SUBCHAPTER E. TEXAS WINDSTORM INSURANCE ASSOCIATION
DIVISION 3 LOSS FUNDING, INCLUDING CATASTROPHE RESERVE TRUST FUND, FINANCING ARRANGEMENTS, AND PUBLIC SECURITIES
28 TAC §§5.4161 - 5.4167, 5.4171 - 5.4173, and 5.4181 - 5.4192

1. INTRODUCTION. The Commissioner of Insurance (Commissioner) adopts new §§5.4161 - 5.4167, 5.4171 - 5.4173, and 5.4181 - 5.4192 to implement legislative changes to the Insurance Code Chapter 2210 under House Bill (HB) 4409, 81st Legislature, 2009 Regular Session, and amend the plan of operation of the Texas Windstorm Insurance Association (Association). These sections set forth procedures for making and collecting member assessments and procedures for making and assessing premium surcharges under Chapter 2210, Insurance Code.

Sections 5.4161, 5.4162, 5.4167, 5.4171, 5.4172, 5.4181 - 5.4184, 5.4186, 5.4187, and 5.4189 - 5.4192 are adopted with changes to the proposed text published in the July 30, 2010 issue of the *Texas Register* (35 TexReg 6611). Sections 5.4163 - 5.4166, 5.4173, 5.4185, and 5.4188 are adopted without changes. This adoption does not address proposed new 28 TAC §§5.4101, 5.4102, 5.4111 - 5.4114, 5.4121, 5.4131 - 5.4134, and 5.4141 - 5.4147, which were published in the July 23, 2010 issue of the *Texas Register* (35 TexReg 6476) and were also considered at the August 24, 2010 hearing and are the subject of a separate adoption order.

2. REASONED JUSTIFICATION. The adopted sections are necessary to implement legislative changes to the Insurance Code Chapter 2210 under HB 4409, 81st Legislature, 2009 Regular Session and create a more efficient rule structure by grouping Association loss funding mechanisms in this division. The adopted sections establish the procedures and requirements for determining and collecting member assessments and premium surcharges for the payment of class 2 public security obligations and class 3 public security obligations under the Insurance Code §2210.613 and §2210.6135. Compliance with these requirements is essential to assure the availability of Association insurance coverage for all eligible persons and properties.

Under §2210.001 of the Insurance Code, the Legislature has determined that the provision of windstorm and hail insurance is necessary for the economic welfare of the state and its inhabitants; and that the lack of such insurance in the state's seacoast territories would severely impede the orderly growth and development of the state. The Association was created by the Legislature and is intended to serve as a residual insurer of last resort for windstorm and hail insurance coverage (insurance coverage) in the catastrophe area designated by the Commissioner under the Insurance Code §2210.005. The catastrophe area is underserved for insurance coverage and consists of the 14 Texas coastal counties and parts of Harris County. The Association's purpose is to provide insurance coverage to those persons who are unable to obtain comparable insurance coverage in the voluntary insurance market. The ability to obtain insurance coverage that will provide coverage for losses resulting from windstorm and

hail is crucial to the financial welfare of persons living and working in the designated catastrophe area. The absence of such coverage providing for the payment of losses results in the lack of an important element for economic stability in the region.

House Bill 4409 substantially amended how Association losses and operating expenses in excess of premium and other revenue are funded in new Subchapters B-1 and M, Chapter 2210, Insurance Code. Compliance with these requirements is essential to assure the availability of Association insurance coverage for all eligible persons and properties. The adopted sections implement the means to repay the public security obligations necessary to fund the new loss funding scheme. Thus, adoption of these sections will affect the economic welfare of the state and its inhabitants, and positively impact the orderly growth and development of the state.

The Association operates under a plan of operation which is adopted by rule. The Insurance Code §2210.151 provides that the Commissioner shall adopt by rule the Association's plan of operation to provide Texas windstorm and hail insurance in the catastrophe area. The Insurance Code §2210.152(a)(1) sets out the requirements of the plan of operation and specifies that the plan of operation must provide for the efficient, economical, fair and nondiscriminatory administration of the Association. Further, the Insurance Code §2210.152(a)(2)(G) provides that the plan of operation may include other provisions considered necessary by the Department to implement the purposes of Chapter 2210.

Historically, the Association's plan of operation has been specified in §5.4001 of this chapter (relating to Plan of Operation). Neither the Insurance Code §2210.151 nor §2210.152 require the Association's plan of operation to be in a single section of the Administrative Code. With the adoption of HB 4409 related requirements in §§5.4902 - 5.4908 and 5.4911 of this chapter (relating to Additional Requirements; Declination of Coverage; Flood Insurance; Minimum Retained Premium; Certificate of Compliance Approval Program; Certificate of Compliance Transition Program; Alter and Alteration; and Insurance Policy Forms, Endorsements, Manual Rules, Application Forms, and Underwriting Guidelines; respectively) the Department began to revise the format of the plan of operation into sections related to specific topics. Sections 5.4902 - 5.4908 and §5.4911 were adopted to control over conflicting provisions in §5.4001. The sections in this adoption have similar language with respect to control over §5.4001. However, references in this adoption to the plan of operation incorporate both §§5.4001, 5.4902 - 5.4908, and 5.4911, unless specified otherwise.

As stated, HB 4409 substantially amended how Association losses and operating expenses in excess of premium and other revenue are funded. It is necessary that these new requirements, which amend or augment the Association's existing plan of operation, be integrated into the plan of operation. The adopted sections integrate these requirements into the plan of operation.

Thus, it is necessary to amend the plan of operation to address the following: (i) Association member assessments under the Insurance Code §2210.613 and

§2210.6135; and (ii) the procedure for determining a policyholder surcharge under the Insurance Code §2210.613. It is further necessary to establish the procedures and requirements for collecting premium surcharges for the payment of class 2 public securities under the Insurance Code §2210.613.

To effect these necessary amendments, adopted §§5.4161 - 5.4167, and 5.4173 become part of the Association's plan of operation. While §5.4161 and §5.4162 include new provisions related to the implementation of HB 4409, §§5.4161 - 5.4167 also redesignate existing provisions concerning member assessments that are currently in §5.4001(c)(2) of the plan of operation into this division. The sections are being redesignated because including the Association's assessment procedure with other loss funding provisions will make it more accessible to interested persons. Further, because §5.4001 will be addressed at a later time, the existing provisions in §5.4001(c)(2) will not be repealed at this time. Rather, as provided in §5.4161(c), the redesignated sections will control over any conflicting provisions in §5.4001. Finally, the redesignated sections include nonsubstantive updates and use terminology more consistent with this adoption and current statutes and rules. Section 5.4173 is designated as part of the Association's plan of operation because it establishes the Association's procedure for determining the need for a premium surcharge and the amount of the premium surcharge.

Section 5.4171 and §5.4172 and §§5.4181 - 5.4192 are adopted to establish the procedures and requirements the insurance industry shall use for determining and

collecting premium surcharges for the payment of class 2 public securities under the Insurance Code §2210.613.

The Department further recognizes that the Dodd-Frank Wall Street Reform and Consumer Protection Act, (Public Law 111 - 203, H. R. 4173, July 21, 2010) (Dodd - Frank Act) was enacted by Congress after the submission of the proposal to the *Texas Register*. The Dodd -Frank Act affects the regulation of surplus lines insurance and may be determined to prohibit the inclusion of certain surplus lines premiums in the determination of assessment and premium surcharges. Therefore, §5.4162 and §5.4171 have been changed to exclude such premium and policies that a federal agency or court of competent jurisdiction determines to be exempt from inclusion in the assessment formula or subject to premium surcharge under the Insurance Code Chapter 2210.

The following explains adopted §§5.4161 - 5.4167, 5.4171 - 5.4173, and 5.4181 - 5.4192 in greater detail.

§5.4161. Member Assessments. Section 5.4161 restates existing §5.4001(c)(2)(A) of this chapter, which §5.4161 will control over. Section 5.4161 does not significantly alter existing procedural requirements, but it differs from the existing procedural requirements because the statutory funding scheme for excess losses was amended by HB 4409 and no longer relies on direct assessments to fund certain amounts. Rather, the Insurance Code, Chapter 2210, Subchapter B-1, now requires that losses in excess of the Association’s premium and other revenue, the Catastrophe

Reserve Trust Fund (CRTF), and available reinsurance proceeds, must be paid with the proceeds of class 1, class 2, and class 3 public securities. The Insurance Code §2210.613 and §2210.6135, provide that, if other funds are not available, up to 30 percent of the class 2 public security obligations and all of the class 3 public security obligations are payable from Association member company assessments. The Insurance Code §2210.608 requires the Texas Public Finance Authority (TPFA) to annually inform the Association of the amounts required to fund these public security obligations.

The adopted section also does not include the requirement that the Association's board of directors determine the Assessment amount. The Association's board of directors may still desire to perform this function; however, this phrasing directing the Association to determine this amount is more consistent with other sections in this division.

Also as previously discussed, §§5.4161 - 5.4167 redesignate the existing requirements in §5.4001 and incorporate them into this division. As provided in §5.4161(c), these sections will be considered part of the Association's plan of operation and shall control over any conflicting provision in §5.4001 of this subchapter. Section 5.4161(c) is adopted with a nonsubstantive change to the section references.

§5.4162. Amount of Assessment. Section 5.4162 substantially restates existing §5.4001(c)(2)(B) of this chapter. As addressed in existing §5.4001(c)(2)(B),

this section establishes member participation in the assessment and thus the proportionate amount each member shall be required to pay to the Association.

Section 5.4162(a) also incorporates the HB 4409 amendments to the Insurance Code §2210.052(e), which provides that the Association may not include in the assessment an insurer that became a member of the Association after September 1, 2009, and had not previously been a member of the Association, until after the second anniversary of the date on which the insurer first becomes a member of the Association. Because the term of the class 2 or class 3 public securities issued under the Insurance Code §2210.073 or 2210.074 can be up to 10 years with a corresponding assessment period, §5.4162(a)(2) clarifies that the new member would be eligible for assessment after its second anniversary "without regard as to whether the catastrophic event that gave rise to the class of public securities occurred prior to the second anniversary of the date on which the insurer first became a member of the Association." This provision is consistent with the language of the Insurance Code §§2210.052, 2210.073, 2210.074, 2210.613, and 2210.6135 that provides the members share the loss based on their participation in the Association.

Section 5.4162(b) provides that the participation level shall be computed on a calendar year basis for the year in which the assessment is made. The participation level may thus vary over the term of the public security and will not be fixed in the year that the catastrophic event occurred.

As previously discussed, §5.4162(a)(3) has been added to this section due to the changes in federal law. This change is intended to exclude net direct written premium arising from the transaction of surplus lines business that a federal agency or court of competent jurisdiction determines to be exempt from inclusion in the assessment formula under the Insurance Code Chapter 2210.

A systemic concern was that the insurers may determine that under a variable participation scheme it is best to stop writing wind and hail insurance coverage in the catastrophe area now and then return after the event to lower their participation percentage. The Department disagrees that insurers would reduce writings based on this requirement as a general course of action. Since Hurricane Rita, insurers have reduced writing wind and hail insurance coverage in the catastrophe area to avoid exposure to catastrophic events without regard to the effect or even the potential of an unlimited assessment under former Insurance Code §2210.058. Assessments under the HB 4409 loss funding scheme set out in the Insurance Code §2210.613 and §2210.6135 would amount to an approximate maximum of $800 million, plus interest and administrative expenses, over an eight to eleven year period following a catastrophic event depending on the date of issuance, term, covenants, and potential early repayment of the public securities. Thus, the annual assessment requirements necessary under Insurance Code §2210.613 and §2210.6135 would approximate, albeit probably be greater than, the former $100 million assessment provision in the Insurance Code §2210.058(a)(1). Therefore, the Department does not believe that this

provision will affect insurer's decisions to write in the catastrophe area prior to a storm event. Further, this method may encourage insurers to reduce their participation level by writing in the catastrophe area after a catastrophic event. That would be consistent with the Legislature's expressed intent in the Insurance Code §2210.009(b) and §2210.053(b). Further, even under a fixed participation level due to the need to provide broad based funding support for the public securities, participation levels would vary due to insolvencies and carriers leaving the Texas market. This includes the entry and exit of market participants and changes in company writing practices. Under no situation would the formula be truly fixed for the entire term of the public security obligation, because the formula must consider that over the course of time some members will leave the Texas market or fail financially.

The plan of operation already provides for reallocating an assessment based on insolvency. As for insurers leaving the Texas market, the Department notes that the Insurance Code Chapter 2210 does not have a provision such as in the Insurance Code §2211.209(e), relating to the FAIR Plan Association. Barring the departure of a large market share insurer, these variances should be slight, but under either the fixed or annual basis they may be unavoidable. Also, new members are only exempt from participating in assessments for the first two years. Additionally, members could also seek to decrease their assessment by increasing their writings in the catastrophe area, an incentive which is consistent with the Insurance Code §2210.009(b) and §2210.053(b).

Further, the Association and the members would be required to prepare and use a single calculation for all assessments made during the year for class 2 public securities and class 3 public securities regardless of the year the public securities were issued. Finally, because members would have the same assessment obligation to each class 3 public security regardless of the year in which the security was issued, the TPFA might also be able to more readily refinance outstanding public securities of the same class and take advantage of changing market conditions.

For these reasons the Department has determined that the calendar year formula for determining participation levels currently used by the Association is most consistent with the requirements of the Insurance Code Chapter 2210.

The proposal also generated comments concerning the issuance and payment of class 2 and class 3 public securities. These comments requested a means of paying a lump sum assessment in lieu of participating in the public security obligation and a means of paying a lump sum towards the insurers' public security obligation.

The Insurance Code §2210.613(a) provides that 30 percent of the cost of public securities issued under the Insurance Code §2210.073 shall be paid from member assessments. The Insurance Code §2210.074(b) provides that if losses are paid with class 3 public securities, the class 3 public securities will be repaid in the manner described by the Insurance Code Chapter 2210, Subchapter M, through assessments as provided by §2210.074. Under both the Insurance Code §2210.613(a) and §2210.074(b), the Association shall notify each member of its assessment and that the

proportion of losses allocable to each insurer shall be determined in the manner used to determine the insurer's participation in the Association under the Insurance Code §2210.052. The Insurance Code §2210.6135, which is in Subchapter M, has the same provisions related to notice and allocation as the Insurance Code §2210.074(b), and provides that the class 3 public securities would be paid through member assessments. The Insurance Code §2210.6135, however, further authorizes the Association to assess members up to $500 million per year.

The Insurance Code §§2210.074, 2210.613, and 2210.6135 indicate that the entire membership of the Association, and thus the Texas property insurance market, will be obligated for the repayment of the public securities. The commenter's suggestion would establish two groups with one being obligated to repay the public securities and one not being so obligated. Limiting the group would limit that public security funding resource to the financial strength of the obligated participating insurers and the potential that those insurers will continue to write in Texas until the public securities are repaid. This could limit the ability of the TPFA to issue class 3 public securities.

The question of overall repayment also holds true for an insurer seeking to prepay its proportionate share of any outstanding public security obligation in a lump sum assessment in lieu of continuing to participate in the payment of the public security obligation under the Insurance Code §§2210.074, 2210.609, 2210.613, and 2210.6135. The Insurance Code §§2210.074, 2210.609, 2210.613, and 2210.6135 do not

specifically provide that a member insurer may elect to prepay its class 2 or class 3 public security obligation. Rather, the Insurance Code §2210.609 directs the TPFA to determine the amount of revenue that is required to fund the public security obligation for the current year. The Insurance Code §§2210.074, 2210.613, and 2210.6135 establish the sources of the revenue that will be used to fund that obligation. Sections 2210.074, 2210.613, and 2210.6135 provide that each insurer shall pay an assessment equal to its proportionate share of the amount due as determined under §2210.052. Thus, each member insurer is thus liable for an undivided share of the obligation until the obligation is paid in its entirety.

However, adopted §5.4145 and 5.4147 of this division (relating to Excess Class 2 Member Assessment Revenue and Excess Class 3 Member Assessment Revenue) provide that excess amounts may be used to pay class 2 public security obligations payable in the subsequent year, offsetting the amount of the member assessment that otherwise would be required to be levied for that year under the Insurance Code Chapter 2210, Subchapter M. It is thus conceivable that an insurer could voluntarily overpay its current assessment obligation with an estimated payment of its subsequent year assessment, if such an arrangement was agreeable to the Association. The over-payment, however, would only work as an offset to the insurer's actual assessment in the subsequent year.

Therefore, these rules implement the Insurance Code §§2210.074, 2210.075, 2210.0613, and 2210.06135 by establishing a system that implements the Insurance

Code based on those statutory provisions, including the funding of loss payments through the issuance of class 2 and class 3 public securities that shall be repaid by assessing the Association members. Further, this system reflects a single, annually determined, participation percentage rate for assessing class 2 and class 3 public securities over the course of the public securities, addressing issues resulting from member insurers beginning and ceasing to do business in Texas, and encouraging members to better their assessment position by increasing their writings in the catastrophe area which is consistent with the Insurance Code §2210.009(b) and §2210.053(b). Finally, because §5.4001 defines terms for use in §5.4001 and not this division, it is necessary to incorporate the definition and calculation of "net direct premiums" into this division, which is provided for in §5.4162(b).

Section 5.4162(c) incorporates the remainder of existing §5.4001(c)(2)(B) concerning member participation in the assessment. Section 5.4162(d) incorporates the Association's existing calendar year formula for determining participation levels that are set out in existing §5.4001(c)(2)(B)(i). Section 5.4162(d) also corrects an incomplete citation in the existing rule. The existing provision cites "subsection (a)(2)(i)(III) of this section." As all items within §5.4001(a)(2) have a following capital letter designation, the citation does not refer to any provision. The Department has determined that this provision referred to net direct premium as of 1988 using the citation "(a)(2)(I)(i)(III)." In subsequent revisions the "(I)" was inadvertently omitted. The Department is not aware of any time in which this alternative provision was used in

determining participation levels. Section 5.4162(d) restates the citation as "§5.4001(a)(2)(N)(i)(III)" using the correct reference to "net written premium." This section also incorporates Figure: 28 TAC §5.4162(d), which is the same as that at §5.4001(c)(2)(B)(i).

Section 5.4162(e) restates existing §5.4001(c)(2)(B)(ii) of this subchapter concerning the Association's procedure for determining the member's participation percentage and notifying the member of that percentage. Section 5.4162(f) restates existing §5.4001(c)(2)(B)(iii) of this subchapter concerning the member's requirement to furnish to the Association on or before March 1 of each year a copy of its Exhibit of Premiums and Losses (Statutory Page 14) for the State of Texas. Finally, as necessary, §5.4162 makes nonsubstantive updates and uses terminology more consistent with this division, current statutes, and rules.

§5.4163. Notice of Assessment. Section 5.4163 restates existing §5.4001(c)(2)(C) of this subchapter which §5.4163 will control over. Section 5.4163 does not make any substantive changes to the existing provisions, but does divide the existing provision into three subsections to make it more accessible. As necessary, the section makes nonsubstantive updates and uses terminology more consistent with this §§5.4161 - 5.4167, and current statutes and rules.

§§5.4164, 5.4165, 5.4166 and 5.4167. Payment of Assessment, Failure to Pay Assessment, Contest after Payment of Assessment, and Inability to Pay Assessment by Reason of Insolvency. Sections 5.4164, 5.4165, and 5.4166 restate

existing §5.4001(c)(2)(D) of this subchapter, which §§5.4164, 5.4165, and 5.4166 will control over. The sections do not make any substantive changes to the existing provisions, but do divide the existing provisions into three sections and various subsections to make them more accessible. Section 5.4167 restates existing §5.4001(c)(2)(E) of this subchapter, which §5.4167 will control over. Section 5.4167 does not make any substantive changes to the existing requirement, which address the inability of a member to pay an assessment and the reallocation of the assessment.

As necessary, §§5.4164, 5.4165, 5.4166, and 5.4167 make nonsubstantive updates and use terminology more consistent with this §§5.4161 - 5.4167, and current statutes and rules. Section 5.4167 was changed to capitalize the term “Association.”

§5.4171. Premium Surcharge Requirement . Section 5.4171(a) identifies insurers that are, and that are not, subject to the provisions of §§5.4171 - 5.4172 and 5.4181 - 5.4192. Several commenters, however, questioned if the premium surcharge applied to surety contracts. It is determined that the Insurance Code §2210.613 did not intend to include surety contracts and has changed §5.4171(b) to specifically exclude surety from the scope of §§5.4171 - 5.4173 and 5.4181 – 5.4192. In reaching this conclusion the Department considered the context of the language in the Insurance Code §2210.613 and the decision in *Great American Insurance V. North Austin Municipal Utility District No. 1*, 908 S.W.2d 415 (Tex. 1995).

The *Great American* decision provides that under Texas law, insurance and surety are legally distinct. This differs from other states such as Florida which

statutorily defines an insurer as "every person engaged as indemnitor, surety, or contractor in the business of entering into contracts of insurance or of annuity" (Florida Statutes §604.03 cited in *Snow v. Jim Rathman Chevrolet, Inc*., 39 So.3d 368 (Fla.App. 5 Dist. 2010)). The Department does not take the position that the failure to reference terms related to surety contracts excludes those contracts from the application of a particular statute.

Thus, the Department looks to the specific terms used and the context of their usage. The Insurance Code §2210.613(c) provides that the premium surcharge applies to all “policies” described in §2210.613(b) that provide “coverage” for all “property and casualty lines of insurance.” The Insurance Code §2210.613(b) provides that each “insurer,” the Association and the Texas FAIR Plan Association shall assess a premium surcharge to its policyholders. Further, the term “insurer” is defined for use in the Insurance Code Chapter 2210, Subchapter M under §2210.602(6) as “each property and casualty insurer authorized to engage in the business of property and casualty insurance in this state and an affiliate of such an insurer, as described by §823.003, including an affiliate of that is not authorized to engage in the business of property and casualty insurance in this state.” The use of the terms “insurer,” “policyholders,” “policies,” “coverage,” and “property and casualty lines of insurance” in these contexts indicate that the Legislature was addressing insurance contracts only rather than taking a more expansive view of applying the premium surcharge to both insurance and surety contracts.

Based on comments concerning costs associated with implementing §§5.4171 - 5.4173 and 5.4181 – 5.4192, the Commissioner has also considered other alternatives to accomplish the statutory requirements. It is recognized that insurers do not rate coverage or allocate premium for some lines of property and casualty insurance based on the location of an insured's operation. Further, even those insurers that write property lines in addition to other lines may not have systems that can readily identify and communicate this type of information internally because it was unnecessary prior to the enactment of HB 4409. Thus, allocating such previously unallocated premium to the catastrophe area will require insurers writing such lines to incur significant costs in upgrading their systems and information gathering requirements.

The Insurance Code §2210.613(c), however, requires that the premium surcharge apply to all policies that provide coverage on any premises, locations, operations, or property located in the catastrophe area for all property and casualty lines of insurance, other than the four listed exceptions. Thus the option is either to allocate the premium to the catastrophe area or surcharge the total premium of any policy meeting those qualifications.

An apparent intent of HB 4409 in reducing the Association's reliance on statewide assessments was to shift greater responsibility for Association losses to the catastrophe area. A premium surcharge of the total policy premium, while affecting property and operations in the catastrophe area, would also spread the Association's costs throughout the state. This spreading would be unequal, however, as it would only

affect persons with property or operations in the catastrophe area. Further, the amount of the surcharge would be unrelated to the actual exposure in the catastrophe area versus the remainder of the state. This could result in commercial operations choosing not to do business in the catastrophe area. Thus, a premium surcharge on the total premium would be inconsistent with the intent of HB 4409 and could adversely impact the economy of the catastrophe area, and thus the state, which is inconsistent with the purpose of the Insurance Code Chapter 2210, as described in §2210.001.

Therefore, the remaining option is to develop procedures to allocate the premium to the catastrophe area so that the premium surcharge may be assessed in compliance with the Insurance Code §2210.613. Several means of reducing the expense of implementing this requirement have been addressed in this adoption. Additionally, the Legislature may reconsider the premium surcharge and allocation based on the cost factors outlined in the proposal, which is expected to range from several hundred thousand dollars to several million dollars per insurer or insurer group.

Time periods for implementing these sections have also been evaluated and extended based on the timing of this order. The proposal was made during hurricane season with the possibility that a hurricane could occur within months of the proposal. The timing of this adoption, however, provides additional time for implementation prior to the next hurricane season. Therefore, §5.4171(d) has been added to read: “For all lines of insurance subject to §5.4182 of this division (relating to Allocation Method for Specified Lines of Insurance) this section, §§5.4172, 5.4173 and 5.4181 - 5.4192 of this

division are effective June 1, 2011." Additionally, §5.4171(e) has been added to read: "For all other lines, this section, §§5.4172, 5.4173, and 5.4181 - 5.4192 of this division are effective October 1, 2011." The requirement in §5.4192(b) has been revised to provide as follows: (1) for policies subject to §5.4182, compliance is required for all policies *in force* on or after October 1, 2011; and (2) for policies subject to §5.4183, compliance is required for all policies effective on or after October 1, 2011. Finally §5.4171 is adopted with nonsubstantive change to the section references.

§5.4172. Premium Surcharge Definitions. Section 5.4172 provides definitions used in this §§5.4171 - 5.4172 and 5.4181 - 5.4192. The definitions are derived in part from Subchapter M, Chapter 2210 of the Insurance Code. The definition of "insurer" was expanded from the definition contained in Subchapter M, Chapter 2210 of the Insurance Code to include the Association and the Texas FAIR Plan Association (FAIR Plan). The Insurance Code §2210.613 provides that premium surcharges also apply to Association and FAIR Plan policyholders that reside in, or have insured property or operations in the catastrophe area. This section also provides definitions for "insured property," "premises," and "operations," since these terms are not defined in the Insurance Code §2210.613.

In response to comments concerning the use of the term "resides in" the definition of operations was reconsidered. The intent of using the term "resides in" was to require insurers to surcharge personal automobile policies only if the insured resided in the catastrophe area, notwithstanding whether the insured regularly drives to, within,

or through the catastrophe area. The alternative reading based on the location of a business owner or board member's residence was unintended. To reduce this potential for confusion the definition of "operations" in §5.4172(6) has been changed to remove the term "resides in" and to specifically reference automobiles located in the catastrophe area. Further, to be consistent with the terminology, references in §5.4172(4) and §5.4182(a)(1) have been conformed to refer to the term "automobile" or "auto," rather than motor vehicle. These changes will have no effect on any decision to surcharge automobile policies, because §5.4182(a)(1) provides that the surcharge is based on the location where the automobiles are principally garaged. Finally §5.4172 is adopted with nonsubstantive change to the section references.

§5.4173. Determination of the Surcharge. Section 5.4173 establishes the procedure for the Association to request Commissioner approval of a premium surcharge in an amount that is sufficient to fund class 2 public security obligations, including any required contractual coverage amounts that are reported to the Association by the TPFA.

§§5.4181 - 5.4183. Premiums to be Surcharged, Allocation Method for Specified Lines of Insurance, and Allocation Method For Other Lines of Insurance. Insurance policies can provide coverage for risks located in a single location, risks located in multiple locations, or even property in transit. Some insurance coverages, such as property insurance, are rated based on the specific location of the risk, and thus insurers can determine how much of the policy premium relates to

insured property or operations located within the catastrophe area. Other lines of insurance may require an allocation calculation. Section 5.4181 sets forth which premium is to be surcharged. Section 5.4182 provides the method for determining the premium surcharge for certain lines of insurance, including fire; allied lines; multi-peril crop; farmowners; homeowners; commercial multi-peril (property); commercial multi-peril policies written on an indivisible premium basis; earthquake; boiler and machinery; burglary and theft; private passenger auto; and commercial auto policies rated based on the location of the vehicle(s). Section 5.4183 establishes the procedure for determining the premium surcharge for other lines of insurance, including those that are not rated based on the specific location of the risk.

In considering comments on the proposal it was determined that certain nonsubstantive grammatical changes were necessary to §5.4181(a)(2). Specifically, the references to premium tax, surplus lines premium tax, and independently procured premium tax should be separated by semicolons, and this change has been made. Additionally, the reference “surplus lines premium taxes” has been changed to “surplus lines premium tax.”

Section 5.4182(a)(1) specifically lists the lines of insurance where a direct method of determining the surcharge is required. The lines of insurance listed in §5.4182 are lines where insurers know, or should know, the geographic location of their risks. Section 5.4183 has been changed as a result of comments to specify that it applies to all other applicable lines of insurance not specified in §5.4182. Thus,

§5.4183 does not apply to those lines listed in §5.4182, nor does it apply to lines, insurers, premiums, or policies excluded under §5.4171(b) and (c).

Finally, §5.4182(a)(1) has been changed to make the list more complete with the addition of earthquake, boiler and machinery; burglary and theft coverage. In addition, in reviewing comments related to the use of the commercial property premium for the determination of the catastrophe allocation percentage under §5.4183, it was determined that policies written under the commercial multi-peril (liability) line of insurance are more appropriately covered under §5.4183(2). However, commercial multi-peril policies written on an indivisible premium basis were retained under §5.4182. These policies, similar to homeowner's policies, are rated in a manner such that a separate property and liability premium is not determined. Because of their similarity to homeowners policies in this regard, the Department believes the surcharge should be determined in a similar manner.

In comments on the proposal it was noted that the term "operations" in the Insurance Code §2210.613(c) is vague and ambiguous and will lead to confusion for insurers who have to determine how to apply the statute and rule's surcharge provisions. This may be especially true for lines such as directors' and officers' liability insurance, general liability insurance, which may not be tied to specific locations, as well as commercial automobile liability insurance which may provide coverage for vehicles traveling through the catastrophe area on a regular basis. For this reason §5.4173(6) defines the term "operations" as "[A] person's interest in property, or

activities, that may result in, or give rise to, a loss that is insurable under a property or casualty insurance policy, including the use of an automobile; ownership, lease, or occupancy of a residence or other real property; and activities performed by a person in connection with the manufacture, distribution, or sale of goods or services. A person is considered to have operations in the catastrophe area if the person maintains an automobile or a physical location in the catastrophe area, regardless of whether that location is owned, leased, rented, or occupied by the person."

Therefore, an insured is not considered to have "operations" in the catastrophe area unless the insured maintains an automobile or a physical location within the catastrophe area. So, for example, a commercial automobile insured that traveled intermittently through the catastrophe area but did not maintain a business location in the catastrophe area where operations are performed, would not be subject to the premium surcharge.

Further, as suggested in comments, as a means to avoid confusion and uncertainty for businesses that have premises, operations, or insured property located both in and outside the catastrophe area, proposed §5.4183 has been changed to provide for the use of the allocation percentage indicated by the insured's commercial property insurance premium in cases where the insurer also provides commercial property insurance to the insured.

Property in the catastrophe area is a significant factor indicating "operations" in the catastrophe area. Since the insurer is already required to determine the

percentage of premium attributed to the catastrophe area for its insured's commercial property policy, this information should be available to the insurer. In cases where the insurer also provides commercial property insurance to the insured and the insurer cannot reasonably determine or allocate the other premium to the catastrophe area, the insurer will determine the catastrophe area allocation percentage as the ratio of the commercial property premium attributable to the catastrophe area, divided by the total Texas premium of the commercial property policy. The insurer will then apply this allocation percentage to the insured's Texas premium for lines of insurance covered under §5.4183. As revised, §5.4183 also provides that in the case where the insurer does not provide commercial property insurance to the insured, the percentage of premium attributable to the catastrophe area shall be determined by the insurer from information provided by its insured. Insurers are not required to verify or otherwise determine the reasonableness of the allocation percentage provided by the insured.

Section 5.4183 should reduce disputes between insurers and insureds over the premium allocation. In the case where the insurer also writes the insured's commercial property, there should be no dispute as to the allocation. In the case where the insurer does not write the insured's commercial property, the insurer may rely on information provided by the insured. Because of these changes the proposed provisions for establishing a default allocation that increased over time and the appeal procedure requirement for handling disagreements between the insurer and the insured have been removed.

This allocation methodology is adopted with the awareness that some insureds, or insurers on the insured's behalf, might seek to underestimate the amount of premium attributable to the catastrophe area as a means to avoid paying their "full" surcharge. Seeking to reach a perfect allocation, however, is an impractical solution to this problem and would only result in requiring insurers and insureds alike to incur significant additional costs. The adopted allocation methodology provides a reasonable means to implement the Insurance Code §2210.613 at this time. If necessary, the adopted allocation methodology in §5.4182 and §5.4183 may be refined in the future based on experience.

Finally, the Department disagrees that insurer underreporting could lead to a completely unreliable and unpredictable revenue stream which may result in problems when marketing the public securities. The Department consulted with the TPFA regarding this question and was informed that such a result was unlikely. First, the premium surcharge will be based on the reported premium in the catastrophe area as required in the Insurance Code §2210.613. If premium is underreported, the result would be a greater percentage premium surcharge and not an unpredictable revenue stream. Second, to the extent that such reporting did raise a concern, the lenders would require an additional contractual coverage requirement (an amount required to be collected annually in excess of the principal, interest and expenses due on the public securities) to cover any uncertainty in the revenue stream. To the extent that an additional contractual coverage amount was required, any excess class 2 premium

surcharge revenue would be distributed annually as provided in the Insurance Code §2210.611. Thus, marketability of the bonds would not be endangered.

The changes to the allocation methodology set forth in §5.4183 requires conforming changes to the proposed text in §§5.4184(d), 5.4184(f), 5.4187(a), 5.4189, 5.4190(e), and 5.4192(b).

§5.4184. Application of the Surcharges. Section 5.4184 provides that all applicable policies with effective dates on or after the date of the Commissioner's surcharge order are to be surcharged. It also makes clear that insurers are not responsible for collecting surcharges on policies that did not go into effect, or were cancelled as of the inception date, as well as provides instructions for surcharging policies that remain in effect for multiple years. Section 5.4184 further establishes how premium surcharges are to be determined when the policy is either cancelled mid-term or the premium is changed on the policy in the middle of the policy period. The Insurance Code §2210.613 states that premium surcharges are non-refundable, thus there is no refund for the "unexpired" portion of the surcharge when a policy is cancelled prior to the expiration date. Similarly, since premium surcharges are non-refundable, when the premium on the policy is changed in mid-term resulting in a *reduction* in the total policy premium, there is no commensurate refund of the surcharge, but there is a commensurate increase in the premium surcharge for mid-term changes resulting in an increase in the premium.

In consideration of comments, §5.4184(b) has been changed to reflect that an additional surcharge is not required for a reinstated policy. This change was done to conform with such provisions as the Insurance Code §551.106. Although commenters used other terms such as reissue with regards to this concept, the term reinstated was selected because it is used in the Insurance Code §551.106. The revised provision also provides that for the purposes of this division a policy is reinstated if it covers the same period as the original policy without a lapse in coverage, except as provided in the Insurance Code §551.106. Policies that do not meet this definition of reinstated, regardless of what the practice is called, are subject to an additional surcharge.

The purpose of the language in §5.4184(c) regarding “all transactions on a policy occurring within a seven day period” is to recognize that multiple related transactions on a policy may occur over the course of several days. The purpose is to allow insurers to combine the premium effect of all policy transactions over a short period of time to determine the amount of any additional premium that may apply to the policy. For example, an insured may add a new vehicle to a policy and several days later delete an old vehicle. The purpose is to allow insurers to “net out” these transactions before determining if they result in an additional premium and an additional premium surcharge is required. The Department is aware that this may result in additional programming and systems costs to insurers, however, it should also reduce conflicts between insurers and insureds related to the order transactions are completed and concepts of continuous coverage.

Further with respect to §5.4184(c), the requirement is that a premium surcharge be applied to any additional premium. If this provision were not included, insureds could attempt to reduce their surcharge by purchasing minimal coverage initially and then immediately adding additional coverage to that policy. As for the amount of the additional premium and the premium surcharge, many insurers already have rules in place that waive additional or return premiums for what may be considered “de minimus” amounts. Thus, the insurer has already determined that any additional (or return) premium is above a “de minimus” amount. For additional premiums, if the insurer has determined it is worth the cost of collecting the additional premium, as such, an additional surcharge should also be collected in these cases.

Section 5.4184(f) addresses policies that are subject to premium audits, retrospective rating adjustments, or other similar adjustments that occur after policy expiration. In the case of a policy subject to audit or retrospective rating adjustments, the premium paid at policy inception is merely a “deposit premium” and not the “policy premium.” In this case there is the expectation of the insurer and insured that the “policy premium” will be determined after retrospective rating adjustments or audit adjustments. This differs from a mid-term adjustment to the policy premium considered under §5.4184(c), because there was no expectation that the premium paid at the policy inception would later be adjusted and the actual premium would be determined after the policy expired. Further, §5.4184(f) only applies to an audit adjustment that results from an audit after the policy expires. Thus, §5.4184(f) should not result in new

costs to the insurer based on determining cancelation return premium and mid-term change return premium.

Finally §5.4184(d) and (f) have been changed to conform with the previously discussed changes in §5.4183.

§5.4185. Premium Surcharges are Mandatory. Section 5.4185 provides that premium surcharges are mandatory, and are paid on a “first dollar” basis. Insurers may not pay the surcharge on behalf of the insured, and insurers must apply policyholder payments to the surcharge before applying any payments to premiums or other amounts owed to the insurer. Section 5.4185(c) also reiterates the provision in Insurance Code §2210.613(d) that failure to pay a premium surcharge constitutes failure to pay premium for the purposes of policy cancellation.

§5.4186. Remittance of Premium Surcharges. Section 5.4186 establishes the procedure for remitting collected premium surcharges to the Association and has been changed in response to comments to provide that insurers shall remit all surcharges paid by its insureds not later than the last day of the month following the month in which the surcharge was received.

Section 5.4186 does not provide that the Surplus Lines Stamping Office of Texas (SLSOT) will be the primary source of collection and reporting surplus lines information required under §5.4186. Such an action would require amending the SLSOT’s plan of operation, which was not contemplated in the proposal or evaluated for cost. The Department will continue to receive information related to whether the

SLSOT should be required to collect the information related to surplus lines insurers. Further, §5.4186(a) makes clear that surplus lines insurers will ultimately be held responsible for the failure of its agents to comply with these rules. Additional language stating what may and may not be placed in a contract between an insured and its agent as a result of these rules is not necessary.

§5.4187 and §5.4188. Offsets and Surcharges not Subject to Commissions or Premium Taxes. Section 5.4187 provides a method for crediting an insurer for surcharges previously paid that were not due to the Association. Section 5.4187(a)(3) has been removed to conform with the changes in §5.4183. Section 5.4188 provides that premium surcharges are neither subject to agents' commissions nor premium taxes. This reiterates the language contained in Insurance Code §2210.613(d), and prohibits an insurer from increasing the surcharge in order to pay agents' commissions or premium taxes on a surcharge, and prohibits an agent from collecting or charging a commission on a surcharge.

§5.4189. Notification Requirements. Section 5.4189 provides that insurers must provide insureds subject to a premium surcharge a uniform notice that a premium surcharge has been applied to their policy. Section 5.4189(a) provides the text of the notice required for all policyholders subject to the premium surcharge. In response to comments that the notice was not consumer friendly, the notice has been revised. The bracketed area of the revised notice allows the insurer the option of including the amount of the surcharge, as required by §5.4189(b), either in this notice or a separate

document. In response to comments that providing the notice to applicants creates an undue burden, §5.4189(c) has been revised to require that notice of the premium surcharge will be provided only be provided at the time the policy is issued, in the case of new business, and with the renewal notice, in the case of renewal business. In a conforming change based on previously discussed changes to §5.4183, proposed language in §5.4189(c) and (e) concerning additional information that insurers were to have provided policyholders has been removed. In responses to comments, §5.4189(c) has also been revised to extended the time period for providing the notice following a mid-term policy change from 10 to 20 days after completion of the transaction. This time period remains the same for all insurers and surplus lines insurers. The requirement that the notice be sent with a renewal notice has not been changed.

§5.4190 and §5.4191. Annual Premium Surcharge Report and Premium Surcharge Reconciliation Report. Section 5.4190 and §5.4191 specify the types of information insurers are required to maintain for the purposes of determining compliance with §§5.4171 - 5.4173 and 5.4181 - 5.4188. Section 5.4190 requires insurers to provide an annual report to the Association which provides information regarding the amount of premium collected subject to surcharge, the amount of premium surcharges remitted to the Association, and the amount of premium surcharges collected by the insurer during the previous calendar year. In response to comments, the required time period for providing these reports to the Association is

been extended from 60 to within 90 days after the end of a calendar year in which a surcharge is in effect. However, annual reports are not required if a surcharge has been in effect for less than 45 days in the applicable calendar year. Each insurance company is required to provide an annual report.

Section 5.4190 has been revised to remove the requirement that the annual premium surcharge report be provided by line of business. This was done in response to a comment that the requirement to report collected premium surcharges by line of business placed a significant cost burden on insurers. The Department will monitor the data collection to make certain that current measures are sufficient to fulfill the requirements of the Insurance Code §2210.613. Further, in response to a comment suggesting a simplified reporting scheme, §5.4190(e)(4)(A) - (C) have been combined under subparagraph (A) and subparagraph (D) has been redesignated as subparagraph (B). It is anticipated that this change will reduce insurer compliance costs. Finally, §5.4190(e)(4)(A) has been revised to conform with the changes to the allocation methodology that has been previously discussed in §5.4183.

Also as a matter of clarification, §5.4190 does not require SLSOT to make any changes to its reporting system or report on behalf of affiliated surplus lines insurers. However, §5.4190 does not prohibit SLSOT from reporting on behalf of surplus lines insurers if SLSOT and the insurer agree to such an arrangement.

Section 5.4191 requires insurers to maintain sufficient records in order to, within 10 days of a request, provide the Department with a reconciliation report for a time

period specified in the request. These reports are adopted under the authority set forth in the Insurance Code §2210.008, because the reports are necessary to ensure compliance with §§5.4171 - 5.4173 and 5.4181 - 5.4188 and, as such, are necessary to the implementation of Chapter 2210. The purpose of the reports is to track the actual collection of premium surcharges and enhance compliance with the premium surcharge requirements.

As discussed, §5.4190 has been revised generally to remove references to collecting and providing premium surcharge information by line of business. Because §5.4191 would rely on the same information, the requirement that annual premium surcharge information be available by line of business has also been removed from this section in response to a comment. Additionally, because a reconciliation report is considered a regulatory report, §5.4191(b) has been revised to provide that only the Department may request a reconciliation report under §5.4191.

With respect to both §5.4190 and §5.4191, a commenter noted that because the surcharge report and annual premium surcharge reconciliation report ask for premium written in the calendar year, as well as premium surcharges collected in the calendar year, these figures are never going to reconcile because written premium is different from collected premium. Under the example offered by the commenter, if a company writes a policy in December the company would report the full annual premium as written premium; but if the premium were billed on an installment basis, the company

would only be allowed to collect surcharge on the first installment of premium. The Department disagrees that the commenter's example exposes a significant flaw.

Some mismatches may occur between calendar year written premium and surcharges collected for the same period of time. The Department, however, believes that the reports will provide useful information for the Department and Association concerning the collection of premium surcharges. Further, the Department does not consider it necessary at this time for insurers to incur additional costs to enhance the reconciliation of these reports. Additionally, the commenter's example incorrectly states that under an installment plan only one month of the surcharge would have been collected. As previously discussed, §5.4185(b) requires insurers to apply money received from the insured to the premium surcharge prior to applying funds to premium or any other obligations. Section 5.4185(b)(1) clarifies this requirement by prohibiting insurers from allocating pro-rata or otherwise mixing premium surcharges with premium over installment plan payments.

Finally, §5.4190 and §5.4191 have been revised to conform to the determination that §§5.4171 - 5.4173 and 5.4181 – 5.4192 do not apply to surety contracts as previously discussed in §5.4171.

§5.4192. Data Collection. Section 5.4192 requires each insurer to maintain sufficient records in order to report certain information to the Department. This information will provide the premium base available to be surcharged and thus is necessary to the implementation of the Insurance Code §2210.613. This section does

not change, is not intended to change, and should not be construed as changing, any statistical plan reporting requirements established pursuant to the Insurance Code Chapter 38 or other requirement.

Section 5.4192(b) has been changed to modify the reporting requirement and provide an extension for insurers using the allocation methodology established in §5.4183. Proposed §5.4192(b) established the requirement for all policies with effective dates on or after October 1, 2010. This requirement in §5.4192(b) has been revised to provide as follows: (1) for policies subject to §5.4182, compliance is required for all policies *in force* on or after October 1, 2011; and (2) for policies subject to §5.4183, compliance is required for all policies effective on or after October 1, 2011.

The change is necessary because it is possible that there may be a catastrophic event in 2011. The TPFA will need reliable catastrophe area premium information to secure the issuance of any public securities that may be issued under the Insurance Code §2210.073. Additionally, if a surcharge is needed, the Commissioner and the Association must be able to obtain reliable catastrophe area premium information in a timely manner in order to determine any necessary premium surcharge percentage. Further, it is anticipated that the lines of insurance subject to §5.4182 will make up the bulk of the catastrophe area premium.

As previously discussed, for lines of insurance subject to §5.4182, insurers already know, or should already know, the geographic location of these risks. In

addition, for residential and commercial property lines of insurance, insurers should know premiums attributable to risks located in the catastrophe area.

The Department recognizes that for lines of insurance other than residential and commercial property, insurers may not know whether a Harris County insured is located within those portions of Harris County designated as a catastrophe area. The Department believes the October 1, 2011 date provides sufficient time for insurers to make this determination for policies in force on that date.

For lines of insurance subject to §5.4183, insurers may not know the geographic location of its insureds. Thus, the requirement for compliance with §5.4192 is extended to apply to those policies effective on or after October 1, 2011.

3. HOW THE SECTIONS WILL FUNCTION. The sections implement legislative changes to the Insurance Code Chapter 2210 under HB 4409, 81st Legislature, 2009 Regular Session, and create a more efficient rule structure by grouping Association loss funding mechanisms in this division.

§5.4161. Member Assessments. Section 5.4161(a) provides that the Association shall determine if a member assessment is necessary to fund the Association's outstanding class 2 and class 3 public security obligations based upon the evaluation of information provided to the Association by the Texas Public Finance Authority. Section 5.4161(b) provides that if the Association determines an assessment to be reasonable and necessary, the Association shall assess its member insurers.

Section 5.4161(c) establishes that §§5.4161 - 5.4167 shall control over any conflicting provision in §5.4001 of this subchapter.

§5.4162. Amount of Assessment. Section 5.4162(a) provides that the Association shall determine which of its members shall participate in the assessment. This includes determining if the member is eligible for the two year exemption period. Section 5.4162(b) provides that the member participation shall be determined in the year the assessment is made and not the year of the occurrence, unless they are the same. Section 5.4162(c) provides that each member shall pay its proportionate share of the assessment. Section 5.4162(d) sets out how each member's share of the assessment shall be calculated. Section 5.4162(e) addresses the Association's procedure for determining the member's participation percentage and notifying the member of that percentage. Section 5.4162(f) establishes the requirement that each member must furnish to the Association on or before March 1 of each year a copy of its Exhibit of Premiums and Losses (Statutory Page 14) for the State of Texas which shall also be used in determining the member's participation percentage.

§5.4163. Notice of Assessment. Section 5.4163 provides the procedure by which the Association shall give notice of an assessment to its members and addresses how members may appeal their individual assessments.

§5.4164. Payment of Assessment. Section 5.4164 provides that the assessment must be paid within 30 days of receipt of the assessment notice.

5.4165. Failure to Pay Assessment. Section 5.4165 addresses the procedure and remedies if a member insurer fails to pay its assessment.

5.4166. Contest after Payment of Assessment. Section 5.4166 provides the procedure for a member to contest its assessment even after payment of the assessment.

5.4167. Inability to Pay Assessment by Reason of Insolvency. Section 5.4167 addresses the reallocation of an insolvent members share amongst the remaining members.

§5.4171. Premium Surcharge Requirement. Section 5.4171(a) - (c) identify insurers that are, and that are not, subject to §§5.4171 - 5.4173 and 5.4181 - 5.4192. Section 5.4171(d) has been added to read: "For all lines of insurance subject to §5.4182 of this division (relating to Allocation Method for Specified Lines of Insurance) this section, §§5.4172, 5.4173 and 5.4181 - 5.4192 of this division are effective June 1, 2011." Additionally, §5.4171(e) has been added to read: "For all other lines, this section, §§5.4172, 5.4173, and 5.4181 - 5.4192 of this division are effective October 1, 2011."

§5.4172. Premium Surcharge Definitions. Section 5.4172 provides definitions used in §§5.4171 - 5.4173 and 5.4181 - 5.4192. The definitions are derived in part from Subchapter M, Chapter 2210 of the Insurance Code. The definitions are in addition to those adopted in §5.4102 of this division.

§5.4173. Determination of the Surcharge. Section 5.4173 establishes the procedure for the Association to request Commissioner approval of a premium surcharge in an amount that is sufficient to fund class 2 public security obligations, including any required contractual coverage amounts that are reported to the Association by the TPFA.

§§5.4181 - 5.4183. Premiums to be Surcharged, Allocation Method for Specified Lines of Insurance, and Allocation Method For Other Lines of Insurance. Section 5.4181 sets forth which premium is to be surcharged. Section 5.4182 provides the method for determining the premium surcharge for certain lines of insurance, including fire; allied lines; multi-peril crop; farmowners; homeowners; commercial multi-peril (property); commercial multi-peril policies written on an indivisible premium basis; earthquake; boiler and machinery; burglary and theft; private passenger auto; and commercial auto policies rated based on the location of the vehicle(s). Section 5.4183 establishes the procedure for determining the premium surcharge for other lines of insurance, including those that are not rated based on the specific location of the risk.

§5.4184. Application of the Surcharges. Section 5.4184 provides that all applicable policies with effective dates on or after the date of the Commissioner's surcharge order are to be surcharged. The section also makes clear that insurers are not responsible for collecting surcharges on policies that did not go into effect, or were cancelled as of the inception date, as well as provides instructions for surcharging

policies that remain in effect for multiple years. Section 5.4184 further establishes how premium surcharges are to be determined when the policy is either cancelled mid-term or the premium is changed on the policy in the middle of the policy period. The Insurance Code §2210.613 states that premium surcharges are non-refundable, thus there is no refund for the "unexpired" portion of the surcharge when a policy is cancelled prior to the expiration date. Similarly, since premium surcharges are non-refundable, when the premium on the policy is changed in mid-term resulting in a *reduction* in the total policy premium, there is no commensurate refund of the surcharge, but there is a commensurate increase in the premium surcharge for mid-term changes resulting in an increase in the premium. Section 5.4184(f) addresses policies that are subject to premium audits, retrospective rating adjustments, or other similar adjustments that occur after policy expiration.

§5.4185. Premium Surcharges are Mandatory. Section 5.4185 provides that premium surcharges are mandatory, and are paid on a "first dollar" basis. Insurers may not pay the surcharge on behalf of the insured, and insurers must apply policyholder payments to the surcharge before applying any payments to premiums or other amounts owed to the insurer. Section 5.4185(c) also reiterates the provision in Insurance Code §2210.613(d) that failure to pay a premium surcharge constitutes failure to pay premium for the purposes of policy cancellation.

§5.4186. Remittance of Premium Surcharges. Section 5.4186 establishes the procedure for remitting collected premium surcharges to the Association. It

provides that insurers shall remit all surcharges paid by its insureds not later than the last day of the month following the month in which the surcharge was received.

§5.4187 and §5.4188. Offsets and Surcharges not Subject to Commissions or Premium Taxes. Section 5.4187 provides a method for crediting an insurer for surcharges previously paid that were not due to the Association. Section 5.4188 provides that premium surcharges are neither subject to agents' commissions nor premium taxes. This reiterates the language contained in the Insurance Code §2210.613(d), and prohibits an insurer from increasing the surcharge in order to pay agents' commissions or premium taxes on a surcharge, and prohibits an agent from collecting or charging a commission on a surcharge.

§5.4189. Notification Requirements. Section 5.4189 provides that insurers must provide insureds subject to a premium surcharge a uniform notice that a premium surcharge has been applied to their policy. Section 5.4189(a) provides the text of the notice required for all policyholders subject to the premium surcharge. The bracketed area of the notice allows the insurer the option of including the amount of the surcharge, as required by §5.4189(b), either in this notice or a separate document. Section 5.4189(c) establishes requirements regarding the form of the notice and when the notice must be delivered.

§5.4190 and §5.4191. Annual Premium Surcharge Report and Premium Surcharge Reconciliation Report. Section 5.4190 and §5.4191 specify the types of information insurers are required to maintain for the purposes of determining

compliance with §§5.4171 - 5.4173 and 5.4181 - 5.4188. Section 5.4190 requires insurers to provide an annual report to the Association which provides information regarding the amount of premium collected subject to surcharge, the amount of premium surcharges remitted to the Association, and the amount of premium surcharges collected by the insurer during the previous calendar year.

Section 5.4191 requires insurers to maintain sufficient records in order to, within 10 days of a request, provide the Department with a reconciliation report for a time period specified in the request.

§5.4192. Data Collection. Section 5.4192 requires each insurer to maintain sufficient records in order to report certain information to the Department. This information will provide the premium base available to be surcharged and thus is necessary to the implementation of the Insurance Code §2210.613. This section does not change, is not intended to change, and should not be construed as changing, any statistical plan reporting requirements established pursuant to the Insurance Code Chapter 38 or other requirement. As to the reporting requirement, §5.4192(b) provides as follows: (1) for policies subject to §5.4182, compliance is required for all policies *in force* on or after October 1, 2011; and (2) for policies subject to §5.4183, compliance is required for all policies effective on or after October 1, 2011.

4. SUMMARY OF COMMENTS AND AGENCY RESPONSE TO COMMENTS. During the August 24, 2010 public hearing the Commissioner extended the period for

submitting written comments by five days. The Department considers the extension to include only business days. Thus, the original date for the submission of written comments of Monday, August 30, 2010, was extended through the Labor Day weekend and expired at 5:00 p.m., Tuesday, September 7, 2010.

General. A commenter questioned whether the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) would prohibit premium surcharges on some surplus lines insurance policies.

Agency Response. The Dodd-Frank Act affects the regulation of surplus lines insurance and may be determined to prohibit the inclusion of certain surplus lines premiums in the determination of premium surcharges and assessments. Because the Dodd-Frank Act was adopted after the proposal was submitted to the *Texas Register* it was not considered in the proposal. Further the Department is not aware of any final decision exempting surplus lines premium or policies from the application of the Insurance Code Chapter 2210. However, because the possibility does exist §5.4162 and §5.4171 have been changed to exclude such surplus lines premium and policies that a federal agency or court of competent jurisdiction determines to be exempt from assessment or premium surcharge under the Insurance Code Chapter 2210.

General. A commenter suggested that the Association be required to semiannually evaluate its capital position, including capacity to pay claims at varying levels of catastrophe loss, expenses, expected costs of capital and the consideration of funding sources such as reinsurance.

Agency Response. The requirements and costs that would be involved in implementing the commenter's suggestion were not addressed in the proposal. Such matters, however, may be considered by the Association's Board of Directors without the need for an additional requirement.

General. A commenter questioned as to whether public security funding was limited to $2.5 billion per catastrophe event or whether the Department interprets the Insurance Code Chapter 2210 to permit the issuance of additional public securities in subsequent years for a prior event if the first years public securities are insufficient to fund the losses.

Agency Response. The Department considers the Insurance Code Chapter 2210 to authorize the latter approach. The authorized amount of public securities that may be issued per year is limited; however, under the statute and this adoption, over time funding is only limited by the amount of public securities of any class that may be issued. As previously discussed in this adoption, the limit of public securities that may be issued to fund excess losses under the Insurance Code Chapter 2210, Subchapter B-1, is $2.5 billion per year. This adoption also notes that public security funding may be further limited and reduced based on market conditions. However, while §§2210.072 - 2210.074 limit the authorized amount of public securities that may be issued "per year," these limits are not directly tied to losses resulting from an occurrence or series of occurrences in that year.

The Insurance Code Chapter 2210, Subchapter B-1, does not define the term "year." Because the Association is at greatest risk of a catastrophic event during hurricane season, which occurs June through November, it is reasonable to consider this period to be a calendar year and not twelve months between public security issuances. This is because limiting public security issuances to twelve months intervals could work to significantly delay loss payments to Association policyholders who incurred an early season storm in a year following a significant late season storm. Thus, on January 1 of each year an additional amount of funding is authorized.

The Insurance Code §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 shall be paid as provided by the Insurance Code Chapter 2210, Subchapter B-1. The Insurance Code Chapter 2210, Subchapter B-1 does not specifically limit funding to the year in which the catastrophic event occurred. Rather, the only limitation is the "per year" amount of public securities that may be issued to fund the losses. Thus, funding, in class order as available, may be accessed to cover losses incurred in a prior year so long as the basic condition of a "catastrophic event" persists.

However, using funds authorized for a subsequent year has certain limitations. Some sources of funding under §§2210.072 - 2210.074 may not be available to the Association annually based on market conditions. Further, use of current year

authorized public securities to essentially fund continuing losses from a prior year would significantly reduce or eliminate those remaining funding resources in the current year. Thus, the Legislature may determine that an alternative funding structure is necessary if losses exceed $2.5 billion or those lesser amounts that can be reasonably borrowed based on market conditions.

Sections 5.4161, 5.4162, and 5.4164. A commenter suggested as a means of simplifying the process and reducing costs that the rule allow member insurers the option of paying their proportionate share of any loss in lieu of annually participating in the payment of the public security obligation. Thus, the members would not participate in the public security obligation.

Agency Response. The Department considers the suggestion that an insurer may elect to pay their proportionate share of any loss in a lump sum assessment in lieu of continuing to participate in the payment of the public security obligation under the Insurance Code §§2210.074, 2210.609, 2210.613, and 2210.6135 to be inconsistent with the Insurance Code Chapter 2210 or the adopted rules implementing the Insurance Code Chapter 2210. Therefore, no changes have been made based on this comment.

The Insurance Code §2210.613(a) provides that 30 percent of the cost of public securities issued under the Insurance Code §2210.073 shall be paid from member assessments. The Insurance Code §2210.074(b) provides that if losses are paid with class 3 public securities, the class 3 public securities will be repaid in the manner

described by the Insurance Code Chapter 2210, Subchapter M, through assessments as provided by §2210.074. Under both the Insurance Code §2210.613(a) and §2210.074(b), the Association shall notify each member of its assessment and that the proportion of losses allocable to each insurer shall be determined in the manner used to determine the insurer's participation in the Association under the Insurance Code §2210.052. The Insurance Code §2210.6135, which is in Subchapter M, has the same provisions related to notice and allocation as the Insurance Code §2210.074(b), and provides that the class 3 public securities would be paid through member assessments. The Insurance Code §2210.6135, however, further authorizes the Association to assess members up to $500 million per year.

The Insurance Code §§2210.074, 2210.613, and 2210.6135 indicate that the entire membership of the Association, and thus the Texas property insurance market, will be obligated for the repayment of the public securities. The commenter's suggestion would establish two groups with one being obligated to repay the public securities and one not being so obligated. This could limit that public security funding resource to the financial strength of the obligated participating insurers and the potential that those insurers will continue to write in Texas until the public securities are repaid. This could limit the ability of the TPFA to issue class 3 public securities.

Sections 5.4161, 5.4162, and 5.4164. A commenter suggests as a means of simplifying the process and reducing costs that, following the issuance of public securities, the rule allow member insurers the option of paying their proportionate share

of any outstanding public security obligation in a lump sum assessment in lieu of annually participating in the payment of the public security obligation.

Agency Response. The Department considers the suggestion that an insurer may elect to pay their proportionate share of any outstanding public security obligation in a lump sum assessment in lieu of continuing to participate in the payment of the public security obligation under the Insurance Code §§2210.074, 2210.609, 2210.613, and 2210.6135 to be inconsistent with the Insurance Code Chapter 2210 or the adopted rules implementing the Insurance Code Chapter 2210. Therefore, no changes have been made based on this comment.

The Insurance Code §§2210.074, 2210.609, 2210.613, and 2210.6135 do not specifically provide that a member insurer may elect to prepay its class 2 or class 3 public security obligation. Rather the Insurance Code §2210.609 directs the TPFA to determine the amount of revenue that is required to fund the public security obligation for the current year. The Insurance Code §2210.613 and §2210.6135 establish the sources of the revenue that will be used to fund that obligation. The Insurance Code §§2210.074, 2210.613, and 2210.6135 provide that each insurer shall pay an assessment equal to its proportionate share of the amount due as determined under the Insurance Code §2210.052. Each member insurer is thus liable for an undivided share of the obligation until the obligation is paid in its entirety. Additionally, prepayment may not result in a reduced annual obligation, but rather simply spread the annual obligation amount over the remaining members.

However, §5.4145 and §5.4147 of this division (relating to Excess Class 2 Member Assessment Revenue and Excess Class 3 Member Assessment Revenue) provide that excess amounts may be used to pay class 2 public security obligations payable in the subsequent year, offsetting the amount of the member assessment that otherwise would be required to be levied for that year under the Insurance Code Chapter 2210, Subchapter M. It is thus conceivable that an insurer could voluntarily overpay its current assessment obligation with an estimated payment of its subsequent year assessment, if such an arrangement was agreeable to the Association. The over payment however, would only work as an offset to the insurers actual assessment in the subsequent year.

Prepayment of the obligation is also not consistent with adopted procedures that will create annual adjustments to the participation percentage to incentivize increased writings in the catastrophe area and account for members entering and leaving the Texas insurance market under the Insurance Code §§2210.009, 2210.052, and 2210.053.

Section 5.4162. A commenter suggested that allowing the participation percentage to adjust annually, rather than being established in the year of the occurrence of the catastrophic event, would allow for consistency between the insurers Association loss obligations and statutory accounting.

Agency Response. The Department agrees that fixing the amount of an insurer's obligation to the Association in the year the catastrophic event occurred could simplify

accounting for the insurer's loss obligation. However, as addressed in other responses to comments concerning this section, the insurer's loss obligation is not "fixed" as to the insurer, but is an obligation of the member insurers to satisfy over the term of the public securities. Basing the insurer's responsibility for the public security obligation on just those insurers participating in the year of the catastrophic event does not limit potential changes in the obligation. This is because of the potential for members to withdraw from the Texas market. Thus, under the commenter's proposed methodology or the adopted methodology, the amount of each insurer's total liability for the public securities liability is initially an estimate and will not become known with certainty until all of the public securities are retired. No changes have been made in response to this comment.

General. A commenter suggested that given the estimated costs of compliance with §§5.4171 - 5.4173 and 5.4181 - 5.4192 the Commissioner consider other alternatives to accomplish the statutory requirements.

Agency Response. The Department recognizes that insurers do not rate coverage or allocate premium for some lines of property and casualty insurance based on the location of an insured's operation. Further, even those insurers that write property lines in addition to other lines may not have systems that can readily identify and communicate this type of information internally because it was unnecessary prior to the enactment of HB 4409. Thus, allocating such previously unallocated premium to the

catastrophe area will require insurers writing such lines to incur significant costs in upgrading their systems and information gathering requirements.

The Insurance Code §2210.613(c), however, requires that the premium surcharge apply to all policies that provide coverage on any premises, locations, operations, or property located in the catastrophe area for all property and casualty lines of insurance, other than the four listed exceptions. Thus the option is either to allocate the premium to the catastrophe area or surcharge the total premium of any policy meeting those qualifications.

An apparent intent of HB 4409 in reducing the Association's reliance on statewide assessments was to shift greater responsibility for Association losses to the catastrophe area. A premium surcharge of the total policy premium, while affecting property and operations in the catastrophe area, would also spread the Association's costs throughout the state. This spreading would be unequal, however, as it would only affect persons with property or operations in the catastrophe area. Further, the amount of the surcharge would be unrelated to the actual exposure in the catastrophe area versus the remainder of the state. This could result in commercial operations choosing not to do business in the catastrophe area. Thus, a premium surcharge on the total premium would be inconsistent with the intent of HB 4409 and could adversely impact the economy of the catastrophe area, and thus the state, which is inconsistent with the purpose of the Insurance Code Chapter 2210, as described in §2210.001.

Therefore, the remaining option is to develop procedures to allocate the premium to the catastrophe area so that the premium surcharge may be assessed in compliance with the Insurance Code §2210.613. Several means of reducing the expense of implementing this requirement have been addressed in this adoption. Additionally, the Legislature may reconsider the premium surcharge and allocation based on the cost factors outlined in the proposal, which is expected to range from several hundred thousand dollars to several million dollars per insurer or insurer group.

Section 5.4171 and §5.4192. Several commenters stated that the time periods for implementing these sections should be extended based on the various changes and procedures that will be required.

Agency Response. The Department agrees that insurers will need adequate time to implement these sections. Therefore, §5.4171(d) has been added to read: "For all lines of insurance subject to §5.4182 of this division (relating to Allocation Method for Specified Lines of Insurance) this section, §§5.4172, 5.4173 and 5.4181 - 5.4192 of this division are effective June 1, 2011." Additionally, §5.4171(e) has been added to read: "For all other lines, this section, §§5.4172, 5.4173, and 5.4181 - 5.4192 of this division are effective October 1, 2011." The requirement in §5.4192(b) has been revised to provide as follows: (1) for policies subject to §5.4182, compliance is required for all policies *in force* on or after October 1, 2011; and (2) for policies subject to §5.4183, compliance is required for all policies effective on or after October 1, 2011.

Section 5.4171. Several commenters argued that the Legislature did not intend to include surety contracts within the scope of the Insurance Code §2210.613 and that the proposed text should be amended to clarify that surety contracts were not subject to premium surcharge within the scope of §5.4171.

Agency Response. The Department agrees with the comment and has changed §5.4171(b) to specifically exclude surety from the scope of §§5.4171 - 5.4173 and 5.4181 – 5.4192. In reaching this conclusion the Department considers the context of the language in the Insurance Code §2210.613 and the decision in *Great American Insurance V. North Austin Municipal Utility District No. 1*, 908 S.W.2d 415 (Tex. 1995).

The *Great American* decision provides that under Texas law, insurance and surety are legally distinct. This differs from other states such as Florida which statutorily defines an insurer as "every person engaged as indemnitor, surety, or contractor in the business of entering into contracts of insurance or of annuity" (Florida Statutes §604.03 cited in *Snow v. Jim Rathman Chevrolet, Inc*., 39 So.3d 368 (Fla.App. 5 Dist. 2010)). The Department does not take the position that the failure to reference terms related to surety contracts excludes those contracts from the application of a particular statute.

Thus, the Department looks to the specific terms used and the context of their usage. The Insurance Code §2210.613(c) provides that the premium surcharge applies to all “policies” described in §2210.613(b) that provide “coverage” for all “property and casualty lines of insurance.” The Insurance Code §2210.613(b) provides

that each “insurer,” the Association and the Texas FAIR Plan Association shall assess a premium surcharge to its policyholders. Further, the term “insurer” is defined for use in the Insurance Code Chapter 2210, Subchapter M, under §2210.602(6) as “each property and casualty insurer authorized to engage in the business of property and casualty insurance in this state and an affiliate of such an insurer, as described by §823.003, including an affiliate of that is not authorized to engage in the business of property and casualty insurance in this state.” The use of the terms “insurer,” “policyholders,” “policies,” “coverage,” and “property and casualty lines of insurance” in these contexts indicate that the Legislature was addressing insurance contracts only rather than taking a more expansive view of applying the premium surcharge to both insurance and surety contracts.

Section 5.4171. Several commenters argued that application of the premium surcharge was unworkable with respect to surety contracts, and thus the sections should explicitly exclude surety contracts.

Agency Response. The Department disagrees with this argument. The person purchasing the surety contract could pay the premium surcharge just as easily as a person purchasing an insurance contract may pay the premium surcharge. Further discussion of this issue is unnecessary because the Department has determined that the Insurance Code §2210.613 premium surcharge does not apply to surety contracts.

Section 5.4172(6). A commenter stated that the inclusion of the term “resides in” in the definition of “operations” causes confusion with regard to commercial coverages and

should be deleted from the definition. The commenter argued that location of a business owner or board member's residence should have no effect on the premium or premium surcharge related to a commercial policy.

Agency Response. The Department agrees with the commenter. The intent of using the term "resides in" was to require insurers to surcharge personal automobile policies only if the insured resided in the catastrophe area, notwithstanding whether the insured regularly drives to, within, or through the catastrophe area. The alternative reading based on the location of a business owner or board member's residence was unintended. To reduce this potential for confusion, the Department has removed the term "resides in" from §5.4172(6) and amended the definition to include automobiles located in the catastrophe area. Further, to be consistent with the terminology, references in §5.4172(4) and §5.4182(a)(1) have been conformed to refer to the term "automobile" or "auto," rather than motor vehicle. These changes will have no effect on any decision to surcharge automobile policies, because §5.4182(a)(1) provides that the surcharge is based on the location where the automobiles are principally garaged.

Section 5.4182. A commenter questions the necessity of §5.4182(b) and (c) and suggests that sufficient instruction is given in §5.4183 to allocate premium to the catastrophe area based on the proportion the exposure in the catastrophe area bears to the total exposure on the policy.

Agency Response. The Department disagrees that §5.4182(b) and (c) are unnecessary. Section 5.4182 specifically lists the lines of insurance where a direct

method of determining the surcharge is required. The lines of insurance listed in §5.4182 are lines where insurers know, or should know, the geographic location of their risks. Section 5.4183 refers to other lines not included within the scope of §5.4182.

Section 5.4182 and §5.4183. A commenter states that the term “operations” in the Insurance Code §2210.613(c) is vague and ambiguous and will lead to confusion for insurers who have to determine how to apply the statute and rule’s surcharge provisions. The commenter brought up examples of directors’ and officers’ liability insurance, general liability insurance, which may not be tied to specific locations, as well as commercial automobile liability insurance which may provide coverage for vehicles traveling through the catastrophe area on a regular basis.

Agency Response. The Department agrees that the Insurance Code §2210.613(c) does not define the term “operations,” and agrees it is challenging to determine the proportion of operations attributable to the catastrophe area for some lines of insurance, such as D&O, and general liability, where the premium is not determined based on the geographic location of the insured’s operations. In response to this comment §5.4183 has been changed.

Section 5.4173(6) defines the term “operations” as “[a] person's interest in property, or activities, that may result in, or give rise to, a loss that is insurable under a property or casualty insurance policy, including the use of an automobile; ownership, lease, or occupancy of a residence or other real property; and activities performed by a person in connection with the manufacture, distribution, or sale of goods or services. A

person is considered to have operations in the catastrophe area if the person maintains an automobile or a physical location in the catastrophe area, regardless of whether that location is owned, leased, rented, or occupied by the person."

Therefore, an insured is not considered to have "operations" in the catastrophe area unless the insured maintains an automobile or a physical location within the catastrophe area. So, for example, a commercial automobile insured that traveled intermittently through the catastrophe area but did not maintain a business location in the catastrophe area where operations are performed, would not be subject to premium surcharge. Section 5.4183 has been changed to provide for the use of the allocation percentage indicated by the insured's commercial property insurance premium in cases where the insurer also provides commercial property insurance to the insured. Since the insurer is already required to determine the percentage of premium attributed to the catastrophe area for its insured's commercial property policy, this information should be available to the insurer. In the case where the insurer does not provide commercial property insurance to the insured, the percentage of premium attributable to the catastrophe area shall be determined by the insurer from information provided by the insured. Further, as a means to reduce potential confrontation in implementing this section, insurers are not required to verify or otherwise determine the reasonableness of the allocation percentage provided by the insured.

Section 5.4183. A commenter suggested that §5.4183 should provide an exhaustive list of insurance lines subject to the premium surcharge or specify which insurance lines are not included.

Agency Response. The Department agrees that the rule should specify that lines of insurance not included in §5.4182 are addressed in §5.4183. Therefore, §5.4183 has been changed to specify that it applies to all other applicable lines of insurance not specified in §5.4182. Thus, §5.4183 does not apply to those lines listed in §5.4182, nor does it apply to lines, insurers, premiums, or policies excluded under §5.4171(b) and (c). In considering this comment the Department also examined §5.4181 and determined that certain nonsubstaintive grammatical changes were necessary to §5.4181(a)(2). Specifically, the Department separated the references to premium tax, surplus lines premium tax, and independently procured premium tax by semicolons and changed the reference “surplus lines premium taxes” to “surplus lines premium tax.”

Section 5.4183. As a means to avoid confusion and uncertainty for businesses that have premises, operations, or insured property located both in and outside the catastrophe area, several commenters recommend that if a premium surcharge percentage and catastrophe area premium percentage can be established for the insured’s property coverage, then the premium allocations for other lines should default to the allocation percentage of the insured’s property coverage. The commenters’ proposals differed in degree of complexity and terminology.

Agency Response. The Department concurs in this concept. Thus, §5.4183 has been changed to provide for the use of the allocation percentage indicated by the insured's commercial property insurance premium in cases where the insurer provides commercial property insurance to the insured in addition to other lines. As discussed in response to prior comments, property in the catastrophe area is a significant factor indicating "operations" in the catastrophe area. Since the insurer is already required to determine the percentage of premium attributed to the catastrophe area for its insured's commercial property policy, this information should be available to the insurer. In cases where the insurer also provides commercial property insurance to the insured and the insurer cannot reasonably determine or allocate premium to the catastrophe area, the insurer will determine the catastrophe area allocation percentage as the ratio of the commercial property premium attributable to the catastrophe area divided by the total Texas premium of the commercial property policy. The insurer will then apply this allocation percentage to the insured's Texas premium for lines of insurance covered under §5.4183.

As revised, §5.4183 also provides that in the case where the insurer does not provide commercial property insurance to the insured, the percentage of premium attributable to the catastrophe area shall be determined by the insurer from information provided by its insured. Insurers are not required to verify or otherwise determine the reasonableness of the allocation percentage provided by the insured. Therefore, in the case where the insurer also writes the insured's commercial property, there should be

no dispute as to the allocation. In the case where the insurer does not write the insured's commercial property, the insurer may rely on information provided by the insured, so there should be no reason for a dispute.

The adopted allocation methodology provides a reasonable means to implement the Insurance Code §2210.613 at this time. If necessary, the adopted allocation methodology in §5.4182 and §5.4183 may be refined in the future based on experience. The changes to the allocation methodology set forth in §5.4183 requires conforming changes to the proposed text in §§5.4184(d), 5.4184(f), 5.4187(a), 5.4189, 5.4190(e), and 5.4192(b).

Section 5.4183. A commenter states that they have serious concerns with the allocation methodology, especially as it applies to the commercial policies that are not physically located in the hurricane zone. The commenter stated that there was no provision in the rule that speaks to what is to be done if the insurer and the insured disagree on the amount of property located in catastrophe area, and that is a problem. The commenter believed the proposed system could lead to insured fraud and could lead to a completely unreliable and unpredictable revenue stream for class 2 public securities, which the commenter thought would lead to concerns regarding the marketability of the bonds.

Agency Response. As previously stated in these responses, the Department agrees that it is challenging to determine the proportion of operations attributable to the catastrophe area for some lines of insurance. The Department considered in its

proposal several means of trying to alleviate the potential for allocation disputes between the insurer and the insured, including a notice procedure and a default percentage. As previously discussed in these responses to comments, the provisions establishing a procedure for handling disagreements between the insurer and the insured have been removed. Rather, in the case where the insurer also writes the insured's commercial property, there should be no dispute as to the allocation. In the case where the insurer does not write the insured's commercial property, the insurer may rely on information provided by the insured.

The Department is aware that some insureds, or insurers on the insured's behalf, might seek to underestimate the amount of premium attributable to the catastrophe area as a means to avoid paying their "full" surcharge. Seeking to reach a perfect allocation, however, is an impractical solution to this problem and would only result in requiring insurers and insureds alike to incur significant additional costs. It is in this attempt to balance imposing significant additional costs on insurers and insureds versus the amount of the surcharge for reporting insureds that the Department has revised the §5.4183 allocation scheme to be based, if possible, on catastrophe area property coverage as discussed in prior comments.

The Department however, will continue to monitor the situation. If insurers or insureds are uncooperative in their participation and compliance, the Department may revisit this allocation methodology and take appropriate remedial action.

Finally, the Department disagrees that such activity could lead to a completely unreliable and unpredictable revenue stream which may result in problems when marketing the public securities. The Department consulted with the TPFA regarding this question and was informed that such a result was unlikely. First, the premium surcharge will be based on the reported premium in the catastrophe area as required in the Insurance Code §2210.613. If premium is underreported, the result would be a greater percentage premium surcharge and not an unpredictable revenue stream. Second, to the extent that such reporting did raise a concern, the lenders would require an additional contractual coverage requirement (an amount required to be collected annually in excess of the principal, interest and expenses due on the public securities) to cover any uncertainty in the revenue stream. To the extent that an additional contractual coverage amount was required, any excess class 2 premium surcharge revenue would be distributed annually as provided in the Insurance Code §2210.611. Thus, marketability of the bonds would not be endangered.

Section 5.4183. A commenter suggests that there are some constitutional problems with increasing the default allocation percentages three percent per year.

Agency Response. The Department does not agree with the suggestion; however, as discussed in prior comments, the allocation method discussed in the comment has been removed from the text and therefore further discussion is unnecessary.

Section 5.4183. A commenter recommends the insured's appeal option be removed from the rule because allowing the insured an opportunity to object to the allocation

methodology will require a burdensome, manual process to implement and to respond to objections.

Agency Response. As previously discussed in these responses to comments, §5.4183 has been changed. The premium surcharge will be based on the insured's allocated property premium, or if such information is unavailable, the information provided by the insured. Therefore, because the information is provided by the insured, the requirements concerning an objection by the insured have been removed.

Section 5.4184(b). Several commenters suggest that the requirement in §5.4184(b) be amended to not require an additional premium surcharge upon reinstatement or reissuance of a policy, such as is authorized in the Insurance Code §551.106.

Agency Response. The Department agrees with the suggestion and has changed §5.4184(b) but has adopted the term "reinstated" for use in this section, rather than "reissued." The Department considers a policy to be "reinstated" if it covers the same period as the original policy without a lapse in coverage, except as provided in the Insurance Code §551.106. In this context, policies that do not meet this definition of reinstated, regardless of what the practice is called, are subject to an additional surcharge.

Section 5.4184(c) and (d). Several commenters asked for clarification concerning the meaning of §5.4184(c) as it relates to "all transactions on a policy occurring within a seven day period."

Agency Response. The purpose of the language in §5.4184(c) regarding "all transactions on a policy occurring within a seven day period" is to recognize that multiple related transactions on a policy may occur over the course of several days. The purpose is to allow insurers to combine the premium effect of all policy transactions over a short period of time to determine the amount of any additional premium that may apply to the policy. For example, an insured may add a new vehicle to a policy and several days later delete an old vehicle. The purpose is to allow insurers to "net out" these transactions before determining if an additional premium surcharge is required. The Department is aware that this may result in additional programming and systems costs to insurers, however, it should also reduce conflicts between insurers and insureds related to the order transactions are completed and concepts of continuous coverage.

§5.4184(c) and (d). A commenter recommended that a "fixed dollar amount threshold" mechanism be substituted for the "seven day" trigger mechanism for mid-term policy changes to eliminate unnecessarily "de minimus" mid-term premium increase resulting in additional premium surcharges.

Agency Response. The Texas Insurance Code §2210.613 requires the premium surcharge on the policy premium. The rule requires a premium surcharge be applied to any additional premium. If this provision were not included, insureds could attempt to reduce their surcharge by purchasing minimal coverage initially and then immediately adding additional coverage to that policy. As for the amount of the additional premium

and the premium surcharge, many insurers already have rules in place that waive additional or return premiums for what may be considered “de minimus” amounts. Thus, the insurer has already determined that any additional (or return) premium is above a “de minimus” amount. For additional premiums, the insurer has determined it is worth the cost of collecting the additional premium, as such, an additional surcharge should also be collected in these cases.

Section 5.4184(e) and (f). Several commenters assert that §5.4184(f) is inconsistent with the statutory provisions providing that the premium surcharge is nonrefundable because it allows a refund of a premium surcharge based on a preliminary deposit premium if “after exposure or premium audit, retrospective rating adjustment, or other similar adjustment after policy expiration, the deposit premium exceeds the actual premium . . . “. The commenters also noted that the rule allowed for a refund of the premium surcharge under §5.4184(f) but not for a mid-term policy change under §5.4184(e).

Agency Response. The Department disagrees with the assertion and considers the section to be consistent with the statute. In the case of a policy subject to audit or retrospective rating adjustments, the premium paid at policy inception is merely a “deposit premium” and not the “policy premium.” In this case there is the expectation of the insurer and insured that the “policy premium” will be determined after retrospective rating adjustments or audit adjustments. This differs from a mid-term adjustment to the policy premium, because there was no expectation that the premium paid at the policy

inception would later be adjusted and the actual premium would be determined after the policy expired. Thus, no changes have been made in response to this comment.

Section 5.4184(f). A commenter asserts that §5.4184(f), will require insurers to incur additional costs to develop software, systems and procedures necessary to identify and determine audited policies, cancelation return premium, and mid-term change return premium that would not be subject to surcharge premium.

Agency Response. The Department disagrees with the commenter's assertion because §5.4184(f) only applies to an audit adjustment that results from an audit after the policy expires. Thus, §5.4184(f) should not result in new costs to the insurer based on determining cancelation return premium and mid-term change return premium.

Section 5.4186(a). Several commenters recommend that the rule be revised to designate the Surplus Lines Stamping Office of Texas (SLSOT) as the primary source of collection and reporting surplus lines information required under §5.4186. A commenter points out that SLSOT currently collects data related to surplus lines transactions and that the information required to be reported under these sections could be piggybacked on to that reporting process.

Agency Response. Such an action would require amending the SLSOT's plan of operation, which was not contemplated in the proposal or evaluated for cost. The Department will continue to receive information related to whether the SLSOT should be required to collect the information related to surplus lines insurers. The section was not changed in response to this comment.

Section 5.4186(a). A commenter recommends that the rule be changed to state that the responsibility for reporting and surcharges may not be shifted to the surplus lines agent by contract. The commenter proposes the following language: "[A]n affiliated surplus lines insurer may not delegate to a surplus lines agent any duty of the insurer under these Rules, except as otherwise authorized by Chapter 981, Insurance Code, or these Rules."

Agency Response. The Department disagrees that the suggested change is necessary at this time. Section 5.4186(a) already makes clear that surplus lines insurers will ultimately be held responsible for the failure of its agents to comply with these rules. Additional language stating what may and may not be placed in a contract between an insured and its agent as a result of these rules is not necessary.

Section 5.4186(b). Several commenters argue that the insurers and surplus lines agents should be given additional time to remit surcharges under §5.4186(b). One commenter suggested the deadline should be extended to 30 or 45 days after the end of the month. Another commenter suggested that the deadline for surplus lines agents should be extended to 60 days after the end of the month.

Agency Response. The Department agrees that the deadline should be extended to provide insurers, including surplus lines agents allowed by affiliated surplus lines insurers to remit the surcharges on their behalf, additional time to remit surcharges to the Association. Therefore §5.4186(b) has been changed to provide insurers and

surplus lines agents until the end of the following month to remit surcharges to the Association.

Section 5.4189. A commenter suggests that the proposed notice required under §5.4189 is not consumer friendly and should be revised.

Agency Response. The Department has revised the notice based in part on suggested language from the commenter. The bracketed area of the revised notice allows the insurer the option of including the amount of the surcharge, as required by §5.4189(b), either in this notice or a separate document.

Section 5.4189. A commenter requests that §5.4189 be amended so that insurers are not required to provide notice to “applicants” and that notification must only be provided on the issuance or renewal of a policy.

Agency Response. The Department agrees that it is not necessary to require the notice to applicants and that the notice must be provided only upon policy issuance. The policy is purchased and priced for its intended term. The premium surcharge is a statutory requirement in addition to the price of the policy. Further, the additional information required under proposed §5.4189(c) has been deleted because, as provided in the changes to §5.4183, the method of determining the allocation percentage will either be determined by the insured based on their commercial property policy, or based on information provided by the insured. This makes the requirement that insurers notify their insureds of their right to dispute the allocation percentage unnecessary.

Section 5.4189(c). A commenter recommends that §5.4189 be revised to triple the time periods for satisfying the surcharge notice requirement when a policy is provided by a surplus lines agent.

Agency Response. The Department agrees that the proposed 10-day time period may have been too aggressive for all situations. Therefore, §5.4189(d) has been amended to give insurers 20 days after a mid-term change before an additional notice is required. The time period remains the same for all insurers and surplus lines insurers.

Section 5.4190. Several commenters suggest that the §5.4190 requirement for insurers to report surcharge collections may present implementation challenges because some insurers do not reconcile against amounts actually collected from insureds but instead track and reconcile to billed surcharges. The commenters request that the section allow sufficient time for implementation.

Agency Response. The Department agrees that insurers will require time to program and implement this requirement. As provided in the changes to §5.4171, this section shall not become effective until June 1, 2011, for all lines of insurance subject to §5.4182 of this division and October 1, 2011 for all other lines subject to §§5.4171 - 5.4173, and 5.4181 - 5.4192 of this division. Additionally, §5.4190 has been changed to require the report 90 days after the end of calendar year.

Section 5.4190(b). A commenter suggests that the 60-day period for filing the report required under §5.4190(b) is unworkable because surcharges are collected based on

the effective date of policies written in the surcharge period, thus making it possible (and likely) that surcharge collection will continue long after the end of the calendar year.

Agency Response. The Department disagrees that surcharges will be routinely collected long after the end of the calendar year. As provided in §5.4185(b), insurers must apply money received from the insured to the premium surcharge prior to applying funds to premium or any other obligations. Section 5.4185(b)(1) clarifies this requirement by prohibiting insurers from allocating pro-rata or otherwise mixing premium surcharges with premium over installment plan payments. Thus, except for possible additional surcharges due to mid-term policy changes, insurers will not collect surcharges over the life of the policy, but rather upon policy inception. Mid-term policy changes, and adjustments for policies based on premium audits or retrospective rating occurring in a subsequent year would be reported on the subsequent year's annual report. As to the proposed 60-day period, §5.4190 has been changed to require the report 90 days after the end of the calendar year.

Section 5.4190(c). A commenter assumes that the SLSOT would make the report required under §5.4190 on behalf of affiliated surplus lines insurers when possible.

Agency Response. The Department disagrees that §5.4190 establishes such a reporting requirement. Section 5.4190 does not require SLSOT to make any changes to its reporting system or report on behalf of affiliated surplus lines insurers. However,

§5.4190 does not prohibit SLSOT from reporting on behalf of surplus lines insurers if SLSOT and the insurer agree to such an arrangement.

Section 5.4190(e). A commenter asks that the purpose of the distinction between surcharges determined under subparagraphs (A), (B), and (C) of §5.4190(e)(4) be clarified. The commenter suggests that it seems sufficient to provide the allocation of total premium to the catastrophe area and of total premium outside the catastrophe area. Further, requiring additional layers of reporting is not necessary under HB 4409 and will vastly increase the cost and time needed to enhance insurer computer systems.

Agency Response. The Department agrees that §5.4190 can be simplified by combining §5.4190(e)(4)(A) – (C) under subparagraph (A) and redesignation of subparagraph (D) as subparagraph (B).

Section 5.4190 and §5.4191. A commenter notes that because the annual premium surcharge report and annual premium surcharge reconciliation report ask for premium written in the calendar year, as well as premium surcharges collected in the calendar year, these figures are never going to reconcile because written premium is different from collected premium. For example, if a company writes a policy in December the company would report the full annual premium as written premium. But if the premium were billed on an installment basis, the company would only be allowed to collect surcharge on the first installment of premium.

Agency Response. The Department agrees that in some instances there may be mismatches between calendar year written premium and surcharges collected for the same period of time. However, the reports provide useful information for the Department and Association concerning the collection of premium surcharges. The Department does not consider it necessary at this time for insurers to incur additional costs to enhance the reconciliation of these reports.

The Department disagrees with the statement in the example that under an installment plan only one month of the surcharge would have been collected. As previously discussed, §5.4185(b) requires insurers to apply money received from the insured to the premium surcharge prior to applying funds to premium or any other obligations. Section 5.4185(b)(1) clarifies this requirement by prohibiting insurers from allocating pro-rata or otherwise mixing premium surcharges with premium over installment plan payments.

Section 5.4190 and §5.4191. A commenter argues that there is no apparent reason for requiring information by line under §5.4191, but requiring it by line adds a huge cost for each insurer trying to comply with this regulation. The annual premium surcharge report requires insurers to report collected premium surcharges by line of business and requires insurers to provide information at the policy and risk level, including any alternative allocation percentages used, which represents a significant issue, since any alternative method will be a manual calculation resulting only in a surcharge amount being booked.

Agency Response. The Department disagrees that the requirement that insurers report by line of business requires insurers to provide information at the policy and risk level. However, the Department agrees that it is not necessary at this time to collect this data by line of business. As such §5.4190 and §5.4191 have been changed to remove the requirement that these reports be provided by line of business.

Section 5.4192. A commenter suggests that implementing the requirements in §5.4192 will take a significant amount of time and suggests that the proposed October 1, 2010 effective date under §5.4192 be postponed until March 1, 2011.

Agency Response. As previously discussed in the responses to comments, the Department agrees that implementation of the §5.4192 will involve a significant amount of time. Therefore the implementation date for this section has been established as follows: (1) for policies subject to §5.4182, compliance is required for all policies *in force* on or after October 1, 2011; and (2) for policies subject to §5.4183, compliance is required for all policies effective on or after October 1, 2011.

Section 5.4192. A commenter suggests that §5.4192 should be revised to require that the Department initially obtain the information required from affiliated surplus lines insurers through the stamping office, and that the stamping office amend its procedures to facilitate such collection, maintenance, and reporting of information.

Agency Response: The Department declines to make the suggested change. Section §5.4192(c) states the Department's intent to utilize SLSOT as a resource when it is possible and practical. The described change, however, would require the

Department to amend SLSOT's plan of operation, which was not contemplated in the proposed rules or evaluated for costs. The Department will continue to receive information related to whether the SLSOT is best to collect the information related to surplus lines insurers. Therefore, the Department has not made any changes in response to this comment.

Section 5.4192. A commenter requests confirmation that §5.4192 (a) - (c) establishes that the duty of collecting, maintaining and reporting the required information is on the insurer and that the proposed rules impose no similar or related duty on surplus lines agents.

Agency Response. Section 5.4192 (a) - (c) establishes the requirements set forth in that section. It is not intended that this section require a surplus lines agent to assume the duties of a surplus lines insurer.

Section 5.4192. A commenter requests confirmation that the §5.4192(b) requirement that each insurer shall collect, maintain, and report sufficient data records . . . "[f]or policies with effective dates on or after October 1, 2010 . . . " means that the data collection, maintenance and reporting duties are to be performed by insurers on a "go forward" basis beginning on October 1; and apply to policies with an "inception date" or "renewal date" on or after October 1, and not those policies merely in force on that date.

Agency Response. Section 5.4192(b) has been changed to modify the reporting requirement and provide an extension for insurers using the allocation methodology

established in §5.4183. Proposed §5.4192(b) established the requirement for all policies with effective dates on or after October 1, 2010. This requirement in §5.4192(b) has been revised to provide as follows: (1) for policies subject to §5.4182, compliance is required for all policies *in force* on or after October 1, 2011; and (2) for policies subject to §5.4183, compliance is required for all policies effective on or after October 1, 2011.

The change is necessary because it is possible that there may be a catastrophic event in 2011. The TPFA will need reliable catastrophe area premium information to secure the issuance of any public securities that may be issued under the Insurance Code §2210.073. Additionally, if a surcharge is needed, the Commissioner and the Association must be able to obtain reliable catastrophe area premium information in a timely manner in order to determine any necessary premium surcharge percentage. Further, it is anticipated that the lines of insurance subject to §5.4182 will make up the bulk of the catastrophe area premium.

As previously discussed, for lines of insurance subject to §5.4182, insurers already know, or should already know, the geographic location of these risks. In addition, for residential and commercial property lines of insurance, insurers should know premiums attributable to risks located in the catastrophe area.

The Department recognizes that for lines of insurance other than residential and commercial property, insurers may not know whether a Harris County insured is located within those portions of Harris County designated as a catastrophe area. The

Department believes the October 1, 2011 date provides sufficient time for insurers to make this determination for policies in force on that date.

For lines of insurance subject to §5.4183, insurers may not know the geographic location of their insureds. Thus, the requirement for compliance with §5.4192 is extended to apply to those policies effective on or after October 1, 2011.

5. NAMES OF THOSE COMMENTING AGAINST THE SECTIONS.

Against, with changes: American Insurance Association; Association of Fire and Casualty Companies of Texas; Casey, Gentz & Magness, L.L.P.; Insurance Council of Texas; Liberty Mutual Insurance Company; Office of Public Insurance Counsel; Property and Casualty Insurers of America; Surplus Lines Stamping Office of Texas; Texas Surplus Lines Association, Inc.; The Surety and Fidelity Association of America; and Travelers

6. STATUTORY AUTHORITY. The sections are adopted under the Insurance Code §§2210.008, 2210.052, 2210.053, 2210.071, 2210.072, 2210.073, 2210.074, 2210.151, 2210.152, 2210.609, 2210.613, 2210.6135, and 36.001. Section 2210.008(b) authorizes the Commissioner to adopt reasonable and necessary rules in the manner prescribed in Subchapter A, Chapter 36, Insurance Code.

The Insurance Code §2210.052(a) requires that a member company share in the losses and expenses of the Association based on the proportion that the net direct

premiums of that member during the preceding calendar year bears to the aggregate net direct premiums by all members of the Association. Under the Insurance Code §2210.052(c), a member company's share of the losses and expenses of the Association is required to be determined annually and in the manner provided by the plan of operation. In the determination of a member company's share of the losses and expenses of the Association, the Insurance Code §2210.052(d) specifies that members are entitled to a credit for insurance voluntarily written in the catastrophe areas. The Insurance Code §2210.052(d) also requires that the method for calculating the credit be contained in the plan of operation.

Section 2210.052(e) provides an exemption from participation in any insured losses and operating expenses of the Association in excess of premium and other revenue of the Association until the second anniversary of the date on which the insurer first becomes a member of the Association for an insurer that becomes a member of the Association and that has not previously been a member of the Association. The Insurance Code §2210.053(b) provides the Department may develop a program designed to create incentives for insurers to write voluntary windstorm and hail insurance in the catastrophe areas.

Section 2210.071(a) 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 shall be paid as provided by Subchapter B-1, Chapter 2210,

Insurance Code. Section 2210.072(a) provides that losses not paid under the Insurance Code §2210.071 shall be paid as provided by §2210.072 from the proceeds from class 1 public securities. Section 2210.072(b) authorizes class 1 public securities to be issued in a principal amount not to exceed $1 billion per year. Section 2210.072(c) requires class 1 public securities to be repaid in the manner prescribed by Subchapter M, Chapter 2210, Insurance Code, from Association premium revenue.

Section 2210.073 provides that losses not paid under Insurance Code §2210.072 shall be paid as provided by §2210.073 from the proceeds from class 2 public securities issued in accordance with Subchapter M, Chapter 2210, Insurance Code. Section 2210.073(b) authorizes class 2 public securities to be issued in a principal amount not to exceed $1 billion per year and requires class 2 public securities to be repaid in the manner prescribed by Subchapter M, Chapter 2210, Insurance Code. Section 2210.074(a) provides that losses not paid under Insurance Code §2210.072 and §2210.073 shall be paid as provided by §2210.074 from the proceeds from class 3 public securities issued in accordance with Subchapter M, Chapter 2210, Insurance Code. Section 2210.074(b) authorizes class 3 public securities to be issued in a principal amount not to exceed $500 million per year and requires class 3 public securities to be repaid in the manner prescribed by Subchapter M, Chapter 2210, Insurance Code.

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 provides 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 considered necessary by the Department to implement the purposes of Chapter 2210. The Insurance Code §2210.152(a)(2)(A) requires the plan of operation to include a plan for the equitable assessment of the members of the Association to defray losses and expenses.

Section 2210.609 provides that the Association shall repay all public security obligations from available funds, and if those funds are insufficient, from revenue collected in accordance with the Insurance Code §§2210.612, 2210.613, and 2210.6135. Section 2210.609 further provides that the Association shall deposit all revenue collected under §§2210.612, 2210.613, and 2210.6135 in the public security obligation revenue fund and further provides for the payment of the public security obligations and the public security administrative expenses by irrevocably pledging revenues received from premiums, premium surcharges, and amounts on deposit in the public security obligation revenue fund, together with any public security reserve fund.

Section 2210.613 provides that the Association shall pay class 2 public securities issued under §2210.073 with premium surcharges and member assessments as provided by §2210.613. Section 2210.6135 provides that the Association shall pay class 3 public securities issued under Section §2210.074 as provided by §2210.6135 through member assessments. Section 36.001 provides that the Commissioner of

Insurance 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.

7. TEXT.

§5.4161. Member Assessments.

(a) The Association shall determine if a member assessment is necessary to fund the Association's outstanding class 2 and class 3 public security obligations, including any required contractual coverage amount (required obligations) based upon the evaluation of information that is provided to the Association by the Texas Public Finance Authority.

(b) Pursuant to Insurance Code Chapter 2210 and the Association's plan of operation, if the Association determines that a member assessment is required to fulfill the Association's required obligations the Association shall assess the members of the Association in an amount the Association determines to be reasonable and necessary to fully provide for the Association's required obligations.

(c) This section and §§5.4162 - 5.4167 of this division (relating to Amount of Assessment; Notice of Assessment; Payment of Assessment; Failure to Pay Assessment; Contest After Payment of Assessment; and Inability to Pay Assessment by Reason of Insolvency, respectively) are a part of the Texas Windstorm Insurance

Association's plan of operation and shall control over any conflicting provision in §5.4001 of this subchapter (relating to Plan of Operation).

§5.4162. Amount of Assessment.

(a) The Association shall determine which members of the Association shall participate in any assessment to provide for the Association's required obligations as determined under §5.4161 of this division (relating to Member Assessments).

(1) The Association may not include in the assessment an insurer that became a member of the Association after September 1, 2009, and had not previously been a member of the Association, until after the second anniversary of the date on which the insurer first becomes a member of the Association. The anniversary date shall be the date the insurer is authorized by the department to engage in the business of property insurance in this state.

(2) The Association shall include in the assessment an insurer described under paragraph (1) of this subsection after the second anniversary of the date on which the insurer first becomes a member of the Association without regard as to whether the catastrophic event that gave rise to the class of public securities occurred prior to the second anniversary of the date on which the insurer first became a member of the Association.

(3) The Association may not include in the assessment formula, the net direct premium of an affiliate insurer engaged in the business of surplus lines insurance

as described in the Insurance Code §2210.052(c), that a federal agency or court of competent jurisdiction determines to be exempt from the assessment formula under the Insurance Code Chapter 2210.

(b) This determination shall be computed on a calendar year basis for the year in which the assessment is made. This determination shall not be based on the year in which the catastrophic event occurred, except for an assessment made during that year. Net direct premiums shall be determined as provided under §5.4001 of this subchapter (relating to Plan of Operation).

(c) The designated members of the Association shall participate in any assessment levied in the proportion that the net direct premiums of such member written in this state during the preceding calendar year bears to the aggregate net direct premiums written in this state by all members of the Association as furnished to the Association by the department after review of annual statements, other reports, and required statistics; provided, however, that if at the time of such assessment the department has not furnished to the Association information necessary to compute a member's participation during the preceding calendar year, then each member's participation shall be based upon information furnished to the Association from the last calendar year in which such information is available and, upon obtaining the necessary information from the department, the Association shall reassess or refund to each member such amounts as are necessary to properly reflect such member's

participation; provided, further, that a member shall be entitled to receive the following credit for insurance, similar to catastrophe insurance, written in such catastrophe areas.

(d) The Figure: 28 TAC §5.4162(d) graphically depicts the Texas Windstorm Insurance Association Procedure For Calculating Member Assessment Percentages Including Credit For Voluntary Writings. All premiums are for the most recent preceding calendar year ending December 31, as furnished by the department. Column 1(a): Statewide net direct premiums for extended coverage and other allied lines. Column 1(b): Statewide net direct premiums for extended coverage and other allied lines portion of the multiple peril line. Column 1(c): Statewide net direct premiums for homeowners and farm and ranch owners. Column 2: The sum of the statewide net direct premiums at 90% of the extended coverage and other allied lines, and 50% of the homeowners and farm and ranch owner's, or such percentage as may be determined in accordance with §5.4001(a)(2)(N)(i)(III) of this chapter (90% of Column 1(a) plus 90% of Column 1(b) plus 50% of Column 1(c)). Column 3: Each company's percentage of the net direct premiums as described in Column 2, which is the basis for indicating normal required participation in the Association prior to credits for voluntary writings in the designated areas. Column 4: Total windstorm and hail premiums in the designated areas (Association premiums plus voluntary premiums). Column 5: Normal company quota of total windstorm and hail premiums (Column 3 x Column 4). Column 6: Each company's voluntary writings in the designated areas multiplied by the same percentages as shown in Column 2. Note: Maximum credit shall be limited to

company's normal quota. Column 7: Each company's maximum possible allocation after applying credits for voluntary writings (Column 5 minus Column 6). Negative allocation to be shown as zero. Column 8: Percentage participation of each member company in the Association, prior to application of offset. Note: The offset figure measures the excess premiums developed by the maximum credit in Column 6. Column 9: Percentage participation of each member company in the Association.

Figure: 28 TAC §5.4162(d):

TEXAS WINDSTORM INSURANCE ASSOCIATION PROCEDURE FOR CALCULATING MEMBER ASSESSMENT PERCENTAGES INCLUDING CREDIT FOR VOLUNTARY WRITINGS			
[1] STATEWIDE DIRECT WRITTEN PREMIUMS	[2] NET DIRECT WRITTEN PREMIUMS	[3] COMPANY PERCENT OF STATEWIDE PREMIUMS WRITTEN	[4] TOTAL PREMIUMS IN CATASTROPHE AREAS
(a)(b)(c) E.C. CMP HO	Total of Col. [1](a) & (b) x 90% Col. [1](c) x 50%	[2] ÷ Total of [2]	(ASSOCIATION + VOLUNTARY)
[5] NORMAL REQUIRED QUOTA IN DESIGNATED AREAS	[6] CREDIT FOR COMPANY'S VOLUNTARY PREMIUMS	[7] DIFFERENCE BETWEEN NORMAL REQUIRED PARTICIPATION AND VOLUNTARY CREDIT PREMIUMS	[8] ASSOCIATION ASSESSMENT PERCENTAGE PRIOR TO OFFSET
([3] x [4])	(not to exceed	([5] - [6])	[7] ÷ Total of [7]

	column [5])		
[9] NET ASSOCIATION ASSESSMENT PERCENTAGE			
(After application of offset)			

(e) The department shall furnish to the Association the amount of net direct premiums of each member company written on property in this state and the aggregate net direct premiums written on property in this state by all member companies during the preceding calendar year as reported by member companies to the department. Within a reasonable time after the receipt of same from the department, the Association shall notify each member company, in writing, sent by certified mail, the amount of the net direct premiums written on property in this state during the preceding calendar year by the member company to whom notice is given, including the net direct premiums of similar insurance voluntarily written in the catastrophe areas, upon which such company's percentage of participation will be determined. Such notice shall state that such notification, and the content thereof, is an act, ruling, or decision of the Association and that the member company to whom such notice is given shall be entitled to appeal such act, ruling, or decision within 30 days from the date shown on the notice in accordance with the Insurance Code §2210.551. Thereafter, the Association shall determine the percentage of participation for each member company

in the manner provided in this section and shall notify each member company thereof, in writing, sent by certified mail. Such notice shall state that such notification, and the content thereof, is an act, ruling, or decision of the Association insofar as the mathematical determination of the percentage of participation is concerned and that the member company to whom such notice is given shall be entitled to appeal therefrom within 30 days from the date of such act, ruling, or decision as shown on said notice in accordance with the Insurance Code §2210.551.

(f) To assist the Association in determining each member insurer's percentage of participation as soon as possible in the calendar year, each member insurer shall furnish to the Association on or before March 1 of each year a copy of its Exhibit of Premiums and Losses (Statutory Page 14) for the State of Texas that is filed annually with the department as part of the insurer's Texas Property and Casualty Annual Statement.

§5.4163. Notice of Assessment.

(a) Notice of assessment shall be sent to each member, within 30 days after the Association levies the assessment, by certified mail, return receipt requested, addressed to the office of such member as it appears on the books of the Association. Such notice shall state the member's allocated amount of assessment and shall inform each member of the sanctions imposed by §5.4165 of this division (relating to Failure to

Pay Assessment) for the failure to pay such assessment within the time prescribed by this section.

(b) Such notice shall also state that such notification, and the content thereof, is an act, ruling, or decision of the Association insofar as the amount of the assessment for such company is concerned and that a member company to whom such notice is given shall be entitled to appeal therefrom within 30 days from the date of such act, ruling, or decision as shown on said notice, in accordance with the Insurance Code §2210.551; provided, however, that the right of appeal provided for herein shall not include the subject matter of any act, ruling, or decision of the Association determining the amount of net direct premiums of such member company or the percentage of participation for such member company when notice of the amount of such net direct premiums or such percentage of participation has previously been given by the Association in accordance with §5.4162 of this division (relating to Amount of Assessment).

(c) The time period for an appeal of an act, ruling, or decision of the Association respecting net direct premiums or percentage of participation is computed from the date of the act, ruling, or decision of the Association respecting same.

§5.4164. Payment of Assessment. Each member 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.

§5.4165. Failure to Pay Assessment.

(a) If the Association has not received payment in full of a member's allocated amount of assessment within 40 days of notice of the receipt by the member of the notice of assessment, then the Association shall report to the commissioner the fact that such assessment has not been paid, and the commissioner shall immediately issue an order suspending such member's certificate of authority to transact the business of insurance in the State of Texas until such time as the Association certifies to the commissioner that such assessment has been paid in full.

(b) Removal of a member's certificate of authority to transact business in the State of Texas by the commissioner shall in no way affect the right of the Association to proceed against such member in any court of law or equity in the United States for any remedy provided by law or contract to the Association, including, but not limited to, the right to collect such member's assessment.

(c) In addition to any other remedy provided herein, the Association may offset assessments due from a member against any amounts in any account of such delinquent member.

§5.4166. Contest After Payment of Assessment.

(a) A member does not waive any right it may have to contest the computation of its allocated assessment amount by mailing or otherwise delivering payment of its allocated assessment amount to the Association, as provided herein.

(b) Such contest shall not, however, toll the time within which assessments must be paid or the report to be made to the commissioner or the action to be taken by the commissioner upon receipt of such report, all as set out in §5.4165 of this division (relating to Failure to Pay Assessment).

§5.4167. Inability to Pay Assessment by Reason of Insolvency. In the event a member of the Association is placed in temporary or permanent receivership under order of a court of competent jurisdiction based upon a finding of insolvency, and such member has been designated an impaired insurer by the commissioner, and in the event it is necessary to obtain additional funds to provide for operating expenses and losses in the year the insurer is declared impaired, the aggregate net amount not recovered from such insolvent insurer shall be reallocated among the remaining members of the Association in accordance with the method of determining participation as determined in the plan of operation.

§5.4171. Premium Surcharge Requirement .

(a) Following a catastrophic event, insurers may be required to assess a premium surcharge under the Insurance Code §2210.613(b) and §2210.613(c) on all

policyholders with property and casualty insurance policies that provide coverage on premises, operations, or insured property located in a catastrophe area. This requirement applies to admitted insurers, the Association, the Texas FAIR Plan Association, Texas Automobile Insurance Plan Association policies, affiliated surplus lines insurers, and includes policies independently procured from affiliated insurers.

(b) This section and §§5.4172, 5.4173 and 5.4181 – 5.4192 of this division (relating to Premium Surcharge Definitions, Determination of the Surcharge, Premiums to be Surcharged, Allocation Method for Specified Lines of Insurance, Allocation Method for Other Lines of Insurance, Application of the Surcharges, Premium Surcharges are Mandatory, Remittance of Premium Surcharges, Offsets, Surcharges not Subject to Commissions or Premium Taxes, Notification Requirements, Annual Premium Surcharge Report, Premium Surcharge Reconciliation Report, and Data Collection, respectively) do not apply to policies written and reported under the following annual statement lines of business: federal flood; medical malpractice; group accident and health; all other accident and health; workers' compensation; excess workers' compensation, and surety.

(c) This section and §§5.4172, 5.4173 and 5.4181 - 5.4192 of this division do not apply to:

(1) a farm mutual insurance company operating under the Insurance Code Chapter 911;

(2) a nonaffiliated county mutual fire insurance company described by the Insurance Code §912.310 that is writing exclusively industrial fire insurance policies as described by the Insurance Code §912.310(a)(2);

(3) a mutual insurance company or a statewide mutual assessment company engaged in business under Chapter 12 or 13, Title 78, Revised Statutes, respectively, before those chapters' repeal by §18, Chapter 40, Acts of the 41st Legislature, 1st Called Session, 1929, as amended by Section 1, Chapter 60, General Laws, Acts of the 41st Legislature, 2nd Called Session, 1929, that retains the rights and privileges under the repealed law to the extent provided by those sections; and

(4) premium and policies issued by an affiliated surplus lines insurer that a federal agency or court of competent jurisdiction determines to be exempt from a premium surcharge under the Insurance Code Chapter 2210.

(d) For all lines of insurance subject to §5.4182 of this division (relating to Allocation Method for Specified Lines of Insurance) this section, §§5.4172, 5.4173 and 5.4181 - 5.4192 of this division are effective June 1, 2011.

(e) For all other lines, this section, §§5.4172, 5.4173 and 5.4181 - 5.4192 of this division are effective October 1, 2011.

§5.4172. Premium Surcharge Definitions. The following words and terms when used in §§5.4171, 5.4173 and 5.4181 - 5.4192 of this division (relating to Premium Surcharge Requirement , Premiums to be Surcharged, Allocation Method for Specified Lines of Insurance, Allocation Method for Other Lines of Insurance, Application of the

Surcharges, Premium Surcharges are Mandatory, Remittance of Premium Surcharges, Offsets, Surcharges not Subject to Commissions or Premium Taxes, Determination of the Surcharge, Notification Requirements, Annual Premium Surcharge Report, Premium Surcharge Reconciliation Report, and Data Collection, respectively) shall have the following meanings unless the context clearly indicates otherwise:

(1) Affiliated insurer--An insurer that is an affiliate, as described by the Insurance Code §823.003, of an insurer authorized to engage in the business of property or casualty insurance in the State of Texas. Affiliated insurer includes an insurer not authorized to engage in the business of property or casualty insurance in the State of Texas.

(2) Affiliated surplus lines insurer--An eligible surplus lines insurer that is an affiliate, as described by the Insurance Code §823.003, of an insurer authorized to engage in the business of property or casualty insurance in the State of Texas.

(3) Exposure--The basic unit of risk that is used by an insurer to determine the insured’s premium.

(4) Insured property--Real property, or tangible or intangible personal property, including automobiles, covered under an insurance policy issued by an insurer.

(5) Insurer--Each property and casualty insurer authorized to engage in the business of property or casualty insurance in the State of Texas and an affiliate of such an insurer, as described by the Insurance Code §823.003, including an affiliate

that is not authorized to engage in the business of property or casualty insurance in the State of Texas, the Association, and the Texas Fair Access to Insurance Requirements Plan Association. The term specifically includes a county mutual insurance company, a Lloyd's plan, and a reciprocal or interinsurance exchange.

(6) Operations--A person's interest in property, or activities, that may result in, or give rise to, a loss that is insurable under a property or casualty insurance policy, including the use of a automobile; ownership, lease, or occupancy of a residence or other real property; and activities performed by a person in connection with the manufacture, distribution, or sale of goods or services. A person is considered to have operations in the catastrophe area if the person maintains an automobile or physical location in the catastrophe area, regardless of whether that location is owned, leased, rented, or occupied by the person.

(7) Premises--A physical location where a person resides, or owns, leases, rents, or occupies real property, or has operations.

(8) Premium surcharge percentage--The percentage amount determined by the commissioner under §5.4173 of this division (relating to the Determination of the Surcharge).

§5.4173. Determination of the Surcharge.

(a) The Association shall review information provided by the Texas Public Finance Authority concerning the amount of the class 2 public security obligations and

estimated amount of the class 2 public security administrative expenses, including any required contractual coverage amount, to determine whether the Association has sufficient available funds to pay the public security obligations and public security administrative expenses, if any, including any contractual coverage amount, or whether a premium surcharge under the Insurance Code §2210.613 is required. The Association may consider all of the Association's outstanding obligations and sources of funds to pay those obligations.

(b) If the Association determines that it is necessary to collect revenue specified in the Insurance Code §2210.613, the Association shall submit a written request to the commissioner to approve a premium surcharge on policyholders with premises, operations, or insured property in the catastrophe area as authorized under the Insurance Code §2210.613. The Association's request must specify:

(1) the total amount of the class 2 public security obligations and estimated amount of the class 2 public security administrative expenses, including any required contractual coverage amount, provided in the TPFA notice;

(2) the amount to be collected from insurers through a member assessment, which may not exceed 30 percent of the amount specified in the TPFA notice;

(3) the amount to be collected from catastrophe area policyholders through premium surcharges, which may not exceed 70 percent of the amount specified in the TPFA notice; and

(4) the date upon which the premium surcharge is to commence and the date the premium surcharge for the noticed amount is to end.

(c) On approval by the commissioner each insurer shall assess a premium surcharge in a percentage amount set by the commissioner to the insurer's policyholders. The premium surcharge percentage shall be applied to the premium attributable to premises, operations, and insured property located in the catastrophe area on policies that become effective, or on multi-year policies that become effective or have an anniversary date, during the premium surcharge period when the premium surcharge percentage will be in effect, as specified in §§5.4181 - 5.4188 of this division (relating to Premiums to be Surcharged, Allocation Method for Specified Lines of Insurance, Allocation Method for Other Lines of Insurance, Application of the Surcharges, Premium Surcharges are Mandatory, Remittance of Premium Surcharges, Offsets, and Surcharges not Subject to Commissions or Premium Taxes, respectively).

(d) This section is part of the Texas Windstorm Insurance Association's plan of operation and shall control over any conflicting provision in §5.4001 of this subchapter (relating to Plan of Operation).

§5.4181. Premiums to be Surcharged.

(a) The premium surcharge percentage shall be applied to:

(1) amounts reported as premium for the purposes of reporting under the Annual Statement, Exhibit of Premiums and Losses (Statutory Page 14), Texas; and

(2) if not reported as described in paragraph (1) of this subsection, those additional amounts collected that are subject to premium taxation by the comptroller, including policy fees not reported as premium; surplus lines premium tax; and independently procured premium tax.

(b) Premium surcharges do not apply to fees that are neither reported as premium in the Annual Statement, Exhibit of Premiums and Losses (Statutory Page 14), Texas, nor subject to premium taxation by the comptroller.

§5.4182. Allocation Method for Specified Lines of Insurance.

(a) The methods addressed in this section shall apply to all:

(1) policies written and reported under the following annual statement lines of business: fire; allied lines; multi-peril crop; farmowners; homeowners; commercial multi-peril (property); commercial multi-peril policies written on an indivisible premium basis, regardless whether reported as commercial multi-peril (property) or commercial multi-peril (liability); earthquake; private passenger auto no fault (personal injury protection (PIP)), other private passenger auto liability, and private passenger auto physical damage; and commercial auto no fault (personal injury protection (PIP)), other commercial auto liability, and commercial auto physical damage for policies where the premium is determined based on the geographic location of the exposures, or where the automobiles are principally garaged; boiler and machinery; burglary and theft;

(2) personal and residential policies, including boat owners, personal liability, personal umbrella, and personal inland marine policies; and

(3) personal and commercial risks assigned by the Texas Automobile Insurance Plan Association (TAIPA) pursuant to the Insurance Code Chapter 2151.

(b) If the policy is rated based on the geographic location of the insured's premises, operations, or insured property, the premium surcharge shall be determined by applying the premium surcharge percentage to the policy premium determined in §5.4181 of this division (relating to Premiums to be Surcharged), attributable to premises, operations, or insured property located in the catastrophe area.

(c) In cases where the policy is not rated based on the geographic location of the insured's premises, operations, or insured property, the insurer shall allocate premium to the catastrophe area based on the proportion the exposure in the catastrophe area bears to the total exposure on the policy. The premium surcharge percentage shall apply to that portion of the policy premium allocated to the catastrophe area.

§5.4183. Allocation Method for Other Lines of Insurance. For all other applicable lines of insurance not specified in §5.4182 of this division (relating to Allocation Method for Specified Lines of Insurance) the surcharge shall be determined as follows:

(1) For lines of insurance where, as part of its normal underwriting, rating, or data collection processes, the insurer has sufficient information to determine the

premium or exposure for each location, or can otherwise reasonably allocate premium to the catastrophe area, the insurer shall use the direct allocation methods set forth in §5.4182 of this division and determine the premium surcharge amount by applying the premium surcharge percentage to the premium attributable to the catastrophe area.

(2) For other lines and types of insurance not included in paragraph (1) of this section, and where the insurer, including an affiliate, provides insurance to the named insured covering real property and/or tangible personal property under a commercial property policy or a commercial multi-peril policy, regardless whether such coverage is provided on a monoline or multi-peril basis, the premium surcharge shall be determine as follows:

(A) The insurer shall determine the catastrophe area allocation percentage as the proportion of premium attributable to the catastrophe area for property insured under the commercial property or commercial multi-peril policy.

(B) The premium surcharge shall be determined by multiplying the total Texas premium by the catastrophe area allocation percentage and the premium surcharge percentage.

(3) For other lines, and types of insurance not included in subsection (a) of this section, and where neither the insurer nor an affiliate of the insurer provides insurance to the named insured covering real property and/or tangible personal property under a commercial property policy or a commercial multi-peril policy, the premium surcharge shall be determined as follows:

(A) Prior to the effective date of each new policy, and at the renewal of each renewal policy, the insurer shall determine from the insured the catastrophe area allocation percentage. The catastrophe area allocation percentage is determined as the proportion of premium attributable to the catastrophe area for property insured under the commercial property or commercial multi-peril (property) policy or the percentage of self-insured premium attributable to property located in the catastrophe area in the case where the insured is self-insured.

(B) The premium surcharge shall be determined by multiplying the total Texas premium by the catastrophe area allocation percentage and the premium surcharge percentage.

(C) Information required to be collected by insurers under subparagraph (A) of this paragraph shall be collected regardless whether or not a premium surcharge is in effect on the effective date, in the case of new policies, or the renewal date, in the case of renewal policies.

(D) Insurers are not required to verify or otherwise determine the reasonableness of information provided to them under subparagraph (A) of this paragraph.

§5.4184. Application of the Surcharges.

(a) When assessed under the Insurance Code §2210.613, the premium surcharges shall apply to all policies with premises, operations, or insured property in

the catastrophe area that are issued or renewed with effective dates in the assessment period specified in the commissioner's order, with two exceptions:

(1) insurers shall not surcharge policies, and are not responsible for collecting premium surcharges on policies, that did not go into effect or were cancelled as of the inception date of the policy; and

(2) for multi-year policies, the premium surcharge in effect on the effective date of the policy, or the anniversary date of the policy, shall be applied to the 12-month premium for the applicable policy period.

(b) Premium surcharges are non-refundable under the Insurance Code §2210.613.

(1) If the policy is cancelled, a pro-rata portion of the surcharge is not returned to the policyholder; however,

(2) an additional surcharge shall not apply to a policy that was cancelled subsequent to the effective date of the policy, and is later reinstated. For purposes of this section a policy is reinstated if it covers the same period as the original policy without a lapse in coverage, except as provided in the Insurance Code §551.106.

(c) A mid-term policy change consists of all transactions on a policy occurring within a seven day period that result in a change in the premium.

(d) If a mid-term policy change increases the premium on the policy, insureds must pay an additional surcharge for the increased premium attributable to premises,

operations, or insured property in the catastrophe area which shall be determined as follows:

(1) For policies where the premium surcharge is determined under §5.4182 or §5.4183(1) of this division (relating to Allocation Method for Specified Lines of Insurance and Allocation Method for Other Lines of Insurance), the additional premium surcharge is determined by applying the applicable premium surcharge percentage to that portion of the additional premium attributable to premises, operations or insured property located in the catastrophe area.

(2) For policies where the premium surcharge is determined under §5.4183(1) and (2) of this division, the additional premium surcharge is determined by applying the premium surcharge percentage and the catastrophe area allocation percentage to the additional premium.

(e) If a mid-term policy change decreases the premium, there shall be no corresponding decrease in the surcharge or refund of the surcharge.

(f) Surcharges or refunds shall apply to all premium changes due to exposure or premium audits, retrospective rating adjustments, or other similar adjustments that occur after policy expiration. Upon policy inception, the premium surcharge shall be collected on the deposit premium paid. If after exposure or premium audit, retrospective rating adjustment, or similar adjustment after policy expiration, an additional premium is required, an additional surcharge shall be paid. If after exposure or premium audit, retrospective rating adjustment, or other similar adjustment after

policy expiration, the deposit premium exceeds the actual premium, the excess surcharge shall be refunded to the insured, and the insurer may credit any refund paid to the Association through the offset process described in §5.4187 of this division (relating to Offsets). Additional surcharges and refunds shall be determined as follows:

(1) For policies where the premium surcharge is determined under §5.4182 or §5.4183(1) of this division, the additional premium surcharge (or refund) is determined by applying the premium surcharge percentage in effect on the inception date of the policy, or the anniversary date of the policy in the case of multi-year policies, to the additional premium (or return premium) attributable to the catastrophe area.

(2) For policies where the premium surcharge is determined under §5.4183(1) and (2) of this division, the additional premium surcharge (or refund) is determined by applying the premium surcharge percentage and the catastrophe area allocation percentage to the additional premium (or return premium).

(g) Notwithstanding whether a surcharge was in effect on the inception date of the policy, or the anniversary date in the case of multi-year policies, no additional premium surcharges or refunds shall apply to premium changes resulting from exposure or premium audits, retrospective rating adjustments, or other similar adjustments that occur when there is no premium surcharge in effect.

§5.4185. Premium Surcharges are Mandatory.

(a) Insurers may not pay the surcharges in lieu of surcharging their policyholders; however, an insurer may remit a surcharge prior to collecting the surcharge from its policyholder.

(b) Insurers shall apply any money received from the insured to the premium surcharge prior to applying the funds to premium or any other obligation or debt owed to the insurer.

(1) Premium surcharges may not be allocated pro-rata or otherwise mixed with premium over installment plan payments. All money received under an installment plan shall be applied first to the premium surcharge prior to applying the money to premium or any other obligation or debt owed to the insurer.

(2) Premium surcharges may not be refunded to a premium finance company.

(c) Pursuant to the Insurance Code §2210.613(d), the failure of a policyholder to pay the premium surcharge constitutes failure to pay premium for the purposes of policy cancellation.

§5.4186. Remittance of Premium Surcharges.

(a) Insurers shall remit to the Association the aggregate amount of surcharges paid by its policyholders; however, an affiliated surplus lines insurer may allow a surplus lines agent to remit premium surcharges to the Association on its behalf in

accordance with any procedures established by the Association relating to premium surcharge remissions from surplus lines agents.

(b) Insurers, or surplus lines agents allowed by affiliated surplus lines insurers to remit surcharges pursuant to subsection (a) of this section, shall remit all surcharges paid by its insureds not later than the last day of the month following the month in which the surcharge was received.

(c) Insurers and agents may not allow, or require, policyholders to make separate payments for the surcharge amounts which are payable to the Association.

(d) Subsection (b) of this section applies to all insurers regardless of whether the insured paid the premium surcharge through an agent of the insurer or the insured paid the premium surcharge directly to the insurer.

(e) An affiliated surplus lines insurer who allows an agent to remit premium surcharges to the Association pursuant to subsection (a) of this section may be held liable by the department for the failure of its agent to remit the premium surcharges or timely remit the premium surcharges, pursuant to subsection (b) of this section.

§5.4187. Offsets.

(a) An insurer may credit a premium surcharge amount on its next remission to the Association if the insurer has already remitted the amount to the Association for:

(1) the portion of the surcharge the insurer was not able to collect from the insured prior to the collection of any funds for premium or any other obligation or debt owed to the insurer; or

(2) the portion of a surcharge paid to the Association in excess of a deposit premium as described in §5.4184 of this division (relating to Application of the Surcharges).

(b) An agent may not offset payment of a premium surcharge to the insurer for any reason. However, a surplus lines agent allowed by an affiliated surplus lines insurer to remit surcharges to the Association on its behalf under §5.4186(a) of this division (relating to Remittance of Premium Surcharges), may offset as provided in this section.

§5.4188. Surcharges not Subject to Commissions or Premium Taxes.

(a) As provided by the Insurance Code §2210.613(d), premium surcharges are not subject to either premium taxes or agents' commissions.

(b) Insurers may not increase the premium surcharges for premium taxes or commissions, and agents, including a surplus lines agent, may not collect or charge commissions for the premium surcharges.

§5.4189. Notification Requirements.

(a) Insurers shall provide written notice to policyholders receiving a premium surcharge that their policy contains a surcharge. The notice shall read:

"Texas Insurance Code Sections 2210.073 and 2210.613 require a premium surcharge be added to certain property and casualty insurance policies providing coverage in the catastrophe area to pay the debt service on public securities issued to pay Texas Windstorm Insurance Association claims resulting from a catastrophe event.

A premium surcharge [in the amount of $_____] has been added to your premium. This premium surcharge is non-refundable under Texas Insurance Code Section 2210.613. Should your policy be canceled by you or the insurer prior to its expiration date, the premium surcharge will not be refunded to you. Failure to pay the surcharge is grounds for cancellation of your policy."

(b) Insurers shall provide written notice to policyholders of the dollar amount of the premium surcharge.

(c) Notices required under subsections (a) and (b) of this section shall:

(1) be provided at the time the policy is issued, in the case of new business;

(2) be provided with the renewal notice, in the case of renewal business;

(3) be provided within 20 days of the end of the transaction period as specified in §5.4184(c) of this division (relating to Application of the Surcharges) for any mid-term change in the premium surcharge; and

(4) use at least 12 point font and either be contained on a separate page or shown in a conspicuous location on the declarations page.

§5.4190. Annual Premium Surcharge Report.

(a) This section does not apply to an insurer that, during the calendar year, exclusively wrote any or all of the following lines of insurance: federal flood insurance; medical malpractice insurance; accident and health insurance; workers' compensation insurance; or surety**.**

(b) No later than 90 days following the end of a calendar year in which a premium surcharge was in effect, each insurer shall provide the Association with an annual premium surcharge report for the calendar year. However, an annual premium surcharge report for a given year is not required if premium surcharges were in effect for less than 45 days within the calendar year.

(c) Annual premium surcharge reports shall provide information for each insurance company writing property or casualty insurance in the State of Texas, including affiliated surplus lines insurers, and affiliated insurers not authorized to engage in the business of insurance that issued independently procured insurance policies covering premises, operations, or insured property in the State of Texas.

(d) Annual premium surcharge reports shall provide information for all applicable annual statement lines of business for which the insurer reported premium for the applicable calendar year.

(e) Annual premium surcharge reports shall provide the following information:

(1) the name and contact information of the individual responsible for submitting the report;

(2) the five-digit NAIC number of the insurance company;

(3) the name of the insurance company;

(4) for policies with effective dates, or multi-year policies with anniversary dates, within the calendar year, separately for each surcharge period in effect during the calendar year, and within each surcharge period in effect during the calendar year for all applicable lines of business:

(A) For all policies subject to a premium surcharge:

(i) the total written premium attributable or allocated to premises, operations, or insured property in the catastrophe area; and

(ii) the total written premium attributable or allocated to premises, operations, or insured property outside the catastrophe area; and

(B) the total written premium for policies not subject to a premium surcharge because the insured had no premises, operations, or insured property in the catastrophe area;

(5) for policies effective in portions of the calendar year when no surcharge period was in effect, or in the case of multi-year policies with an anniversary date in portions of the calendar year when no surcharge was in effect, the total written premium;

(6) the total amount of premium surcharges collected during the applicable calendar year; and

(7) the total amount of premium surcharges remitted to the Association during the applicable calendar year.

(f) The Association shall:

(1) review the reports submitted under this section as necessary to determine:

(A) the consistency of premium surcharges actually remitted to the Association with premium surcharges shown in the reports as collected and the premium surcharges shown in the reports as remitted to the Association; and

(B) the consistency of premiums shown in the reports as attributable to the catastrophe area with premium surcharges shown in the reports as collected by the insurer, given the requirements regarding the determination of premium surcharges in this division;

(2) inform the department of any insurer the Association believes may not be in compliance with the rules established under this division; and

(3) before July 1 on each year reports are required to be submitted to the Association, provide an aggregate summary of the reports to the department.

§5.4191. Premium Surcharge Reconciliation Report.

(a) This section does not apply to an insurer that, during an applicable calendar year, exclusively wrote any or all of the following lines of insurance: federal flood insurance; medical malpractice insurance; accident and health insurance; workers' compensation insurance, or surety.

(b) Upon the written request of the department, an insurer shall provide the department with a premium surcharge reconciliation report for the year specified by the department in its request.

(c) Reconciliation reports shall be provided to the department within 10 working days after the date the request is received by the insurer.

(d) Reconciliation reports shall consist of the following information concerning premiums written and surcharges collected, separately for each applicable surcharge period, including periods in which no premium surcharges were in effect, within the specified year:

(1) premium written at policy issuance for policies effective within the year, including anniversary dates within the year on multi-year policies, separately for:

(A) premium subject to a premium surcharge, including premium allocated to the catastrophe area on policies having premises, operations, or insured property both in and outside of the catastrophe area; and

(B) premium not subject to a premium surcharge, including premium not allocated to the catastrophe area on policies having premises, operations, or insured property both in and outside of the catastrophe area; and

(2) premium written due to mid-term coverage changes occurring within the specified time period separately for:

(A) premium increases subject to a premium surcharge, including premium allocated to the catastrophe area on policies having premises, operations, or insured property both in and outside of the catastrophe area; and

(B) premium not subject to a premium surcharge, including premium increases not allocated to the catastrophe area on policies having premises, operations, or insured property both in and outside of the catastrophe area and premium refunds, whether related to coverage within or without the catastrophe area; and

(3) total premium due to post-term premium changes occurring within the specified time period, including adjustments due to premium or exposure audits, retrospective rating adjustments, or other similar adjustments that occur after policy expiration, separately for:

(A) premium subject to a premium surcharge, including premium allocated to the catastrophe area on policies having premises, operations, or insured property both in and outside of the catastrophe area; and

(B) premium not subject to a premium surcharge, including premium not allocated to the catastrophe area on policies having premises, operations, or insured property both in and outside of the catastrophe area; and

(4) separately for paragraphs (1)(A), (2)(A), and (3)(A) of this subsection, the amounts of premium surcharges collected; and

(5) the total amount of written premium for policies written in the State of Texas as reported in the Annual Statement, Exhibit of Premiums and Losses (Statutory Page 14), Texas.

(e) Nothing in this section limits the department's authority to obtain information from insurers under the Insurance Code.

(f) A report provided to the department under this section may be provided to the Association.

§5.4192. Data Collection.

(a) The department may request from each insurer the information necessary to enable the department to determine the premium surcharge percentage applicable to insureds with premises, operations, or insured property located in the catastrophe area.

(b) For lines of insurance subject to §5.4182 of this division (relating to Allocation Method for Specified Lines of Insurance) for policies in force on or after October 1, 2011, and for lines of insurance subject to §5.4183 of this division (relating to Allocation Method for Other Lines of Insurance) for policies effective on or after October 1, 2011, each insurer shall maintain sufficient records to report the following information to the department:

(1) for policies where the premium surcharge was, or would be determined under §5.4182 or §5.4183(1) of this division, the total written premium attributable to the catastrophe area for policies with premises, operations, or insured property located in the catastrophe area; and

(2) for policies where the premium surcharge was, or would be determined under §5.4183(1) or (2) of this division, the total written premium allocated to the catastrophe area.

(c) When possible, and practical, the department will obtain information from the Texas Surplus Lines Stamping Office prior to requesting information from affiliated surplus lines insurers.

(d) Nothing in subsection (c) of this section should be read to mean that subsections (a) and (b) of this section do not apply to affiliated surplus lines insurers.

(e) Nothing in this section limits the department’s authority to obtain information from insurers under the Insurance Code.

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

Issued at Austin, Texas, on January 26, 2011.

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

IT IS THEREFORE THE ORDER of the Commissioner of Insurance that new §§5.4161 - 5.4167, 5.4171 - 5.4173, and 5.4181 - 5.4192 to implement legislative changes to the Insurance Code Chapter 2210 under House Bill (HB) 4409, 81st Legislature, 2009 Regular Session, and amend the plan of operation of the Texas Windstorm Insurance Association as specified herein, are adopted to be effective June 1, 2011.

AND IT IS SO ORDERED.

MIKE GEESLIN
COMMISSIONER OF INSURANCE

ATTEST:

Gene C. Jarmon
General Counsel and Chief Clerk

COMMISSIONER'S ORDER NO. 11-0087

JAN 27 2011