the payment of public security obligations.

These rules will be incorporated into the association's plan of operation. The association operates under a plan of operation that must provide for the efficient, economical, fair, and nondiscriminatory administration of the association and include procedures for obtaining and repaying amounts under any authorized financial instruments. The plan of operation may also include other provisions that the department considers necessary to implement the purposes of Insurance Code Chapter 2210. Because HB 3 amended how the association's excess losses and operating expenses are funded, it is necessary to propose these rules and amend the plan of operation. A thorough discussion of the new proposed rule sections and amendments follows.

§5.4101. Applicability. As previously discussed, the association operates under a plan of operation. Section 5.4101(a) has been amended to include the proposed new sections in this division that will be part of the association's plan of operation and will control over any conflicting provision in §5.4001 of this title. Section 5.4001 contains the association's plan of operation, but that plan has been augmented by rules in other sections. Changes

were also made to conform to agency style.

§5.4102. Definitions. Proposed §5.4102 defines terms used in this division. The defined terms are derived from Insurance Code Chapter 2210 and information and terminology TPFA provided to the department. New terms that have been defined in this section include: class 1 payment obligation, earned premium, member assessment trust fund, net premium, obligation revenue fund, premium, premium surcharge and member assessment repayment obligation, premium surcharge trust fund, public security administrative expenses, and repayment obligation trust fund. Other terms have been amended based on changes in the statute as a result of HB 3, for clarity and to conform to agency style.

§5.4121. Financing Arrangements. Insurance Code §2210.072 and §2210.612 provide that the association may enter into financing arrangements directly with a market source to enable the association to pay losses or obtain public securities under Insurance Code §2210.072. Amended §5.4121(b)(1) provides that the association may pay for the financing arrangement with net premium that is not required for the payment of class 1 public securities, or the repayment of premium surcharge or member assessment repayment obligations. HB 3 revised Insurance Code §2210.612 to define the revenue stream available to fund class 1 public security obligations and public security administrative expenses as “net premium” rather than “premium.” Insurance Code §2210.609 establishes a priority for the use of net premium to fund class 1 public security obligations and public security administrative expenses. Section 5.4121(b)(1) reflects that the use of net premium and other revenue for the payment of financing arrangements is subordinate to the payment of class 1 public security obligations under §5.4126 and §5.4141 and Insurance Code §2210.612 and §2210.6136. The amendment to §5.4121(c)

states the collateral assignment applies to “any class of public security issued under Insurance Code Chapter 2210” rather than listing each class.

§5.4123. Public Securities Request, Approval, and Issuance. Before public securities may be issued, Insurance Code §2210.604 requires the association to submit a request for the issuance of public securities. The commissioner must approve that request before TPFA may issue public securities on behalf of the association. Under the statute, class 1 public securities may be issued before or after a catastrophic event, and class 2 and class 3 public securities may be issued only after a catastrophic event.

This section allows the association to request public securities as often as necessary and at any time. This means that the association can submit a request for issuance of post-event public securities to the commissioner for approval prior to a catastrophe, but the public securities may be issued only after a catastrophe occurs. The department drafted this provision to allow TPFA the opportunity to review and prepare for the issuance of public securities prior to an event without actually issuing the securities. TPFA has informed the department that it cannot begin preparation for the issuance of public securities until it has a request for issuance from the association that is approved by the commissioner. By allowing the association to submit requests for commissioner approval prior to a catastrophe, TPFA can prepare for the issuance of public securities so that, in the event of a catastrophe, TPFA can more expediently issue public securities.

The proposed rule establishes the supporting documentation that must be included in the association’s request and provides that the commissioner may request additional information. The association must provide to the department any requested information concerning public securities or the pending issuance of public securities. It is important that this information be accessible to maintain effective regulation of the association. The

commissioner may deny the association's request. If a request is denied, the association may submit another request for the commissioner's consideration. When the association's request is approved, the department must provide the commissioner's written approval to the association and TPFA.

The procedures established by this section apply to the issuance of public securities and the reissuance and refinancing of public security obligations.

§5.4124. Issuance of Class 1 Public Securities Before a Catastrophic Event. HB 3 amended Insurance Code §2210.072 to authorize the issuance of class 1 public securities before a catastrophic event. The association's board of directors must request the issuance of the public securities, and the commissioner must approve the board's request before TPFA can issue the class 1 public securities. This rule establishes specific requirements for a request to issue class 1 public securities before a catastrophic event and the method for calculating the outstanding aggregate principal amount of class 1 public securities issued before a catastrophic event. This rule also details the information the association must submit with its request to the commissioner, including a cost-benefit analysis required by Insurance Code §2210.604(a) for all public security requests. The contents of the cost-benefit analysis are set out in §5.4135 of this proposal. Additionally, the association must submit a three-year pro forma financial statement reflecting the financial impact to the association if class 1 public securities are issued before a catastrophic event.

The association may submit one or more requests to issue class 1 public securities before a catastrophic event under this section. Section 5.4124(d) establishes the method of calculating the outstanding aggregate principal amount of class 1 public securities issued before a catastrophic event. Insurance Code §2210.072(b) limits the amount of

outstanding class 1 public securities issued before a catastrophic event to \$1 billion, regardless of the calendar year when the class 1 public securities were issued. Insurance Code §2210.072(e) states that the association must deplete the proceeds of outstanding class 1 public securities issued before a catastrophic event before the proceeds of class 1 public securities issued after a catastrophic event may be used. Insurance Code §2210.072(f) states that the proceeds of outstanding class 1 public securities issued before a catastrophic event count against the \$1 billion catastrophe year limit set out in Insurance Code §2210.072(b). These provisions authorize the association to issue class 1 public securities before a catastrophic event in an outstanding aggregate principal amount of up to \$1 billion. If the proceeds of the class 1 public securities issued before a catastrophic event must be depleted, those proceeds are applied to that catastrophe year cap, but do not count against the aggregate principal amount cap for class 1 public securities issued before a catastrophic event. This will enable the association to continue to use class 1 public securities issued before a catastrophic event for liquidity in years following a catastrophic event.

§5.4125. Issuance of Public Securities after a Catastrophic Event. This section establishes specific requirements for the association's request to issue class 1, class 2, and class 3 public securities following a catastrophic event and the method for calculating the authorized principal amount of public securities that TPFA may issue. As previously discussed, the statute limits when the public securities can be issued, not when the public securities may be requested. Requests for issuance of public securities may be submitted prior to a catastrophe even though the public securities may not be issued until after a catastrophe. The association may submit a request for the issuance of public securities after a catastrophe for commissioner's approval at any time, although TPFA will not

actually issue the public securities until a catastrophic event has occurred.

Section 5.4125(b) lists the information the association must provide to the commissioner to support its request, including a cost-benefit analysis. Section 5.4125(c) establishes the method of calculating the authorized principal amount of public securities that can be requested for issuance. Section 5.4125(d) clarifies that for each catastrophe year, the association must request the statutorily authorized principal amount of each class of public security before it can request the next class of public security. Section 5.4124(e) provides that the association may make one or more requests to issue public securities under this section and clarifies that the association need not exhaust all proceeds from a class of public security before it requests issuance of the next class of public security. Depending on the severity of a catastrophic event, the association may need additional loss funding from one or more classes of public security. TPFA has informed the department that it measures the process of issuing public securities from the request to obtaining the proceeds in months. This rule section allows the association to request more than one class of public security so the association may have adequate proceeds available as timely as possible for prompt payment of claims.

§5.4126. Alternative for Issuing Class 2 and Class 3 Public Securities. Insurance Code §2210.073 provides that class 2 public security proceeds are to pay for losses that have not been paid by class 1 public security proceeds. This raises an issue of providing adequate loss funding for the association if the entire \$1 billion authorized amount of class 1 public securities cannot be issued due to market conditions. Class 1 public securities are to be repaid with the association's net premium under Insurance Code §2210.612. A catastrophic event may result in losses that exceed the association's revenue and impair its ability to repay class 1 public securities. If the association's class 1 public securities are

not marketable, Insurance Code §2210.6136 allows the commissioner to authorize the issuance of class 2 public securities. Section 5.4126 implements the procedure for the association to request issuance of class 2 and 3 public securities under Insurance Code §2210.6136 when all or any portion of class 1 public securities cannot be issued.

Section 5.4126(a) establishes that the purpose of this section is the issuance of class 2 and class 3 public securities if TPFA cannot issue on behalf of the association all or any portion of the authorized principal amount of class 1 public securities. Section 5.4126(b) lists the information that the association must provide to the commissioner in support of its request for issuance of class 2 or class 3 public securities. Section 5.4126(c) requires that the association must first request the authorized principal amount of class 1 public securities, as determined under §5.4125(c) of this title, before the association may request class 2 public securities under this alternative issuance procedure. The association is not required to have requested the maximum authorized principal amount of class 1 public securities because the catastrophic event may not reach that level of loss. The amount of the request under this section will be based on the amount of class 1 public securities that TPFA cannot issue on behalf of the association to fund the catastrophic loss.

The commissioner may issue an order authorizing TPFA to issue class 2 public securities in an amount that does not exceed the authorized principal amount as determined under §5.4125(c) of this title. The principal amount is further limited by the amount the association needs to fund the excess losses. The commissioner may rely on information from any source in ordering the issuance of class 2 public securities. Subsection (e) sets forth the required contents of the commissioner's order authorizing the issuance of class 2 public securities. Subsection (f) allows the commissioner to revise the

order as necessary because the association has paid excess amounts towards repayment of the premium surcharges and member assessments, or the association's financial situation has changed, necessitating a change in the repayment schedule. As discussed in §5.4127(d), the priority of the repayment obligation is subordinate to the payment of the class 1 public securities.

TPFA may issue the class 2 public securities authorized in the commissioner's order. TPFA may elect to issue the class 2 public securities in separate series. Section 5.4126(h) clarifies that the association may request and the commissioner may approve the issuance of class 3 public securities prior to the issuance of class 2 public securities under this section and Insurance Code §2210.6136. TPFA cannot issue the class 3 public securities until after TPFA has issued \$1 billion in class 2 public securities on behalf of the association for that catastrophe year.

§5.4127. Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments. The Legislature enacted Insurance Code §2210.6136 for funding excess losses when a sufficient amount of class 1 public securities cannot be issued. HB 3 does not express any legislative intent that the association is to stop paying claims based on its inability to market class 1 public securities, which are paid from the association's net premium and other revenue. Insurance Code §2210.6136 allows TPFA to issue class 2 public securities if it cannot issue all or any portion of the total authorized principal amount of class 1 public securities. Class 2 public securities are repaid by a combination of member assessments and premium surcharges under Insurance Code §2210.613.

Insurance Code §2210.6136 specifies that if class 2 public securities are issued under that section, then the class 2 public securities must be repaid by the association's

net premium and other revenue in an amount equal to the lesser of \$500 million or the portion of class 1 public securities that cannot be issued. This has the effect of treating class 2 public securities issued under Insurance Code §2210.6136 as class 1 public securities, which are repayable by premium and revenue. This is inconsistent with the purpose of Insurance Code §2210.6136 to provide for the issuance of class 2 public securities because class 1 public securities cannot be issued. If a hurricane occurs that results in excess losses, the fully authorized amount of class 1 public securities may not be available to pay for those losses because those securities are based on the association's premium and revenue. The fully authorized amount of class 1 public securities may not be marketable because the association's net premium and other revenue may not be a large enough to secure the full \$1 billion in class 1 public securities. In the event of catastrophic losses, the association is obligated to pay claims. If class 1 public securities are not marketable and cannot be issued, then class 2 public securities and class 3 public securities must be issued.

This means that under Insurance Code §2210.6136, the association must then repay the principal, interest, and cost of class 2 public securities with premium surcharges and member assessments. This is the only reasonable reading of Insurance Code §2210.6136 that is consistent with Government Code §311.021. If a catastrophe occurs that results in losses in excess of funding authorized under Insurance Code §2210.072, and the association cannot issue all or any portion of class 1 public securities, then class 2 public securities may be issued under Insurance Code §2210.6136. Under the plain language of Insurance Code §2210.6136, the association must issue \$500 million in class 2 public securities that are to be repaid by the association's premium and other revenue. Under this provision, class 2 public securities are repaid from the same source of revenue

used to pay class 1 public securities. If the association can issue class 2 public securities that are to be repaid by premium, then this means the association is capable of issuing class 1 public securities. This eliminates the need for having an alternative to issue class 2 public securities when class 1 public securities cannot be issued. It is not feasible to read the statute to require TPFA to issue all of the class 1 public securities it can based on the association's net premium and other revenue, and then expect TPFA to issue additional public securities using the same funding sources simply because the name of the public security has changed. Such a reading would render Insurance Code §2210.6136 meaningless. The statute does not require the association to borrow additional amounts. The statute requires the association to repay the costs incurred on some of the class 2 public securities. The association must repay the premium surcharges and member assessments to fulfill that requirement.

Section 5.4127 implements the repayment scheme in Insurance Code §2210.6136. Section 5.4127(a) requires the association to pay class 2 public securities issued under §5.4126 of this title using premium surcharges and member assessments. Section 5.4127(a)(1) and (2) clarify that the definition of insurer and the procedures for collecting premium surcharges and member assessments under this section are the same as those used for class 2 public securities that will be issued under §5.4125. Section 5.4127(b) provides the method of determining the principal amount of class 2 public securities to be repaid by member assessments and premium surcharges. Section 5.4127(c) clarifies that the requirement is to repay premium surcharges and member assessments that are paid, or payable, on the total principal amount, plus any costs and contractual coverage amount associated with that amount.

Section 5.4127(d) describes the primary sources of funding for repayment of the

premium surcharges and member assessments. The association must collect premium and other revenue to make the repayments, which means that the collection of premium to repay the amount owed should be reflected in the association's rates. Section 5.4127(f) describes the methods the association may use to make the repayment and addresses the situation when the association has sufficient funds to pay class 2 obligations, which will eliminate or reduce the need to collect premium surcharges and member assessments. The association will make deposits necessary to make this payment in the appropriate trust funds. This may result in savings on administrative costs for the association that results from a reduction in the amount of premium surcharge repayments the association must track. Association policyholders may also benefit from prepayment of premium surcharges, because association insurance coverage is subject to the premium surcharge. Section 5.4127(f)(2) requires the association to deposit funds in a repayment obligation trust fund to repay the premium surcharges and member assessments. The funds will later be distributed to insurers for repayment in compliance with the commissioner's order. Together, through prepayment or repayment, the association must fulfill its obligation under this section and Insurance Code §2210.6136.

Subsection (g) requires the association to track receipts of premium surcharges and member assessments. Subsection (h) provides that insurers may pay, on behalf of their policyholders, the premium surcharges that will be subject to repayment under Insurance Code §2210.6136(b). The insurer will then collect the repayment when made, as described in §5.4128(c) of this division.

§5.4128. Repayment of Premium Surcharges to Policyholders and Member Assessments to Insurers. Section 5.4128 addresses the repayment procedures the association and insurers must use to repay premium surcharges and member

assessments. The association must specify the surcharge and assessment period being repaid. Subsection (b) establishes when the repayments must begin, and subsection (c) establishes insurer requirements for making repayments to their policyholders. The repayment will be proportional to the amount paid for that period, and the insurer may not claim a greater share of the premium surcharge than the portion it paid on behalf of its policyholder during that period. Member assessments will be returned to the insurer or insurance group that paid the member assessment.

§5.4133. Public Security Proceeds. The public security proceeds are held in trust with the trust company for the benefit of the association and may only be used for certain purposes specified by statute. This section establishes the procedure for the association to request the trust company to disburse funds for use. HB 3 amended Insurance Code §2210.608 to specifically allow two additional uses of public security proceeds and prohibit the association from using the proceeds of public securities issued before a catastrophic event to purchase reinsurance. The amendment to §5.4133 removes the reference to using public security proceeds and points to Insurance Code §2210.608 for the authorized uses of public security proceeds.

§5.4135. Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit

Analysis. This section discusses the marketability of public securities and sets out factors that may be considered in determining the marketability of class 1 public securities. Subsection (a) defines “marketable public securities.” Subsection (b) establishes factors the association must consider in determining whether class 1 public securities are not marketable. This information is necessary for the determination of issuing class 2 public securities under §5.4126. Subsection (c) addresses the factors the

association must consider in determining "market conditions and requirements" under §5.4135(b).

Subsection (d) requires the association to submit a cost-benefit analysis as required by Insurance Code §2210.604(a) and lists the information the cost-benefit analysis must include.

§5.4136. Association Rate Filings. HB 3 amended Insurance Code §2210.355 to clarify that association rates must consider class 1 public security obligations and contractual coverage amounts that the association determines to be required for the issuance of marketable public securities. This section restates the statutory requirement and clarifies that it also applies to repayment amounts owed under §5.4127(b), which are repaid from the same sources of funds as class 1 public securities. This section establishes how the association must comply with this requirement.

§5.4141. Obligation Revenue Fund for the Payment of Class 1 Public Security Obligations and Operating Reserve Fund. HB 3 amended Insurance Code §2210.609 to direct the association to deposit its net premium and other revenue collected under Insurance Code §2210.612 in the obligation revenue fund for the payment of class 1 public securities. Subsection (a) of this section was amended to be consistent with this requirement. The amendment replaces the reference to "net revenue" with "net premium and other revenue." The association must deposit net premium in the amounts and for the periods required in the class 1 public security agreements. The intent is to allow greater flexibility in establishing payment schemes while the association continues to operate.

Insurance Code §2210.609(c) requires that all revenue collected under Insurance Code §§2210.612, 2210.613, and 2210.6135 be deposited in the appropriate public security obligation revenue fund. Subsection (b) was amended to provide the association

flexibility to transfer funds from any operating reserve fund or other association held funds into the obligation revenue fund to pay class 1 public securities.

§5.4142. Excess Obligation Revenue Fund Amounts. From time to time, the association may need to disburse funds in the obligation revenue fund, including the contractual coverage amount. Section §5.4142 provides that excess revenue collected in the obligation revenue fund is an asset of the association and may be disbursed for any purpose authorized by Insurance Code §2210.056, including the repayment of the premium surcharge and member assessments under §5.4127. If the association elects to repay class 1 public securities early, commissioner approval is required under Insurance Code §2210.072. Although the funds in the obligation revenue fund consist of net premium and other revenue, excess funds released under §5.4142 do not apply to class 1 public security payment obligations. Distribution of the excess revenue in the obligation revenue fund does not affect the amounts due under Insurance Code §2210.6136 or §5.4126 of this title. The distribution provides the association with additional funds that can be used for pre-paying the amounts due under Insurance Code §2210.6136 or §5.4126 of this title. The proposal does not require prepayment because it is impossible to determine what the association's financial position will be at the time of the distribution or what will be the best use of the distribution.

§5.4143 and §5.4146. Trust Funds for the Payment of Class 2 and Class 3

Public Securities and Member Assessment Trust Fund for the Payment of Class 3

Public Securities. Insurance Code §2210.613 provides for the payment of class 2 public security obligations with premium surcharges on property and automobile insurance policies in the catastrophe area and member insurer assessments. Insurance Code §2210.6135 provides for the payment of class 3 public security obligations with

association member insurer assessments. The procedure for establishing, assessing, collecting, reporting, accounting for, and transmitting the premium surcharges and member assessments to the association are currently set out in §§5.4161 - 5.5467, 5.4171 - 5.5173, and 5.4181 - 5.4192 of this title. HB 3 amended Insurance Code §2210.613 to specify the lines of insurance subject to the premium surcharge; rules implementing the premium surcharge are addressed in a separate rule proposal published in this edition of the *Texas Register*.

Sections 5.4143 and 5.4146 concern how the amounts collected from premium surcharges and member assessments are deposited. The association is required to deposit the collected revenue in the appropriate trust fund. The amendments to these sections reflect HB 3 changes to Insurance Code §2210.609, which created distinct revenue trust accounts for the premium surcharges and member assessments. Additionally, the proposal requires the association to transfer the collected money in the trust funds on receipt. The rules also allow the option for insurers to direct deposit the funds electronically into the appropriate funds. If insurers are required by the financial agreements to direct deposit, the association must send notice to the insurers with direct deposit information. Finally, the amended sections limit the use of these funds. The deposited funds may only be used to fund the appropriate public security obligation or as authorized in this title, which includes the use of excess funds under §§5.4144, 5.4145, and 5.4147 as authorized by Insurance Code §2210.611.

§§5.4144, 5.4145, and 5.4147. Excess Class 2 Premium Surcharge Revenue, Excess Class 2 Member Assessment Revenue, and Excess Class 3 Member Assessment Revenue. The revenue funds may have excess funds. HB 3 amended Insurance Code §2210.611 to include procedures for handling both excess premium surcharge and

member assessment revenue. The amendments to these sections conform to the existing provisions of Insurance Code §2210.611, as amended.

§5.4148 and §5.4149. Repayment Obligation Trust Fund for the Payment of Amounts Owed Under §5.4127 and Excess Repayment Obligation Trust Fund Amounts.

Insurance Code §2210.6136 requires the association to collect net premium and other revenue for the repayment of premium surcharges and member assessments as provided in Insurance Code §2210.612, which states that the collected net premium and other revenue are to be deposited in the revenue obligation fund. While the trust company could create accounts within the fund, use of the term “revenue obligation fund” for the purposes of class 1 public security payment and the repayment of premium surcharges and member assessments could be confusing. To clarify, §5.4148 creates procedures for a designated repayment obligation trust fund. Section 5.4149 provides that the purpose of these funds is the payment of class 2 public securities subject to repayment under §5.4127(b) of this title, and the repayment of all amounts owed under §5.4127(b). To the extent funds in this account are distributed, the funds must first be used to repay class 2 public securities. Once those amounts have been paid, excess funds will be disbursed to the association.

§5.4164. Payment of Assessment. Section 5.4164 was revised to allow insurers to deposit member assessments directly into the member assessment trust fund. Changes were made to this section to provide that insurers may be required to deposit assessments directly into the member assessment trust fund instead of remitting assessments to the association.

2. FISCAL NOTE. C. H. Mah, associate commissioner of the Property and Casualty Section, has determined that for each year of the first five years the proposed sections will be in effect, there will be no fiscal impact to state and local governments as a result of the enforcement or administration of the proposal. There will be no measurable effect on local employment or the local economy as a result of the proposal. This rule proposal implements the requirements in the statute. Any impact on local employment or the local economy resulting from the premium surcharges required by Insurance Code §2210.613 are a result of the statute and not as a result of this proposal.

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

Anticipated public benefits. The department anticipates that a primary public benefit resulting from the proposal will be the implementation of HB 3, which is intended to provide efficient access to funding for association insured losses and operating expenses exceeding the association's premium and other revenue.

Estimated costs for persons required to comply with the proposal. The association will incur costs resulting from new administrative, reporting, loss evaluation, and analysis requirements related to public securities under §§5.4124 - 5.4128, 5.4135, 5.4136, 5.4143, 5.4146, and 5.4148. Insurers writing lines of insurance that are subject to the premium surcharge, including the association, will incur costs resulting from new administrative and reporting requirements under §5.4127 and §5.4128. Except for actuarial costs under §5.4136, the costs identified in this proposal will follow the issuance

of class 2 public securities under Insurance Code §2210.6136.

Public security costs. The association was to provide windstorm and hail insurance in the designated catastrophe area. As a residual insurer, the association must provide this coverage. Further, the association must comply with the requirements of Insurance Code Chapter 2210 and regulations implemented under the statute.

While the proposal implements HB 3, many of the requirements in these rule sections are the same or substantially similar to existing requirements. The department has chosen in some instances to restate overall costs estimates for the requirements in these sections rather than attempt to estimate if each new requirement had a measurable cost. Overall, the department anticipates that these activities will involve both managerial and administrative personnel, office space, and equipment. Some systems, including electronic systems, may need to be developed or updated to complete these functions. Other new and amended sections in this proposal restate existing requirements and do not add additional costs.

The association previously provided cost information to the department concerning these functions and the department does not anticipate the requirements in its proposal will change those estimated costs. The association indicated that the actual costs may differ from these estimates due to unanticipated situations and expenses. While the association indicated that the proposal will result in labor costs, the association did not identify specific costs resulting from additional staff, office space, new equipment, or systems development resulting from the proposal.

§5.4124 and §5.4125. As previously discussed, this new section requires the association to submit certain information with its request to issue public securities for the commissioner's approval. Section 5.4124 concerns the issuance of class 1 public

securities before a catastrophic event and §5.4125 concerns the issuance of public securities after a catastrophic event. The commissioner needs the information specified in the rules to determine whether to approve the association's request.

In response to a department request, the association stated it does not anticipate that providing this information will require additional staff. As to §5.4124, the association stated that its current staff will prepare and provide this information and estimates the costs associated with doing so to be \$15,000 per year. If the association submits a request under §5.4125, the association estimates the cost to prepare a submittal to be \$2,000 per year in addition to the cost of a submittal under §5.4124.

§5.4126 and §5.4135. HB 3 amended Insurance Code Chapter 2210, Subchapters B-1 and M, to provide an alternative funding means of issuing class 2 and class 3 public securities if all or any portion of the class 1 public securities could not be issued, and to require that a cost-benefit analysis be submitted with each request for public securities. Section 5.4126 establishes the procedural requirements for the association to request the issuance of class 2 and class 3 public securities if all or any portion of class 1 public securities cannot be issued. Section 5.4135 establishes the requirements for demonstrating the class 1 public securities are not marketable for purposes of §5.4126 and the requirements for the cost-benefit analysis. The commissioner needs this information to determine whether to approve the association's request. Although reorganized, the requirements for requesting the issuance of class 1, class 2, and class 3 public securities have not significantly changed.

The association previously estimated the cost of preparing information to support a public security funding request to be \$800 per submission. The department estimates that this \$800 cost will also apply to the request for the issuance of public securities under

§5.4126. The department also anticipates that preparation of the cost-benefit analysis could result in increased association costs for all public security requests. However, the additional information and analysis will not more than double the cost of the existing requirements. The department estimates the additional cost of preparing the cost-benefit analysis will not exceed \$800 per request, in addition to the costs for existing public security request requirements and the costs of requesting public securities under §5.4126. Each public security request is estimated to cost \$1,600. The department further estimates that these costs will not change over the first five year period this proposal is to be in effect.

§§5.4127, 5.4128, and 5.4148. Insurance Code §2210.6136 requires the association to repay premium surcharges and member assessments used to pay class 2 public securities. Section 5.4127 requires the association to record the premium surcharges and member assessments it collects to pay class 2 public securities so that the association can repay those amounts. While the association must account for these receipts under current requirements, it is not required to distinguish the amounts that must be repaid. This requirement will result in administrative costs to the association to distinguish and record these amounts, and then report these amounts when repayments are made under §5.4128.

In response to a department request, the association estimated that the additional costs to develop information systems and implement financial procedures to administer the collection and return of premium surcharges and member assessments to be \$80,000 in the first year and in subsequent years to be \$20,000 to maintain. This cost does not include the administrative cost of making premium surcharge repayments to policyholders.

Insurance Code §2210.6136 requires the association to repay premium surcharges

and member assessments used to pay class 2 public securities. Section 5.4127 requires the association to collect and deposit funds to repay the premium surcharges and member assessments as ordered by the commissioner under §5.4126. Section 5.4148 establishes the repayment obligation trust fund, which will hold some or all of the collected repayment amounts. The association may deposit other collected repayment funds in the premium surcharge trust fund and the member assessment trust fund. The department anticipates the association will incur some administrative and accounting costs for these transactions.

The association previously considered the cost of administrative and accounting costs for collecting and depositing class 2 and class 3 revenue funds. The association considered that the activity will be similar to those necessary to comply with §5.4111 of this title and estimated the cost of the activity to be \$5,000 per year. The department anticipates that the requirements for collecting and depositing the funds collected under §5.4147 will be similar to those for collecting and depositing the other funds, and estimates the cost of the activity to be \$5,000 per year. The department further estimates that this cost will not change over the first five year period this proposal is to be in effect.

§5.4136. Insurance Code §2210.355 requires the association to consider the cost of class 1 public securities in its rates. Section 5.4136 establishes the information and analysis that the association must submit to comply with Insurance Code §2210.355. Section 5.4136 further extends this requirement to the net premium that the association uses to repay premium surcharges and member assessments under §5.4126 and Insurance Code §2210.6136. In response to a department request, the association estimated that the additional cost of preparing this information and analysis will be negligible. The department anticipates that an actuary will work approximately two hours to prepare this information and analysis. The department estimates that this requirement

will result in an approximate cost of \$200 to the association, which employs an actuary. The department further estimates that this cost will not change over the first five year period this proposal is in effect.

§5.4143 and §5.4146. Sections 5.4143 and 5.4146 concern how the amounts collected from premium surcharges and member assessments are deposited. The association is required to deposit the collected revenue in the appropriate trust fund. Insurance Code §2210.609, as amended by HB 3, creates distinct revenue trust accounts for the premium surcharges and member assessments. These rule sections require the association to deposit premium surcharges and member assessments into the appropriate trust accounts. The rules also provide that insurers may direct deposit the funds. If insurers are required to direct deposit, the association must provide notice of the direct deposit requirement to insurers.

In response to a department request, the association estimated the cost of complying with the notice requirement contained in these rules to be \$5,000 based on the cost of printing and postage. The association stated that if insurers are not required to direct deposit, the association will establish a process to manually deposit the checks into the appropriate trust funds. The association stated that the costs associated with manually depositing the funds will be negligible, but that direct deposit is a better control for collecting and depositing the funds.

Repayment of premium surcharges and member assessments. Insurance Code §2210.6136 requires insurers to collect premium surcharges and pay member assessments to pay for class 2 public securities. This proposal does not affect existing requirements for the collection of premium surcharges and payment of member assessments. Additional costs will result from the requirement to repay premium

surcharges to the insurer's policyholders. Member assessments will simply be repaid to the insurer or insurer group that paid them and will result in no measurable additional administrative cost for the insurer.

As indicated in §5.4127, the term "insurer" in this context is the same as that defined in §5.4172 of this title. The term applies to insurers that write lines in the catastrophe area that are subject to the premium surcharge. This includes the association. The repayment costs apply to the association and are in addition to the association's administrative costs previously discussed.

Section 5.4128 specifies that the repayment must be made within 90 days after the insurer receives a distribution from the association. To comply with this requirement, the insurer must identify all policyholders who paid premium surcharges during the period specified in the association's distribution. The insurer must track premium surcharges that will be repaid separately from premium surcharges that will not be repaid. Both types of surcharges will be collected during the same periods. Section 5.4128 does not specify how the repayment will be made. The insurer will have options for compliance within that period, particularly if the policyholder is still a customer of the insurer.

Overall, the department anticipates that the repayment of premium surcharges will involve managerial and staff personnel, office space, and equipment. Some systems, including electronic systems, may need to be developed or updated to complete these functions. The department anticipates that compliance will require additional systems programming to the insurers' accounting, billing, and policy systems. This involves information technology costs, including programmers, software engineers, database managers, and computer support specialists.

The department anticipates the cost will vary significantly between insurers, in part

based on the number of lines the insurer writes that are subject to the premium surcharge, the number of policyholders for these lines that the insurer has in the catastrophe area, and the insurer's current systems and procedures. Further, the insurer will have to develop systems for transmitting the repayment to its policyholders, including former policyholders.

In response to a department request, the association estimated that the additional costs to develop the systems and procedures necessary to repay its policyholder's premium surcharges will be \$100,000 for the first year of implementation and that each succeeding year, it will cost the association \$20,000 to maintain. Based on this analysis and the association's estimate, the department estimates the cost for compliance with the premium surcharge repayment requirement will be from several tens of thousands of dollars to several hundreds of thousands of dollars. The department estimates that the cost will not change over the first five year period this proposal is in effect. The department notes that these costs will follow the issuance of class 2 public securities under Insurance Code §2210.6136, which may not occur during that period.

Because the administrative cost of tracking policyholders over the course of several years may be costly and burdensome, §5.4127 provides insurers with the alternative of paying the premium surcharge on behalf of its policyholder. The insurer will then receive the repayment. The insurer will still need to identify which policy it paid the premium surcharge on, but it will not need to track the policyholder for repayment. Because this option is not required, it is not included as a cost of this proposal. Each insurer will make a business decision as to the best means to comply with the repayment requirement.

4. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY ANALYSIS

FOR SMALL AND MICRO BUSINESSES. Section 2006.002(c) of the Government Code requires that if a proposed rule may have an economic impact on small businesses, state agencies must prepare as part of the rulemaking process an economic impact statement that assesses the potential impact of the proposed rule on these businesses, and a regulatory flexibility analysis that considers alternative methods of achieving the purpose of the rule. 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. 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.

As specified in the Public Benefit and Cost Note section of this proposal, the proposal has an economic impact on the association and insurers that write lines of insurance that are subject to the premium surcharge.

The association. The association does not meet the definition of a small business under Government Code §2006.001(2). The association is a statutorily created association of property insurers, not a corporation, partnership, nor sole proprietorship. It is not formed for the purpose of making a profit. The association is not independently owned and operated. Further, the association has approximately 150 employees (including employees who are providing services by contract to the Texas Fair Access to Insurance Requirements Plan Association (FAIR Plan)) and net receipts well over \$6 million. Based on these factors, the association does not meet the definition of a small or micro business under Government Code §2006.001(1) and (2), and an analysis of the economic impact of this proposal on the association under Government Code §2006.002(c) is not required.

Insurers. As discussed in the Public Benefit and Cost Note section of this proposal, it is anticipated that insurers subject to §5.4127 and §5.4128 will also be subject to additional costs from the adoption and enforcement of those proposed sections. The costs will arise from the requirement to repay premium surcharges to the insurer's policyholders under those sections and Insurance Code §2210.6136.

As discussed in the Public Benefit and Cost Note section of this proposal, the term "insurer" has the same meaning as defined in §5.4172 of this title. Insurer refers to each property and casualty insurer authorized to engage in the business of property and casualty insurance in the State of Texas and an affiliate of the insurer, as described by Insurance Code §823.003, including an affiliate that is not authorized to engage in the business of property and casualty insurance in the State of Texas, the association, and the FAIR Plan. The term specifically includes a county mutual insurance company, a Lloyd's plan, and a reciprocal or interinsurance exchange. This includes some insurers that qualify as small and micro businesses.

The department has determined that §5.4127 and §5.4128 may have an adverse economic effect on insurers operating as small or micro businesses. The department, in compliance with Government Code §2006.002(c-1), considered the following alternative methods of achieving the purpose of the proposed rule, while reducing costs to insurers operating as small and micro businesses: reduce or eliminate the notice requirement.

The department considered allowing insurers to pay that portion of the premium surcharge that is subject to the repayment on behalf of their policyholder. This will eliminate the need for the insurer to distribute funds to the policyholder in the future, which may be burdensome if the customer is no longer a policyholder. The department considers this option to be reasonable and included it in the proposal for all insurers.

The department considered requiring the association to directly repay other insurers' policyholders. The department determined that this procedure will be impractical, because the association does not have access to up-to-date billing and location information, and the insurer will be required to transfer significant amounts of personal financial information to the association. Without current information, the association will be required to contact the insurer to make the payment. To facilitate the refund, the insurer will have to design systems to make the information readily available to the association. Further, if a question over the premium surcharge or repayment amount arose, the insurer will still be required to maintain a record of the collection and transmittal information to resolve the inquiry or dispute. Finally, Insurance Code §2210.6136 does not indicate that the legislature intended that policyholders will be compelled to provide their personal financial information to the association to obtain repayment of the premium surcharge they paid. The department determined that a requirement for the association to directly repay the policyholders of small and micro businesses is not practical.

The department considered waiving the repayment requirement for small and micro businesses. Insurance Code §2210.6136 requires repayment and does not make exception for the insurer's size. The department considers that waiving the repayment requirement is not consistent with the statute because it will discriminate against policyholders of small and micro businesses.

5. TAKINGS IMPACT ASSESSMENT. The department has determined that this proposal affects no private real property interests 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 so it does not constitute a taking or require a takings impact

assessment under Government Code §2007.043.

6. REQUEST FOR PUBLIC COMMENT. To have your comments considered, you must submit written comments on the proposal no later than 5 p.m., Central time on March 10, 2014. You may send your comments electronically to the Chief Clerk by email at chiefclerk@tdi.texas.gov, or by mail to Chief Clerk, Mail Code 113-2A, Texas Department of Insurance, P.O. Box 149104, Austin, Texas 78714-9104. You must simultaneously submit your comments by email to Brian Ryder in the Property and Casualty Actuarial Office at Brian.Ryder@tdi.texas.gov, or by mail to Brian Ryder, Property and Casualty Actuarial Office, Mail Code 105-5F, Texas Department of Insurance, P.O. Box 149104, Austin, Texas 78714-9104.

The commissioner will consider the adoption of the proposed amendments and new sections in a public hearing under Docket No. 2764 scheduled for March 3, 2014, at 9:30 a.m. in Room 100 of the William P. Hobby, Jr. State Office Building, 333 Guadalupe Street, Austin, Texas. The hearing will reconvene under the same docket number on March 5, 2014, at 9 a.m. in Ballrooms B and C at Texas A&M University–Corpus Christi, 6300 Ocean Drive, Corpus Christi, Texas. The commissioner will consider written and oral comments presented at the hearing.

7. STATUTORY AUTHORITY. The department proposes the new and amended sections under Insurance Code §§2210.008, 2210.056, 2210.071, 2210.072, 2210.073, 2210.074, 2210.151, 2210.152, 2210.604, 2210.608, 2210.609, 2210.611, 2210.612, 2210.613, 2210.6135, 2210.6136, and 36.001. Section 2210.008(b) authorizes the commissioner to adopt reasonable and necessary rules in the manner prescribed by

Insurance Code Chapter 36, Subchapter A.

Section 2210.056 establishes the allowable uses for the association's assets.

Section 2210.071 provides that if an occurrence or series of occurrences in a catastrophe area results in insured losses and operating expenses of the association in excess of premium and other revenue of the association, the excess losses and operating expenses must be paid as provided by Insurance Code Chapter 2210, Subchapter B-1. Section 2210.072 authorizes the association to use the proceeds of class 1 public securities before, on, or after an occurrence or series of occurrences and establishes the maximum principal amount of class 1 public securities that may be issued before, on, or after an occurrence or series of occurrences to pay losses not paid under Insurance Code §2210.071. Section 2210.072 also authorizes the association to enter into financing arrangements with any market source so that the association can pay losses and obtain public securities.

Section 2210.073 authorizes the association to use the proceeds of class 2 public securities issued after an occurrence or series of occurrences to pay for losses not paid under §2210.072, and establishes the maximum principal amount of class 2 public securities. Section 2210.074 authorizes the association to use the proceeds of class 3 public securities issued after an occurrence or series of occurrences to pay for losses not paid under §2210.073, and establishes the maximum principal amount of class 3 public securities.

Section 2210.151 authorizes the commissioner to adopt the association's plan of operation to provide Texas windstorm and hail insurance coverage in the catastrophe area by rule. Section 2210.152 requires that the association's plan of operation provide for the efficient, economical, fair, and nondiscriminatory administration of the

association and include both underwriting standards and other provisions that the department considers necessary to implement the purposes of Insurance Code Chapter 2210.

Section 2210.604 requires commissioner approval of the association's request to TPFA to issue class 1, class 2, or class 3 public securities prior to issuance. Section 2210.608 provides for how the association may use public security proceeds and excess public security proceeds. Section 2210.609 provides that the association must repay all public security obligations from available funds, and if those funds are insufficient, revenue collected under Insurance Code §§2210.612, 2210.613, 2210.6135, and 2210.6136. Section 2210.609 further provides that the association must deposit all revenue collected under §§2210.612, 2210.613, and 2210.6135 in the obligation revenue fund, premium surcharge obligation revenue fund, and the member assessment obligation revenue fund.

Section 2210.611 establishes that for class 2 public securities the association may use premium surcharge revenue and member assessment revenue collected under Insurance Code §2210.613, in any calendar year that exceeds the amount of the class 2 security obligations and public security administrative expenses payable in that calendar year and interest earned on those funds to: (i) pay the applicable public security obligations payable in the subsequent year; (ii) redeem or purchase outstanding public securities; or (iii) make a deposit in the CRTF. Section 2210.611 further establishes that the association may handle member assessment revenue collected under Insurance Code §2210.6135 in any calendar year that exceeds the amount of the class 3 security obligations and public security administrative expenses payable in that calendar year, and interest earned on the those funds in the same manner as the excess class 2 amounts.

Section 2210.612 provides that the association must pay class 1 public securities issued under §2210.072 from its net premium and other revenue. Section 2210.613 provides that the association must collect premium surcharges and member assessments to pay class 2 public securities issued under §2210.073. Section 2210.6135 provides that the association collect member assessments to pay class 3 public securities issued under Section 2210.074.

Section 2210.6136 provides that if all or any part of the class 1 public securities cannot be issued, the commissioner may order the issuance of class 2 public securities. Section 2210.6136 further provides that the commissioner will order the association to repay the premium surcharges and member assessments used to pay the cost of a portion of the class 2 public securities issued under this section.

Section 36.001 provides that the commissioner may adopt any rules necessary and appropriate to implement the powers and duties of the Texas Department of Insurance under the Insurance Code and other laws of the state.

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

<u>Rule</u>	<u>Statute</u>
§5.4101	Insurance Code §2210.151 and §2210.152
§5.4102	Insurance Code §§2210.056, 2210.071, 2210.072, 2210.073, 2210.074, 2210.151, 2210.152, 2210.259, 2210.355, 2210.452, 2210.453, 2210.604, 2210.608, 2210.609, 2210.611, 2210.612, 2210.613, 2210.6135,

	and 2210.6136
§5.4121	Insurance Code §§2210.056, 2210.072, 2210.608, and 2210.612
§§5.4123 - 5.4128	Insurance Code §§2210.072, 2210.073, 2210.074, 2210.604, and 2210.6136
§5.4133	Insurance Code §§2210.072, 2210.073, 2210.074, 2210.604, and 2210.608
§5.4135	Insurance Code §2210.604
§5.4136	Insurance Code §2210.355
§5.4141 and §5.4142	Insurance Code §§2210.072, 2210.604, 2210.608, 2210.609, 2210.612, and 2210.6136
§§5.4143 - 5.4145	Insurance Code §§2210.073, 2210.604, 2210.608, 2210.609, 2210.611, and 2210.613
§5.4146 and §5.4147	Insurance Code §§2210.604, 2210.608, 2210.609, and 2210.6135
§5.4148 and §5.4149	Insurance Code §2210.612 and §2210.6136
§5.4164	Insurance Code §2210.613

9. TEXT.

§5.4101. Applicability.

(a) Sections 5.4101, 5.4102, 5.4111 - 5.4114, 5.4121, 5.4123 - 5.4128, 5.4133 - 5.4136 [~~5.4131 - 5.4134~~], and 5.4141 - 5.4149 [~~5.4147~~] of this division are a part of the Texas Windstorm Insurance Association's Plan of Operation [~~plan of operation~~] and will [~~shall~~] control over any conflicting provision in §5.4001 of this subchapter (relating to Plan of Operation). If a court of competent jurisdiction holds that any provision of this division is inconsistent with any statutes of this state, is unconstitutional, or is invalid for any reason, the remaining provisions of the sections in this division will [~~shall~~] remain in effect.

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

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

(1) Association--Texas Windstorm Insurance Association.

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

(3) Authorized Representative of the Department [~~representative of the department~~]--Any officer or employee of the Department [~~department~~], empowered to

execute instructions and take other necessary actions on behalf of the Department [~~department~~] as designated in writing by the Commissioner [~~commissioner~~].

(4) Authorized Representative of the Trust Company [~~representative of the trust company~~]~~--~~Any officer or employee of the Comptroller [~~comptroller~~] or the Trust Company [~~trust company~~] who is designated in writing by the Comptroller [~~comptroller~~] as an authorized representative.

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

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

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

(8) Catastrophic Event [~~event~~]~~--~~An occurrence or a series of occurrences in a Catastrophe Area [~~catastrophe area~~] resulting in insured Losses [~~losses~~] and operating expenses of the Association in excess of Premium [~~premium~~] and Other Revenue [~~other revenue~~] of the Association.

(9) Catastrophic Losses [~~losses~~]~~--~~Losses resulting from a Catastrophic Event [~~catastrophic event~~].

(10) Class 1 Payment Obligation~~--~~The contractual amount of Net Premium and Other Revenue that the Association must deposit in the Obligation Revenue Fund at specified periods for the payment of Class 1 Public Security Obligations, Public Security

Administrative Expenses, and Contractual Coverage Amount as required by class 1 public security agreements.

(11) [(10)] Class 1 Public Securities [~~public securities~~]-A debt instrument or other public security that TPFA may issue as authorized [~~to be issued by the TPFA~~] under Insurance Code §2210.072 and Insurance Code Chapter 2210, Subchapter M [~~of Chapter 2210, Insurance Code~~].

(12) [(11)] Class 2 Public Securities [~~public securities~~]-A debt instrument or other public security that TPFA may issue as authorized [~~to be issued by the TPFA~~] under [~~the~~] Insurance Code §2210.073 and Insurance Code Chapter 2210, Subchapter M [~~of Chapter 2210, Insurance Code~~].

(13) [(12)] Class 3 Public Securities [~~public securities~~]-A debt instrument or other public security that TPFA may issue as authorized [~~to be issued by the TPFA~~] under [~~the~~] Insurance Code §2210.074 and Insurance Code Chapter 2210, Subchapter M [~~of Chapter 2210, Insurance Code~~].

(14) [(13)] Commercial Paper Notes [~~paper notes~~]-A debt instrument that the Association may issue as a financing arrangement or that TPFA may issue as any class of [~~type of class 4~~] public security [~~issued by the TPFA~~].

(15) [(14)] Commissioner--Commissioner of Insurance of the State of Texas.

(16) [(15)] Comptroller--Comptroller of the State of Texas.

(17) [(16)] Contractual Coverage Amount [~~coverage amount~~]-Minimum amount over scheduled debt service that the Association is required to deposit in [~~into~~] the applicable public security obligation revenue fund, Premium Surcharge Trust Fund, or Member Assessment Trust Fund as security for the payment of debt service on the public securities, administrative expenses on public securities, or other payments the

Association must pay [~~required to be paid by the Association~~] in connection with public securities.

(18) [(17)] Credit Agreement [~~agreement~~]-An [~~A loan~~] agreement described by Government Code Chapter 1371 that TPFA may issue as authorized under Insurance Code Chapter 2210, Subchapter M [~~, revolving credit agreement, agreement establishing a line of credit, letter of credit, reimbursement agreement, insurance contract, commitment to purchase obligations, purchase or sale agreement, interest rate management agreement, or other commitment or agreement authorized by the TPFA in anticipation of, related to, or in connection with the authorization, issuance, sale, resale, security, exchange, payment, purchase, remarketing, or redemption of some or all of its public security obligations or interest on public security obligations, or both, or as otherwise authorized by Chapter 1371 of the Government Code~~].

(19) [(18)] Department-Texas Department of Insurance.

(20) Earned Premium-That portion of Gross Premium that the Association has earned because of the expired portion of the time for which the insurance policy has been in effect.

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

(22) [(20)] Gross Premium [~~premiums~~]-The amount of Premium the Association receives, less Premium returned to policyholders for canceled or reduced policies. [~~premium received by the Association. The term does not include premium~~

~~surcharges collected by the Association pursuant to the Insurance Code §2210.259 and §2210.613.]~~

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

(24) [(22)] Letter of Instruction [instruction]--The Commissioner's or authorized Department representative's signed written [Written] authorization and direction to an Authorized Representative of the Trust Company [authorized representative of the trust company, which is signed by the commissioner or an authorized representative of the department].

(25) [(23)] Losses--Amounts paid or expected to be paid on Association insurance policy claims, including adjustment expenses, litigation expenses, [and] other claims expenses, and other amounts that are incurred in resolving a claim for indemnification under an Association insurance policy.

(26) Member Assessment Trust Fund--A dedicated trust fund established by TPFA and held by the Trust Company in which the Association or assessed insurers must deposit member assessments collected under Insurance Code §2210.613 and §2210.6135. The Member Assessment Trust Fund may be segregated into separate funds, accounts, or subaccounts, including for the purpose of segregating class 2 and class 3 public security member assessments.

(27) [(24)] Net Gain from Operations [gain from operations]--Net income reported during [The gain from operations, for] a calendar year [or policy year as the case may be] equal to the amount of [including] all Earned Premium, Other Revenue [earned premium, and other revenue] of the Association, and distributions of excess revenues from the Obligation Revenue Fund and the Repayment Obligation Trust Fund that are in

excess of incurred Losses [~~losses~~], operating expenses, reinsurance premium, current year financial arrangement obligations, current year Class 1 Payment Obligations, [and] current year Public Security Administrative Expenses, and Premium Surcharge and Member Assessment Repayment Obligations. [~~amounts to satisfy in whole or in part the obligations of the Association incurred in connection with the Insurance Code Chapter 2210, Subchapters B-1, J, and M, including reinsurance, public securities and financial instruments~~].

(28) Net Premium--Gross Premium less Unearned Premium. Following the issuance of public securities, Net Premium is pledged for the payment of Class 1 Payment Obligation.

(29) [(25)] Net Revenues--Net Premium [~~Gross premiums received by the Association from policyholders,~~] plus Other Revenue [~~other revenue~~], [~~less unearned premium,~~] less Scheduled Policy Claims [~~scheduled policy claims~~], less budgeted operating expenses, less Class 1 Payment Obligation for that calendar year, less Premium Surcharge and Member Assessment Repayment Obligation for that calendar year, and less amounts necessary to fund or replenish any Operating Reserve Fund [~~the operating reserve fund~~].

(30) Obligation Revenue Fund--The dedicated trust fund established by TPFA and held by the Trust Company in which the Association must deposit Net Premium and Other Revenue for the payment of Class 1 Payment Obligation.

(31) [(26)] Operating Reserve Fund--Association or Trust Company held fund [~~The amount budgeted each year by the Association~~] for the payment of budgeted Scheduled Policy Claims [~~scheduled policy claims~~] and budgeted operating expenses [~~divided by four~~].

(32) [(27)] Other Revenue--Revenue of the Association from any source other than Premium [premiums]. Other Revenue [revenue] includes Investment Income [~~investment income~~] on Association assets.[;] Other Revenue [but other revenue] does not include premium surcharges and member assessments collected under [pursuant to the] Insurance Code §§2210.259, 2210.613, 2210.6135, and 2210.6136 and interest income on those amounts [§2210.259, premiums surcharges collected from Association policyholders and other insurers under the Insurance Code §2210.613, Association member assessments collected under the Insurance Code §2210.613 and §2210.6135, and investment income on premium surcharges and member assessments collected under the Insurance Code §§2210.259, 2210.613, and 2210.6135].

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

(34) Premium--Amounts received in consideration for the issuance of Association insurance coverage. The term does not include premium surcharges collected by the Association under Insurance Code §§2210.259, 2210.613, and 2210.6136.

(35) Premium Surcharge and Member Assessment Repayment Obligation--The amount of premium surcharge and member assessment that the Commissioner has ordered the Association to repay under §5.4126 of this division (relating to Alternative for Issuing Class 2 and Class 3 Public Securities).

(36) Premium Surcharge Trust Fund--The dedicated trust fund established by TPFA and held by the Trust Company in which the Association or insurers must deposit premium surcharges collected under Insurance Code §2210.613.

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

(38) Public Security Administrative Expenses--Expenses incurred by the Association, TPFA, or TPFA consultants to administer public securities issued under Insurance Code Chapter 2210, including fees for credit enhancement, paying agents, trustees, attorneys, and other professional services.

(39) [(30)] Public Security Obligations [security obligations]--The principal of a public security and any premium and interest on a public security issued under Insurance Code Chapter 2210, Subchapter M [this subchapter], together with any amount owed under a related Credit Agreement [credit agreement].

(40) Repayment Obligation Trust Fund--The dedicated trust fund that the Trust Company holds in which the Association deposits Net Premium and Other Revenue that is not contractually required for the Class 1 Payment Obligation in amounts necessary to comply with the Commissioner's order under §5.4126 of this division for payment of the Premium Surcharge and Member Assessment Repayment Obligation.

(41) [(34)] Scheduled Policy Claims--That portion of the Association's Earned Premium [earned premium] and Other Revenue [other revenue] expected to be paid in connection with the disposition of Losses [losses] that do not result from a Catastrophic Event [catastrophic event].

(42) [(32)] Trust Company--The Texas Treasury Safekeeping Trust Company managed by the Comptroller under [comptroller pursuant to the] Government Code §404.101, et seq.

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

(44) [(34)] TPFA--Texas Public Finance Authority.

(45) [(35)] Unearned Premium--That portion of Gross Premium [~~gross premiums~~] that has been collected in advance for insurance that the Association has not yet [~~been~~] earned [~~by the Association~~] because of the unexpired portion of the time for which the insurance policy has been in effect.

§5.4121. Financing Arrangements.

(a) The Association may enter into financing arrangements. The financing arrangement must:

(1) enable the Association [~~association~~] to:

(A) pay Losses [~~losses~~] under [~~the~~] Insurance Code §2210.072; or

(B) obtain public securities under [~~the~~] Insurance Code §2210.072;

and[-]

(2) be approved by the Association's board of directors

before [~~prior to~~] the Association enters [~~entering~~] into the financing arrangement.

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

(1) Net Premium [~~premiums~~] and Other Revenue [~~other revenue~~] of the Association that is not required for payment of Class 1 Payment Obligations or Premium Surcharge and Member Assessment Repayment Obligations;

(2) - (3) (No change.)

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

(5) (No change.)

(c) As collateral security for such financial arrangements, including interest bearing loans or other financial instruments, the Association may grant in favor of the applicable market source a collateral assignment and security interest in and to all or any portion of the Association's assets, including without limitation, all or any portion of the Association's right, title, and interest in and to all proceeds of any class of public security issued under Insurance Code Chapter 2210 ~~[or all class 1 public securities, including commercial paper notes, class 2 public securities, and/or class 3 public securities, with the priority of each such collateral assignment and security interest, whether first or secondary, to be determined by the Association in its discretion].~~

§5.4123. Public Securities Request, Approval, and Issuance.

(a) The Association's board of directors must request the issuance of public securities as prescribed in §§5.4124 - 5.4126 of this division (relating to Issuance of Class 1 Public Securities Before a Catastrophic Event; Issuance of Public Securities After a Catastrophic Event; and Alternative for Issuing Class 2 and Class 3 Public Securities).

(1) The request must be submitted to the Commissioner for approval with all required supporting documentation prescribed in §§5.4124 - 5.4126 of this division.

(2) The Association's board of directors may request public securities as often as necessary.

(3) If multiple classes of public securities are combined into a single request, the request must separately identify and provide supporting documentation for the issuance of each class of public securities.

(4) The Association's board of directors may submit a request for the issuance of public securities to be issued after a Catastrophic Event at any time. If the request for the issuance of public securities after a Catastrophic Event is submitted before a Catastrophic Event, the Association's request must specify that the requested public securities may only be issued after a Catastrophic Event.

(b) The Commissioner must approve the request before TPFA may issue the requested public securities.

(1) If the supporting documentation is incomplete, the Commissioner or the Department may request additional documentation without rejecting the request.

(2) In considering the Association's request, the Commissioner may rely on any statements or notifications of definitive or estimated Losses, Association revenue, reinsurance proceeds, and any other related or supporting information from any source, including from the general manager of the Association and from TPFA and its consultants and legal counsel.

(3) If the Commissioner disapproves the request, the Association's board of directors may reconsider the matter and submit another request under subsection (a) of this section.

(4) The Department must provide the Commissioner's written approval of the request to the Association and TPFA.

(c) Following the Commissioner's written approval of the request, TPFA may issue public securities and Credit Agreements on behalf of the Association, as authorized in

Insurance Code Chapter 2210 and §§5.4124 - 5.4126 of this division, for the issuance, reissuance, refinancing, and payment of Public Security Obligations and Public Security Administrative Expenses.

(d) The Association must provide to the Department and the Commissioner any requested information concerning public securities or the pending issuance of public securities, including information TPFA, a TPFA consultant, or TPFA legal counsel provides to the Association.

(e) A request for issuance of public securities under Subsection (a) of this section includes a request for the reissuance and refinancing of Public Security Obligations.

§5.4124. Issuance of Class 1 Public Securities before a Catastrophic Event.

(a) The Association's board of directors may request that TPFA issue Class 1 Public Securities before a Catastrophic Event, if the Association's board of directors determines that Class 1 Public Security proceeds may become necessary and the Commissioner approves the request.

(b) The Association must submit its board of directors' written request under subsection (a) of this section to the Commissioner. The request must include the following information:

(1) the reason why the requested Class 1 Public Securities may become necessary;

(2) the amount of Premium and Other Revenue that the Association expects will be available to pay loss claims in the current calendar year;

(3) reinsurance coverage that the Association expects will be available to pay claims in the current calendar year;

(4) the amount in the CRTF that the Association expects will be available to pay loss claims in the current calendar year;

(5) the principal amount of Class 1 Public Securities that are authorized and available to be issued before a Catastrophic Event, and that are requested;

(6) the estimated amount of debt service for the public securities, including any Contractual Coverage Amount and Public Security Administrative Expenses;

(7) the structure and terms of the public securities, including any terms that may change as a result of a Catastrophic Event or the use of any proceeds of Class 1 Public Securities issued before a Catastrophic Event;

(8) market conditions and requirements necessary to sell marketable public securities;

(9) a cost-benefit analysis as described in §5.4135 of this division (relating to Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis);

(10) a three-year pro forma financial statement consisting of a balance sheet, income statement, and a statement of cash flows, reflecting the financial impact of issuing Class 1 Public Securities before a Catastrophic Event that assumes the proceeds will be used in the event of a catastrophe; and

(11) any other relevant information requested by the Commissioner.

(c) The Association may make one or more requests under this section.

(d) The Association may request Class 1 Public Securities up to an aggregate principal amount not to exceed \$1 billion outstanding at any one time, regardless of the

calendar year or years in which the securities are issued, except that Class 1 Public Securities that are issued before a Catastrophic Event and that have been used to pay for insured Losses or expenses will not continue to count against the combined \$1 billion aggregate limit described in this subsection. This section does not authorize the Association to request Class 1 Public Securities in an amount in excess of the catastrophe year limit prescribed in §5.4125(c) of this division (relating to Issuance of Public Securities after a Catastrophic Event).

§5.4125. Issuance of Public Securities after a Catastrophic Event.

(a) As provided in §5.4123 of this division (relating to Public Securities Request, Approval, and Issuance) and subject to the Commissioner's approval, the Association's board of directors may request that TPFA issue public securities after a Catastrophic Event has occurred. The Association's board of directors may make the request:

(1) after the Catastrophic Event if the Association's board of directors determines that actual Catastrophic Losses are estimated to exceed available money in the CRTF and available reinsurance proceeds, and that the public security proceeds are necessary to fund the Catastrophic Losses; or

(2) before the Catastrophic Event if the Association's board of directors determines that public security proceeds may become necessary to fund potential Catastrophic Losses. This paragraph does not affect the requirements for issuing public securities that are issued after a Catastrophic Event or the use of proceeds from public securities issued after a Catastrophic Event.

(b) The Association must submit its board of directors' written request under subsection (a) of this section to the Commissioner. The request must include the following information:

(1) an estimate of the actual, or potential, Losses and expenses from the Catastrophic Event;

(2) the Association's current Premium and Other Revenue;

(3) the Association's current Net Revenues;

(4) the sources and amount of loss funding other than public securities,

including:

(A) the amount of the loss paid from Premium and Other Revenue;

(B) the amount requested from the CRTF;

(C) amounts available from other financing arrangements, and the Association's obligations for other financing arrangements, including whether such amounts must be repaid from public security proceeds or from other means; and

(D) available reinsurance proceeds;

(5) the principal amount of each requested class of public securities that is authorized and available to be issued and that is requested;

(6) the estimated costs associated with each requested amount and class of public securities under this section, including any contractual coverage requirement and Public Security Administrative Expenses;

(7) the structure and terms of the public securities;

(8) market conditions and requirements necessary to sell marketable public securities;

(9) a cost-benefit analysis as described in §5.4135 of this division (relating to Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis); and

(10) any other relevant information requested by the Commissioner.

(c) For each class of public securities requested under this section, the Association must determine and submit as part of its request the authorized amount of public securities. This amount must be the lesser of:

(1) the statutorily authorized principal amount for that class, less any principal amount of that class of public security that was issued in the catastrophe year, less, in the case of Class 1 Public Securities, the proceeds of Class 1 Public Securities issued under §5.4124 of this division (relating to issuance of Class 1 Public Securities before a Catastrophic Event) that were available for a Catastrophic Event at the beginning of the catastrophe year for which the Class 1 Public Securities are requested under this section; or

(2) the amount of the estimated loss, and estimated costs including the costs associated with the issuance of that class of public security.

(d) The Association must request, in aggregate for each catastrophe year:

(1) the statutorily authorized principal amount of Class 1 Public Securities before Class 2 Public Securities may be requested; and

(2) the statutorily authorized principal amount of Class 2 Public Securities before Class 3 Public Securities may be requested.

(e) The Association:

(1) may make one or more requests under this section;

(2) may, following a Catastrophic Event, request the issuance of Class 1 Public Securities under this section, before the exhaustion of any remaining proceeds from Class 1 Public Securities issued before a Catastrophic Event;

(3) must deplete the proceeds of any outstanding Class 1 Public Securities issued before a Catastrophic Event before using the proceeds of Class 1 Public Securities requested under this section; and

(4) may request the issuance of Class 2 and Class 3 Public Securities under this section, before the exhaustion of all Class 1 or Class 2 Public Security proceeds.

§5.4126. Alternative for Issuing Class 2 and Class 3 Public Securities.

(a) If all or any portion of the authorized principal amount of Class 1 Public Securities requested under §5.4125 of this division (relating to Issuance of Public Securities after a Catastrophic Event) cannot be issued based on the factors described in §5.4135 of this division (relating to Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis), the Commissioner may order the issuance of Class 2 and Class 3 Public Securities as provided in by this section.

(b) In its request to the Commissioner to order issuance of public securities under this section, the Association must submit the following information:

- (1) the information required by §5.4125(b) of this division; and
- (2) information based on the analyses described in §5.4135 of this division;
- (3) the amount of Class 1 Public Securities that can be issued;
- (4) the amount of Class 1 Public Securities that cannot be issued; and

(5) the specific reasons, market conditions, and requirements that prevent TPFA from issuing all or any portion of the authorized principal amount of Class 1 Public securities. The Association may rely on information and advice provided by TPFA, TPFA consultants, TPFA legal counsel, and third parties retained by the Association for this purpose.

(c) The Association must request that TPFA issue the authorized principal amount of Class 1 Public Securities that can be issued under §5.4125(c) of this division before Class 2 Public Securities may be issued under this section.

(d) The Commissioner may rely on information provided to the Commissioner under this section, §5.4125 of this division, and from any other source, including information and advice provided by the Association, TPFA, TPFA consultants, and TPFA legal counsel. If the Commissioner finds that all or any portion of the authorized amount of Class 1 Public Securities cannot be issued, the Commissioner may order the issuance of Class 2 Public Securities in an amount that does not exceed the authorized principal amount of Class 2 Public Securities as determined in §5.4125(c) of this division.

(e) The order must specify:

(1) the maximum principal amount of Class 2 Public Securities that are to be issued;

(2) the information and amount required under §5.4127(b) of this division (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments);

(3) the maximum term of the Class 2 Public Securities;

(4) when the Association is to begin collecting funds under this section for deposit in the Repayment Obligation Trust Fund;

(5) the Premium Surcharge and Member Assessment Repayment

Obligation; and

(6) the year repayment begins under §5.4128 of this division (relating to Repayment of Premium Surcharges to Policyholders and Member Assessments to Insurers).

(f) The Commissioner may revise an order issued under this section as necessary if the Association prepays amounts due or to maintain the Association's ability to fund the Class 1 Payment Obligations or other Association obligations, including Losses.

(g) TPFA may issue the Class 2 Public Securities authorized by the Commissioner's order under this section. TPFA may issue the Class 2 Public Securities that are subject to §5.4127(b) of this division as a separate series from other Class 2 Public Securities.

(h) If Class 2 Public Securities are issued in the manner authorized under this section, Class 3 Public Securities may be issued only after Class 2 Public Securities have been issued in the statutorily authorized principal amount of \$1 billion for that catastrophe year. Despite the restriction on issuing Class 3 Public Securities in this subsection, the Association may request, the Commissioner may approve, and TPFA may prepare for the issuance of Class 3 Public Securities before the issuance of all Class 2 Public Securities. Class 3 Public Securities must be requested as provided in §5.4123 of this division (relating to Public Securities Request, Approval, and Issuance) and §5.4125 of this division.

§5.4127. Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments.

(a) All Public Security Obligations and Public Security Administrative Expenses for Class 2 Public Securities issued under §5.4126 of this division (relating to Alternative for Issuing Class 2 and Class 3 Public Securities) must be paid 30 percent from member assessments and 70 percent from premium surcharges on those Catastrophe Area insurance policies subject to premium surcharge under Insurance Code §2210.613.

(1) For purposes of the premium surcharge, in this section and §5.4128 of this division (relating to Repayment of Premium Surcharges to Policyholders and Member Assessments to Insurers), the term “insurer” has the meaning that is defined in §5.4172 of this division (relating to Premium Surcharge Definitions).

(2) The Association must collect and deposit the member assessments and premium surcharges as directed in §§5.4143 - 5.4146 of this division (relating to Trust Funds for the Payment of Class 2 Public Securities; Excess Class 2 Premium Surcharge Revenue; Excess Class 2 Member Assessment Revenue; and Member Assessment Trust Fund for the Payment of Class 3 Public Securities).

(b) The Commissioner’s order described in §5.4126(d) and (e) of this division must require the Association to repay the cost of the Class 2 Public Securities issued under subsection (a) of this section in an amount equal to the lesser of:

(1) \$500 million total principal amount, plus any costs associated with that amount; or

(2) that portion of the total principal amount of Class 1 Public Securities authorized to be issued as described in §5.4125 of this division (relating to Issuance of Public Securities after a Catastrophic Event) that cannot be issued, plus any costs associated with that portion.

(c) The Association must repay the costs under subsection (b) of this section by repaying the amount of premium surcharges and member assessments that are paid, or payable, on the total principal amount, plus any costs and Contractual Coverage Amount associated with that amount.

(d) The sources of funds for the repayment required under subsection (b) of this section include:

(1) the Association's Net Premium and Other Revenue that is not contractually pledged to Class 1 Payment Obligations; and

(2) excess amounts released from the Obligation Revenue Fund that are released as described in §5.4142 of this division (relating to Excess Obligation Revenue Fund Amounts).

(e) In addition to Premium and Other Revenue amounts that the Association must collect to pay for outstanding Class 1 Payment Obligations, the Association must collect Premium and Other Revenue in an amount sufficient to repay the Premium Surcharge and Member Assessment Repayment Obligation owed under the Commissioner's order in subsection (b) of this section.

(f) Using either or both of the following methods, the Association must repay the amounts required under the Commissioner's order in subsection (b) of this section.

(1) To reduce the need for collecting premium surcharges and member assessments, the Association may deposit funds described in subsection (d) of this section in the Premium Surcharge Trust Fund, Member Assessment Trust Fund, or both funds, before the collection of any premium surcharges or member assessments.

(2) The Association may deposit funds described in subsection (d) of this section in the Repayment Obligation Trust Fund for repayment of class 2 premium

surcharges and member assessments already collected.

(g) For each year in which the Association owes funds to repay member assessments or premium surcharges used to pay debt service for public securities described under subsection (b) of this section, the Association must record the following information:

(1) the amount of premium surcharges the Association owes to each insurer for that year; and

(2) the amount of member assessments the Association owes to each insurer for that year.

(h) Despite any other requirement in this division, an insurer may pay on behalf of its policyholder all or any part of a premium surcharge that is subject to repayment under this section. If the insurer makes the payment under this subsection, the insurer is entitled to repayment of that amount when the Association repays it. The insurer:

(1) may only pay the premium surcharge to pay the amounts owed for the payment of Class 2 Public Security Obligations and Public Security Administrative Expenses associated with the amount to be repaid under the Commissioner's order in subsection (b) of this section;

(2) must pay the premium surcharges for all policyholders of that insurer subject to the premium surcharge equally; and

(3) must maintain records that track the amount of premium surcharges paid to their policyholders and those not paid.

§5.4128. Repayment of Premium Surcharges to Policyholders and Member

Assessments to Insurers.

(a) When providing a repayment to insurers for amounts paid for class 2 premium surcharges and member assessments, the Association must specify the surcharge and assessment period being repaid.

(b) Beginning with the year designated in the Commissioner's order described in §5.4126 of this division (relating to Alternative for Issuing Class 2 and Class 3 Public Securities), not later than March 1 of each year the Association must direct payment of the funds held in the Repayment Obligation Trust Fund to the insurer or insurance group to which the funds are owed for repayment of premium surcharges or member assessments.

(c) Within 90 days of receipt of a premium surcharge repayment from the Association, insurers must repay to the policyholders who made the payments all amounts received from the Association. Premium surcharge repayments must be proportional to the amount of premium surcharge each insured paid in the period the Association specified in its repayment. To the extent that the insurer paid all or any portion of the premium surcharge for its policyholders as provided under §5.4127 of this division (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments), the insurer may recoup the amount it paid for the period refunded from the Association repayment as if it were the insured to whom the repayment was owed.

§5.4133. Public Security Proceeds.

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

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

(2) other amounts as authorized in Insurance Code §2210.608 [~~to purchase reinsurance for the Association~~].

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

(1) the amount of the request; and

(2) the purpose of the request.

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

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

§5.4135. Marketable Public Securities: the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis.

(a) Marketable public securities under this division are public securities for which the Association in consultation with TPFA determines:

(1) are consistent with state debt issuance policy requirements;

and

(2) achieve the goals of the Association.

(b) In determining the amount of Class 1 Public Securities that can and cannot be issued, the Association must consider:

(1) the Association's current Premium and Net Revenue;

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

(3) the Association's obligations for outstanding Class 1 Public Securities, including contractual coverage requirements and Public Security Administrative Expenses;

(4) the estimated Premium Surcharge and Member Assessment Repayment

Obligations;

(5) the Association's outstanding Premium Surcharge and Member

Assessment Repayment Obligations;

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

(7) any conditions precedent to issuing Class 1 Public Security Obligations contained in any applicable public security financing documents;

(8) TPFA administrative rules;

(9) applicable State of Texas debt issuance policies;

(10) administrative rules of the Office of the Attorney General of Texas that require evidence of debt service and other obligation coverage; and

(11) market conditions and requirements necessary to sell marketable public securities, including issuing classes in installments.

(c) The Association may rely on the advice and analysis of TPFA, TPFA consultants, TPFA legal counsel, and third parties the Association has retained for this

purpose in determining “market conditions and requirements” under subsection (b) of this section. The Association’s determination may include consideration of the following factors:

(1) interest rate spreads;

(2) municipal bond ratings of the public securities;

(3) prior issuances of catastrophe related public securities in Texas or any other state;

(4) similar financings in the market within the preceding 12 months;

(5) news or other publications relating to the Association or the issuance of catastrophe-related public securities;

(6) a nationally recognized investment banking firm’s confidence memorandum;

(7) legal and regulatory conditions; and

(8) any other market conditions and requirements that the Association deems necessary and appropriate.

(d) As part of each request for public securities, the Association must submit to the Commissioner a cost-benefit analysis of the various financing methods and funding structures that are available to the Association. A cost-benefit analysis must include:

(1) for public securities requested under §5.4124 of this division (relating to Issuance of Class 1 Public Securities before a Catastrophic Event):

(A) estimates of the monetary costs of issuing public securities, including issuance costs, debt service costs, and any contractual coverage requirement;

(B) the benefits associated with issuing public securities, including benefits to the Association's claim-paying capabilities, liquidity position, and other benefits associated with issuing public securities before a Catastrophic Event; and

(C) estimates of the monetary costs, benefits associated with, and the availability of funding alternatives, such as:

(i) purchasing additional reinsurance for similar funding at a similar level;

(ii) providing financing arrangements, or additional financing arrangements, that provide similar funding and at a similar layer; or

(iii) other alternative risk transfer arrangements, such as catastrophe bonds, that provide similar funding and at a similar layer;

(2) for public securities requested under this division following a Catastrophic Event:

(A) estimates of the monetary costs of issuing public securities, including issuance costs, debt service costs, and any contractual coverage requirement;

(B) the benefits associated with issuing public securities, including benefits to the Association's claim-paying capabilities and other benefits associated with issuing public securities; and

(C) the availability of alternative funding arrangements, if any, including the monetary costs and benefits associated with any available alternative funding arrangements.

§5.4136. Association Rate Filings.

While there are outstanding Class 1 Public Securities, or there are repayment obligations under §5.4127(b) of this division (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments), the Association:

(1) must consider its obligations for the payment of Class 1 Public Securities and the repayment of Class 2 Public Securities, including the additional amount of any debt service coverage that the Association determines is required for the issuance of marketable public securities in developing its rates;

(2) must include in a rate filing submitted to the Department an analysis that demonstrates that the filed rates produce Premium sufficient to provide for at least:

(A) the expected operating costs of the Association, including expected nonhurricane wind and hail Losses and loss adjustment expenses; and

(B) the expected payment of Class 1 Public Security Obligations and the expected repayment of Class 2 Public Securities, including any Contractual Coverage Amount the Association determines is required for the issuance of marketable public securities, during the period in which the rates will be in effect; and

(3) must include a cost component in the rates sufficient to at least provide for the expected payment of Class 1 Payment Obligations and the expected repayment of Premium Surcharge and Member Assessment Repayment Obligations during the period in which the rates will be in effect.

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

(a) While Class 1 Public Securities [~~class 1 public securities~~] are outstanding, the Association must [~~all of the Association's net revenue shall be paid into the obligation-~~

~~revenue fund created for such class 1 public securities. The Association shall] deposit Net Premium and Other Revenue in [the required amounts in] the Obligation Revenue Fund [obligation revenue fund created for class 1 public securities] at [such] periods and in amounts as required by the Class 1 Public Security Agreements to fund the Class 1 Payment Obligation [under agreements with the TPFA].~~

(b) Without limiting other options, the Class 1 Public Security Agreements may include an Operating Reserve Fund [The operating reserve fund shall be held by the Association]. If the Class 1 Public Securities Obligation Revenue Fund [class 1 public securities obligation revenue fund] does not contain sufficient money to pay debt service on the Class 1 Public Securities [class 1 public securities], administrative expenses on the class public securities, or other Class 1 Public Security Obligations [class 1 public security obligations], the Association must [shall] transfer sufficient money from any Operating Reserve Fund or other Association held funds [the operating reserve fund] to the Obligation Revenue Fund [obligation revenue fund for class 1 public securities] to make [such] the payment.

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

(a) Excess revenue collected in the Obligation Revenue Fund [to fund class 1 public security obligations] that is disbursed to the Association is [shall be] an asset of the Association and may be used for any purpose authorized in [the] Insurance Code §2210.056, including as provided in §5.4127 of this division (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments), or deposited in [into] the CRTF [catastrophe reserve trust fund].

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

§5.4143. Trust Funds ~~[Obligation Revenue Fund]~~ for the Payment of Class 2 Public Securities.

(a) As required by any agreements between the Association, TPFA, or the Trust Company, insurers may be required to deposit premium surcharges and member assessments directly into the Premium Surcharge Trust Fund and Member Assessment Trust Fund, respectively.

(b) If insurers are required to direct deposit under subsection (a) of this section, then the Association must provide notice to the Commissioner and insurers:

(1) for premium surcharges, no later than 60 days before the insurers must implement the surcharge; and

(2) for member assessments, with the notice required under §5.4163 of this division (relating to Notice of Assessments).

(c) The notice under subsection (b) of this section must include all applicable deposit instructions, including any required routing information and account numbers.

(d) Insurers must deposit the funds into the appropriate accounts on the date the funds must otherwise be remitted to the Association under §5.4164 of this division (relating to Payment of Assessment) and §5.4186 of this division (relating to Remittance of Premium Surcharges).

(e) If insurers are not required to direct deposit under subsection (a) of this section, then the Association must deposit the collected premium surcharges and Association member assessments on receipt into the appropriate accounts as required under

agreements with TPFA and the Trust Company. The Association may not directly or indirectly use, borrow, or in any manner pledge or encumber premium surcharges and Association member assessments collected, or to be collected, by the Association under Insurance Code §2210.613, except for the payment of Class 2 Public Security obligations and as otherwise authorized in this title.

(f) The Trust Company must deposit any Investment Income earned on the premium surcharges or member assessments into the appropriate trust fund accounts while these amounts are on deposit.

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

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

§5.4144. Excess Class 2 Premium Surcharge Revenue.

(a) Revenue collected in any calendar year from premium surcharges under ~~[the]~~ Insurance Code §2210.613 that exceeds the amount of Class 2 Public Security Obligations ~~[class 2 public security obligations]~~ and Class 2 Public Security Administrative Expenses ~~[class 2 public security administrative expenses]~~ payable in that calendar year from premium surcharges and interest earned on the Premium Surcharge Trust Fund deposits ~~[class 2 public security obligation fund]~~ may, at ~~[in]~~ the discretion of the Association, be:

(1) used to pay Class 2 Public Security ~~[class 2 public security]~~ obligations payable in the following calendar ~~[subsequent]~~ year, offsetting the amount of the premium surcharge that would otherwise be required to be levied for the year under ~~[the]~~ Insurance Code Chapter 2210, Subchapter M;

(2) used to redeem or purchase outstanding Class 2 Public Securities ~~[class 2 public securities]~~; or

(3) deposited in the CRTF ~~[catastrophe reserve trust fund]~~.

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

§5.4145. Excess Class 2 Member Assessment Revenue.

(a) Revenue collected in any calendar year from a member assessment under ~~[the]~~ Insurance Code §2210.613 that exceeds the amount of Class 2 Public Security Obligations ~~[class 2 public security obligations]~~ and class 2 Public Security Administrative

Expenses [public security administrative expenses] payable in that calendar year from member assessments and interest earned on the Member Assessment Trust Fund created for Class 2 Public Securities deposits may, at the discretion of the Association, [may] be:

(1) used to pay Class 2 Public Security Obligations [~~class 2 public security obligations~~] payable in the following calendar [~~subsequent~~] year, offsetting the amount of the member assessment that would otherwise be required to be levied for the year under [~~the~~] Insurance Code Chapter 2210, Subchapter M; [~~or~~]

(2) used to redeem or purchase outstanding Class 2 Public Securities [~~class-2 public securities~~]; or

(3) deposited in the CRTF.

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

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

§5.4146. Member Assessment Trust [Obligation Revenue] Fund for the Payment of Class 3 Public Securities.

(a) As required by any agreement between the Association, TPFA, or the Trust Company, insurers may be required to direct deposit member assessments into the Member Assessment Trust Fund.

(b) If insurers are required to direct deposit under subsection (a) of this section, then the Association must provide notice of the direct deposit requirement to the

Commissioner and insurers with the notice required under §5.4163 of this division

(relating to Notice of Assessments).

(c) If insurers are not required to direct deposit under subsection (a) of this section, then the Association must deposit the collected member assessments on receipt in the Member Assessment Trust Fund. The deposits must be made as required under agreements with TPFA and the Trust Company.

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

(e) ~~[(b) Pending deposit as required under subsection (a) of this section, the Association shall hold such collected Association member assessments as required under agreements with the TPFA, or in the absence of an agreement, as required in the Association's plan of operation, including this section. Member assessments collected by the Association pursuant to the Insurance Code §2210.6135, must be held by the Association separately from all other Association funds.]~~ The Association may not directly or indirectly use, borrow, or in any manner pledge or encumber Association member assessments collected, or to be collected, by the Association under [pursuant to the] Insurance Code §2210.6135, except for the payment of Class 3 Public Security obligations and as otherwise authorized by this title.

§5.4147. Excess Class 3 Member Assessment Revenue.

(a) Revenue collected in any calendar year from a member assessment under ~~[the]~~ Insurance Code §2210.6135 that exceeds the amount of Class 3 Public Security Obligations ~~[class 3 public security obligations]~~ and Class 3 Public Security ~~[class 3 public security]~~ administrative expenses payable in that calendar year from member assessments and interest earned on the Member Assessment Trust Fund created for Class 3 Public Securities deposits may, in the discretion of the Association, ~~[may]~~ be:

(1) used to pay Class 3 Public Security Obligations ~~[class 3 public security obligations]~~ payable in the following calendar ~~[subsequent]~~ year, offsetting the amount of the member assessments that would otherwise be required to be levied for the year under ~~[the]~~ Insurance Code Chapter 2210, Subchapter M; ~~[or]~~

(2) used to redeem or purchase outstanding Class 3 Public Securities ~~[class 3 public securities]~~; or

(3) deposited in the CRTF.

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

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

§5.4148. Repayment Obligation Trust Fund for the Payment of Amounts Owed under §5.4127.

(a) As required by the Commissioner's order under §5.4126(d) (relating to Alternative for Issuing Class 2 and Class 3 Public Securities) of this division, the Association must deposit funds collected under §5.4127(d)(2) (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments) of this division in the Repayment Obligation Trust Fund. The Trust Company must deposit any Investment Income earned on these amounts while they are on deposit in the Repayment Obligation Trust Fund.

(b) The Association may not directly or indirectly use, borrow, or in any manner pledge or encumber Repayment Obligation Trust Funds held by the Trust Company except as authorized under Insurance Code Chapter 2210 and this division.

§5.4149. Excess Repayment Obligation Trust Fund Amounts.

Following the payment of all Class 2 Public Securities subject to repayment under §5.4127(b) (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments) of this division and the repayment of all amounts owed under §5.4127(b) of this division, any funds remaining in the Repayment Obligation Trust Fund must be disbursed to the Association as an asset of the Association and may be used for any purpose authorized in Insurance Code §2210.056.

§5.4164. Payment of Assessment.

Except as provided by §5.4143 of this division (relating to Trust Funds for the Payment of Class 2 Public Securities) and §5.4146 of this division (relating to Member Assessment Trust Fund for the Payment of Class 3 Public Securities), each ~~Each~~ member must

[shall] remit to the Association payment in full of its assessed amount of any assessment levied by the Association within 30 days of receipt of notice of assessment.

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

Issued at Austin, Texas, on January 28, 2014.



Sara Waitt
General Counsel
Texas Department of Insurance