SUBCHAPTER A. Examination and Financial Analysis

28 TAC §7.18

1. INTRODUCTION. The Texas Department of Insurance (department) proposes amendments to §7.18 concerning Statements of Statutory Accounting Principles (SSAP) that provide guidance to independent accountants, industry accountants, and the department's analysts and examiners as to how to properly record business transactions for the purpose of accurate statutory reporting. SSAP provide a nationwide standard method of accounting which most insurers, including health maintenance organizations, are required to use for statutory financial reporting guidance. Although SSAP create a more consistent regulatory environment, they do not preempt individual state legislative and regulatory authority. SSAP are adopted by the National Association of Insurance Commissioners (NAIC) through its maintenance process which involves preparation of the SSAP, exposure, comment, and adoption by the NAIC. The Accounting Practice and Procedure Manual (Manual) is a comprehensive guide to statutory accounting principles and includes the SSAP that have been adopted by the NAIC. The proposed amendments will adopt by reference the March 2004 version of the Manual with the exceptions noted in §7.18. The proposed amendments include new SSAP Nos. 88, 89, 91, and subsection (e). SSAP No. 88 supersedes SSAP No. 46, paragraphs 2 and 3 of SSAP No. 32, and paragraphs 4-6 of SSAP No. 68. SSAP No. 88 is a new SSAP on the valuation of subsidiary, controlled, and affiliated entities. SSAP No. 89 supersedes SSAP No. 8 and provides statutory accounting guidance for accounting for employers' pensions. SSAP No. 91 supersedes SSAP Nos. 18, 33, and

45 and provides for accounting for transfers and servicing of financial assets including securitizations and various repurchase agreements. New subsection (e) provides for a 30-day prior notice for a request to the department of a permitted accounting practice.

2. FISCAL NOTE. Ms. Betty Patterson, Senior Associate Commissioner, Financial Program, has determined that for the first five years the amended section is in effect, there will be no fiscal implications for state or local government as a result of this amendment, and there will be no effect on local employment or the local economy.

3. PUBLIC BENEFIT/COST NOTE. Ms. Patterson has also determined that for each year of the first five years the amended section is in effect, the public benefit will be the more efficient regulation of insurance and a decrease in costs to insurers that are currently required to file multiple financial statements in multiple states. The proposed adoption of the March 2004 Manual will provide for a more consistent regulatory environment and will become a single source for accounting guidance. The March 2004 Manual is available from the NAIC at a cost of $395 for a soft cover manual or a CD-ROM. The cost to comply with the provisions of the Manual will vary from insurer to insurer. Since the Manual was first adopted on January 1, 2001, most of the costs of programming and training have been incurred. Based upon the department's experience, each company will have to ensure that at least one employee familiar with the company's accounting practices is instructed in the provisions of the Manual and monitors changes in the Manual. This instruction can be accomplished through self-study, attendance at a seminar, or a combination of the two methods. The NAIC offers

a self-study course at a cost of $175 per copy. Seminars that offer instruction on the Manual cost approximately $850 per attendee for a two-day course. The number of employees sent to training is largely dependent on the size and expertise of the company's accounting staff but is not dependent on the overall size of the company. As the size of the accounting staff increases, the likelihood that the company will choose to send more than one employee to a seminar for training increases. The department estimates that companies with five or fewer accounting employees will either require the use of self-study training or send one employee to a seminar. Those companies with six to ten employees on the accounting staff will likely send one to three employees to seminars for instruction and supplement that training with self-study materials. Those companies with eleven or more employees on the accounting staff will likely send three or more employees to seminars and supplement with self-study materials. Each employee is estimated to be compensated at a rate of $17 to $30 an hour. These estimates are based upon the department's discussions with industry representatives. Changes in the Manual may also require changes to a company's electronic accounting system. The cost of changes to accounting systems is dependent on the company's line of insurance, the complexity of the company's transactions, and whether the system is proprietary or created by third-party vendors. Costs due to system changes increase with the complexity of transactions and the percentage of proprietary computer code in the system. In the department's experience, small companies do not usually rely upon internally created proprietary systems and do not generally enter complex transactions on a regular basis. Large companies are more likely to have an internally created proprietary system and enter into complex transactions. Accordingly, system change costs, when necessary, will be greater for large companies. Therefore, it is the department's position that the adoption of the Manual will have no adverse economic effect on small and micro businesses. Farm mutual insurance companies, statewide mutual assessment companies, local mutual aid associations, and mutual burial associations will incur no costs as a result of the proposed amendment as they are specifically exempted from this section. Such companies have traditionally accounted for their business on a cash basis and the department has determined that compliance with the provisions of the Manual is not necessary for these types of companies. Regardless of the fiscal effect, the requirements of this section are mandated by the underlying statutes. In considering the nature of the statutes, it is neither legal nor feasible to waive or modify the requirements of this section for small and micro businesses because doing so would result in a disparate effect on enrollees, policyholders, and other persons affected by the section.

4. <u>REQUEST FOR PUBLIC COMMENT</u>. To be considered, written comments on the proposal must be submitted no later than 5:00 p.m. on January 24, 2005. All comments should be submitted to Gene C. Jarmon, General Counsel and Chief Clerk, Texas Department of Insurance, Mail Code 113-2A, P. O. Box 149104, Austin, Texas 78714-9104. An additional copy of the comments should be submitted simultaneously to Betty Patterson, Senior Associate Commissioner, Texas Department of Insurance, Financial Program, Mail Code 305-2A, P.O. Box 149104, Austin, Texas 78714-9104. A request for a public hearing on the proposal should be submitted separately to the Office of the Chief Clerk.

5. STATUTORY AUTHORITY. The amendments are proposed under the Texas Insurance Code Articles 1.15, 1.32, 3.33, 5.61, 21.28-A, 21.39 and §§32.041, 36.001, 802.001, 823.012, 841.004, 843.151, 861.255, 862.001. Article 1.15 mandates that the department examine the financial condition of each carrier organized under the laws of Texas or authorized to transact the business of insurance in Texas and adopt by rule procedures for the filing and adoption of examination reports. Article 1.32 authorizes the Commissioner to establish standards for evaluating the financial condition of an insurer. Article 3.33 authorizes the Commissioner to adopt rules, minimum standards, or limitations as may be appropriate for the implementation of the article. Article 5.61 provides that reserves shall be computed in accordance with rules adopted by the Commissioner for the purpose of adequately protecting insureds. Article 21.28-A authorizes the Commissioner to adopt rules necessary to remedy the financial condition and the management of certain insurers. Article 21.39 authorizes the Commissioner to adopt rules for establishing reserves applicable to each line of insurance recommended by the NAIC. Sections 32.041 and 802.001 authorize the Commissioner to provide required financial statement forms. Section 823.012 authorizes the Commissioner to issue rules and orders necessary to implement the provisions of Chapter 823 of the Insurance Code (Insurance Holding Company Systems). Section 843.151 authorizes the Commissioner to promulgate rules as are necessary to carryout the provisions of Chapter 843 of the Insurance Code. Sections 841.004, 861.255 and 862.001 authorize the Commissioner to adopt rules defining electronic machines and systems, office equipment, furniture, machines and labor saving devices, and the maximum period for

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

6. CROSS REFERENCE TO STATUTE. The following provisions of the Texas Insurance Code are affected by this proposal: Articles 1.15, 21.39 and §§32.041, 802.001, 841.004, 861.255, 862.001.

7. TEXT.

§7.18 NAIC Accounting Practices and Procedures Manual.

(a) The purpose of this section is to adopt statutory accounting principles, which will provide independent accountants, industry accountants, and [department] department's analysts and examiners guidance as to how to properly record business transactions for the purpose of accurate statutory reporting. The March 2004 [~~2003~~] version of the National Association of Insurance Commissioners *Accounting Practices and Procedures Manual* [~~(Manual)~~] ("Manual") will be utilized as the guideline for statutory accounting principles in Texas to the extent the Manual does not conflict with provisions of the Texas Insurance Code or rules of the department. The Commissioner reserves all authority and discretion to resolve any accounting issues in Texas. When making a determination on the proper accounting treatment for an insurance or health plan transaction, the Commissioner shall refer to the sources in paragraphs (1)-(6) of this subsection in the respective order of priority listed. Furthermore, §§3.1501-3.1505, 3.1605, 3.1606, 3.7004, 7.7, 7.85 and 11.803 of this title (relating to Annuity Mortality

Tables, General Requirements, Required Opinions, Contract Reserves, Subordinated Indebtedness, Audited Financial Reports and Investments, Loans and Other Assets), preempt any contrary provisions in the Manual.

(1) Texas statutes;

(2) department rules;

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

(4) the Manual;

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

(6) Generally Accepted Accounting Practices.

(b) The Commissioner adopts by reference the March <u>2004</u> [~~2003~~] version of the *Accounting Practices and Procedures Manual* published by the National Association of Insurance Commissioners, with the exceptions and additions set forth in subsections (c) and (d) of this section, as the source of accounting principles for the department when examining financial reports and for conducting statutory examinations and rehabilitations of insurers and health maintenance organizations licensed in Texas, except where otherwise provided by law. This adoption by reference shall be applied to examinations conducted as of January 1, <u>2005</u> [~~2004~~] and thereafter and also shall be used to prepare all financial statements filed with the department for periods after January 1, <u>2005</u> [~~2004~~].

(c) The Commissioner adopts the following exceptions and additions to the Manual:

(1) In addition to the statements of statutory accounting principles in the Manual, Statement of Statutory Accounting Principles number 88 regarding valuation of subsidiary, controlled, and affiliated entities and number 91 regarding accounting for transfers and servicing of financial assets including securitizations and various repurchase agreements adopted by the NAIC on September 12, 2004 and are effective January 1, 2005, is adopted by reference and shall be used to prepare all financial statements for years ending on and after December 31, 2005. This adoption of SSAP Nos. 88 and 91 effectively replaces SSAP Nos. 18, 33, 45, 46, paragraphs 2 and 3 of SSAP No. 32, and paragraphs 4-6 of SSAP No. 68.

(2) [~~(1)~~] Retrospective premiums must be billed within 60 days of computation and audit premiums must be billed within 60 days of the completion of the audit in determining the beginning date from which the ninety day period is calculated to determine admissibility of uncollected premium balances under Statement of Statutory Accounting Principles number 6.

(3) [~~(2)~~] Electronic machines, constituting a data processing system or systems and operating systems software used in connection with the business of an insurance company acquired after December 31, 2000, may be an admitted asset as permitted by Texas Insurance Code §§841.004, 861.255, 862.001, and any other applicable law and shall be amortized as provided by the Manual. All such property acquired prior to January 1, 2001, may be an admitted asset as permitted by Texas Insurance Code §§841.004, 861.255, 862.001, and any other applicable law, and shall be amortized in full over a period not to exceed ten years.

(4) [~~(3)~~] Furniture, labor-saving devices, machines, and all other office equipment may be admitted as an asset as permitted by Texas Insurance Code §§841.004, 861.255, 862.001, and any other applicable law and, for such property acquired after December 31, 2000, depreciated in full over a period not to exceed five years. All such property acquired prior to January 1, 2001, may be an admitted asset as permitted by Texas Insurance Code §§841.004, 861.255, 862.001, and any other applicable law, and shall be depreciated in full over a period not to exceed ten years.

(5) [~~(4)~~] Goodwill, as reported on a regulated entity's statutory financial statements as of December 31, 2000, and any additional goodwill acquired thereafter, beginning January 1, 2001, shall be admitted as an asset and accounted for as permitted by Statements of Statutory Accounting Principles numbers 61 and 68. All other amounts of goodwill, including, but not limited to, such amounts that may have been previously expensed, shall not be allowed as an admitted asset. However, notwithstanding the provisions of Statements of Statutory Accounting Principles numbers 61 and 68, all methods of non-insurer subsidiary and affiliate valuation permitted by Texas Insurance Code §§823.301-823.307 may be used for the purposes of goodwill calculation.

(6) [~~(5)~~] All certificates of deposit, of any maturity, may be classified as cash and are subject to the accounting treatment contained in Statement of Statutory Accounting Principles number 2, notwithstanding the provisions of Statement of Statutory Accounting Principles number 26.

(d) A farm mutual insurance company, statewide mutual assessment company, local mutual aid association, or mutual burial association that has less than $5 million in annual direct written premiums need not comply with the Manual.

(e) In the event a domestic insurer desires to deviate from accounting guidance in Texas statute, this regulation or any other, such insurer is required to file the desired deviated accounting as a request for a permitted accounting practice. Such filing shall be made with Cathy Lockett, Associate Chief Examiner, Texas Department of Insurance, Mail Code 305-2E, P.O. Box 149104, Austin, Texas 78714-9104 at least 30-days prior to the filing of the financial statement affected by the deviated accounting practice. Insurers shall not use deviated accounting practice without prior approval of the department.

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

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

Issued at Austin, Texas on ______________________________, 2004.

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Gene C. Jarmon
General Counsel and Chief Clerk
Texas Department of Insurance