

**SUBCHAPTER D. RISK-BASED CAPITAL AND SURPLUS  
AND OTHER REQUIREMENTS  
28 TAC §§7.402, 7.403, and 7.404**

**1. INTRODUCTION.** The Texas Department of Insurance (Department) proposes amendments to §7.402, concerning risk-based capital and surplus requirements for insurers and health maintenance organizations (HMOs); new §7.403, concerning a transition period for certain county mutual insurance companies to comply with new minimum surplus requirements; and new §7.404, concerning a transition period for stipulated premium insurance companies to comply with new minimum capital and surplus requirements.

The proposed amendments to §7.402 are necessary to implement and update the risk-based capital and surplus requirements for year-end 2009 and for year-end 2010 for property and casualty insurers, life insurance companies, fraternal benefit societies, stipulated premium insurance companies, HMOs, and insurers filing the National Association of Insurance Commissioners (NAIC) Health blank by (i) adopting the 2009 NAIC risk-based capital formulas and instructions to be used for year-end 2009; (ii) adopting the 2010 NAIC risk-based capital formulas and instructions to be used for year-end 2010; (iii) adding stipulated premium insurance companies only doing business in Texas and certain county mutual insurance companies to the list of defined “carriers” which must comply with the section; and (iv) specifying the filing requirements for the 2009 and 2010 risk-based capital reports and supplemental reports and forms. Insurers and HMOs subject to §7.402 are referred to collectively in this proposal as “carriers”. Proposed new §7.403 is necessary to implement the Insurance Code §912.056(f), as added by House Bill (HB) 2449, 81st Legislature, Regular

Session, which provides a transition period for certain county mutual insurance companies to comply with the new minimum surplus requirements. Proposed new §7.404 is necessary to implement the Insurance Code §884.054(a) and (c), as amended by House Bill (HB) 2570, 81st Legislature, Regular Session, which provides a transition period for stipulated premium insurance companies to comply with the new minimum capital and surplus requirements.

The proposed amendments to §7.402 are necessary to regulate risk-based capital and surplus requirements for carriers. The risk-based capital requirement is a method of ensuring that a carrier has an appropriate level of policyholder surplus after taking into account the underwriting, financial, and investment risks of a carrier. The updated NAIC risk-based capital formulas provide the Department with a widely used regulatory tool to identify the minimum amount of capital and/or surplus appropriate for a carrier to support its overall business operations in consideration of its size and risk exposure. The proposed amendments are necessary to adopt by reference the 2009 NAIC risk-based capital formulas to be used for year-end 2009. These formulas include the 2009 NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies, the 2009 NAIC Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies, the 2009 NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies, and the 2009 NAIC Health Risk-Based Capital Report including Overview and Instructions for Companies. Specifically, the proposed amendments to §7.402(d), in paragraphs 1 – 4, replace the date “2008” with “2009.” The proposed amendments also are necessary to adopt by reference the 2010 NAIC risk-based capital formulas to be used for year-end 2010.

These formulas include the 2010 NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies, the 2010 NAIC Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies, the 2010 NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies, and the 2010 NAIC Health Risk-Based Capital Report including Overview and Instructions for Companies. Specifically, the proposed amendments to §7.402(d) add new paragraphs 5 – 8.

The proposed amendments to §7.402 are also necessary to add stipulated premium insurance companies only doing business in Texas and certain county mutual insurance companies to the list of defined “carriers” which must comply with the section. Under the amendments to §7.402(b)(1) and (e)(3), as proposed, stipulated premium insurance companies only doing business in Texas will be subject to the section’s risk-based capital requirements for life insurance companies and will be required to file an electronic version of the 2010 risk-based capital report and any supplemental forms and reports with the NAIC in accordance with and by the due date specified in the RBC instructions. Specifically, the proposed amendments to §7.402(b)(1) (i) add the word “insurance” after the phrase “stipulated premium” and before the word “companies;” (ii) delete the phrase “doing business in other states;” and (iii) delete the sentence specifying “This section does not apply to stipulated premium companies only doing business in Texas.” Proposed new §7.402(e)(3) requires stipulated premium insurance companies only doing business in Texas to file the 2010 risk-based capital report and any supplemental forms and reports. However, proposed new §7.402(e)(3) does not require these type of carriers to file the 2009 risk-based capital report. Under the

amendments to §7.402(b)(2) and (e)(4), as proposed, county mutual insurance companies that do not meet the express criteria contained in the Insurance Code §912.056(f) will be subject to the section's risk-based capital requirements for property and casualty companies and will be required to file an electronic version of the 2010 risk-based capital report and any supplemental forms and reports with the NAIC in accordance with and by the due date specified in the RBC instructions. Specifically, the proposed amendments to §7.402(b)(2) clarify the scope of the rule's application to property and casualty companies by adding the phrase "including county mutual insurance companies that do not meet the express criteria contained in the Insurance Code §912.056(f), but..." and at the end of the sentence adds the phrase "subject to the Insurance Code §822.205." The proposed amendments to §7.402(b)(2) also delete the phrase "that write business only in this state and are not required to have capital stock". Proposed new §7.402(e)(4) requires county mutual insurance companies that do not meet the express criteria contained in the Insurance Code §912.056(f) to file the 2010 risk-based capital report and any supplemental forms or reports. However, proposed new §7.402(e)(4) explicitly provides that these type of carriers are not required to file the 2009 risk-based capital report.

Also, the proposed amendments to §7.402(e)(1) and (2) clarify the filings requirements for all other types of carriers subject to the section. Specifically, the proposed amendments to §7.402(e)(1) clarify that all companies subject to this section, except fraternal benefit societies, stipulated premium companies doing business only in Texas, and county mutual insurance companies that do not meet the express criteria contained in the Insurance Code §912.056(f), are required to file electronic versions of

the 2009 and the 2010 RBC reports and any supplemental RBC forms and reports with the NAIC in accordance with and by the due dates specified in the RBC instructions. The proposed amendments to §7.402(e)(2) clarify that fraternal benefit societies are required to (i) prepare, maintain, and file a paper copy of the 2009 RBC report and any supplemental RBC forms and reports with the Department whenever requested by the Department; and (ii) to prepare and maintain a paper copy of the 2010 RBC report and any supplemental RBC forms and reports by March 1, 2011, and make the reports and forms available for review whenever requested by the Department. Additionally, the proposed amendments to §7.402 include new subsection (g)(7) which imposes a new substantive requirement for year-end 2009, and each calendar year thereafter, that subjects health insurers to a trend test if their total adjusted capital to authorized control level risk-based capital is between 200 percent and 300 percent. In that case, and if the result of the trend test as determined by the formula is "YES", the health insurer will be subject to the company action level requirements and will need to file additional reporting with the Department as a result of the trend test. This new requirement is necessary because it will allow for early identification of insurers that are likely to reach a company action level in the following year. This is based on research by the NAIC's Health Risk-Based Capital (E) Working Group that showed a strong correlation between the trend test's criteria and the triggering of at least the company action level in the following year. By triggering a company action level sooner, insurers can plan better for their capital needs and the Department will receive information related to its solvency regulatory duties which is necessary to protect the interests of the public. Specifically, the proposed amendments to §7.402(g) add new paragraph (7) containing the new

testing requirement that subjects health insurers to a trend test if their total adjusted capital to authorized control level risk-based capital is between 200 percent and 300 percent.

Copies of the documents proposed in §7.402 for adoption by reference are available for inspection in the Financial Analysis Division of the Texas Department of Insurance, William P. Hobby Jr. State Office Building, Tower Number III, Third Floor, Mail Code 303-1A, 333 Guadalupe, Austin, Texas.

The Department also proposes new §7.403 to provide a transition period for certain county mutual insurance companies to comply with the new surplus minimums required by the Insurance Code §912.056(f), as amended by HB 2449, 81st Legislature, Regular Session. In part, HB 2449 amended the Insurance Code §912.056 by adopting new §912.056(f), which requires that certain specified county mutual insurance companies maintain a higher minimum unencumbered surplus. HB 2449 also enacted new Insurance Code §912.056(g), which requires the Commissioner to adopt a transition period for these specified county mutual insurance companies to meet the requirements of §912.056(f) and for the pro rata elimination of any deficiencies in the amounts required under §912.056(f) over a period of not less than five years. Specifically, new §7.403(a) states that the new section applies to county mutual insurance companies that cede 85 percent or more of their direct and assumed risks to one or more nonaffiliated reinsurers, and further provides that such companies are otherwise required to comply with the Insurance Code §912.056(f) relating to the new surplus minimums required by the Insurance Code §912.056(f), as amended by HB 2449. New §7.403(b) provides that a county mutual insurance company shall comply

with §7.402 unless the company meets the express criteria contained in the Insurance Code §912.056(f). In accordance with the prescriptive requirements of the Insurance Code §912.056(g), proposed new §7.403 requires the pro rata elimination of any deficiencies in the amounts required under §912.056(f) over a period of not less than five years. Specifically, new §7.403(c) sets out a five-year graduated transition period for the county mutual insurance companies subject to the section.

The Department further proposes new §7.404 to provide a transition period for stipulated premium insurance companies to comply with the new minimum capital stock and surplus rules required by the Insurance Code §884.054 as amended by HB 2570, 81st Legislature, Regular Session. In part, HB 2570 amended the Insurance Code §884.054, which specifies the minimum capital and surplus requirements for stipulated premium insurance companies. SECTION 12 of HB 2570 requires that a stipulated premium insurance company shall increase its capital stock and surplus as required under the Insurance Code Chapter 884, as amended, not later than a date prescribed by rule by the Commissioner in connection with a schedule of intermediate increases adopted by the Commissioner to provide for a 10-year phase-in of the requirements. In accordance with the prescriptive requirements of SECTION 12 of HB 2570, proposed new §7.404 requires a stipulated premium insurance company to increase its capital stock and surplus as required under the Insurance Code Chapter 884, as amended, in connection with a reasonable schedule of intermediate increases adopted by the Commissioner to provide for a 10-year phase-in of the requirements. New §7.404(a) provides that a stipulated premium insurance company shall comply with §7.402. New §7.404(b) sets out a 10-year graduated transition period for stipulated premium

insurance companies to comply with the new minimum capital stock and surplus rules required by the Insurance Code §884.054 as amended by HB 2570.

Additionally, the proposed amendments amend the title of Subchapter D by adding the phrase “and Other Requirements” after the phrase “Risk-based Capital and Surplus.”

**2. FISCAL NOTE.** Mr. Danny Saenz, Senior Associate Commissioner, Financial Program, has determined that, for each year of the first five years the proposed new and amended sections will be in effect, there will be no fiscal implications for state or local government as a result of enforcing or administering the sections. The new and amended sections will have no effect on local employment or local economy.

**3. PUBLIC BENEFIT/COST NOTE.** Mr. Saenz also has determined that for each year of the first five years the proposed new and amended sections are in effect, the anticipated public benefit will be that the Department will be able to more effectively utilize existing resources in the review of the operations and financial condition of carriers, to more efficiently monitor solvency of the carriers subject to the proposal, and to implement the most current risk-based capital requirements. The new and amended sections will enable the Department to administer appropriate and proactive regulatory actions to protect the interests of the public against carriers whose financial condition may potentially be hazardous. The risk-based capital requirements, along with the new minimum surplus requirements for certain county mutual insurance companies and new minimum capital and surplus requirements for stipulated premium insurance companies,

are methods of ensuring carrier solvency for the benefit of policyholders and others conducting business with insurers. The risk-based capital requirement ensures that a carrier has an appropriate level of policyholders' surplus after taking into account the underwriting, financial, and investment risks of a carrier. The NAIC risk-based capital formulas provide the Department with a widely used regulatory tool to identify the minimum amount of capital and surplus appropriate for a carrier to support its overall business operations considering its size and risk exposure. The new minimum capital and/or surplus requirements similarly require carriers to maintain minimum amounts of net assets to safely operate and pay policyholder claims.

With the exception of new subsection (g)(7) related to health insurers, the proposed amendments to §7.402 contain the same substantive risk-based capital and surplus requirements of existing §7.402 for year-end 2008 but the compliance with the requirements will be based on the use of the 2009 and the 2010 NAIC risk-based capital formulas. Therefore, carriers previously subject to the rule will incur the same types of costs for year-end 2009 and for year-end 2010 to comply with these requirements that were incurred for year-end 2008. The Department does not anticipate that any new, incremental costs will be incurred by carriers that were previously subject to §7.402 as a result of the proposed amendments. Furthermore there is no cost to individuals.

However, because the scope of proposed §7.402(b) is amended to also include stipulated premium insurance companies doing business only in Texas and certain county mutual insurance companies, all of the costs for these specific carriers to now comply with the rule are set out below.

***Section 7.402.***

The Department has determined that the requirements of §7.402, which are proposed to be expanded to apply to stipulated premium insurance companies only doing business in Texas and to certain county mutual insurance companies, contain two separate sets of requirements that must be analyzed in order to determine costs to carriers required to comply with the proposal. The two sets of requirements that may result in costs to carriers relate to (1) §7.402(b), (d), and (e) concerning risk based capital reports; and (2) §7.402(g)(1), (2), (5), (6), and proposed new (7) concerning additional reporting requirements.

Section 7.402(b), (d), and (e) concern, respectively, the scope of §7.402, the adoption of the risk-based capital formulas by reference, and the filing requirements for the subject carriers. Section 7.402(b), (d), and (e) require, regardless of size, certain property and casualty insurers, certain life insurance companies, fraternal benefit societies, stipulated premium insurance companies, HMOs, and insurers filing the National Association of Insurance Commissioners (NAIC) Health blank (the term “carriers” refers to all of these entities) to complete a risk-based capital report and reflect the results of that report in their financial statements filed with the Department. Section 7.402 does not apply to certain types of specified insurers and certain specified insurers with limited operations. Specifically, §7.402(b)(1) provides that §7.402 does not apply to any insurance company that writes or assumes a life insurance or annuity contract or assumes liability on or indemnifies one person for any risk under an accident and health insurance policy, or any combination of these policies, in an amount that is \$10,000 or less. Further, the scope indicated in §7.402(b)(1) does not include certain carriers regulated by the Department, such as a statewide mutual assessment

association, a local mutual aid association, a mutual burial association and an exempt association.

Certain carriers that have business subject to §7.402(d)(1) are also required to perform risk-based capital calculations pursuant to the 2008 life risk-based capital C-3 Phase II instructions. This requirement relates to certain unique types of annuity business that is generally written only by large carriers. The C-3 Phase II calculations are considered a more appropriate measure of the capital requirement for the interest rate risks and market risks associated with this type of annuity business, by requiring carriers to evaluate how various guarantees react to changes in equity markets and interest rates. The less than 10 large domestic carriers expected to be affected by the 2009 life risk-based capital C-3 Phase II instructions will incur ongoing annual actuarial and computer personnel costs to perform the C-3 Phase II calculations. The Department estimates that these actuarial personnel costs will range from \$25 per hour to approximately \$300 per hour. Computer personnel costs are estimated to range from \$25 per hour to approximately \$150 per hour. The annual costs for each of these few large domestic carriers in Texas are estimated to range from one-half of one percent to one percent of the annual costs of administering each of the carrier's business affected by the C-3 Phase II requirements. The Department anticipates that such annual costs per carrier are believed to be similar for each foreign carrier in Texas with business subject to these requirements. The Department's estimations are based upon discussions with industry representatives familiar with resources and costs needed for these computations. Discussions with industry representatives involved several of the large domestic carriers in Texas estimated to have over half of the domestic carrier

variable annuity business in Texas as measured on the basis of accumulation value for this business. Also, regardless of size, carriers specified in §7.402(b) that fail to maintain capital and surplus in accordance with the specified levels in §7.402(g)(1), (2), (5), (6), and (7) are required to prepare and implement a comprehensive financial plan under §7.402(g)(1), (2), (5), (6), and (7).

Any carrier specified in §7.402(b) is required to comply with the requirements in §7.402(d) and (e) to prepare a risk-based capital report and reflect the results of the report in the carrier's financial statements filed with the Department. These costs will vary from carrier to carrier based on various factors, which include the size and type of the carrier, the character of its investments, the kinds and nature of the risks insured, the type of software used by the carrier to complete its annual statement, and employee compensation expenses. Under §7.402, each carrier subject to §7.402(b), (d), and (e), regardless of size, is required to acquire NAIC risk-based capital software at a cost of approximately \$650 per entity for each carrier. The labor cost to transfer the information from a carrier's records to the applicable report will vary depending on the size of the carrier and the character of its investments; the transfer by larger carriers and carriers with more complex investments will generally take longer. If a carrier uses the annual statement software that conforms to NAIC specifications provided by authorized vendors to prepare its annual report, and if that software is linked to the risk-based capital formula software, the Department estimates that the information can be transferred and the formula completed in four hours or less. If the annual statement software is not linked to the risk-based capital formula, the Department estimates that a carrier will be able to transfer the information from its records to the risk-based formula

in eight to 16 hours. The Department's estimations are based upon discussions with industry representatives who are responsible for maintaining accounting records for carriers. It is anticipated that a carrier, regardless of size, will utilize an employee who is familiar with the accounting records of the carrier and accounting practices in general. The Department estimates that the compensation for this employee will range from approximately \$20 to \$40 an hour. After the completion of the transfer of information, the resulting risk-based capital report will likely be reviewed by an officer of the carrier who is responsible for the preparation of the financial reports of the carrier. The Department estimates that such officers are compensated at a range from approximately \$40 per hour to approximately \$100 per hour, or more. The Department also estimates that large carriers generally will compensate these officers at the higher end of the salary range. Therefore, based on the Department's experience, the cost of review of the risk-based capital report for small carriers will typically be less than the cost for large carriers.

Section 7.402(g)(1), (2), (5), (6), and proposed new (7) concern reporting requirements for certain carriers and certain remedial actions the Commissioner is authorized or required to take based upon a carrier's specific risk-based capital calculations. A few carriers (estimated to be less than one percent of the total carriers doing business in Texas) may need to prepare and file additional reporting with the Department at the company action level, as provided in §7.402(g)(1), (2), (5), (6), and proposed new (7) relating to health insurance carriers. The costs of this reporting will vary by company size and complexity, as well as the amount of risk that each company assumes, but will generally involve an employee who is familiar with the accounting

records of the carrier and is compensated at an estimated rate from \$20 to \$40 per hour. Assistance from actuarial staff may be required, and actuarial personnel costs is estimated to range from \$25 per hour to approximately \$300 per hour. The additional reporting requirements typically will involve the chief financial officer or other similar officer responsible for preparing the financial reports; such officers are generally compensated at hourly rates that may range from \$40 per hour to approximately \$300 per hour. The Department also estimates that large carriers generally will compensate these officers at the higher end of the salary range. Therefore, based on the Department's experience, the costs of preparation and filing of the additional reporting to the Department at the company action level are estimated to be relatively less for small and micro business carriers compared to large business carriers. Company action level reporting and its associated costs are intended to stave off other, higher costs that impacted carriers will likely incur absent their timely action to address the underlying concerns. Company action level reporting enables the Department to administer appropriate and proactive regulatory actions in order to protect the interests of the public against carriers whose financial condition may potentially be hazardous.

The Department does not anticipate any new, incremental costs as a result of the adoption of the 2009 and 2010 risk-based capital formulas to require a level of capital that is significantly different from the capital requirements for 2008. A relatively large percentage of carriers have been required by the Department to comply with the risk-based capital requirements for several years. For stipulated premium insurance companies only doing business in Texas and the county mutual insurance companies ~~insurers~~ now required to comply with the 2010 risk-based capital requirements due to

the proposed expansion of the scope of §7.402, the costs associated with compliance will be that same as that for other carriers as set out herein. However, the function of the risk-based capital formula is to protect policyholders from the effects of insolvency, which may require some carriers to increase their capital and/or surplus, or otherwise reduce the amount of risk that the carriers assume to ensure they have an adequate amount of capital. To the extent any carrier must increase its capital and/or surplus or as a result of the risk-based capital requirements, that cost is the amount of capital and/or surplus or other action required and is a result of the statutory requirements in the Insurance Code Chapter 404 and §§441.001, 441.005, 441.051, 441.052, 822.210, 822.211, 841.205, 841.206, 843.404, and 884.206. Moreover, as certain stipulated premium insurance companies and county mutual insurance companies were not previously subject to risk-based capital requirements pursuant to prior Department regulations, the Department anticipates that these specific carriers will be more likely to be required to increase their capital and/or surplus or take other action as a result of the application of the proposed amendments when compared to carriers that were previously subject to risk-based capital requirements. To the extent that additional capital and/or surplus or other action may be required, the exact cost of compliance will vary significantly between carriers based upon a number of factors, which include: (1) the amount of capital and/or surplus currently maintained by the carrier; (2) the amount of capital and/or surplus required based upon the application of the risk-based capital requirements under the proposed new section; (3) the size and complexity of the carrier; and (4) the amount and complexity of the underwriting, financial, and investment risks that are assumed by the carrier.

***Section 7.403.***

The Department also proposes new §7.403 to provide a transition period for certain county mutual insurance companies to comply with the new minimum surplus requirements of the Insurance Code §912.056(f), as amended by HB 2449, 81st Legislature, Regular Session. In part, HB 2449 amended the Insurance Code §912.056 by adopting new §912.056(f), which requires that certain specified county mutual insurance companies maintain a higher minimum unencumbered surplus. HB 2449 also enacted new Insurance Code §912.056(g), which requires the Commissioner to adopt a transition period for these specified county mutual insurance companies to meet the requirements of §912.056(f) and for the pro rata elimination of any deficiencies in the amounts required under §912.056(f) over a period of not less than five years. In accordance with the prescriptive requirements of the Insurance Code §912.056(g), proposed new §7.403 requires the pro rata elimination of any deficiencies in the amounts required under §912.056(f) over a period of not less than five years.

The adoption of new proposed §7.403 is expressly required by the Insurance Code §912.056(g). Accordingly, the Department has determined that the cost of compliance with new proposed §7.403 is attributable to the Insurance Code §912.056(g), and not as a result of the adoption of this proposed section.

***Section 7.404.***

The Department further proposes new §7.404 to provide a transition period for stipulated premium insurance companies to comply with the new capital stock and surplus minimums required by the Insurance Code §884.054, as amended by HB 2570, 81st Legislature, Regular Session. In part, HB 2570 amended the Insurance Code

§884.054, which specifies the minimum capital and surplus requirements for stipulated premium insurance companies. SECTION 12 of HB 2570 requires that a stipulated premium insurance company shall increase its capital stock and surplus as required under the Insurance Code Chapter 884, as amended, not later than a date prescribed by rule by the Commissioner in connection with a schedule of intermediate increases adopted by the Commissioner to provide for a 10-year phase-in of the requirements. In accordance with the prescriptive requirements of SECTION 12 of HB 2570, proposed new §7.404 requires a stipulated premium insurance company to increase its capital stock and surplus as required under the Insurance Code Chapter 884, as amended, in connection with a reasonable schedule of intermediate increases adopted by the commissioner to provide for a 10-year phase-in of the requirements.

The adoption of new proposed §7.404 is expressly required by the Insurance Code §884.054(g) and SECTION 12 of HB 2570. Accordingly, the Department has determined that the cost of compliance with new proposed §7.404 is attributable to the Insurance Code §884.054 and SECTION 12 of HB 2570, respectively, and not as a result of the proposed section.

**4. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY ANALYSIS FOR SMALL AND MICRO BUSINESSES.** The Government Code §2006.002(c) requires that if a proposed rule may have an economic impact on small businesses, state agencies must prepare as part of the rulemaking process an economic impact statement that assesses the potential impact of the proposed rule on small businesses and a regulatory flexibility analysis that considers alternative methods of achieving the

purpose of the rule. The Government Code §2006.001(2) defines “small business” as a legal entity, including a corporation, partnership, or sole proprietorship, that is formed for the purpose of making a profit, is independently owned and operated, and has fewer than 100 employees or less than \$6 million in annual gross receipts. The Government Code §2006.001(1) defines “micro business” similarly to “small business” but specifies that such a business may not have more than 20 employees. The Government Code §2006.002(f) requires a state agency to adopt provisions concerning micro businesses that are uniform with those provisions outlined in the Government Code §2006.002(b) - (d) for small businesses.

As required by the Government Code §2006.002(c), the Department has determined that the proposed amendments to §7.402, with the exception of new subsection (g)(7), contain the same requirements also applicable to the risk-based capital and surplus requirements for year-end 2008 but now using the 2009 and 2010 risk-based capital formulas. Therefore, the same types of costs that were incurred for year-end 2008 to comply with these requirements will also be incurred for year-end 2009 and for year-end 2010. The Department does not anticipate any new, incremental costs as a result of the proposed amendments for carriers that are subject to the existing requirements of §7.402. As previously detailed, however, the scope of the proposed new requirements in §7.402 for 2010 has been expanded to include stipulated premium insurance companies only doing business in Texas and certain county mutual insurance companies and, therefore, the Department provides the following analysis of the economic impact on the stipulated premium insurance companies and certain

county mutual insurance companies which must now comply with §§7.402, 7.403, and 7.404.

**Section 7.402.**

The Department has determined that §7.402 contains two separate sets of requirements which will now apply to all carriers, unless they are expressly exempted, including stipulated premium insurance companies only doing business in Texas and certain county mutual insurance companies which are also small and micro business carriers. The two sets of requirements that may result in costs to carriers relate to (1) §7.402(b), (d), and (e); and (2) §7.402(g)(1), (2), (5), (6), and proposed new (7). As previously stated in the Public Benefit/Cost Note part of this proposal, all of the requirements in the existing §7.402 continue to apply, but the compliance with the requirements will be based on the use of the 2010 risk-based capital formulas and instructions for stipulated premium insurance companies only doing business in Texas and certain county mutual insurance companies. Therefore, the same types of costs that were incurred by small and micro business carriers for year-end 2008 to comply with these requirements would be incurred by stipulated premium insurance companies only doing business in Texas and certain county mutual insurance companies for year-end 2010.

Section 7.402(b), (d), and (e) require carriers specified in §7.402(b), regardless of size, to complete a risk-based capital report and reflect the results of that report in their financial statements filed with the Department. Separate and apart from any requirements of the Government Code §2006.002(c), §7.402(b)(1) excludes certain insurers from compliance with the §7.402 requirements. These insurers are more likely

to be small or micro business carriers because of the insurers' types or methods of operation. Under §7.402(b)(1), the risk-based capital requirements in §7.402 do not apply to any insurance company that writes or assumes a life insurance or annuity contract or assumes liability on or indemnifies one person for any risk under an accident and health insurance policy, or any combination of these policies, in an amount that is \$10,000 or less. Further, under §7.402(b)(1), certain insurers are excluded entirely from compliance with the §7.402 requirements. These include statewide mutual assessment associations, local mutual aid associations, mutual burial associations, and exempt associations. Section 7.402(d) and (e) require carriers specified in §7.402(b), regardless of size, to maintain capital and surplus in accordance with the specified levels. The failure to do so triggers the requirements in §7.402(g) that the carrier prepare and implement a comprehensive financial plan. Certain carriers that have annuity business subject to §7.402(d)(1) are required to perform risk-based capital calculations pursuant to the proposed 2008 life risk-based capital C-3 Phase II instructions. The C-3 Phase II requirement relates to certain unique types of annuity business that are generally written only by large carriers. As required by the Government Code §2006.002(c), the Department has determined that §7.402(d)(1) will not have an adverse economic effect on any small or micro businesses, including the stipulated premium insurance companies doing business only in Texas and county mutual insurance companies added to the list of carriers subject to §7.402. The Department does not anticipate that any small or micro business carriers will have business subject to §7.402(d)(1). Therefore no small or micro business will be required

to perform risk-based capital calculations pursuant to the 2008 life risk-based capital C-3 Phase II instructions.

As required by the Government Code §2006.002(c), the Department has determined that approximately 50 to 100 of the carriers specified in §7.402(b) are small or micro-business carriers that will be required to comply with the requirements in §7.402(d) and (e) to prepare a risk-based capital report and reflect the results of the report in the carrier's financial statements filed with the Department. These small or micro business carriers will incur routine costs associated with completing the risk-based capital report and reflecting the results in their financial statements filed with the Department. Also, as required by the Government Code §2006.002(c), the Department has determined that these routine costs will not have an adverse economic effect on the approximately 50 to 100 small or micro business carriers. These routine costs of compliance will vary between large business carriers and small or micro-business carriers based upon the carrier's type and size and other factors, including the character of the carrier's investments, the kinds and nature of the risks insured, the type of software used by the carrier to complete its annual statement, and employee compensation expenses. The Department's cost analysis and resulting estimated routine costs for carriers in the Public Benefit/Cost Note portion of this proposal are equally applicable to small and micro-businesses. As indicated in the Public Benefit/Cost Note analysis, these routine costs will be less for small or micro business carriers. This is primarily because small or micro business carriers will incur less labor costs in transferring information from their records to the risk-based capital reports due to their smaller and less complex investment portfolios than large business carriers.

Also, small or micro business carriers may compensate officers who review risk-based capital reports at a lower salary than large business carriers.

Under the Government Code §2006.002(c), before adopting a rule that may have an adverse economic effect on small or micro businesses, an agency is required to prepare in addition to an economic impact statement a regulatory flexibility analysis that includes the agency's consideration of alternative methods of achieving the purpose of the proposed rule. Because the Department has determined that the routine costs to comply with this amendment, i.e., completing the risk-based capital report and reflecting the results in the carrier's financial statements filed with the Department, will not have an adverse economic effect on small or micro businesses, the Department is not required to consider alternative methods of achieving the purpose of these requirements in the proposed rule.

§7.402(g)(1), (2), (5), (6), and proposed new (7). As required by the Government Code §2006.002(c), the Department has determined that the costs to comply with §7.402(g)(1), (2), (5), (6), and proposed new (7) may have an adverse economic effect on an estimated one or two small or micro-business carriers (i.e., all carriers subject to §7.402 including stipulated premium insurance companies doing business only in Texas or county mutual insurance companies). Such costs will only be incurred by these relatively few small or micro-business carriers because of the failure of the individual carrier to maintain capital and surplus in accordance with the levels required in §7.402(g)(1), (2), (5), (6), and (7). This failure will trigger the requirement in §7.402(g)(1), (2), (5), (6), and (7) that the carrier prepare and implement a comprehensive financial plan. This plan will be necessary to identify the conditions that

contribute to the carrier's financial condition. The plan must contain proposals to correct areas of substantial regulatory concern and projections of the carrier's financial condition, both with and without the proposed corrections, including plans to restore its capital and surplus to acceptable levels. The total cost of compliance with §7.402(g)(1), (2), (5), (6), and (7) for preparing and implementing comprehensive financial plans will depend on the size and type of the small or micro-business carrier and several other factors. The other factors will vary by company size and complexity, as well as the amount of risk that each company assumes. The Department's cost analysis and resulting estimated costs for carriers who will be required to prepare and implement a comprehensive financial plan in the Public Benefit/Cost Note portion of this proposal are equally applicable to small or micro-businesses. As indicated in the Public Benefit/Cost Note analysis, these costs will be less for small or micro-business carriers, primarily because small or micro business carriers will incur less labor costs in transferring information from their records to the risk-based capital reports due to their smaller and less complex investment portfolios than large business carriers and because small or micro business carriers may compensate officers that review risk-based capital reports at a lower salary than large business carriers. The function of the risk-based capital formulas in §7.402(d) is to protect policyholders, enrollees, and carriers from the effects of carrier insolvency. Therefore, carriers, regardless of size, that are required to submit comprehensive financial plans may also be required to increase their capital. To the extent any carrier must increase its capital as a result of the risk-based capital requirements, that cost is the amount of capital required and is a result of the statutory requirements in the Insurance Code Chapter 404 and §§441.051, 822.210, 822.211,

841.205, 841.206, 843.404, 884.206, 885.401, 982.105, and 982.106. These statutes authorize or require the Commissioner to order carriers that are operating in a potentially hazardous manner to take action to remedy such hazardous condition, which may include the requirement that the carriers increase their capital and surplus and take other remedial action.

In accordance with the Government Code §2006.002(c-1), the Department has determined that even though §7.402(g)(1), (2), (5), (6), and (7) may have an adverse economic effect on small or micro-businesses that are required to comply with these proposed requirements, the Department is not required to prepare a regulatory flexibility analysis as required in §2006.002(c)(2) of the Government Code. Section 2006.002(c)(2) requires a state agency, before adopting a rule that may have an adverse economic effect on small businesses, to prepare a regulatory flexibility analysis that includes the agency's consideration of alternative methods of achieving the purpose of the proposed rule. Section 2006.002(c-1) of the Government Code requires that the regulatory flexibility analysis ". . . consider, if consistent with the health, safety, and environmental and economic welfare of the state, using regulatory methods that will accomplish the objectives of applicable rules while minimizing adverse impacts on small businesses." Therefore, an agency is not required to consider alternatives that, while possibly minimizing adverse impacts on small and micro-businesses, would not be protective of the health, safety, and environmental and economic welfare of the state.

Section 7.402(g)(1), (2), (5), (6), and proposed new (7) are authorized by the following Insurance Code statutes: Chapters 404 and 441 and §§822.210, 841.205, 843.404, 884.206, 885.401, 982.105, and 982.106. The primary purpose of §§822.210,

841.205, 843.404, 884.206 885.401, 982.105, and 982.106 is to require a carrier to maintain capital and surplus in amounts that exceed the minimum amounts required by statute because of (i) the nature and kind of risks the carrier underwrites or reinsures; (ii) the premium volume of risks the carrier underwrites or reinsures; (iii) the composition, quality, duration, or liquidity of the carrier's investments; (iv) fluctuations in the market value of securities the carrier holds; (v) or the adequacy of the carrier's reserves. These statutes further require that a rule adopted by the Commissioner be designed to ensure the financial solvency of a carrier for the protection of policyholders, enrollees, creditors, or the general public from the harmful effects of carrier insolvency. Additionally, the primary purpose of Chapters 404 and 441 is to protect insureds, enrollees or creditors, and the public against an insurer or HMO becoming insolvent, delinquent, or in a condition that renders the continuance of its business hazardous to its insureds, enrollees or creditors, or to the public. Chapter 404 permits the Commissioner to take various actions against an insurer upon a finding or impairment or hazardous condition, including a requirement that the capital and surplus of an insurer be increased. Section 441.001(g) provides that for the reasons stated in §441.001, the substance and procedures relating to insurer delinquencies and insolvencies in Insurance Code Chapter 441 are the public policy of the State of Texas and are necessary to the public welfare. Section 441.001(a) states that insurer delinquencies destroy public confidence in the state's ability to regulate insurers and an insurer delinquency affects other insurers by creating a lack of public confidence in insurance and insurers. Section 441.001(b) states that placing an insurer in receivership often destroys or diminishes, or is likely to destroy or diminish, the value of the insurer's

assets. Further, the purpose of Insurance Code §§441.051, 822.211, and 841.206 is to prohibit the impairment of a carrier's minimum required capital or surplus, and these statutes require that the Commissioner take action to remedy the impairment. Sections 441.051, 822.211, and 841.206 further provide that the failure of a carrier to maintain its required capital or surplus at levels required by the Commissioner by rule is considered a prohibited impairment.

The purpose of §7.402(g)(1), (2), (5), (6), and proposed new (7) is to protect the economic welfare of (i) carriers; (ii) consumers that purchase insurance policies, annuities and other contracts issued by property and casualty insurers, life insurance companies, health insurance companies, fraternal benefit societies, stipulated premium insurance companies, HMOs, and insurers filing the NAIC Health blank; (iii) other persons and entities that would be adversely affected by a carrier insolvency against the risk that a carrier may become insolvent and unable to pay its insureds' claims and other obligations as they become due; and (iv) the public and the state of Texas generally.

The requirements in §7.402(g) that carriers maintain capital and surplus at acceptable levels or prepare a comprehensive financial plan to restore their capital and surplus to acceptable levels are consistent with and necessary to implement the legislative intent of Chapters 404 and 441 and §§822.210, 841.205, 843.464, 884.206, 885.401, 982.105, and 982.106 of the Insurance Code. This intent is to ensure the financial solvency of a carrier, regardless of size, for the protection of the economic interests of all policyholders and not just the economic interests of those policyholders insured by large carriers.

Therefore, the Department has determined, in accordance with §2006.002(c-1) of the Government Code, that because the purpose of §7.402(g)(1), (2), (5), (6), and proposed new (7) and the authorizing statutes of the Insurance Code is to protect carrier and consumer economic interests and the state's economic welfare, there are no additional regulatory alternatives to the required comprehensive financial plans and increased capital required as a result of the risk-based capital requirements that will sufficiently protect the economic interests of carriers and consumers and the economic welfare of the state.

**Sections 7.403 and 7.404.**

Because of the similarity of their subject matter, proposed new §7.403 and §7.404 are discussed together in this section. As required by the Government Code §2006.002(c), the Department has determined that: (i) the costs to comply with §7.403 may have an adverse economic effect on zero to four small or micro-business carriers formed as county mutual insurance companies that meet the express criteria prescribed the Insurance Code §912.056(f) as amended by HB 2449; and (ii) the costs to comply with §7.404 may have an adverse economic effect on three to six small or micro-based carriers formed as stipulated premium insurance companies. These costs will be incurred by these relatively few small or micro-business carriers because of their failure to maintain capital/or surplus in accordance with the minimum levels required (i) the Insurance Code §912.056(f) and (g), in the case of certain county mutual insurance companies; and (ii) the Insurance Code §884.054(a) and (c) as well as SECTION 12 of HB 2570 in the case of stipulated premium insurance companies. This failure will trigger the requirement that the carrier increase its capital and/or surplus to the

minimum levels required by (i) the Insurance Code §912.056(f) and (g) and the transition periods contained in proposed new §7.403 in the case of certain county mutual insurance companies; and (ii) the Insurance Code §884.054(a) and (c), as well as SECTION 12 of HB 2570 and the transition period contained in proposed new §7.404 in the case of certain stipulated premium insurance companies.

HB 2449 increased the minimum amount of unencumbered surplus, or guaranty fund and unencumbered surplus, that must be maintained by certain county mutual insurance companies that meet the express criteria contained in the Insurance Code §912.056(f), which includes that the carrier must cede 85 percent or more of its risks to one or more nonaffiliated reinsurers. These carriers are required to maintain unencumbered surplus, or guaranty fund and unencumbered surplus, equal to the greater of \$2 million or five percent of the company's recoverable for reinsurance after taking credit against that recoverable for certain specified collateral that ensures the collection of the reinsurance. The Insurance Code §912.056(g) requires the Commissioner to adopt a rule that provides a transition period for these certain carriers to meet the requirements of §912.056(f), and for the pro rata elimination of any deficiencies in the amounts required by §912.056(f), which must be for a period of not less than five years.

HB 2570 increased the minimum amount of capital and surplus that must be maintained by stipulated premium insurance companies. These carriers are required to maintain minimum capital equal to \$200,000 and minimum surplus equal to \$75,000. SECTION 12 of HB 2570 requires a stipulated premium insurance company to increase its capital stock and surplus as required under Chapter 884 of the Insurance Code, as

amended by HB 2570, not later than a date prescribed by rule by the Commissioner in connection with a reasonable schedule of intermediate increases to provide for a 10-year phase-in period.

The total cost of compliance with proposed new §7.403 and §7.404 that is necessary to comply with the Insurance Code §912.056(f), in the case of certain county mutual insurance companies, and the Insurance Code §884.054(a) and (c), in the case of certain stipulated premium insurance companies, is the capital and/or surplus that a small or micro-sized carrier impacted by these proposed sections must raise in order to comply with these statutory requirements and the proposed new sections. The total costs for increasing capital and/or surplus will depend on a variety of factors, including (i) the size and type of the small or micro-business carrier; (ii) the amount of capital and/or surplus that must be raised; (iii) whether the capital and/or surplus may be obtained from internal sources, such as from the retention of profits; (iv) whether the capital and/or surplus must be obtained from external sources, such as from financial institutions or capital markets; and (v) the source and character of the underlying funds that are ultimately used to finance the capital and/or surplus. The function of the minimum surplus, or minimum capital and surplus, in §7.403 and §7.404 is to protect policyholders, enrollees, and carriers from the effects of carrier insolvency. To the extent any carrier must increase its capital and/or surplus as a result of the minimum surplus and/or minimum capital and surplus, that cost is a result of the statutory requirements in the Insurance Code Chapter §912.056(f) and (g), in the case of certain county mutual insurance companies, or §884.054(a) and (c), and SECTION 12 of HB 2570, in the case of stipulated premium insurance companies. These statutes

increased the minimum level of unencumbered surplus and/or minimum capital and surplus and require and/or contemplate the commissioner to adopt rules in accordance with proposed new §7.403 and §7.404. Such costs of compliance are also a result of the statutory requirements in the Insurance Code Chapter 404 and §§441.001, 441.005, 441.051, 441.052, 822.210, 822.211, 884.206, and 912.056. These statutes authorize or require the Commissioner to order carriers that are operating in a potentially hazardous manner to take action to remedy such hazardous condition, which may include the requirement that the carriers increase their capital and surplus and take other remedial action. In accordance with the Government Code §2006.002(c-1), the Department has determined that even though §7.403 and §7.404 may have an adverse economic effect on small or micro-businesses that are required to comply with these proposed requirements, the Department is not required to prepare a regulatory flexibility analysis as required in §2006.002(c)(2) of the Government Code. Section 2006.002(c)(2) requires a state agency, before adopting a rule that may have an adverse economic effect on small businesses, to prepare a regulatory flexibility analysis that includes the agency's consideration of alternative methods of achieving the purpose of the proposed rule. Section 2006.002(c-1) of the Government Code requires that the regulatory flexibility analysis “. . . consider, if consistent with the health, safety, and environmental and economic welfare of the state, using regulatory methods that will accomplish the objectives of applicable rules while minimizing adverse impacts on small businesses.” Therefore, an agency is not required to consider alternatives that, while possibly minimizing adverse impacts on small and micro-businesses, would not be protective of the health, safety, and environmental and economic welfare of the state.

Proposed new §7.403 and §7.404 are authorized by the Insurance Code Chapter §912.056(g), in the case of certain county mutual insurance companies, and SECTION 12 of HB 2570, in the case of stipulated premium insurance companies, which require and/or contemplate the Commissioner to adopt rules to provide a transition period for the new minimum surplus and/or minimum capital and surplus requirements. Proposed new §7.403 and §7.404 are also authorized by other Insurance Code statutes, including: Chapter 404 and §§441.051, 822.210, and 884.206. The purpose of these statutes is to require a carrier to maintain capital and/or surplus at levels commiserate with the amount of risk that they assume because of (i) the nature and kind of risks the carrier underwrites or reinsures; (ii) the premium volume of risks the carrier underwrites or reinsures; (iii) the composition, quality, duration, or liquidity of the carrier's investments; (iv) fluctuations in the market value of securities the carrier holds; or (v) the adequacy of the carrier's reserves. These statutes further require that a rule adopted by the Commissioner be designed to ensure the financial solvency of a carrier for the protection of policyholders, enrollees, creditors, or the general public from the harmful effects of carrier insolvency. Additionally, the primary purpose of Chapters 404 and 441 is to protect insureds, enrollees or creditors, and the public against an insurer or HMO becoming insolvent, delinquent, or in a condition that renders the continuance of its business hazardous to its insureds, enrollees or creditors, or to the public. Chapter 404 permits the Commissioner to take various actions against an insurer upon a finding or impairment or hazardous condition, including a requirement that the capital and surplus of an insurer be increased. Section 441.001(g) provides that for the reasons stated in §441.001, the substance and procedures in Insurance Code Chapter

441 are the public policy of the State of Texas and are necessary to the public welfare. Section 441.001(a) states that insurer delinquencies destroy public confidence in the state's ability to regulate insurers and an insurer delinquency affects other insurers by creating a lack of public confidence in insurance and insurers. Section 441.001(b) states that placing an insurer in receivership often destroys or diminishes, or is likely to destroy or diminish, the value of the insurer's assets. Further, the purpose of Insurance Code §§441.051, 822.211, and 841.206 is to prohibit the impairment of a carrier's minimum required capital or surplus, and these statutes require that the Commissioner take action to remedy the impairment. Sections 441.051, 822.211, and 841.206 further provide that the failure of a carrier to maintain its required capital or surplus at levels required by the Commissioner by rule is considered a prohibited impairment.

The purpose of §7.403 and §7.404 is to protect the economic welfare of (i) carriers; (ii) consumers that purchase insurance policies, annuities and other contracts issued by county mutual insurance companies and stipulated premium insurance companies; (iii) other persons and entities that would be adversely affected by a carrier insolvency against the risk that a carrier may become insolvent and unable to pay its insureds' claims and other obligations as they become due; and (iv) the public and the state of Texas generally.

The requirements in §7.403 and §7.404 that certain carriers maintain higher minimum amounts of capital and/or surplus is consistent with and necessary to implement the legislative intent of the Insurance Code §912.056(f) and (g), in the case of certain county mutual insurance companies, and §884.054(a) and (c) and SECTION 12 of HB 2570, in the case of stipulated premium insurance companies. The

requirements in §7.403 and §7.404 are also consistent with the intent of the Insurance Code Chapter 404 and §§441.001, 441.005, 441.051, 441.052, 822.210, 884.206 and 912.056. This intent is to ensure the financial solvency of a carrier, regardless of size, for the protection of the economic interests of all policyholders and not just the economic interests of those policyholders insured by large carriers.

The Department further notes that the fundamental purpose of the proposed transition periods is to ease the impact to affected carriers by spreading the cost of compliance over a period of several years. The transition period is five years pursuant to the Insurance Code §912.056(g) and proposed §7.403 for certain county mutual insurers. The transition period is 10 years pursuant to SECTION 12 of HB 2570, in the case of stipulated premium insurance companies. The Department further notes that county mutual insurance companies often write very substantial amounts of direct premiums which are supported by surplus amounts that may be more leveraged, which, in the view of the Department, warrants a relatively shorter transition period. The Department believes any adverse impact to small or micro sized carriers impacted by proposed §7.403 and §7.404 will be considerably lessened by these transition periods as compared to a requirement for immediate increases in the minimum capital and/or surplus amounts that must be maintained.

Therefore, the Department has determined, in accordance with §2006.002(c-1) of the Government Code, that because the purpose of §7.403 and §7.404 and the authorizing statutes of the Insurance Code is to protect carrier and consumer economic interests and the state's economic welfare, there are no additional regulatory alternatives to the required transition periods and increased capital required as a result

of the minimum capital and/or minimum surplus requirements for certain county mutual insurance companies and stipulated premium insurance companies that will sufficiently protect the economic interests of carriers and consumers and the economic welfare of the state.

**5. TAKINGS IMPACT ASSESSMENT.** The Department has determined that no private real property interests are affected by this proposal and that this proposal does not restrict or limit an owner's right to property that would otherwise exist in the absence of government action and, therefore, does not constitute a taking or require a takings impact assessment under the Government Code §2007.043.

**6. REQUEST FOR PUBLIC COMMENT.** To be considered, written comments on the proposal must be submitted no later than 5:00 p.m. on November 8, 2010, to Gene C. Jarmon, General Counsel and Chief Clerk, Mail Code 113-2A, Texas Department of Insurance, P. O. Box 149104, Austin, Texas 78714-9104. An additional copy of the comments must be simultaneously submitted to Danny Saenz, Senior Associate Commissioner, Financial Program, Mail Code 305-2A, P. O. Box 149104, Austin, Texas 78714-9104. Any request for a public hearing should be submitted separately to the Office of the Chief Clerk before the close of the public comment period. If a hearing is held, written and oral comments presented at the hearing will be considered.

**7. STATUTORY AUTHORITY.** The amendments and new sections are proposed under the Insurance Code Chapters 404 and 441 and §§822.210, 841.205, 884.054,

884.206, 843.404, 885.401, 912.056, 982.105, 982.106, and 36.001. Chapter 404 addresses the duties of the Department when an insurer's solvency is impaired. Section 404.004 provides that the Commissioner's authority to increase any capital and surplus requirements prevails over the general provisions of the Insurance Code relating to specific companies, and §404.005 authorizes the Commissioner to set standards for evaluating the financial condition of an insurer. Chapter 441 addresses the prevention of insurer delinquencies and insolvencies. Under §441.005, the Commissioner may adopt reasonable rules as necessary to implement and supplement the purposes of Chapter 441. Section 441.051 specifies "the circumstances in which an insurer is considered insolvent, delinquent, or threatened with delinquency" and includes certain statutorily specified conditions, including if an insurer's required surplus, capital, or capital stock is impaired to an extent prohibited by law. Section 822.210 authorizes the Commissioner to adopt rules or guidelines to require an insurer to maintain capital and surplus levels in excess of statutory minimum levels to assure financial solvency of insurers for the protection of policyholders and insurers. Section 841.205 authorizes the Commissioner to adopt rules or guidelines to require an insurer that writes life or annuity contracts or assumes liability on or indemnifies one person for any risk under an accident and health insurance policy, or a combination of these policies, in an amount that exceeds \$10,000 to maintain capital and surplus levels in excess of statutory minimum levels to assure financial solvency of insurers for the protection of policyholders and insurers. Section 884.206 authorizes the Commissioner to adopt rules to require an insurer that writes or assumes life insurance, annuity contracts or accident and health insurance for a risk to one person in an amount that

exceeds \$10,000 to maintain capital and surplus levels in excess of statutory minimum levels to assure financial solvency of insurers for the protection of policyholders and insurers. Section 843.404 authorizes the Commissioner to adopt rules to require a health maintenance organization to maintain capital and surplus levels in excess of statutory minimum levels to ensure financial solvency of health maintenance organizations for the protection of enrollees. Section 884.054 specifies the capital stock and surplus requirements for stipulated premium insurance companies. Section 885.401 requires each fraternal benefit society to file an annual report on the society's financial condition, including any information the Commissioner considers necessary to demonstrate the society's business and method of operation, and authorizes the Department to use the annual report in determining a society's financial solvency. Section 912.056 authorizes the Commissioner to adopt rules to provide a transition period for certain county mutual insurance companies to comply with the new surplus minimums required by the Insurance Code §912.056(f). Section 982.105 specifies the capital, stock, and surplus requirements for foreign or alien life, health, or accident insurance companies. Section 982.106 specifies the capital, stock, and surplus requirements for foreign or alien insurance companies other than life, health, or accident insurance companies. Section 36.001 authorizes the Commissioner to adopt any rules necessary and appropriate to implement the powers and duties of the Texas Department of Insurance under the Insurance Code and other laws of this state.

**8. CROSS REFERENCE TO STATUTES.** The following statutes are affected by this proposal:

<u>Rule</u>	<u>Statute</u>
§7.402	Insurance Code Chapters 404 and 441 and §§404.003, 404.004, 404.005, 822.210, 841.205, 843.404, 982.105, and 982.106
§7.403	Insurance Code Chapters 404 and 441 and §§404.003, 404.004, 404.005, and 912.056
§7.404	Insurance Code Chapters 404 and 441 and §§404.003, 404.004, 404.005, 884.054, and 884.206

## 9. TEXT.

### **SUBCHAPTER D. Risk-based Capital and Surplus and Other Requirements** **§7.402. Risk-Based Capital and Surplus Requirements for Insurers and HMOs**

- (a) (No change.)
- (b) Scope.

(1) Life companies. This section applies to any insurer authorized to do business in Texas as an insurance company that writes or assumes a life insurance or annuity contract or assumes liability on or indemnifies one person for any risk under an accident and health insurance policy, or any combination of these policies, in an amount that exceeds \$10,000 including: capital stock companies, mutual life companies, and stipulated premium insurance companies [~~doing business in other states~~]. Fraternal benefit societies are subject to their own separate risk-based capital instructions as provided in subsection (d)(2) of this section [~~This section does not apply to stipulated premium companies only doing business in Texas.~~].

(2) Property and casualty companies. This section applies to all domestic, foreign, and alien property and casualty companies subject to the provisions of Insurance Code §822.210 and §982.106, including county mutual insurance

companies that do not meet the express criteria contained in the Insurance Code §912.056(f), but excluding monoline financial guaranty insurers, monoline mortgage guaranty insurers, title insurers and those insurers subject to the Insurance Code §822.205 [~~that write business only in this state and are not required to have capital stock~~].

(3) (No change.)

(c) (No change.)

(d) Adoption of RBC formula by reference. The commissioner adopts by reference the following, which are available for inspection in the Financial Analysis Division of the Texas Department of Insurance, William P. Hobby Jr. State Office Building, Tower Number III, Third Floor, Mail Code 303-1A, 333 Guadalupe, Austin, Texas:

(1) The 2009 [~~2008~~] NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(2) The 2009 [~~2008~~] NAIC Fraternal Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(3) The 2009 [~~2008~~] NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(4) The 2009 [~~2008~~] NAIC Health Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(5) The 2010 NAIC Life Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(6) The 2010 NAIC Fraternal Benefit Societies Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(7) The 2010 NAIC Property and Casualty Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(8) The 2010 NAIC Health Risk-Based Capital Report Including Overview and Instructions for Companies which includes the RBC formula.

(e) Filing requirements.

(1) All companies [~~except fraternal~~] subject to this section, except fraternal benefit societies, stipulated premium companies doing business only in Texas, and county mutual insurance companies that do not meet the express criteria contained in the Insurance Code §912.056(f), are required to file [both a paper copy and an] electronic versions of the 2009 and the 2010 RBC reports and any supplemental RBC forms and reports [version] with the NAIC in accordance with and by the due dates [date] specified in the RBC instructions.

(2) Fraternal benefit societies shall prepare, maintain, and file a paper copy of the 2009 RBC report and any supplemental RBC forms and reports with the department whenever requested by the department. Fraternal benefit societies [Fraternal] shall prepare and maintain a paper copy of the 2010 RBC report and any supplemental RBC forms and reports by March 1, 2011, and make the reports and forms available for review whenever requested by the department. The 2009 and 2010 RBC reports and any supplemental RBC forms and reports shall be completed in accordance with the respective calendar-year RBC instructions.

(3) Stipulated premium insurance companies only doing business in Texas are not required to file the 2009 RBC report, but shall file an electronic version of the 2010 RBC report and any supplemental RBC forms and reports with the NAIC in accordance with and by the due date specified in the RBC instructions.

(4) County mutual insurance companies that do not meet the express criteria contained in the Insurance Code §912.056(f) are not required to file the 2009 RBC report but shall file an electronic version of the 2010 RBC report and any supplemental RBC forms and reports with the NAIC in accordance with and by the due date specified in the RBC instructions.

(f) (No change.)

(g) Actions of commissioner. The level of risk-based capital is calculated and reported annually. Depending on the results computed by the risk-based capital formula, the commissioner of insurance may take a number of remedial actions, as considered necessary. The ratio result of the total adjusted capital to authorized control level risk-based capital requires the following actions related to an insurer within the specified ranges:

(1) – (6) (No change.)

(7) A health insurer subject to this section is subject to a trend test if its total adjusted capital to authorized control level risk-based capital is between 200 percent and 300 percent and triggers the trend test determined in accordance with the trend test calculation included in the Health RBC instructions. If the result of the trend test as determined by the formula is "YES", the insurer triggers regulatory attention at the company action level.

(h) – (j) (No change.)

**§7.403. Transition Period for Certain County Mutual Insurance Companies.**

(a) This section applies to a county mutual insurance company that cedes 85 percent or more of the company's direct and assumed risks to one or more nonaffiliated reinsurers and the company is otherwise required to comply with the Insurance Code §912.056(f).

(b) A county mutual insurance company shall comply with §7.402 of this subchapter (relating to Risk-Based Capital and Surplus Requirements for Insurers and HMOs) unless the company meets the express criteria contained in the Insurance Code §912.056(f).

(c) A county mutual insurance company subject to the Insurance Code §912.056(f) that on December 31, 2009, had less than the minimum unencumbered surplus required by §912.056(f) must:

(1) not later than December 31, 2010, have increased the amount of its unencumbered surplus by at least 20 percent of the difference between the minimum amount required by §912.056(f) and the amount held by the company on December 31, 2009;

(2) not later than December 31, 2011, have increased the amount of its unencumbered surplus by at least 40 percent of the difference between the minimum amount required by §912.056(f) and the amount held by the company on December 31, 2009;

(3) not later than December 31, 2012, have increased the amount of its unencumbered surplus by at least 60 percent of the difference between the minimum amount required by §912.056(f) and the amount held by the company on December 31, 2009;

(4) not later than December 31, 2013, have increased the amount of its unencumbered surplus by at least 80 percent of the difference between the minimum amount required by §912.056(f) and the amount held by the company on December 31, 2009; and

(5) not later than December 31, 2014, have increased the amount of its unencumbered surplus by at least 100 percent of the difference between the minimum amount required by §912.056(f) and the amount held by the company on December 31, 2009.

**§7.404. Transition Period for Stipulated Premium Insurance Companies.**

(a) A stipulated premium insurance company shall comply with §7.402 of this subchapter (relating to Risk-Based Capital and Surplus Requirements for Insurers and HMOs).

(b) A stipulated premium insurance company that on December 31, 2009, had less than the minimum amount of capital and surplus required for a newly incorporated company under the Insurance Code §884.054 must:

(1) not later than December 31, 2010, have increased the amount of its capital and surplus by at least 10 percent of the difference between the amount of minimum capital and surplus required for a newly incorporated company under the

Insurance Code §884.054(a) and (c) and the amount of the company's capital and surplus on December 31, 2009;

(2) not later than December 31, 2011, have increased the amount of its capital and surplus by at least 20 percent of the difference between the amount of minimum capital and surplus required for a newly incorporated company under §884.054(a) and (c) and the amount of the company's capital and surplus on December 31, 2009;

(3) not later than December 31, 2012, have increased the amount of its capital and surplus by at least 30 percent of the difference between the amount of minimum capital and surplus required for a newly incorporated company under §884.054 and the amount of the company's capital and surplus on December 31, 2009;

(4) not later than December 31, 2013, have increased the amount of its capital and surplus by at least 40 percent of the difference between the amount of minimum capital and surplus required for a newly incorporated company under §884.054 and the amount of the company's capital and surplus on December 31, 2009;

(5) not later than December 31, 2014, have increased the amount of its capital and surplus by at least 50 percent of the difference between the amount of minimum capital and surplus required for a newly incorporated company under §884.054 and the amount of the company's capital and surplus on December 31, 2009;

(6) not later than December 31, 2015, have increased the amount of its capital and surplus by at least 60 percent of the difference between the amount of minimum capital and surplus required for a newly incorporated company under §884.054 and the amount of the company's capital and surplus on December 31, 2009;

(7) not later than December 31, 2016, have increased the amount of its capital and surplus by at least 70 percent of the difference between the amount of minimum capital and surplus required for a newly incorporated company under §884.054 and the amount of the company's capital and surplus on December 31, 2009;

(8) not later than December 31, 2017, have increased the amount of its capital and surplus by at least 80 percent of the difference between the amount of minimum capital and surplus required for a newly incorporated company under §884.054 and the amount of the company's capital and surplus on December 31, 2009;

(9) not later than December 31, 2018, have increased the amount of its capital and surplus by at least 90 percent of the difference between the amount of minimum capital and surplus required for a newly incorporated company under §884.054 and the amount of the company's capital and surplus on December 31, 2009;

and

(10) not later than December 31, 2019, have at least the minimum amount of capital and surplus required under §884.054 for a newly incorporated company.