

SUBCHAPTER A. Examination and Financial Analysis
28 TAC §7.84

1. INTRODUCTION. The Texas Department of Insurance proposes new §7.84, concerning the frequency of financial examinations conducted under the Insurance Code §401.052. This new section is necessary to implement Senate Bill (SB) 1253, 80th Legislature, Regular Session, which amended the Insurance Code §401.052. Amended §401.052(a) permits the Department to examine carriers as often as the Department considers necessary, but not less frequently than once every five years. Amended §401.052(b) directs the Commissioner to adopt rules governing the frequency of examinations of carriers that have been organized or incorporated for less than five years. The new section will replace existing §7.84, which is proposed for repeal and also published in this issue of the *Texas Register*.

Purpose of §7.84

Prior to the enactment of SB 1253, 80th Legislature, Regular Session, the Department was required by the Insurance Code §401.052 to examine newly licensed Texas domestic carriers each year for their first three years of existence and then once every three years thereafter. Existing §7.84 only addresses the frequency of examinations applicable to carriers that have been organized for more than three years and does not apply to health maintenance organizations (HMOs). Proposed new §7.84 is necessary to state the exam frequency rule generally applicable to all carriers, including HMOs, that have been organized for less than five years, in comportment with §401.052(b). The Insurance Code §401.052(a) will continue to apply to all carriers organized for more than five years.

Application to HMOs

Pursuant to the Insurance Code §843.156(h), the financial examination provisions of the Insurance Code §401.052 continue to apply to HMOs. Section 401.052, prior to its amendment by SB 1253, required a minimum examination frequency of three years for all carriers organized for more than three years and annually in their first, second, and third years. The purpose of existing §7.84 is to implement a rule pursuant to §401.052(b) to provide a deferment of up to two years for regular examinations for carriers meeting certain requirements (i.e., some carriers would qualify for a five-year examination frequency). Existing §7.84(d) specifically excludes HMOs because the Department determined that HMOs should not be eligible for the deferment of regular examination specified in §7.84(c). This was based on §401.052(a) which then as now includes authority for the Department to examine carriers as frequently as the Department considers necessary. As a result of SB 1253, §401.052 now requires a minimum examination frequency of five years for all carriers, but directs the Commissioner to adopt rules governing the frequency of examinations of carriers that have been organized or incorporated for less than five years. As the deferment provisions and the HMO exclusion from the deferment are no longer relevant, the purpose of proposed new §7.84 is to adopt rules governing the frequency of examinations of all carriers that have been organized or incorporated for less than five years pursuant to §401.052(b). Based on modern insurance industry regulatory practices, as discussed in the Public Benefit/Cost Note of this proposal, the Department has determined that HMOs organized or incorporated for less than five years should be

examined on the same minimum frequency as other carriers. Under proposed new §7.84, the Department is required to conduct financial examinations of all carriers organized for less than five years no less than in the carrier's first, third, and fifth years.

Workers Compensation Self-insurance

The Labor Code §407A.252 states the examination frequency for workers compensation self-insurance groups as once annually during the first three years of the group's operation and no more frequently than once every three years thereafter unless the Commissioner makes certain findings. The proposed section specifies that it does not apply to self-insurance groups governed by the Labor Code Chapter 407A.

Description of Subsections

Proposed new §7.84(a) states the purpose of the rule.

Proposed new §7.84(b) addresses the applicability of the section, providing that the section applies only to examinations commenced after the effective date of this section.

Proposed new §7.84(c) defines certain terms used in the section, including "carrier" which is broadly defined to include any insurance entity subject to examination under the Insurance Code §401.051, and "self-insurance groups," which are subject to the exclusion stated in proposed new §7.84(g).

Proposed new §7.84(d) cites the general carrier examination frequency requirement of the Insurance Code §401.052(a) governing carriers organized for five years or more, noting the exception for self-insurance groups and HMOs.

Proposed new §7.84(e) states the general examination frequency requirement for carriers organized for less than five years, providing that the Department shall

conduct such examinations in the carrier's first, third, and fifth years. The proposed subsection further provides that the first year examination for a domestic carrier that receives a certificate of authority or other authorization from the Department on or before June 30, shall be the calendar year in which the carrier received the certificate of authority or other authorization from the Department. For a domestic carrier that receives a certificate of authority or other authorization after June 30, the first year to be examined shall be the calendar year immediately following the calendar year in which the carrier received the certificate of authority or other authorization from the Department and will include the first partial year. The proposed subsection also provides that if a Texas domestic carrier organized for less than five years under the laws of this state is a member of an insurance holding company system with one or more affiliated Texas domestic carriers, the Department may, under certain circumstances, conduct an examination of the Texas domestic carrier at the same time it conducts the examination of the affiliated Texas domestic carrier or carriers.

Proposed new §7.84(f) provides that the Department shall conduct an examination of a redomesticated carrier no later than five years from the carrier's last examination by a prior state of domicile or three years from the date the carrier redomesticates to Texas, whichever is less.

Proposed new §7.84(g) notes that the Labor Code §407A.252 governs the frequency of examinations for self-insurance groups.

Proposed new §7.84(h) reserves the Commissioner's broad examination authority, providing that the proposed section does not in any way limit the Commissioner's authority under the Insurance Code Chapters 401 and 843, including

the authority to visit or examine a carrier as often as the Commissioner considers necessary.

Proposed new §7.84(i) provides that, in the event of a conflict between this section and the Insurance Code or the Labor Code, the provisions of the Insurance Code or the Labor Code prevail.

2. FISCAL NOTE. Mr. Danny Saenz, Senior Associate Commissioner, Financial Program, has determined that, for each year of the first five years the proposed section will be in effect, there will be no fiscal implications for state or local government as a result of enforcing or administering the proposed section. The proposal 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 section is in effect, the public benefits anticipated as a result of the proposed new sections will be an improved examination process resulting in a more effective and efficient means of monitoring the financial solvency of carriers. Mr. Saenz has further determined that the overall costs to carriers of complying with the proposal will be reduced compared to complying with the Department's examination requirements based on existing §7.84 and prior law. Specifically, carriers will be subject to a reduced number of required Department examinations, resulting in a cost savings for individual carriers and the industry as a whole. The Department anticipates that the costs associated with each individual examination, as described hereafter, remain the same as that under previous law. However, under the proposal, the costs that

previously were associated with the examinations conducted during a carrier's first three years of existence will now correspond to the costs associated with the examinations conducted for a carrier's initial five year period. As under the previous rule and law, carriers may be subject to additional examinations as often as the Department considers necessary.

Anticipated Public Benefits. The anticipated public benefits include increasing the efficiency and effectiveness of the Department's financial examination process by enhancing the Department's flexibility to allocate staff and other resources in monitoring the financial condition of carriers to better assure financial solvency, thereby allowing the Department more latitude in prioritizing financial reviews of troubled carriers. The proposal will also reduce the costs of regulatory compliance for most carriers.

Enhanced Ability to Allocate Department Staff and Other Resources. The proposal impacts carriers that have been organized or incorporated for less than five years by requiring that their first three examinations occur in the carrier's first, third, and fifth years of existence, rather than each of their initial three years of existence as required under the previous regulatory framework. The proposal would also impact most carriers that have been organized for more than five years by extending the typical interval between required Department examinations from three to five years. Based on modern insurance industry regulatory practices, this schedule of minimum required examinations constitutes an updating of prior practice. Additionally, the proposed section would provide the Department with regulatory flexibility by requiring fewer required annual examinations for carriers overall, while simultaneously providing a framework that allows more frequent examinations as may be necessary if any

particular carrier generates regulatory concerns. As a result, the Department anticipates that carriers will be subject to fewer examinations. For example, certain carriers which generate solvency, compliance or other regulatory concerns may be subject to more examinations than the minimum number required by the proposal if deemed necessary by the Department. However, this is not a change as the Department has long had authority to examine a specific carrier whenever circumstances so require. The proposal specifically restates the statutory authority granted to the Department in the Insurance Code §401.052(a) to examine carriers as often as it considers necessary. Operating under the proposal, Department staff and resources will be more readily available to perform other examination functions that the Department desires to emphasize, which allows a more efficient use of staff resources. In addition, the proposal will allow more flexibility for coordination of examinations with other states, thereby leading to a more efficient examination process.

The proposal will also allow the Department to achieve greater flexibility from an enhanced ability to align the examination dates of affiliated carriers who are members of the same holding company group, which will enable both the Department and carriers to plan better for examinations and to utilize their staff and other resources more efficiently. The ability to align the examination dates of affiliated carriers will also provide the Department with an increased understanding of both specific carriers and their group as a whole. Aligning a larger number of examination dates of affiliated carriers will also result in a reduction in the number of examinations required of shared systems and platforms that are jointly used by affiliated carriers, which will further free up Department staff for other examination functions. Reducing the number of required

examinations is appropriate and desirable as a number of modern day regulatory requirements now exist that serve to protect the interests of the public, including risk based capital, required actuarial opinions on reserves held by carriers and required audit reports on carriers from certified independent accountants. These modern day regulatory requirements did not exist when the original statutory examination frequency framework was enacted. In summary, as a result of the enhanced regulatory flexibility discussed previously, the proposal will enable the Department to administer narrowly-tailored and proactive regulatory actions to protect the interests of the public against carriers whose financial condition may be potentially hazardous.

The Department estimates that 25 - 35 carriers that are organized or incorporated for less than five years will be directly impacted by the proposal, which represents the Department's estimate of the number of these particular carriers that typically exist at any particular point in time. Of these, the Department estimates 1 – 3 carriers will meet the definition of a small or micro business as defined by the Government Code §2006.001(1) and (2). While the proposal would result in a decrease in the minimum number of required examinations for carriers that have existed for less than five years, as under the prior rule, these carriers would be subject to more required minimum examinations compared to insurers that have been in existence for more than five years. In the Department's experience, carriers in business for less than five years often have higher rates of noncompliance with regulatory requirements and may pose a higher risk of developing solvency concerns when compared to carriers that have been in existence for a longer period of time. Accordingly, and in compliance with the Insurance Code §401.052(b), the proposal requires more frequent examinations of

carriers in existence less than five years compared to carriers that have been in existence for more than five years.

The Department also estimates that 375 - 400 carriers that have been organized or incorporated for more than five years will be directly impacted by the proposal, which represents the Department's estimate of the number of these carriers that typically exist at any particular point in time. Of these, the Department estimates 10 – 25 carriers will meet the definition of a small or micro business as defined by the Government Code §2006.001(1) and (2).

Effect on Carriers Required to Comply with the Proposal.

Reduced Costs of Compliance. The proposed section will result in fewer minimum required examinations and therefore, the proposal will result in cost savings for carriers. Prior to the enactment of SB 1253, 80th Legislature, the Department was required by the Insurance Code §401.052 to examine newly licensed Texas domestic carriers each year for their first three years of existence and then typically once every three years thereafter. Current §7.84, which is simultaneously proposed to be repealed, permits the Department under certain circumstances to examine carriers once every four or five years; however, in practice, most carriers did not qualify for examination intervals that extended to four or five years. Prior to SB 1253, carriers were typically subject to a total of three examinations in each of their first three years of existence, and subsequent examinations once every three years. In addition to requiring the Commissioner to adopt rules to govern the frequency of examinations for carriers incorporated or organized less than five years, SB 1253 also extended the regular examination interval for carriers that have been in existence for more than five years

from a three year interval to a five year interval. Under proposed §7.84(e)(1) and (h), newly created carriers would typically be subject to a total of three examinations in their first five years of existence, in their first, third, and fifth years, and once every five years thereafter, resulting in a reduction in the required number of minimum examinations and a cost savings for the carriers impacted by the proposed section. Additional cost savings are anticipated pursuant to proposed §7.84(e)(2), which provides that affiliated Texas carriers may be examined at the same time. In effect, §7.84(e)(2) would allow certain examinations to be deferred in order to align the examination dates of affiliated carriers who are members of the same holding company system. Aligning the examination dates of affiliated carriers will also result in cost savings by reducing the number of examinations required of systems and platforms that are commonly shared by affiliated carriers in holding company systems.

Carriers Organized or Incorporated for More than Five Years in Texas. The Department does not anticipate additional costs for carriers that have been organized or incorporated for more than five years. Rather, the Department anticipates that these carriers will experience a decrease in costs related to the decrease in the required minimum number of examinations. Before its amendment by SB 1253, the Insurance Code generally required examination at least once every three years. Current §7.84 provides that certain carriers may be eligible for additional one or two year deferments; however, in practice, the majority of carriers did not have their examinations deferred under §7.84. As a result, most carriers are subject to a three year examination interval under the current framework that is simultaneously proposed to be repealed. Under proposed §7.84(d) eligibility for deferment is eliminated and therefore all carriers

incorporated for more than five years will be subject to a required examination on a five year interval period.

Carriers that Redomesticate to Texas From Another State. The Department anticipates that a small number of companies that elect to redomesticate to Texas may be subject to one required examination under the proposal that covers less than a five year period of time. Under current Department practice, the Department generally examines carriers that redomesticate from another state to Texas within five years from the carrier's last examination by its prior state of domicile. Proposed §7.84(f) provides that the Department shall conduct an examination of a carrier that redomesticates from another state to Texas no later than five years from the carrier's last examination by its prior state of domicile or three years from the date the carrier redomesticates to Texas, whichever is less. As a result, a small number of carriers that choose to redomesticate to Texas may be subject to one required examination that covers less than a five year period of time. In the last three fiscal years, one carrier has elected to redomesticate to Texas and the Department does not anticipate an increasing trend in the number of carriers that will elect to redomesticate to Texas over the next five years. Carriers decide for their own business and economic reasons whether to redomesticate to Texas. Thus, carriers are in complete control over whether they incur costs under proposed §7.84(f). However, should they choose to incur those costs, those costs are estimated to be the same as that for similar size carriers as in this section of the proposal.

Worker's Compensation Self-insurance Groups. The proposal will not affect the examination frequency for worker's compensation self-insurance groups as proposed

§7.84(h) simply refers to the statutory examination frequency requirements in the Labor Code 407A.252, which will continue to govern the examination frequency for self-insurance groups.

Carriers Organized or Incorporated for Less than Five Years in Texas. In addition to being subject to fewer required examinations over the first five years of their existence as under previous law and Department practice, it is the experience of the Department that carriers licensed or incorporated for less than five years in Texas will often incur fewer costs per examination than those carriers that have been licensed for more than five years in Texas. The cost of an examination is not primarily based on the type of carrier, e.g. HMO, life insurance company, property and casualty company. Rather, the cost of an examination is more directly associated with the size and complexity of the carrier being examined, including the amount of its business volume, the level of sophistication of its systems, operations, assets and liabilities, and the location of its records. Examination costs are typically less when a carrier is initially licensed because its operations are often relatively small and less complex. These costs frequently increase over time in later years in correlation with an increase in a carrier's size, business volume and complexity. These costs will also typically increase if substantial regulatory compliance or solvency concerns are encountered during the course of an examination. However, proposed §7.84(e) will result in a reduction of costs for carriers organized or incorporated less than five years compared to previous statutory requirements and Department practice. The Department previously examined new carriers at least once each year for the first three years of their existence. Under proposed §7.84(e) a carrier will be examined in their first, third and fifth year. Thus,

costs that previously were associated with a three year period will correspond to a five year period under the proposal.

Additional Examination Costs Incurred by Certain Carriers. For those redomesticating carriers and carriers subject to additional examinations because of solvency concerns, the costs of each examination are the same as that for any other examination and are described as follows: The expenses incurred by the Department while examining a carrier are billed to that carrier as required by the Insurance Code §401.151, *et seq.* However, carriers can essentially recoup these costs pursuant to the Insurance Code §401.154 which allows carriers to take a credit (deduction) against insurance premium taxes the carriers would have otherwise paid to the state. However, for insurers that choose to locate their principal office and books and records outside of Texas, certain premium tax credits may not apply. The Insurance Code §803.007 places certain limits on the amount of tax credits that may be taken by a Texas domestic carrier that elects to locate its principal office and books and records outside of Texas. Section §803.007 prohibits tax credits for examination fees or expenses paid to another state and certain other expenses incurred by the Department related to domestic companies with principal offices located outside Texas.

The Department's direct examination costs are comprised of the Department's professional staff time and related expenses, such as food and lodging in those certain cases where overnight travel is required. The amount of staff time and related expenses required for an examination will vary based upon a number of factors. As previously noted, these factors include the size and complexity of the carrier, the amount of its business volume, the level of sophistication of its systems, operations,

assets and liabilities, and the location of its records. Based on actual historical amounts billed to carriers in the past, these expenses are typically less for smaller and less complex insurers. As a result, the Department anticipates that the majority of carriers organized for less than five years will incur direct examination costs that are billed by the Department for amounts generally ranging from \$5,000 to \$25,000. In general, the Department anticipates an examination of a small, non-complex carrier may require less than 100 hours of professional staff time by the Department's staff, whereas a larger, more-complex carrier may require 800 hours or more of professional staff time. Moreover, a locally based carrier will typically be billed for insignificant travel related expenses, such as driving expenses and daily meals. However, non-local carriers will often be billed for more significant travel related expenses, such as flights and hotel lodging particularly if the carrier elects to locate its books and records out of state. Although the Department does not anticipate that it would happen frequently, a carrier could grow to become a medium sized carrier and/or engage in relatively complex operations during its initial five years of existence, in which case the Department estimates the costs of examinations could range from \$20,000 to \$50,000. However, the Department views this possibility as an exception to typical situations. A carrier that has been in existence for less than five years would incur additional examinations in excess of the initial \$5,000 to \$25,000 estimate if that carrier is found to be operating in a hazardous financial condition, or if substantial non-compliance with regulatory requirements is discovered during the course of an examination. It is therefore possible that a carrier may require more frequent examinations and therefore incur additional costs, but this would generally not be considered a typical event. Thus, the Department

does not anticipate that the proposed section will result in increased costs related to the minimum required examinations for any group of carriers. Although carriers will incur costs under the proposed section, as under prior law, overall the proposed section should typically result in a cost decrease for carriers for the reasons previously detailed.

Additional Indirect Examination Costs Incurred by Certain Carriers. Carriers examined by the Department also incur indirect costs resulting from the examination process, which primarily relate to the carrier's staff time that is necessary to respond to requests for information from the Department's examiners, document production, and the review of the examination reports. Examiners routinely request a variety of documents and other records from a carrier being examined. A carrier's staff time that is necessary to respond to examinations will vary substantially based upon several factors including the carrier's size and complexity, the adequacy of its books, records, systems and internal controls, the adequacy and competency of its staff, and whether its operations are conducted at diverse geographic locations. The carrier's staff time required may also vary significantly based upon whether material issues of regulatory non-compliance are encountered and whether the carrier is operating in a hazardous financial condition. Accordingly, and based on these factors, the carrier's indirect costs will vary based upon the number of hours of the carrier's staff time that is needed to respond to the examination. The Department anticipates a carrier, regardless of size, will designate a current employee to serve as a liaison with the Department's examiners and that such employee will be familiar with the accounting records of the carrier and accounting practices in general. The Department estimates that the compensation for this employee will be the mean salary rate for an accountant of \$30.73 per hour as set

forth in the May 2008 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Because the Department's actuaries typically interact with a carrier's actuaries, the Department anticipates that a carrier, regardless of size, will typically utilize a current staff actuary who is familiar with the carrier to respond to actuarial issues. The Department estimates that the carrier's actuary will be compensated at the mean salary rate for an actuary of \$49.87 per hour as set forth in the in the May 2008 State Occupational Employment and Wage Estimates for Texas. Because the Department's examiners often request computer-generated reports, the Department further anticipates that a carrier, regardless of size, will utilize a current employee who is familiar with the computerized records of the carrier to respond to requests for computer-generated reports. The Department estimates that such an employee will be compensated at the mean salary rate for a computer programmer of \$37.28 per hour as set forth in the in the May 2008 State Occupational Employment and Wage Estimates for Texas. The Department further estimates that one or more members of a carrier's management will typically be involved in interacting with examiners, at the mean salary rate of \$47.03 per hour, for management occupations, and \$79.81 for chief executives, as set forth in the May 2008 State Occupational Employment and Wage Estimates for Texas. The Department also anticipates that a carrier, regardless of size, may often utilize other employees who are compensated at hourly rates substantially similar to the amounts detailed previously as needed to respond to examiner requests. Individual carriers are in the best position to estimate the hourly wages that they pay their employees.

The total number of carrier staff hours necessary to comply with this proposal, and thus the total probable indirect costs to comply with the new proposed section, will vary substantially among carriers based upon the factors previously described including the carrier's size, complexity of its systems, and, more importantly, the adequacy of the carrier's books, records and internal controls, whether material issues of regulatory non-compliance are encountered and whether the carrier is operating in a hazardous financial condition. For example, if a carrier has inadequate internal controls over its systems that govern the establishment of claim reserves, the carrier may incur additional costs as the Department's examiners ascertain whether the carrier has set aside sufficient reserves to secure claims owed to policyholders. In this example, the costs may be incurred as the examiners review the carrier's compliance with other various requirements relating to reserve adequacy. Because the fundamental purpose of the examination process is to ascertain compliance by the carrier with various other provisions of the Insurance Code and the Texas Administrative Code, any other indirect costs for carriers to comply with the proposed new section result from the enactment of these other various financial solvency requirements contained in the Insurance Code and the Texas Administrative Code and are not a result of the adoption, enforcement, or administration of the proposal.

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 §2006.001(1) does not specify a maximum level of gross receipts for a “micro business.”

Proposed new §7.84 specifies the frequency of examinations of insurance carriers that have been organized or incorporated for less than five years. Small or micro business insurance carriers will be subject to the proposed rule. The cost analysis in the Public Benefit/Cost Note part of this proposal is also applicable to these small and micro businesses. Therefore, in accordance with the Government Code §2006.002(c), the Department has determined that proposed new §7.84 will not have an adverse economic effect on small or micro businesses that are required to comply with the proposal. As previously stated in the Public Benefit/Cost Note, proposed §7.84 does not impose any new requirements or costs with which businesses, including small and micro businesses as defined by the Government Code §2006.001(1) and (2), must comply. The new section will in fact result in a reduction of costs for carriers, irrespective of size or age, compared to previous statutory requirements and Department practice. The Department previously examined new carriers once each

year for the first three years of their existence. Under proposed §7.84(e) a new carrier will be examined in its first, third and fifth year. Thus, costs that previously were associated with a three year period will now correspond to a five year period under the proposal. The same types of costs that were identified for small and micro business carrier examinations over a three year period under existing §7.84 are also identified for small and micro business carriers for compliance with the requirements in this proposal but extended over a five year period. Therefore, the Department does not anticipate any increase in the estimated costs for this proposal from those estimated for compliance with existing §7.84 requirements. The Department also does not anticipate any difference in the economic impact on small and micro business carriers from that determined for compliance with the existing rule and law. In accordance with the Government Code §2006.002(c), the Department has therefore determined that a regulatory flexibility analysis is not required because the proposed amendments to §7.84 will not have an adverse impact on small or micro businesses.

Because there are no additional costs to insurers as a result of proposed §7.84, there is no differential impact between small, large and micro businesses in complying with proposed new §7.84 and therefore, it is neither legal nor feasible nor necessary to waive the requirements of proposed new §7.84 for small or micro businesses.

However, even if the proposed new §7.84 or the statutory requirements reiterated in the proposed amendments were to result in an adverse economic impact on small or micro business insurance companies, the Department, in accordance with the Government Code §2006.002(c-1), has determined that 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 or micro 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 §7.84 is mandated by the Insurance Code §401.052(b). Although the Department, based on modern financial examination practices, proposes to institute an examination frequency schedule in which carriers will be subject to a reduced number of required Department examinations, the primary purpose of §401.052 and §7.84 is to ensure the efficiency and effectiveness of the Department's financial examination process. New §7.84 will facilitate and modernize the Department's monitoring of the financial solvency of insurance carriers thereby protecting the economic welfare of: (i) insurance companies; (ii) consumers that purchase insurance contracts; (iii) other persons and entities that would be adversely affected by an insurance company insolvency; and (iv) the public and the state of Texas generally. The examination frequency requirements of new §7.84 are consistent with and necessary to implement the legislative intent of §401.052(b). Exempting small or micro

businesses from minimum examination frequency rules or altering the rules for such businesses would not be consistent with the public policy of requiring all insurance carriers to be regularly monitored for insolvency problems and other issues which may only be revealed through the examination process. Thus, small insurers need to be examined, at minimum, on the frequency specified in the proposed rule, and anything less would be insufficient to protect carrier solvency and the interests of consumers.

In summary, all carriers will incur costs under the proposed section, as under the prior rule and law, but the proposed section will result in an overall cost decrease for all carriers for the reasons previously detailed. Moreover, these costs will be incurred by carriers not as a result of the proposed rule but pursuant to the Insurance Code Chapter 401, Subchapter B. Also, carriers can essentially recoup the examination costs pursuant to Insurance Code §401.154 which allows carriers to take a credit (deduction) against insurance premium taxes the carriers would have otherwise paid to 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 5:00p.m. on July 26, 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 should be submitted simultaneously to Danny Saenz, Senior Associate Commissioner, Financial Program, Mail Code 305-2A, Texas Department of Insurance, P. O. Box 149104, Austin, Texas 78714-9104. Any request for a public hearing on the proposal should be submitted separately to the Office of the Chief Clerk before the close of the public comment period. If a hearing is held, oral and written comments presented at the hearing will be considered.

7. STATUTORY AUTHORITY. The new section is proposed pursuant to the Insurance Code §401.052 and §36.001. Section 401.052(a) permits the Department to examine carriers as often as the Department considers necessary, but not less frequently than once every five years, and §401.052(b) requires the Commissioner to adopt rules governing the frequency of examinations of carriers that have been organized or incorporated for less than five years. Several chapters of the Insurance Code continue to adopt by reference the examination authority of the Department. The following statutes specifically adopt by reference §401.052 for the noted carriers: the Insurance Code §842.209 adopts by reference §401.052 for group hospital service plans; the Insurance Code §843.156(h) specifies that Chapter 401, Subchapter B applies to health maintenance organizations except to the extent that the commissioner determines the nature of the organization renders the applicability of those provisions clearly inappropriate.; the Insurance Code §846.003 adopts by reference §401.052 for multiple employer welfare arrangements; the Insurance Code §861.257 adopts by reference §401.052 for general casualty companies; the Insurance Code §882.002 adopts by

reference §401.052 for mutual life insurance companies; the Insurance Code §884.002 adopts by reference §401.052 for stipulated premium insurance companies; the Insurance Code §885.410 adopts by reference §401.052 for fraternal benefit societies; the Insurance Code §887.062 adopts by reference §401.052 for certain mutual assessment companies; the Insurance Code §911.001 adopts by reference, except to the extent of any conflict with Chapter 911, §401.052 for farm mutual companies; the Insurance Code §912.002 adopts by reference §401.052 for county mutual insurance companies; the Insurance Code §942.003 adopts by reference §401.052 for reciprocal and interinsurance exchanges; the Insurance Code §961.002 adopts by reference §401.052 for nonprofit legal services corporations; the Insurance Code §982.255 adopts by reference §401.052 for foreign and alien insurance companies; the Insurance Code §2201.156 adopts by reference §401.052 for risk retention groups and purchasing groups; the Insurance Code §2203.004 adopts by reference §401.052 for medical liability insurance joint underwriters; and the Insurance Code §2551.001 adopts by reference Chapter 401 for title insurers. Section 36.001 authorizes the Commissioner of Insurance 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: Insurance Code §§401.052, 842.209, 843.156(h), 846.003, 861.257, 882.002, 884.002, 885.410, 887.062, 911.001, 912.002, 942.003, 961.002, 982.255, 2201.156, 2203.004, and 2551.001.

9. TEXT.

§7.84. Examination Frequency.

(a) Purpose. This section governs the frequency of examinations conducted under the Insurance Code §401.052. The section implements the Insurance Code §401.052(b) which directs the commissioner to adopt rules governing the frequency of examinations of carriers that have been organized or incorporated for less than five years.

(b) Applicability. This section applies only to examinations commenced after the effective date of this section.

(c) Definitions. The following words and terms, when used in this section, shall have the following meanings, unless the context clearly indicates otherwise.

(1) Carrier--For the purposes of this section, carrier includes any entity subject to examination under the Insurance Code §401.051. The term does not include a workers compensation self-insurance group as that term is defined by the Labor Code Chapter 407A.

(2) Commissioner--The Commissioner of Insurance.

(3) Department--The Texas Department of Insurance.

(4) Insurance Holding Company System--As described in the Insurance Code §823.006.

(5) Redomesticated Carrier--A carrier that redomesticates to this state from another state under the Insurance Code §983.051.

(6) Self-Insurance Group--An unincorporated association or business trust composed of five or more private employers holding a certificate of approval to act as a workers' compensation self-insurance group issued by the department under the Labor Code Chapter 407A.

(d) Examination of Texas Domestic Carriers Organized or Incorporated for Five Years or More Under the Laws of This State. Except as provided in subsections (f) and (g) of this section, the Insurance Code §401.052(a) governs the frequency of examinations for Texas domestic carriers organized or incorporated for five years or more under the laws of this state.

(e) Examination of Texas Domestic Carriers Incorporated or Organized for Less Than Five Years Under the Laws of This State.

(1) Except as provided in paragraph (2) of this subsection and subsections (f) and (g) of this section, the department shall conduct an examination of a Texas domestic carrier incorporated or organized for less than five years under the laws of this state in the carrier's first, third, and fifth years. For a Texas domestic carrier that receives a certificate of authority or other authorization from the department on or before June 30, the first year to be examined shall be the calendar year in which the carrier received the certificate of authority or other authorization from the department. For a Texas domestic carrier that receives a certificate of authority or other authorization from the department after June 30, the first year to be examined shall be the calendar year immediately following the calendar year in which the carrier received the certificate of authority or other authorization from the department and shall include

the first partial year. Thereafter, the Insurance Code §401.052(a) shall govern the frequency of examination.

(2) If a Texas domestic carrier incorporated or organized for less than five years under the laws of this state is a member of an insurance holding company system with one or more affiliated Texas domestic carriers, the department may conduct an examination of the Texas domestic carrier at the same time it conducts the examination of the affiliated Texas domestic carrier or carriers, provided one or more of the Texas domestic affiliated carriers has conducted the business of insurance in Texas continuously for 10 or more consecutive calendar years. In making this determination, the department shall consider whether any affiliated carriers of the Texas domestic carrier are in a hazardous condition or conditions, including the conditions described in §8.3 of this title (relating to Hazardous Conditions); whether:

(A) any affiliated carriers of the Texas domestic carrier are in a hazardous condition or conditions, including the conditions described in §8.3 of this title;

(B) any affiliated carriers of the Texas domestic carrier are the subject of pending administrative action by a regulatory agency of this state, the United States, or another state; and

(C) the department has any financial or other regulatory concerns regarding any affiliated carriers of the Texas domestic carrier.

(f) Examination of Redomesticated Carriers. The department shall conduct an examination of a redomesticated carrier no later than five years from the carrier's last examination by a prior state of domicile or three years from the date the carrier redomesticates to Texas, whichever is less. The department shall conduct an

examination of a redomesticated carrier as often as the department considers necessary.

(g) Examination of Self-Insurance Groups. This section does not apply to self-insurance groups governed by the Labor Code §407A.252.

(h) Commissioner's Authority. This section does not in any way limit the commissioner's authority to visit or examine a carrier as often as the commissioner considers necessary.

(i) Conflicts. In the event of a conflict between this section and the Insurance Code or the Labor Code, the provisions of the Insurance Code or the Labor Code prevail.