

**SUBCHAPTER A. Examination and Financial Analysis**  
**28 TAC §7.18**

**1. INTRODUCTION.** The Texas Department of Insurance adopts amendments to 28 Texas Administrative Code §7.18, concerning the National Association of Insurance Commissioners Accounting Practices and Procedures Manual. These amendments are adopted with changes to the proposal published in the June 29, 2012, issue of the *Texas Register* (37 TexReg 4806) and will be republished. These amendments primarily adopt by reference the March 2012 version of *The Accounting Practices and Procedures Manual*, published and issued by the NAIC. Additionally, the amendments make conforming changes to §7.18 to reflect the adoption of this version.

In accord with Government Code §2001.033(a)(1), the department's reasoned justification for these rules is set out in this order, which includes the preamble and rules. The preamble contains a summary of the factual basis of the rules, a summary of comments received from interested parties, names of those groups and associations who commented and whether they were in support of or in opposition to adoption of the rules, the reasons why the department agrees or disagrees with some of the comments and recommendations, and all other department responses to the comments.

The public comment period for the proposed amendments to §7.18 of this title closed on July 30, 2012. The department received one public comment.

**2. REASONED JUSTIFICATION.** *The Accounting Practices and Procedures Manual* (Manual), published and issued by the NAIC, incorporates the statements of statutory

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

The department uses the Manual as its source of statutory accounting principles when analyzing financial reports and for conducting statutory examinations and rehabilitations of carriers licensed in Texas unless a department rule or other state law provides otherwise. The department periodically adopts the Manual by reference, with certain modifications and exceptions, in §7.18 of this title to codify this usage. These adopted amendments update §7.18 of this title to adopt by reference the March 2012 version of the Manual, which substantively revises the March 2010 version of the Manual in several ways.

First, the March 2012 version of the Manual adds SSAP No. 94R, which the NAIC finalized on December 7, 2011. SSAP No. 94R revises SSAP No. 94 to allow entities to treat non-transferable state tax credits as admitted assets if specific criteria are met. The substantive revisions in SSAP No. 94R are effective for reporting periods ending on or after December 31, 2011.

Second, the March 2012 version of the Manual adds SSAP No. 101, which the NAIC finalized on August 30, 2011. SSAP No. 101 replaces SSAP No. 10R and SSAP

No. 10 and provides revised statutory accounting principles for current and deferred federal and foreign income taxes and current state income taxes. SSAP No. 101 is effective for reporting periods ending on or after January 1, 2012. The March 2012 version of the Manual also makes five substantive placement revisions, which the NAIC finalized on August 30, 2011.

In addition, the adopted amendments to §7.18 of this title make conforming changes to the section, fully described below, that reflect the adoption of the March 2012 Manual. The adopted amendments also make nonsubstantive changes to §7.18 of this title that are necessary for the section to conform to current nomenclature, for reformatting, consistency, clarity, or editorial reasons, and to correct typographical and grammatical errors.

The department adopts these amendments to §7.18 of this title with changes from the amendments formally proposed on June 29, 2012. The department has replaced “making a determination on” to “determining” and “that preempts” to “preempting” in subsection (a). These changes are nonsubstantive and made for editorial reasons.

The department has also, in response to comment, amended subsection (c)(1) to provide that intercompany balances shall be settled within 90 days of the period for which the “amounts” rather than “services” are being billed. The change is necessary to clarify that the exception to SSAP No. 25 provided in subsection (c)(1) applies to all intercompany transactions addressed by SSAP No. 25, not only receivables resulting from services.

The department has also deleted the phrase “currently located in Appendix H” after “SSAP No. 25” in subsection (c)(1) and inserted the phrase “located in Appendix H” after “SSAP No. 96” in the same paragraph. This change is nonsubstantive and corrects a typographical error in the June 29, 2012, proposal.

The department has also, in response to comment, deleted subsection (c)(2), which provided “Retrospective premiums must be billed within 60 days of computation and audit premiums must be billed within 60 days of the completion of the audit in determining the beginning date from which the 90-day period is calculated to determine admissibility of uncollected premium balances under SSAP No. 6.” The department has deleted this exception to the Manual because it is no longer necessary, and it can be burdensome for carriers for the reasons stated by the commenter. The department has also made conforming codification changes to subsections (c)(3)-(5) because of this change.

The department has also changed “Deputy Commissioner” to “deputy commissioner” in subsection (e). This change is nonsubstantive and corrects a formatting error in the June 29, 2012, proposal.

The department has also added “a” to subsection (e) between “use” and “deviated.” This change is nonsubstantive and corrects a typographical error in the existing rule.

**3. HOW THIS SECTION WILL FUNCTION.** The adopted amendments to §7.18(a) and (b) update the reference to the Manual to refer to the March 2012 version of the Manual.

The adopted amendments to subsections (b) and (c) delete references to various SSAPs and to Issue Paper No. 99 because these SSAPs and issue paper are now included in the adopted March 2012 version of the Manual.

The adopted amendments to §7.18(c) redesignate the subdivisions of subsection (c) to reflect the deletion of paragraph (1). The adopted amendments to §7.18(c) also reflect that the NAIC moved guidance in SSAP No. 96, located in Appendix H of the Manual, to SSAP No. 25. The NAIC did this through adoption of a placement revision (Reference No. 2011-13). The adopted amendments also, in response to comment, amend paragraph (1) to provide intercompany balances shall be settled within 90 days of the period for which the “amounts” rather than “services” are being billed. The change is necessary to clarify that the exception to SSAP No. 25 provided in subsection (c)(1) applies to all intercompany transactions addressed by SSAP No. 25, not only receivables resulting from services. The department has also made conforming codification changes to subsections (c)(3)-(5) because the department has deleted subsections (c)(2).

The adopted amendments to §7.18(e) also reflect structural reorganization within the department. They change “Senior Associate Commissioner” to “deputy commissioner” and change “Financial Program” to “Financial Regulation Division.”

#### **4. SUMMARY OF COMMENTS AND AGENCY RESPONSES.**

##### **§7.18(c)**

**COMMENT:** One commenter requests that the department review its proposed modifications and exceptions to the NAIC AP&P Manual. The commenter states that

these accounting differences increase operating expenses for insurers that must maintain dual accounting records to comply with department rules and the NAIC AP&P Manual. The commenter notes that the proposal provides no justification for these modifications and that these exceptions and modifications conflict with the Consistency Concept in paragraph 31 of the AP&P Manual preamble, which Texas has also adopted.

**AGENCY RESPONSE:** The department declines to make a change based on the commenter's concerns. To clarify, the department did not justify its modifications and exceptions in its proposal to amend §7.18 of this title because the department did not propose any substantive amendments to these modifications or exceptions.

Additionally, while the department acknowledges that carriers operating in multiple states may incur additional expenses based on the varying accounting requirements of different states, these expenses inevitably result from operating in multiple states and not from the adopted amendments of §7.18 of this title. The department disagrees that its adopted amendments to §7.18 of this title conflict with preamble to the Manual because the Manual's preamble expressly states that the Manual is not intended to preempt states' legislative and regulatory authority.

**§7.18(c)(1)**

**COMMENT:** One commenter requests that the department adopt SSAP No. 25, regarding the settlement of intercompany balances, without exception. The commenter states that §7.18(c)(1) modifies SSAP No. 25 to require settlement of uncollected balances within 90 days of the period for which the services are being billed instead of

within 90 days of the written agreement due date as required by SSAP No. 25. The commenter disagrees with this modification because it requires dual accounting records for companies and could cause receivables to become nonadmitted before their written agreement due date. The commenter further states that §7.18(c)(1) requires commissioner approval of the written agreement underlying the transaction, and thus the commenter does not understand why the 90-day limit for settlement of uncollected balances is necessary in light of the commissioner approved due date in the written agreement. The commenter states there are often reasons for establishing a due date greater than 90 days from the service date.

**AGENCY RESPONSE:** The department disagrees and declines to make a change. The department did not propose any substantive change to the §7.18(c)(1) of this title, which has not substantively changed since 2007, so the commenter's concerns largely exceed the scope of this adoption order. The Manual does not preempt state regulatory authority, and the department generally has the authority under the Insurance Code, including Chapters 401, 404, 441, 843, and 36, to adopt this exception. This exception is one of many factors necessary to help ensure that, pursuant to Insurance Code §823.101, insurers benefit from fair and equitable transactions with affiliates and that the agreements do not provide for excessively distant due dates that would be unlikely to be agreed to with third parties.

**COMMENT:** One commenter asks if the term "services" in §7.18(c)(1) includes intercompany transactions such as the sale of property or loans to affiliates. The

commenter further asks if loans are included as “services” what would be the billed date for a loan?

**AGENCY RESPONSE:** The department clarifies that the term “services” in the exception to SSAP No. 25 provided in subsection (c)(1) applies to all intercompany transactions addressed by SSAP No. 25, not only receivables resulting from services, and the department has changed “services” in subsection (c)(1) to “amounts” to reflect this clarification. The department further clarifies that the aging for the balances start from the last day of the period subject to the billing, not the billed date.

**§7.18(c)(2)**

**COMMENT:** One commenter urges the department to remove the §7.18(c)(2) exception to SSAP No. 6, regarding the admissibility criteria for retrospective and audit premiums in Texas. The commenter states that this removal would reduce burdens and costs for companies operating in multiple states. The commenter further states that under the Manual the time period for billing is established by the underlying policy or contract, rather than the prescribed 60-day limit of §7.18(c)(2), and the department already reviews those policies and contracts. The commenter believes the policy or contract time period should already be reasonable in light of this review. The commenter notes that the §7.18(c)(2) exception also differs from calculation requirements under paragraph 9 of SSAP No. 66 and SSAP and paragraph 12 of SSAP No. 53, regarding the admissibility of retrospective premiums and the admissibility of audit premiums, respectively.

**AGENCY RESPONSE:** The department agrees generally that this exception to the Manual is no longer necessary, and it has deleted the exception the from the rule.

**5. NAMES OF THOSE COMMENTING FOR AND AGAINST THESE SECTIONS.**

**For:** None.

**Against:** Insurance Council of Texas.

**6. STATUTORY AUTHORITY.** The amendments are adopted under the Insurance Code Chapters 32, 401, 404, 421, 425, 426, 441, 802, 823, 841, 843, 861, and 862, and §36.001. Sections 401.051 and 401.056 mandate that the department examine the financial condition of each carrier organized under the laws of Texas or authorized to transact the business of insurance in Texas and adopt by rule procedures for the filing and adoption of examination reports. Section 404.005(a)(2) authorizes the commissioner to establish standards for evaluating the financial condition of an insurer. Section 421.001(c) requires the commissioner to adopt each current formula recommended by the NAIC for establishing reserves for each line of insurance. Section 425.162 authorizes the commissioner to adopt rules, minimum standards, or limitations that are fair and reasonable as appropriate to supplement and implement the Insurance Code Chapter 425, Subchapter C. Section 426.002 provides that reserves required by §426.001 must be computed in accordance with any rules adopted by the commissioner to adequately protect insureds, secure the solvency of the workers' compensation insurance company, and prevent unreasonably large reserves. Section 441.005 authorizes the commissioner to adopt reasonable rules as necessary to implement and

supplement Chapter 441 of the Insurance Code (Supervision and Conservatorship).

Section 32.041 requires the department to furnish to the companies the required financial statement forms. Section 802.001 authorizes the commissioner to change the form of any annual statement required to be filed by any kind of insurance company, as necessary, to obtain an accurate indication of the company's condition and method of transacting business. Section 823.012 authorizes the commissioner to issue rules and orders necessary to implement the provisions of Chapter 823 of the Insurance Code (Insurance Holding Company Systems). Section 843.151 authorizes the commissioner to promulgate rules that are necessary and proper to implement the provisions of Chapter 843 of the Insurance Code (Health Maintenance Organizations). Section 843.155 requires HMOs to file annual reports with the commissioner, which include a financial statement of the HMO, certified by an independent public accountant.

Sections 841.004(b), 861.255(b), and 862.001(c) authorize the commissioner to adopt rules defining electronic machines and systems, office equipment, furniture, machines, and labor saving devices, and the maximum period for which each such class may be amortized. Section 36.001 provides that the commissioner of insurance may adopt any rules necessary and appropriate to implement the powers and duties of the department under the Insurance Code and other laws of this state.

## **7. TEXT.**

### **§7.18. National Association of Insurance Commissioners Accounting Practices and Procedures Manual.**

(a) The purpose of this section is to adopt statutory accounting principles, which will provide insurers and health maintenance organizations, including accountants employed or retained by these entities, guidance as how to properly record business transactions for the purpose of accurate statutory reporting. The March 2012 version of the *Accounting Practices and Procedures Manual* (Manual) published by the National Association of Insurance Commissioners (NAIC), with the exceptions and modifications set forth in subsections (c) and (d) of this section, will be utilized as the guideline for statutory accounting principles in Texas to the extent the Manual does not conflict with provisions of the Insurance Code or rules of the department. The commissioner reserves all authority and discretion to resolve any accounting issues in Texas. When determining the proper accounting treatment for an insurance or health plan transaction, the commissioner will refer to the sources in paragraphs (1) - (6) of this subsection in the respective order of priority listed. The sources in paragraphs (1) – (3) of this subsection preempt any contrary provisions in the Manual. The department rules preempting any contrary provisions in the Manual, include, but are not limited to: §§3.1501 - 3.1505, 3.1601 - 3.1608, 3.4505(f), 3.6101, 3.6102, 3.7001 – 3.7009, 3.9101 - 3.9106, 3.9401 – 3.9404, 7.7, 7.85<sub>2</sub> and 11.803 of this title (relating to Annuity Mortality Tables; Actuarial Opinion and Memorandum Regulation; General Calculation Requirements for Basic Reserves and Premium Deficiency Reserves; Policy Reserves; Claims Reserves; Minimum Reserve Standards for Individual and Group Accident and Health Insurance; the 2001 CSO Mortality Table; Preferred Mortality Tables; Subordinated Indebtedness, Surplus Debentures, Surplus Notes, Premium Income

Notes, Bonds, or Debentures, and Other Contingent Evidences of Indebtedness;  
Audited Financial Reports; and Investments, Loans, and Other Assets).

(1) Texas statutes;

(2) department rules;

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

(4) the Manual;

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

(6) Generally Accepted Accounting Practices.

(b) The commissioner adopts by reference the March 2012 version of the Manual, with the exceptions and modifications set forth in subsections (c) and (d) of this section, as the source of accounting principles for the department when analyzing financial reports and for conducting statutory examinations and rehabilitations of insurers and health maintenance organizations licensed in Texas, except where otherwise provided by law. This Manual that is adopted by reference with the exceptions and modifications specified in subsections (c) and (d) of this section will be applied to examinations conducted as of December 31, 2011, and thereafter, and also must be used to prepare all financial statements filed with the department for reporting periods beginning on or after December 31, 2011.

(c) The commissioner adopts the following exceptions and modifications to the Manual:

(1) Settlement requirements for intercompany transactions are subject to the accounting treatment in Statement of Statutory Accounting Principles (SSAP) No. 25

(previously SSAP No. 96 located in Appendix H), except that amounts owed to the reporting entity shall be settled by the due date in accordance with the written agreement and the requirements of §7.204 of this title (relating to Commissioner's Approval Required). Intercompany balances shall be settled within 90 days of the period for which the amounts are being billed; otherwise the balances shall be nonadmitted.

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

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

(4) All certificates of deposit, of any maturity, may be classified as cash and are subject to the accounting treatment contained in SSAP No. 2, notwithstanding the provisions of SSAP No. 26.

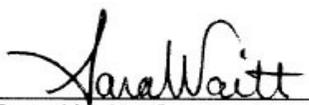
(d) A farm mutual insurance company, statewide mutual assessment company, local mutual aid association, or mutual burial association that has less than \$6 million in annual direct written premiums need not comply with the Manual.

(e) In the event a domestic insurer desires to deviate from the accounting guidance in a Texas statute or any applicable regulation, the insurer must file a written request for a permitted accounting practice and obtain approval prior to using the accounting deviation in a financial statement. The filing must be made with the deputy commissioner of the Financial Regulation Division, Texas Department of Insurance, Mail Code 305-2A, P.O. Box 149104, Austin, Texas 78714-9104 at least 30 days before filing the financial statement that is proposed to be affected by the deviated accounting practice. Insurers must not use a deviated accounting practice without the department's prior approval.

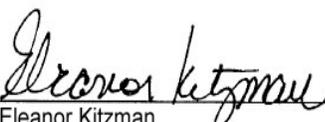
(f) This section shall not be construed to either broaden or restrict the authority provided under the Insurance Code to insurers, including health maintenance organizations.

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

Issued at Austin, Texas, on October 1, 2012.

  
Sara Waitt, General Counsel  
Texas Department of Insurance

The commissioner adopts the amendments to §7.18.

  
Eleanor Kitzman  
Commissioner of Insurance

Commissioner's Order No. 12-0787