

**SUBCHAPTER E. TEXAS WINDSTORM INSURANCE ASSOCIATION
DIVISION 3. LOSS FUNDING, INCLUDING CATASTROPHE RESERVE TRUST
FUND, FINANCING ARRANGEMENTS, AND PUBLIC SECURITIES
28 TAC §§5.4101, 5.4102, 5.4121, 5.4123 - 5.4128, 5.4133, 5.4135, 5.4136, 5.4141 -
5.4147, 5.4148, and 5.4149**

1. INTRODUCTION. The Texas Department of Insurance proposes adding new 28 TAC §§5.4123 - 5.4128, 5.4135, 5.4136, 5.4148, and 5.4149 and amending 28 TAC §§5.4101, 5.4102, 5.4121, 5.4133, and 5.4141 - 5.4147 to implement legislative changes to the Insurance Code Chapter 2210 under House Bill (HB) 3, 82nd Legislature, 1st Called Session, effective September 28, 2011, and amend the Texas Windstorm Insurance Association's (association) plan of operation. These sections concern funding losses and operating expenses in excess of the association's premium and other revenue under Subchapters B-1, J, and M, Chapter 2210, Insurance Code. Matters addressed in the proposed plan of operation amendments include: (i) the catastrophe reserve trust fund (CRTF); (ii) financing arrangements; (iii) issuance of public securities; (iv) use of public securities proceeds; and (v) payment of public security obligations. In conjunction with this proposal, the department is also proposing the repeal of existing 28 TAC §5.4131 and §5.4132 in a separate proposal also published in this issue of the *Texas Register*.

The legislature created the association to serve as a residual insurer of last resort for windstorm and hail insurance coverage (insurance coverage) in the catastrophe area. The commissioner of insurance designates under the Insurance

Code §2210.005. The designated catastrophe area currently consists of the 14 Texas coastal counties and parts of Harris County.

HB 3 amended how association losses and operating expenses in excess of premium and other revenue are funded in new Subchapters B-1 and M, Chapter 2210, Insurance Code. Compliance with these Insurance Code requirements is essential to assure the availability of association insurance coverage for all eligible persons and properties. The proposed sections implement the legislative loss-funding scheme.

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

Historically, the association's plan of operation has been specified in §5.4001 of this title (relating to Plan of Operation). Neither the Insurance Code §2210.151 nor §2210.152 require the association's plan of operation to be in a single section of the Texas Administrative Code. In 2009, the department began to revise the format of the plan of operation into sections related to specific topics.

As stated in §5.4101, the provisions of this division are part of the association's plan of operation. To the extent that the HB 3 requirements amend or augment the association's existing plan of operation, those requirements must be integrated in the plan of operation.

Thus, it is necessary to amend the plan of operation to address the following: (i) financing arrangements; (ii) issuance of public securities; (iii) use of public securities proceeds; and (iv) payment of public securities. This proposal explains in subsequent discussions each of the proposed sections in detail. This proposal also makes nonsubstantive changes based on changes in agency style to the sections being amended.

§5.4101. Applicability. As previously discussed, the association operates under a plan of operation. Amendments to §5.4101(a) include the proposed new sections in this division that will be considered part of the association's plan of operation and will control over any conflicting provision in §5.4001 of this title.

§5.4102. Definitions. Proposed §5.4102 defines terms used in this division. The definitions are from the Insurance Code Chapter 2210 and information and terminology the Texas Public Finance Authority (TPFA) provided to the department. The proposal does not intend to substantively redefine terms used in Chapter 2210; however, the definitions have been further adapted for use in this division.

§5.4121. Financing Arrangements. The Insurance Code §2210.072 and §2210.612 provide that the association may enter into financing arrangements directly with a market source for the purpose of enabling the association to pay losses or obtain

public securities under the Insurance Code §2210.072. Section 5.4121 relates only to the association entering into financing directly with a market source. It is not the department's intent that the proposed section be interpreted or construed as affecting the TPFA's ability to issue public securities on behalf of the association as authorized in Chapter 2210.

Amendments to §5.4121(a) make minor grammatical changes and are not intended to be substantive changes to the existing procedure or requirements. Amendments to §5.4121(b) revise the section based on the use of the term "net premium" as it is defined in this proposal and used in HB 3.

HB 3 revised the Insurance Code §2210.612 to define that the revenue stream available to fund class 1 public security obligations and public security administrative expenses was "net premium" rather than the prior reference to "premium." Additionally, net premium is a funding source for the repayment of premium surcharges and member assessments that are used to pay the class 2 public securities issued under the Insurance Code §2210.6136 and §5.4126 of this title. Other revenue may also be used to fund these amounts.

The Insurance Code §2210.609 establishes a priority for the use of net premium to fund class 1 public security obligations and public security administrative expenses. The repayment of premium surcharges and member assessments is different because these obligations are not paid directly to public security owners. However, the obligation does result from a commissioner's order based on a statutory repayment requirement. Thus, §5.4121(b)(1) reflects that the payment of financing arrangements

is subordinate to the use of net premium and other revenue under §5.4126 and §5.4141 of this title and the Insurance Code §2210.612 and §2210.6136.

The amendment to §5.4121(c) restates the collateral assignment to apply to “any class of public security issued under the Insurance Code Chapter 2210” rather than listing each class. This change is not intended to be substantive.

§5.4123. Public Securities Request, Approval, and Issuance. The Insurance Code Chapter 2210, Subchapter B-1, prescribes how the association must pay for insured losses and operating expenses if an occurrence or series of occurrences in the catastrophe area result in insured losses and operating expenses in excess of the association’s premium and other revenue. Such an occurrence or series of occurrences is defined as a “catastrophic event” under the Insurance Code §2210.602(1-b) and §5.4102(8) of this title. Because the sections in this division apply to funding the association’s insured losses and operating expenses following a catastrophic event, that term is used in this proposal.

The Insurance Code §2210.071 requires the association to first exhaust the CRTF. Once the CRTF is exhausted, the association may use the proceeds of public securities issued by the TPFA, as described in the Insurance Code §§2210.072 - 2210.074. As provided in the Insurance Code §2210.604, the association must request the issuance of public securities and the commissioner must approve that request before the TPFA may issue public securities on behalf of the association.

Section 5.4123 establishes the general procedure that the association must use to request public securities. Sections 5.4124 - 5.4126 of this title establish specific

information requirements for issuing public securities before and after a catastrophic event, as authorized in the Insurance Code Chapter 2210, Subchapter B-1.

Section 5.4123(a) sets forth the requirement that the association's board of directors must request the issuance of public securities and: (1) must submit the request to the commissioner; (2) may request public securities as necessary; (3) may combine requests for the issuance of multiple classes of public securities into one request; and (4) may, at any time, request the issuance of public securities that must be issued after a catastrophic event results in insured losses that are payable under the Insurance Code §§2210.072 - 2210.074.

Section 5.4123(a)(4) is necessary because of the time required for issuing public securities. The TPFA has informed the department that the time from the date of the request for issuance to the actual issuance, or in other words sale, of the public securities and receipt of the proceeds may be to six to eight months.

The order adopting §5.4131 of this title recognized that the TPFA would likely prepare for issuing public securities prior to a catastrophic event and specifically stated: "Because of the complexity of the public security funding arrangements, it is likely that the TPFA will have already made certain arrangements prior to the occurrence of a catastrophic event that will give rise to the need for the public securities. Nothing in this adoption should be construed as limiting the TPFA's ability to perform such actions."

The TPFA has informed the department that it cannot begin preparation for the issuance of public securities until the TPFA has a request for issuance from the association that is approved by the commissioner. Therefore, §5.4123(a)(4) states that

prior to a catastrophic event the association may request the TPFA to issue public securities after a catastrophic event. The Insurance Code Chapter 2210 limits when the public securities may be issued, not when the public securities may be requested.

Section 5.4123(b) sets forth the requirement that the commissioner must approve the request before the TPFA may issue the public securities. The commissioner may request additional information concerning the request without rejecting the request and may rely on information from any source in making the approval decision. Although the statute does not specifically address disapproval, the commissioner may disapprove the request. Disapproval is without prejudice, and the association's board of directors may reconsider the request and submit another request for the issuance of public securities. If the commissioner approves the request, the department shall provide the commissioner's written approval to the association and the TPFA.

Section 5.4123(c) provides that the TPFA may issue public securities and credit agreements on behalf of the association following the commissioner's approval of the association's request. Once authorized to proceed, the TPFA has extensive authority to consider the request and issue the public securities based on market conditions; the Insurance Code Chapter 2210; the TPFA's enabling statutes, laws, and guidelines concerning the issuance of public securities; and the TPFA's own rules and procedures. This includes the TPFA's authority under the Insurance Code §2210.605 and §2210.606.

Section 5.4123(d) provides that the association must provide to the department and commissioner any requested information concerning public securities or the pending issuance of public securities. It is important that this information be accessible to maintain effective regulation of the association. Section 5.4123(e) clarifies that the procedure outlined in this section applies to the issuance of public securities and the reissuance and refinancing of public security obligations.

§5.4124. Issuance of Class 1 Public Securities before a Catastrophic Event. HB 3 amended the Insurance Code §2210.072 to authorize the TPFA to issue class 1 public securities on behalf of the association before a catastrophic event. The association's board of directors must request the issuance of the public securities, and the commissioner must approve the board's request before the TPFA can issue the public securities. Section 5.4124 establishes specific requirements for a request to issue class 1 public securities before a catastrophic event and the method for calculating the outstanding aggregate principal amount of class 1 public securities issued before a catastrophic event.

Section 5.4124(a) sets forth the basic requirement that the commissioner must approve the association's board of directors' request to the TPFA to issue class 1 public securities. Section 5.4124(a) refers to the procedure outlined in §5.4123 of this title. Section 5.4124(b) lists the information that must be provided to the commissioner in support of the request, including a cost-benefit analysis, which the Insurance Code §2210.604(a) requires for all public security requests. The contents of the cost-benefit analysis are set forth in §5.4135 of this proposal. Section 5.4124(c) provides that the

association may submit one or more requests to issue class 1 public securities before a catastrophic event.

Section 5.4124(d) establishes the method of calculating outstanding aggregate principal amount of class 1 public securities issued before a catastrophic event. The Insurance Code §2210.072(b) limits the amount of outstanding class 1 public securities issued before a catastrophic event to \$1 billion, regardless of the calendar year or years in which the class 1 public securities were issued. The Insurance Code §2210.072(e) states that the association must deplete the proceeds of outstanding class 1 public securities issued before a catastrophic event before proceeds of class 1 public securities issued after a catastrophic event may be used. The Insurance Code §2210.072(f) states that the proceeds of outstanding class 1 public securities issued before a catastrophic event that must be depleted count against the \$1 billion catastrophe year limit set forth in the Insurance Code §2210.072(b).

These provisions authorize the association to issue class 1 public securities issued before a catastrophic event in an outstanding aggregate principal amount of up to \$1 billion. If the proceeds of the public security are used, that public security is applied to that catastrophe year cap. Once applied to the catastrophe year cap, that public security no longer counts against the aggregate principal amount cap for class 1 public securities issued before a catastrophic event. This will enable the association to continue to use class 1 public securities issued before a catastrophic event for liquidity in years following a catastrophic event.

§5.4125. Issuance of Public Securities after a Catastrophic Event. Section 5.4125 establishes specific requirements for a request to issue class 1, class 2, and class 3 public securities following a catastrophic event, and the method for calculating the authorized principal amount of public securities that the TPFA may issue. As previously discussed in regard to §5.4123(a)(4), the statute limits when the public securities can be issued, not when the public securities may be requested.

Section 5.4125(a) sets forth the basic requirement that the commissioner approve the association's board of directors' request to the TPFA to issue public securities. Section 5.4125(a) refers to the procedure outlined in §5.4123 of this title, including making the request before or after the catastrophic event. Section 5.4125(b) lists the information that must be provided to the commissioner in support of the request, including a cost-benefit analysis, which the Insurance Code §2210.604(a) requires for all public security requests.

Section 5.4125(c) establishes the method of calculating the authorized principal amount of public securities that can be requested for issuance. Section 5.4125(d) clarifies that, for each catastrophe year, the association must request the statutory authorized principal amount of each class of public security before it can request the next class of public security. Section 5.4124(e) provides that the association may make one or more requests to issue public securities under this section and clarifies that the association need not exhaust all proceeds from a class of public security before it may request issuance of the next class of public security. Depending on the severity of a catastrophic event, the association may need additional loss funding from one or more

classes of public security. The TPFA has informed the department the process of issuing public securities from request to obtaining the proceeds is measured in months. Thus, to have adequate proceeds available as timely as possible for the prompt payment of claims, the association may need to request more than one class of public security. This section would allow for such a request.

§5.4126. Alternative for Issuing Class 2 and Class 3 Public Securities. The Insurance Code §2210.073 provides that class 2 public security proceeds are to pay for losses that have not been paid from the class 1 public security proceeds. This raises an issue of providing adequate loss funding for the association if the entire \$1 billion authorized amount of class 1 public securities cannot be issued due to market conditions. The department adopted rules in §5.4131 of this title to address that situation. Subsequent to the department's rules, the legislature in HB 3 enacted the Insurance Code §2210.6136 to address this situation.

Section 5.4126 is proposed to implement the Insurance Code §2210.6136. Section 5.4126(a) establishes that the purpose of this section is the issuance of class 2 and class 3 public securities if the TPFA cannot issue on behalf of the association all or any portion of the authorized principal amount of class 1 public securities requested under §5.4125 of this title. Section 5.4126(b) lists the information that the association must provide to the commissioner to support that all or any portion of the requested class 1 public securities cannot be issued.

Section 5.4126(c) requires that the association must first request the authorized principal amount of class 1 public securities as determined under §5.4125(c) of this

title, before the association may request class 2 public securities under this alternative issuance procedure. The association is not required to have requested the maximum authorized principal amount of class 1 public securities because the catastrophic event may not reach that level of loss. The amount of the request under this section will be based on the amount of class 1 public securities that the TPFA cannot issue on behalf of the association to fund the catastrophic loss.

Section 5.4126(d) provides that the commissioner may issue an order authorizing the TPFA to issue class 2 public securities in an amount that does not exceed the authorized principal amount as determined under §5.4125(c) of this title. The principal amount is limited to the amount the association needs to fund the excess losses. The commissioner may rely on information from any source in making the approval decision. Section 5.4126(e) sets forth the required contents of the commissioner's order authorizing the issuance of class 2 public securities.

Section 5.4126(f) provides that the commissioner can revise the order authorizing the issuance of class 2 public securities as necessary because the association has paid excess amounts towards repayment of the premium surcharges and member assessments or the association's financial situation has changed necessitating a change in the repayment schedule. As discussed in regards to §5.4121(b), the priority of the repayment obligation to net premium is second only to the payment of the class 1 public securities. However, over the estimated 10-year course of the public securities it is foreseeable that the need for flexibility may arise and it is best to state that such flexibility exists.

Section 5.4126(g) provides that the TPFA may issue the class 2 public securities authorized in the commissioner's order. Further, the subsection points out that the TPFA may elect to issue the class 2 public securities in separate series. As previously discussed with regard to §5.4123(c), once authorized, the TPFA has extensive authority to consider and issue the public securities on behalf of the association.

Section 5.4126(h) is to clarify that the association may request and the commissioner may approve the issuance of class 3 public securities prior to the issuance of class 2 public securities under the section and the Insurance Code §2210.6136; the TPFA simply cannot issue the class 3 public securities until after the TPFA has issued \$1 billion in class 2 public securities on behalf of the association for that catastrophe year.

§5.4127. Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments. As discussed, the legislature enacted the Insurance Code §2210.6136 for funding excess losses when a sufficient amount of class 1 public securities cannot be issued. As with HB 4409, 81st Legislature, 2009 Regular Session, the HB 3 amendments indicate a shift to making the association more self-reliant. However, HB 3 does not express any legislative intent that the association is to stop paying claims based on its inability to market public securities based on the association's net premium and other revenue. If that were the case, the legislature could have required the association to issue a minimum amount of class 1 public securities.

Instead, the legislature created a plan in the Insurance Code §2210.6136 to allow for the TPFA to issue class 2 public securities if it could not issue all or any

portion of the total authorized principal amount of the association's class 1 public securities. Under the Insurance Code §2210.6136, the association must then repay the premium surcharges and member assessments required to pay the principal, interest, and costs on an amount of class 2 public securities as specified in the Insurance Code §2210.6136(b)(1).

This is the only reading of the Insurance Code §2210.6136 that is consistent with the Government Code §311.021. It is not feasible to read the statute to require the TPFA to issue all of the class 1 public securities it can based on the association's net premium and other revenue and then expect the TPFA to issue additional association public securities using the same funding sources simply because the name of the public security has changed. Such a reading would render the Insurance Code §2210.6136 meaningless. The statute does not require the association to borrow additional amounts; the statute requires the association to repay the costs incurred on some of the class 2 public securities. The association must repay the premium surcharges and member assessments to fulfill that requirement.

Section 5.4127 implements the repayment scheme in the Insurance Code §2210.6136. Section 5.4127(a) requires the association to pay class 2 public securities issued under §5.4126 of this title using premium surcharges and member assessments. Section 5.4127(a)(1) and (2) clarify that the definition of insurer and the procedures for collecting premium surcharges and member assessments under this section are the same as those used for class 2 public securities that would be issued under §5.4125. Section 5.4127(b) provides the method of determining the principal amount of class 2

public securities for which the association shall repay member assessments and premium surcharges. Section 5.4127(c) clarifies the requirement is to repay premium surcharges and member assessments that are paid, or payable, on the total principal amount, plus any costs and contractual coverage amount associated with that amount.

Section 5.4127(d) describes the primary sources of funding for the repayment of the premium surcharges and member assessments. Section 5.4127(e) provides that the association must collect premium and other revenue to make the repayments. This means that collection of premium to repay the amount owed should be reflected in the association's rates.

Section 5.4127(f) describes the methods the association may use to make the repayment. Section 5.4127(f)(1) addresses the situation if the association should have sufficient funds to make the payment on class 2 obligations, which would eliminate or reduce the need to collect premium surcharges and member assessments. The association will make deposits necessary to make this payment in the appropriate trust funds. This could result in savings on administrative costs for the association that would result for tracking the premium surcharge repayments. Association policyholders could also benefit because association insurance coverage is subject to the premium surcharge. Section 5.4127(f)(2) requires the association to deposit funds in a repayment obligation trust fund to repay the premium surcharges and member assessments. The funds would later be distributed to insurers for repayment in accordance with the commissioner's order issued under §5.4126 of this title. Together,

through prepayment or repayment, the association must fulfill its obligation under this section and the Insurance Code §2210.6136.

Section 5.4127(g) requires the association to track receipts of premium surcharges and member assessments. Section 5.4127(h) addresses the situation that insurers may desire to avoid some of the administrative costs that would result from tracking premium surcharges for later repayment to their policyholders. Under this section, insurers may pay their policyholders premium surcharges that would be subject to repayment. The insurer would then collect the repayment when made as described in §5.4128(c) of this title.

§5.4128. Repayment of Premium Surcharges to Policyholders and Member Assessments to Insurers. Section 5.4128 addresses the procedures the association and insurers must use concerning the repayment of premium surcharges and member assessments. Section 5.4128(a) specifies the information that the association must provide to insurers when making a repayment. Section 5.4128(b) establishes when the repayments must begin. Section 5.4128(c) establishes insurer requirements for making repayments to their policyholders. The repayment will be proportional to the amount paid for that period and the insurer may not claim a greater share of the premium surcharge than the portion it paid on behalf of its policyholder during that period. Member assessments will be returned to the insurer or insurance group that paid the member assessment.

§5.4133. Public Security Proceeds. The Insurance Code §2210.607 provides that the public security proceeds must be held in trust with the trust company for the

benefit of the association. The Insurance Code §2210.608 provides how public security proceeds may be used. This section establishes the procedure for the association to request the trust company to disburse funds for use.

HB 3 amended §2210.608 to specifically allow two additional uses of public security proceeds and prohibit the association from using the proceeds of public securities issued before a catastrophic event to purchase reinsurance. The amendment to §5.4133 removes the reference to using public security proceeds and directs the reader to the Insurance Code §2210.608 for the authorized uses of public security proceeds.

§5.4135. Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis. Section 5.4135(a) defines the term “marketable public securities.” Section 5.4135(b) addresses the factors that the association must consider in determining whether class 1 public securities are not marketable. This information is necessary for the determination on issuing class 2 public securities under §5.4126 of this title. Section 5.4135(c) addresses the factors that the association must consider in determining "market conditions and requirements" under §5.4135(b).

HB 3 amended the Insurance Code §2210.604(a) to require the association to provide the commissioner with a cost-benefit analysis with each public security issuance request. Section 5.4135(d) states the Insurance Code §2210.604(a) requirement and lists the information that the cost-benefit analysis must include.

§5.4136. Association Rate Filings. HB 3 amended the Insurance Code §2210.355 to clarify that association rates must consider class 1 public security obligations and contractual coverage amounts that the association determines to be required for the issuance of marketable public securities. Section 5.4136 restates the statutory requirement and clarifies that it also applies to repayment amounts owed under §5.4127(b) of this title, which are repaid from the same sources of funds as class 1 public securities. Section 5.4136 establishes how the association must comply with this requirement.

§5.4141. Obligation Revenue Fund for the Payment of Class 1 Public Security Obligations and Operating Reserve Fund. HB 3 amended the Insurance Code §2210.612 to direct the association to deposit its net premium and other revenue in the obligation revenue fund for the payment of class 1 public securities. The statute had previously required the association to deposit its premium and other revenue in the obligation revenue fund.

The Insurance Code Chapter 2210 does not define the term net premium. The term can have a meaning in the insurance industry of earned premium, which is gross premium less unearned premium. Other possible definitions could be net of expenses, but the department, after consultation with the TPFA and review of Chapter 2210, has not proposed such a definition. The TPFA has advised the department that the association's ability to market class 1 public securities directly relates to the public security owners' priority to funds. In establishing class 1 public securities as the first level of public security funding for excess losses under the Insurance Code §2210.072,

the department presumes the legislature intended the class 1 public securities be marketable.

This definition is also consistent with the existing section and requirement. While the section refers to net revenue, all of the funds in the operating reserve fund were available to pay any shortage in the class 1 obligation revenue fund. Together, net revenue and the operating reserve fund equal net premium. The association's obligation to use net revenue and operating reserve fund took priority over any other use of those funds. The proposed section simply removes the requirement to establish an operating reserve fund and uses the statutory term. The TPFA must still meet its Insurance Code §2210.605 obligation to issue public securities that are in the best interest of the association, which includes ensuring that the association remains a viable entity for the purpose of providing windstorm and hail insurance coverage in the designated catastrophe area.

The Insurance Code §2210.609(c) requires that all revenue collected under the Insurance Code §§2210.612, 2210.613, and 2210.6135 must be deposited in the appropriate public security obligation revenue fund. Section 5.4141 continues to establish how the association is to continue its ordinary operations while funding the obligation revenue fund for the payment of class 1 public security obligations, public security administrative expenses, and contractual coverage amounts, which are collectively defined in §5.4102(12) as the "class 1 payment obligation." The department has learned that various payment options may be available to the association. These options would depend on a variety of market factors and conditions.

The proposed amendments to §5.4141(a) remove the net revenue reference that was created for the existing rule and refers to the statutory term of “net premium and other revenue.” The overall requirement remains similar. The association must deposit net premium in the amounts and for the periods required in the class 1 public security agreements. The intent is to allow greater flexibility in establishing payment schemes while the association continues to operate.

§5.4142. Excess Obligation Revenue Fund Amounts. From time to time, the association may need to disburse funds in the obligation revenue fund, including the contractual coverage amount. Section §5.4142 provides that the association may use a disbursement as an association asset; however, if the association elects to redeem or purchase public securities early, commissioner approval is required under the Insurance Code §2210.072. Although the funds in the obligation revenue fund consist of net premium and other revenue, class 1 public security payment obligations no longer apply to excess funds released under §5.4142.

Distribution of the excess revenue in the obligation revenue fund does not affect the amounts due under the Insurance Code §2210.6136 or §5.4126 of this title. The distribution does provide the association with additional funds that can be used for pre-paying the amounts due under the Insurance Code §2210.6136 or §5.4126 of this title. The proposal does not require prepayment because it is impossible to determine now what the association’s financial position will be at the time of the distribution or what will be the best use of the distribution.

§5.4143 and §5.4146. Trust Funds for the Payment of Class 2 and Class 3

Public Securities and Member Assessment Trust Fund for the Payment of Class 3

Public Securities. The Insurance Code §2210.613 provides for the payment of class 2 public security obligations with premium surcharges on most lines of property and casualty insurance policies in the catastrophe area and member company assessments. The Insurance Code §2210.6135 provides for the payment of class 3 public security obligations with association member company assessments. These amounts would include any applicable contractual coverage amounts. The procedure for establishing, assessing, collecting, reporting, accounting for, and transmitting the premium surcharges and member assessments to the association are currently set forth in §§5.4161 - 5.5467, 5.4171 - 5.5173, and 5.4181 - 5.4192 of this title. HB 3 changes to the Insurance Code §2210.613 concerning the lines of insurance subject to the premium surcharge, refunding, and other matters will be the subject of a separate proposal.

Section 5.4143 and §5.4146 have similar requirements. In both instances, the association is required to deposit the collected revenue in the appropriate fund. The amendments to these sections reflect HB 3 changes to the Insurance Code §2210.609, which created distinct revenue trust accounts for the premium surcharges and member assessments. Additionally, the proposal requires the association to transfer the collected money in the trust funds on receipt. Finally, the amended sections further address that the use of these funds is limited. They may only be used to fund the appropriate public security obligation or as authorized in this title, which includes the

use of excess funds under §§5.4144, 5.4145, and 5.4147 as authorized under the Insurance Code §2210.611.

§5.4144, 5.4145, and 5.4147. Excess Class 2 Premium Surcharge Revenue, Excess Class 2 Member Assessment Revenue, and Excess Class 3 Member Assessment Revenue. The revenue funds may have excess funds. HB 3 amended the Insurance Code §2210.611 to include procedures for handling both excess premium surcharge and member assessment revenue. The amendments to these sections are to conform the existing provisions to the Insurance Code §2210.611 as amended.

§5.4148 and §5.4149. Repayment Obligation Trust Fund for the Payment of Amounts Owed under §5.4127 and Excess Repayment Obligation Trust Fund Amounts. HB 3 enacted the Insurance Code §2210.6136. If necessary, that section requires the association to collect net premium and other revenue for the repayment of premium surcharges and member assessments as provided in the Insurance Code §2210.612, which also states that the collected net premium and other revenue are to be deposited in the revenue obligation fund. While the trust company could create accounts within the fund, use of the term “revenue obligation fund” for the purposes of class 1 public security payment and the repayment of premium surcharges and member assessments could be confusing. Thus, §5.4148 creates procedures for a designated repayment obligation trust fund.

Section 5.4149 provides that the first purpose of these funds is the payment of class 2 public securities subject to repayment under §5.4127(b) of this title and the

repayment of all amounts owed under §5.4127(b). To the extent funds in this account are distributed, they would first go to that purpose. To the extent that all of the amounts have been paid, excess funds would be disbursed to the association.

2. FISCAL NOTE. C. H. Mah, associate commissioner of the Property and Casualty Section, has determined that for each year of the first five years the proposed sections will be in effect, there will be no fiscal impact to state and local governments as a result of the enforcement or administration of the proposal. There will be no measurable effect on local employment or the local economy as a result of the proposal.

3. PUBLIC BENEFIT/COST NOTE. Mr. Mah also has determined that for each year of the first five years the proposed sections are in effect, there will be public benefits resulting from the proposal and there will be costs to persons required to comply with the proposal.

Anticipated public benefits. The department anticipates that a primary public benefit resulting from the proposal will be the implementation of HB 3 to provide efficient access to funding for insured losses and operating expenses exceeding the association's premium and other revenue.

Estimated costs for persons required to comply with the proposal. The association will incur costs resulting from new administrative, reporting, loss evaluation, and analysis requirements related to public securities under §§5.4126 - 5.4128, 5.4135, 5.4136, and 5.4148. Insurers that write lines of insurance that are subject to the

premium surcharge, including the association, will incur costs resulting from new administrative and reporting requirements under §5.4127 and §5.4128. Except for actuarial cost under §5.4136, the costs identified in this proposal would follow the issuance of class 2 public securities under the Insurance Code §2210.6136.

Public security costs. The association was created for the purpose of providing windstorm and hail insurance in the designated catastrophe area. It is not a business decision of the association to choose to subject itself to these regulations by electing to write this type of coverage or comply with this proposal.

While the proposal implements HB 3, many of the requirements in these sections are the same or substantially similar to existing requirements. The department has chosen in some instances to restate overall costs estimates for the requirements in these sections rather than attempt to estimate if each individual new requirement had a measurable cost. Overall, the department anticipates that these activities would involve both managerial and staff personnel, office space, and equipment. Some systems, including electronic systems, may need to be developed or updated to complete these functions. Other new and amended sections in this proposal restate existing requirements and do not add additional costs.

The association previously provided cost information to the department concerning these functions and the department does not anticipate the requirements in its proposal would change those estimated costs. The association indicated that the actual costs may differ from these estimates due to unanticipated situations and expenses. While the association indicated that the proposal would result in labor costs,

the association did not directly indicate any costs resulting from additional staff, office space, new equipment, or systems development resulting from the proposal.

§5.4126 and §5.4135. HB 3 amended Insurance Code Chapter 2210, Subchapters B-1 and M, to provide an alternative funding means of issuing class 2 and class 3 public securities if all or any portion of the class 1 public securities could not be issued and to require that a cost-benefit analysis be submitted with each request for public securities. Section 5.4126 establishes the procedural requirements for the association to request issuing class 2 and class 3 public securities. Section 5.4135 establishes the requirements for demonstrating the class 1 public securities are not marketable for purposes of §5.4126 and the requirements for the cost-benefit analysis. The commissioner needs this information to determine if association requests for public security funding should be approved. Although reorganized, the requirements for requesting the issuance of class 1, class 2, and class 3 public securities have not significantly changed. This includes requests for issuance of class 1 public securities before a catastrophic event because the requirement existed for requesting commercial paper as a class 1 public security.

The association previously estimated the cost of preparing information to support a public security funding request to be \$800 per submission. The department estimates that this \$800 cost would also apply to the request for the issuance of public securities under §5.4126. The department also anticipates that preparation of the cost-benefit analysis could result in increased association costs for all public security requests. However, the additional information and analysis would not more than

double the cost of the existing requirements. Therefore, the department estimates the additional cost of preparing the cost-benefit analysis would not exceed \$800 per request in addition to the costs for existing public security request requirements and the costs of requesting public securities under §5.4126. Thus, each public security request is estimated to cost \$1,600. The department further estimates that these costs would not change over the first five year period this proposal is to be in effect.

§§5.4127, 5.4128, and 5.4148. The Insurance Code §2210.6136 requires the association to repay premium surcharges and member assessments used to pay class 2 public securities. Section 5.4127 requires the association to record the premium surcharges and member assessments it collects to pay class 2 public securities so that the association can repay those amounts. While the association must account for these receipts under current requirements, it is not required to distinguish the amounts that must be repaid. This requirement will result in administrative costs to the association to distinguish and record these amounts, and then report these amounts when repayments are made under §5.4128. In response to a department request, the association estimated that the additional costs to develop information systems and implement financial procedures to administer the collection and return of premium surcharges and member assessments to be \$50,000. The association did not provide information of whether this cost would be constant over the first five year period this proposal is to be in effect. This cost does not include the administrative cost of making premium surcharge repayments to policyholders.

The Insurance Code §2210.6136 requires the association to repay premium surcharges and member assessments used to pay class 2 public securities. Section 5.4127 requires the association to collect and deposit funds to repay the premium surcharges and member assessments as ordered by the commissioner under §5.4126. Section 5.4148 establishes the repayment obligation trust fund, which will hold some or all of the collected repayment amounts. The association may deposit other collected repayment funds in the premium surcharge trust fund and the member assessment trust fund. The department anticipates the association will incur some administrative and accounting costs for these transactions.

The association previously considered the cost of administrative and accounting costs for collecting and depositing class 2 and class 3 revenue funds. The association considered that the activity would be similar to those necessary to comply with §5.4111 and estimated the cost of the activity to be \$500 per year. The department anticipates that the requirements for collecting and depositing the funds collected under §5.4147 will be similar to those for collecting and depositing the other funds, and estimates the cost of the activity to be \$500 per year. The department further estimates that this cost would not change over the first five year period this proposal is to be in effect.

§5.4136. The Insurance Code §2210.355 requires the association to consider the cost of class 1 public securities in its rates. Section 5.4136 establishes the information and analysis that the association must submit to comply with the Insurance Code §2210.355. Section 5.4136 further extends this requirement to the net premium that the association to uses to repay premium surcharges and member assessments

under §5.4126 and the Insurance Code §2210.6136. In response to a department request, the association estimated that the additional cost of preparing this information and analysis would be negligible. The department anticipates that compliance would require an actuary approximately two hours of time. The department estimates that this requirement would result in an approximate cost of \$200 to the association, which has an employed actuary. The department further estimates that this cost would not change over the first five year period this proposal is to be in effect.

Repayment of premium surcharges and member assessments. The Insurance Code §2210.6136 requires insurers to collect premium surcharges and pay member assessments to pay class 2 public securities. This proposal does not affect existing requirements for the collection of premium surcharges and payment of member assessments. Additional costs will result from the requirement to repay premium surcharges to the insurer's policyholders. Member assessments will simply be repaid to the insurer or insurer group that paid them, and thus, result in no measurable additional administrative cost for the insurer.

As indicated in §5.4127, the term "insurer" in this context is the same as that defined in §5.4172 of this title. The term applies to insurers that write lines in the catastrophe area that are subject to the premium surcharge. This includes the association. Thus, the repayment costs apply to the association and are in addition to the association's administrative costs that have been previously discussed.

Section 5.4128 specifies that the repayment must be made within 90 days after the insurer receives a distribution from the association. To comply with this

requirement, the insurer must identify all policyholders who paid premium surcharges during the period specified in the association's distribution. The insurer must track premium surcharges that will be repaid separately from premium surcharges that will not be repaid. Both types of surcharges will be collected during the same periods. Section 5.4128 does not specify how the repayment will be made. Thus, the insurer will have options for compliance within that period, particularly if the policyholder is still a customer of the insurer.

Overall, the department anticipates that the repayment of premium surcharges will involve managerial and staff personnel, office space, and equipment. Some systems, including electronic systems, may need to be developed or updated to complete these functions. The department anticipates that compliance will require additional systems programming to the insurers' accounting, billing, and policy systems. This involves information technology costs, including programmers, software engineers, database managers, and computer support specialists.

The department anticipates the cost will vary significantly between insurers, in part based on the number of lines the insurer writes that are subject to the premium surcharge, the number of policyholders for these lines that the insurer has in the catastrophe area, and the insurer's current systems and procedures.

Further, the insurer will have to develop systems for transmitting the repayment to its policyholders, including former policyholders.

In response to a department request, the association estimated that the additional costs to develop the systems and procedures necessary to repay its

policyholder's premium surcharges would be \$100,000. The association did not provide information of whether this cost would be constant over the first five year period this proposal is to be in effect. Based on this analysis and the association's estimate, the department estimates the cost for compliance with the premium surcharge repayment requirement would be from several tens of thousands of dollars to several hundreds of thousands of dollars. The department estimates that the cost would not change over the first five year period this proposal is in effect. The department notes that these costs would follow the issuance of class 2 public securities under the Insurance Code §2210.6136, which may not occur during that period.

Because the administrative cost of tracking policyholders over the course of several years may be costly and burdensome, §5.4127 provides insurers with the alternative of paying the premium surcharge on behalf of its policyholder. The insurer would then receive the repayment. The insurer would still need to identify which policy it paid the premium surcharge on, but it would not need to track the policyholder for repayment. Because this option is not required, it is not included as a cost of this proposal. Each insurer would make a business decision as to the best means to comply with the repayment requirement.

4. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY ANALYSIS FOR SMALL AND MICRO BUSINESSES. Section 2006.002(c) of the Government Code 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 these 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.

As specified in the Public Benefit/Cost Note section of this proposal, the proposal has an economic impact on the association and insurers that write lines of insurance that are subject to the premium surcharge.

The association. The association does not meet the definition of a *small business* under the Government Code §2006.001(2). The association is a statutorily created association of property insurers and not a corporation, partnership, nor sole proprietorship. It is not formed for the purpose of making a profit. The association is not independently owned and operated. Further, the association has approximately 150 employees (including employees who are providing services by contract to the Texas Fair Access to Insurance Requirements Plan Association (FAIR Plan)) and net receipts well over \$6 million. Based on these factors, the association does not meet the definition of a small or micro business under the Government Code §2006.001(1)

and (2), and an analysis of the economic impact of this proposal on the association pursuant to the Government Code §2006.002(c) is not required.

Insurers. As discussed in the Public Benefit/Cost Note section of this proposal, it is anticipated that insurers subject to §5.4127 and §5.4128 would be subject to additional costs arising from the adoption and enforcement of those proposed sections. The costs would arise from the requirement to repay premium surcharges to the insurer's policyholders under those sections and the Insurance Code §2210.6136.

As discussed in the Public Benefit/Cost Note section of this proposal, the term "insurer" has the same meaning as defined in §5.4172 of this title. The term insurer refers to each property and casualty insurer authorized to engage in the business of property or casualty insurance in the State of Texas and an affiliate of such an insurer, as described by the Insurance Code §823.003, including an affiliate that is not authorized to engage in the business of property or casualty insurance in the State of Texas, the association, and the FAIR Plan. The term specifically includes a county mutual insurance company, a Lloyd's plan, and a reciprocal or interinsurance exchange. This would include some insurers that qualify as small and micro businesses.

The department has determined that §5.4127 and §5.4128 may have an adverse economic effect on insurers operating as small or micro businesses. Therefore, the department, in accordance with the Government Code §2006.002(c-1), has considered the following alternative methods of achieving the purpose of the proposed rule while

reducing costs to insurers operating as small and micro businesses: reduce or eliminate the notice requirement.

The department considered allowing insurers to pay that portion of the premium surcharge that is subject to the repayment on behalf of their policyholder. This would eliminate the need for the insurer to distribute funds to the policyholder in the future, which may be burdensome if the customer is no longer a policyholder. The department considers this option to be reasonable and included it in the proposal for all insurers.

The department considered requiring the association to directly repay other insurers' policyholders. The department determined that this procedure would be impractical, because the association does not have access to up-to-date billing and location information, and the insurer would be required to transfer significant amounts of personal financial information to the association. Without current information, the association would be required to contact the insurer to make the payment. Thus, to facilitate the refund the insurer would have to design systems to make the information readily available to the association. Further, if a question over the premium surcharge or repayment amount arose, the insurer would still have to be required to maintain a record of the collection and transmittal information to resolve the inquiry or dispute. Finally, the Insurance Code §2210.6136 does not indicate that the legislature intended that policyholders would be compelled to provide their personal financial information to the association to obtain repayment of the premium surcharge they paid. The department determined that a requirement for the association to directly repay the policyholders of small and micro businesses is not practical.

The department considered waiving the repayment requirement for small and micro businesses. The Insurance Code §2210.6136 requires repayment and does not make exception for the insurer's size. The department considers that waiving the repayment requirement is not consistent with the statute because it would discriminate against policyholders of small and micro businesses.

5. TAKINGS IMPACT ASSESSMENT. The department has determined that this proposal affects no private real property interests 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 have your comments considered, you must submit written comments on the proposal no later than 5:00 p.m. on July 23, 2012, to the Office of Chief Clerk, Mail Code 113-2A, Texas Department of Insurance, P. O. Box 149104, Austin, Texas 78714-9104.

The commissioner will consider the adoption of the proposed amendments and new sections in a public hearing under Docket No. 2736 scheduled for July 12, 2012, at 9:30 am in Room 100 of the William P. Hobby, Jr. State Office Building, 333 Guadalupe Street, Austin, Texas. The commissioner will consider written and oral comments presented at the hearing.

7. STATUTORY AUTHORITY. The department proposes the new and amended sections under the Insurance Code §§2210.008, 2210.056, 2210.071, 2210.072, 2210.073, 2210.074, 2210.151, 2210.152, 2210.259, 2210.355, 2210.452, 2210.453, 2210.604, 2210.608, 2210.609, 2210.611, 2210.612, 2210.613, 2210.6135, 2210.6136, and 36.001. Section 2210.008(b) authorizes the commissioner to adopt reasonable and necessary rules in the manner prescribed in Subchapter A, Chapter 36, Insurance Code. Section 2210.056 establishes the allowable uses for the association's assets.

Section 2210.071 provides that if an occurrence or series of occurrences in a catastrophe area results in insured losses and operating expenses of the association in excess of premium and other revenue of the association, the excess losses and operating expenses must be paid as provided in the Insurance Code, Chapter 2210, Subchapter B-1, including payment from the CRTF. Section 2210.072 authorizes the association to use the proceeds of class 1 public securities before, on, or after an occurrence or series of occurrences and establishes the maximum principal amount of class 1 public securities that may be issued before, on, or after an occurrence or series of occurrences to pay losses not paid under §2210.071.

Section 2210.072 also authorizes the association to enter into financing arrangements with any market source to enable the association to pay losses under the Insurance Code §2210.072 or to enable the association to obtain public securities. Section 2210.073 authorizes the association to use the proceeds of class 2 public securities issued after an occurrence or series of occurrences to pay for losses not paid under §2210.072, and establishes the maximum principal amount of class 2 public

securities. Section 2210.074 authorizes the association to use the proceeds of class 3 public securities issued after an occurrence or series of occurrences to pay for losses not paid under §2210.073, and establishes the maximum principal amount of class 3 public securities.

Section 2210.151 authorizes the commissioner to adopt the association's plan of operation to provide Texas windstorm and hail insurance coverage in the catastrophe area by rule. Section 2210.152 requires that the association's plan of operation provide for the efficient, economical, fair, and nondiscriminatory administration of the association and include both underwriting standards and other provisions that the department considered necessary to implement the purposes of the Insurance Code Chapter 2210.

Section 2210.259 requires the association to assess a 15 percent premium surcharge on a noncompliant residential structure that the association insured as of September 1, 2009, under Section 2210.251(f) that had been approved for insurability under the approval process regulations in effect on September 1, 2009, and to deposit the premium surcharge in the CRTF. Section 2210.355 establishes rate requirements for the association and factors that must be considered in establishing association rates under the Insurance Code Chapter 2210.

Section 2210.452 addresses the operation of the CRTF and requires the commissioner to adopt rules under which the association makes payments to the CRTF. Section 2210.453 provides that the association may purchase reinsurance that operates

in addition to, or in concert with the CRTF, public securities, financial instruments, and assessments that the Insurance Code Chapter 2210 authorizes.

Section 2210.604 requires that the commissioner approve an association request to the TPFA for the issuance of class 1, class 2, or class 3 public securities. Section 2210.608 provides how the association may use public security proceeds and excess public security proceeds. Section 2210.609 provides that the association must repay all public security obligations from available funds, and if those funds are insufficient, revenue collected in accordance with the Insurance Code §§2210.612, 2210.613, and 2210.6135. Section 2210.609 further provides that the association must deposit all revenue collected under §§2210.612, 2210.613, and 2210.6135 in the obligation revenue fund, premium surcharge obligation revenue fund, and the member assessment obligation revenue fund.

Section 2210.611 establishes that for class 2 public securities the association may use premium surcharge revenue and member assessment revenue collected under the Insurance Code §2210.613 in any calendar year that exceeds the amount of the class 2 security obligations and public security administrative expenses payable in that calendar year and interest earned on the those funds to: (i) pay the applicable public security obligations payable in the subsequent year; (ii) redeem or purchase outstanding public securities; or (iii) make a deposit in the CRTF. Section 2210.611 further establishes that association may handle member assessment revenue collected under the Insurance Code §2210.6135 in any calendar year that exceeds the amount of the class 3 security obligations and public security administrative expenses payable in

that calendar year and interest earned on the those funds in the same manner as the excess class 2 amounts.

Section 2210.612 provides that the association must pay class 1 public securities issued under §2210.072 from its net premium and other revenue. Section 2210.613 provides that the association must collect premium surcharges and member assessments to pay class 2 public securities issued under §2210.073. Section 2210.6135 provides that the association collect member assessments to pay class 3 public securities issued under Section 2210.074.

If all or any part of the class 1 public securities cannot be issued, §2210.6136 provides that the commissioner may order the issuance of class 2 public securities. Section 2210.6136 further provides that the commissioner shall order the association to repay the premium surcharges and member assessments used to pay the cost of a portion of the class 2 public securities issued under this section. Section 36.001 provides that the commissioner of insurance may adopt any rules necessary and appropriate to implement the powers and duties of the Texas Department of Insurance under the Insurance Code and other laws of the state.

8. CROSS REFERENCE TO STATUTE. The proposal affects the following statutes:

<u>Rule</u>	<u>Statute</u>
§5.4101	Insurance Code §§2210.151, and 2210.152
§5.4102	Insurance Code §§2210.056, 2210.071, 2210.072, 2210.073, 2210.074, 2210.151, 2210.152, 2210.259, 2210.355, 2210.452, 2210.453, 2210.604, 2210.608, 2210.609, 2210.611, 2210.612, 2210.613, 2210.6135,

	and 2210.6136
§5.4121	Insurance Code §§2210.056, 2210.072, 2210.608, and 2210.612
§§5.4123 - 5.4128	Insurance Code §§2210.072, 2210.073, 2210.074, 2210.453, 2210.604, and 2210.6136
§5.4133	Insurance Code §§2210.072, 2210.073, 2210.074, 2210.604, and 2210.608
§5.4135	Insurance Code §2210.604
§5.4136	Insurance Code §2210.355
§5.4141 and §5.4142	Insurance Code §§2210.072, 2210.604, 2210.608, 2210.609, 2210.612, and 2210.6136
§§5.4143 - 5.4145	Insurance Code §§2210.073, 2210.604, 2210.608, 2210.609, 2210.611, and 2210.613
§5.4146 and §5.4147	Insurance Code §§2210.604, 2210.608, 2210.609, and 2210.6135
§5.4148 and §5.4149	Insurance Code §§2210.612 and 2210.6136

9. TEXT.

§5.4101. Applicability.

(a) Sections 5.4101, 5.4102, 5.4111 - 5.4114, 5.4121, 5.4123 - 5.4128, 5.4133 - 5.4136 [~~5.4131—5.4134~~], and 5.4141 - 5.4149 [~~5.4147~~] of this division are a part of the Texas Windstorm Insurance Association's plan of operation and shall control over any conflicting provision in §5.4001 of this subchapter (relating to Plan of Operation). If a court of competent jurisdiction holds that any provision of this division is inconsistent with any statutes of this state, is unconstitutional, or is invalid for any reason, the remaining provisions of the sections in this division shall remain in effect.

(b) Notwithstanding any provision in this subchapter, the department retains regulatory oversight of the association [~~Association~~] as required by the Insurance Code

Chapter 2210, including periodic examinations of the accounts, books, and records of the association [~~Association~~] and no provision should be interpreted as negating or limiting the department regulatory oversight of the association [~~Association~~].

§5.4102. Definitions. The following words and terms when used in this division shall have the following meanings unless the context clearly indicates otherwise:

(1) - (4) (No change.)

(5) Budgeted operating expenses--All operating expenses as budgeted for and approved by the association's board of directors [~~Association's Board of Directors~~], excluding expenses related to catastrophic losses.

(6) - (7) (No change.)

(8) Catastrophe year--A calendar year in which an occurrence or series of occurrences results in insured losses, regardless of when the insured losses are ultimately paid.

(9) [~~8~~] Catastrophic event--An occurrence or a series of occurrences in a catastrophe area resulting in insured losses and operating expenses of the association [~~Association~~] in excess of premium and other revenue of the association [~~Association~~].

(10) [~~9~~] Catastrophic losses--Losses resulting from a catastrophic event.

(11) Class 1 payment obligation--The contractual amount of net premium and other revenue that the association must deposit in the obligation revenue fund at specified periods for the payment of class 1 public securities security obligations, public

security administrative expenses, and contractual coverage amount as required by class 1 public security agreements.

(12) [(10)] Class 1 public securities--A debt instrument or other public security that the TPFA may issue as authorized [to be issued by the TPFA] under the Insurance Code §2210.072 and Subchapter M of Chapter 2210, Insurance Code.

(13) [(11)] Class 2 public securities--A debt instrument or other public security that the TPFA may issue as authorized [to be issued by the TPFA] under the Insurance Code §2210.073 and Subchapter M of Chapter 2210, Insurance Code.

(14) [(12)] Class 3 public securities--A debt instrument or other public security that the TPFA may issue as authorized [to be issued by the TPFA] under the Insurance Code §2210.074 and Subchapter M of Chapter 2210, Insurance Code.

(15) [(13)] Commercial paper notes--A debt instrument that the association may issue as a financing arrangement or the TPFA may issue as any class of [type of class 1] public security [issued by the TPFA].

(16) [(14)] Commissioner--Commissioner of Insurance of the State of Texas.

(17) [(15)] Comptroller--Comptroller of the State of Texas.

(18) [(16)] Contractual coverage amount--Minimum amount over scheduled debt service that the association [Association] is required to deposit in [into] the applicable public security obligation revenue fund, premium surcharge trust fund, or member assessment trust fund as security for the payment of debt service on the public securities, administrative expenses on public securities, or other payments the

association must pay [~~required to be paid by the Association~~] in connection with public securities.

(19) [(17)] Credit agreement--An [A loan] agreement described by the Government Code Chapter 1371 that the TPFA may issue as authorized under the Insurance Code Chapter 2210, Subchapter M [~~, revolving credit agreement, agreement establishing a line of credit, letter of credit, reimbursement agreement, insurance contract, commitment to purchase obligations, purchase or sale agreement, interest rate management agreement, or other commitment or agreement authorized by the TPFA in anticipation of, related to, or in connection with the authorization, issuance, sale, resale, security, exchange, payment, purchase, remarketing, or redemption of some or all of its public security obligations or interest on public security obligations, or both, or as otherwise authorized by Chapter 1371 of the Government Code~~].

(20) [(18)] Department--Texas Department of Insurance.

(21) Earned premium--That portion of gross premium that the association has earned because of the expired portion of the time for which the insurance policy has been in effect.

(22) [(19)] Financing arrangement--An agreement between the association and [with] any market source under which the market source makes interest bearing loans or provides other financial instruments to the association [Association] to enable the association [Association] to pay losses or obtain public securities under the Insurance Code §2210.072. A financing arrangement is not a credit agreement or public security.

(23) [(20)] Gross premium [~~premiums~~]~~--The amount of premium the association receives [received by the Association], less premium returned to policyholders for canceled or reduced policies. [The term does not include premium surcharges collected by the Association pursuant to the Insurance Code §2210.259 and §2210.613.]~~

(24) [(24)] Investment income--Income [~~received by the Association~~] from the investment of funds [~~held by or for the benefit of the Association~~].

(25) [(22)] Letter of instruction--The commissioner's or authorized department representative's signed written [~~Written~~] authorization and direction to an authorized representative of the trust company[, ~~which is signed by the commissioner or an authorized representative of the department~~].

(26) [(23)] Losses--Amounts paid, or expected to be paid, on association [~~Association~~] insurance policy claims, including adjustment expenses, litigation expenses, [~~and~~] other claims expenses, and other amounts that are incurred in resolving a claim for indemnification under an association insurance policy.

(27) Member assessment trust fund--A dedicated trust fund established by the TPFA and held by the trust company in which the association must deposit member assessments collected under the Insurance Code §2210.613 and §2210.6135. The member assessment trust fund may be segregated into separate funds or accounts, including for the purpose of segregating class 2 and class 3 public security member assessments.

(28) [(24)] Net gain from operations--~~[The gain from operations,] For [for] a~~ calendar year or policy year ~~[as the case may be],~~ the amount of [including] all earned premium, [and] other revenue of the association [Association] , and distributions from the class 1 obligation revenue fund and the repayment obligation trust fund that are in excess of incurred losses, operating expenses, financial arrangement obligations, public security obligations, and public security administrative expenses [amounts to satisfy in whole or in part the obligations of the Association incurred in connection with the Insurance Code Chapter 2210, Subchapters B-1, J, and M, including reinsurance, public securities and financial instruments].

(29) Net premium--Gross premium less unearned premium. Following the issuance of public securities, net premium is pledged for the payment of class 1 payment obligation.

(30) [(25)] Net revenues [Revenues]--Net premium [Gross premiums received by the Association from policyholders,] plus other revenue, [less unearned premium,] less scheduled policy claims, less budgeted operating expenses, less class 1 payment obligation for that calendar year, less premium surcharge and member assessment repayment obligation for that calendar year, and less amounts necessary to fund or replenish the operating reserve fund.

(31) Obligation revenue fund--The dedicated trust fund established by the TPFA and held by the trust company in which the association must deposit net premium and other revenue for the payment of class 1 payment obligation.

(32) ~~[(26)]~~ Operating reserve fund ~~[Reserve Fund]~~--Association or trust company held fund ~~[The amount budgeted each year by the Association]~~ for the payment of budgeted scheduled policy claims and budgeted operating expenses ~~[divided by four]~~.

(33) ~~[(27)]~~ Other revenue ~~[Revenue]~~--Revenue of the association ~~[Association]~~ from any source other than premium ~~[premiums]~~. Other revenue includes investment income on association ~~[Association]~~ assets. Other ~~[but other]~~ revenue does not include premium surcharges and member assessments collected pursuant to the Insurance Code §§2210.259, 2210.613, 2210.6135, and 2210.6136 and interest income on those amounts ~~[\$2210.259, premiums surcharges collected from Association policyholders and other insurers under the Insurance Code §2210.613, Association member assessments collected under the Insurance Code §2210.613 and §2210.6135, and investment income on premium surcharges and member assessments collected under the Insurance Code §§2210.259, 2210.613, and 2210.6135]~~.

(34) ~~[(28)]~~ Plan of operation--The association's ~~[Association's]~~ plan of operation as adopted by the commissioner pursuant to §2210.151 and §2210.152 of the Insurance Code.

(35) Premium--Amounts received in consideration for the issuance of association insurance coverage. The term does not include premium surcharges collected by the association pursuant to the Insurance Code §§2210.259, 2210.613, and 2210.6136.

(36) Premium surcharge and member assessment repayment obligation--

The amount of premium surcharge and member assessment that the commissioner has ordered the association repay under §5.4126 of this title (relating to Alternative for Issuing Class 2 and Class 3 Public Securities).

(37) Premium surcharge trust fund--The dedicated trust fund established

by the TPFA and held by the trust company in which the association must deposit premium surcharges collected under the Insurance Code §2210.613.

(38) [(29)] Public securities [Securities]--Collective reference to class 1

public securities, class 2 public securities, and class 3 public securities.

(39) Public security administrative expenses--Expenses incurred by the

association, TPFA, or TPFA consultants to administer public securities issued under the Insurance Code Chapter 2210, including fees for credit enhancement, paying agents, trustees, attorneys, and other professional services.

(40) [(30)] Public security obligations--The principal of a public security

and any premium and interest on a public security issued under the Insurance Code Chapter 2210, Subchapter M [this subchapter], together with any amount owed under a related credit agreement.

(41) Repayment obligation trust fund--The dedicated trust fund that the

trust company holds in which the association deposits net premium and other revenue that is not contractually required for the class 1 payment obligation in amounts necessary to comply with the commissioner's order under §5.4126 of this title for payment of the premium surcharge and member assessment repayment obligation.

(42) [(34)] Scheduled policy claims [~~Policy Claims~~]-That portion of the association's [~~Association's~~] earned premium and other revenue expected to be paid in connection with the disposition of losses that do not result from a catastrophic event.

(43) [(32)] Trust company [~~Company~~]-The Texas Treasury Safekeeping Trust Company managed by the comptroller pursuant to the Government Code §404.101, et seq.

(44) [(33)] Trust company representative [~~Company Representative~~]-Any individual employed by the trust company [~~Trust Company~~] who is designated by the trust company as its authorized representative for purposes of any agreement related to the catastrophe reserve trust fund or the public securities.

(45) [(34)] TPFA--The Texas Public Finance Authority.

(46) [(35)] Unearned premium [~~Premium~~]-That portion of gross premium [~~premiums~~] that has been collected in advance for insurance that the association has not yet [~~been~~] earned [~~by the Association~~] because of the unexpired portion of the time for which the insurance policy has been in effect.

§5.4121. Financing Arrangements.

(a) The association [~~Association~~] may enter into financing arrangements. The financing arrangement must:

(1) enable the association to:

(A) pay losses under the Insurance Code §2210.072; or

(B) obtain public securities under the Insurance Code §2210.072;

and[-]

(2) be approved by the association's [Association's] board of directors prior to the association [Association] entering into the financing arrangement.

(b) The association [Association] may pay a financing arrangement with any or all:

(1) net premium [premiums] and other revenue of the association [Association] that has not been pledged as security for class 1 payment obligations or required for premium surcharge and member assessment obligations;

(2) - (3) (No change.)

(4) the proceeds of any class of public security issued under the Insurance Code Chapter 2210; or [and]

(5) any other association [Association] asset.

(c) As collateral security for such financial arrangements, including interest bearing loans or other financial instruments, the association [Association] may grant in favor of the applicable market source a collateral assignment and security interest in and to all or any portion of the association's [Association's] assets, including without limitation, all or any portion of the association's [Association's] right, title and interest in and to all proceeds of any class of public security issued under the Insurance Code Chapter 2210 [~~or all class 1 public securities, including commercial paper notes, class 2 public securities, and/or class 3 public securities, with the priority of each such collateral~~]

~~assignment and security interest, whether first or secondary, to be determined by the Association in its discretion].~~

§5.4123. Public Securities Request, Approval, and Issuance.

(a) The association's board of directors must request the issuance of public securities as prescribed in §§5.4124 - 5.4126 of this title (relating to Issuance of Class 1 Public Securities before a Catastrophic Event; Issuance of Public Securities after a Catastrophic Event; and Alternative for Issuing Class 2 and Class 3 Public Securities).

(1) The request must be submitted to the commissioner for approval with all required supporting documentation prescribed in §§5.4124 - 5.4126 of this title.

(2) The association's board of directors may request public securities as often as necessary.

(3) If multiple classes of public securities are combined into a single request, the request must separately identify and provide supporting documentation for the issuance of each class of public securities.

(4) The association's board of directors may submit a request for the issuance of public securities to be issued after a catastrophic event at any time. If the request for the issuance of public securities after a catastrophic event is submitted before a catastrophic event, the association's request must specify that the requested public securities may only be issued after a catastrophic event.

(b) The commissioner must approve the request before the TPFA may issue the requested public securities.

(1) If the supporting documentation is incomplete, the commissioner or the department may request additional documentation without rejecting the request.

(2) In considering the association's request, the commissioner may rely on any statements or notifications of definitive or estimated losses, association revenue, reinsurance proceeds, and any other related or supporting information from any source, including from the general manager of the association and from the TPFA and its consultants and counsel.

(3) If the commissioner disapproves the request, the association's board of directors may reconsider the matter and submit another request under subsection (a) of this subsection.

(4) The department must provide the commissioner's written approval of the request to the association and the TPFA.

(c) Following the commissioner's written approval of the request, the TPFA may issue public securities and credit agreements on behalf of the association as authorized in the Insurance Code Chapter 2210 and §§5.4124 - 5.4126 of this title for the issuance, reissuance, refinancing, and payment of public security obligations and public security administrative expenses.

(d) The association must provide to the department and the commissioner any requested information concerning public securities or the pending issuance of public securities, including information the TPFA, a TPFA contractor, or TPFA legal counsel provides to the association.

(e) A request for issuance of public securities under subsection (a) of this section includes a request for the reissuance and refinancing of public security obligations.

§5.4124. Issuance of Class 1 Public Securities before a Catastrophic Event.

(a) The association's board of directors may request the TPFA to issue class 1 public securities before a catastrophic event, if the association's board of directors determines that the class 1 public security proceeds are necessary and the commissioner approves the request. The procedure for making the request and approval of the request is provided in §5.4123 of this title (relating to Public Securities Request, Approval, and Issuance).

(b) To obtain the commissioner's approval, the association must submit to the commissioner its board of director's written request for the TPFA to issue class 1 public securities and, in a manner that is acceptable to the commissioner, provide the following information:

- (1) the reason why the requested class 1 public securities are necessary;
- (2) the amount of premium and other revenue that the association expects will be available to pay loss claims in the current calendar year;
- (3) reinsurance coverage that the association expects will be available to pay claims in the current calendar year;
- (4) the amount in the CRTF that the association expects will be available to pay loss claims in the current calendar year;

(5) the principal amount of class 1 public securities that are authorized and available to be issued before a catastrophic event, and that are requested;

(6) the estimated amount of debt service for the public securities, including any contractual coverage requirement and public security administrative expenses;

(7) the structure and term of the public securities, including acceptable conditions for sale, rating levels, and interest rates; and

(8) a cost-benefit analysis as described in §5.4135 of this title (relating to Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis).

(c) The association may make one or more requests under this section.

(d) The association may request class 1 public securities up to an aggregate principal amount not to exceed \$1 billion outstanding at any one time, regardless of the calendar year or years in which the securities are issued; except that class 1 public securities that are issued before a catastrophic event and that have been used to pay for insured losses or expenses will not continue to count against the combined \$1 billion aggregate limit described in this subsection. This section does not authorize the association to request class 1 public securities in an amount in excess of the catastrophe year limit prescribed in §5.4125(c) of this title (relating to Issuance of Public Securities after a Catastrophic Event).

§5.4125. Issuance of Public Securities after a Catastrophic Event.

(a) As provided in §5.4123 of this title (relating to Public Securities Request, Approval, and Issuance) and subject to the commissioner's approval, the association's board of directors may request the TPFA to issue public securities after a catastrophic event has occurred. The association's board of directors may make the request:

(1) after the catastrophic event if the association's board of directors determines that actual catastrophic losses are estimated to exceed available money in the CRTF and available reinsurance proceeds and that the public security proceeds are necessary to fund the catastrophic losses; or

(2) before the catastrophic event if the association's board of directors determines that public security proceeds may become necessary to fund potential catastrophic losses.

(b) To obtain the commissioner's approval, the association must submit to the commissioner its board of director's written request for the TPFA to issue public securities and provide in a manner that is acceptable to the commissioner the following information:

(1) an estimate of the actual, or potential, losses and expenses from the catastrophic event;

(2) the association's current premium and other revenue;

(3) the association's current net revenues;

(4) the sources and amount of loss funding other than public securities,

including:

(A) the amount of the loss paid from premium and other revenue;

(B) the amount requested from the CRTF;

(C) amounts available from other financing arrangements, and the association's obligations for other financing arrangements, including whether such amounts must be repaid from public security proceeds or from other means; and

(D) available reinsurance proceeds;

(5) the principal amount of each requested class of public securities that is authorized and available to be issued and that is requested;

(6) the estimated costs associated with each requested amount and class of public securities under this section, including any contractual coverage requirement and public security administrative expenses;

(7) the structure and term of the public securities, including acceptable conditions for sale, rating levels, and interest rates; and

(8) a cost-benefit analysis as described in §5.4135 of this title (relating to Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis).

(c) For each class of public securities requested under this section, the association must determine and submit as part of its request the authorized amount of public securities. This amount must be the lesser of:

(1) the statutory authorized principal amount for that class, less any principal amount of that class of public security that was issued in the catastrophe year, less, in the case of class 1 public securities, the proceeds of class 1 public securities issued pursuant to §5.4124 of this title (relating to issuance of Class 1 Public Securities

before a Catastrophic Event) that were available for a catastrophic event at the beginning of the catastrophe year for which the class 1 public securities are requested under this section; or

(2) the amount of the estimated loss, and estimated costs including the costs associated with the issuance of that class of public security.

(d) The association must request, in aggregate for each catastrophe year:

(1) the statutory authorized principal amount of class 1 public securities before class 2 public securities may be requested; and

(2) the statutory authorized principal amount of class 2 public securities before class 3 public securities may be requested.

(e) The association:

(1) may make one or more requests under this section;

(2) may, following a catastrophic event, request the issuance of class 1 public securities under this section, before the exhaustion of any remaining proceeds from class 1 public securities issued before a catastrophic event;

(3) must deplete the proceeds of any outstanding class 1 public securities issued before a catastrophic event before using the proceeds of class 1 public securities requested under this section; and

(4) may request the issuance of class 2 and class 3 public securities under this section, before the exhaustion of all class 1 or class 2 public security proceeds.

§5.4126. Alternative for Issuing Class 2 and Class 3 Public Securities.

(a) If all or any portion of the authorized principal amount of class 1 public securities requested under §5.4125 of this title (relating to Issuance of Public Securities after a Catastrophic Event) cannot be issued, class 2 and 3 public securities may be issued as provided in this section.

(b) The association must, in addition to the information required pursuant to §5.4125(b) of this title, provide the commissioner in writing the following information, including information based on the analyses described in §5.4135 of this title (relating to Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis):

(1) the amount of class 1 public securities that can be issued;

(2) the amount of class 1 public securities that cannot be issued; and

(3) the specific reasons, market conditions, and requirements that prevent

the TPFA from issuing all or any portion of the authorized principal amount of class 1 public securities. The association may rely on information and advice provided by the TPFA, TPFA consultants, TPFA counsel, and third parties retained by the association for this purpose.

(c) The association must request the TPFA to issue the authorized principal amount of class 1 public securities that can be issued under §5.4125(c) of this title before class 2 public securities may be issued under this section.

(d) The commissioner may rely on information provided to the commissioner under this section, §5.4125 of this title, and from any other source, including information

and advice provided by the association, the TPFA, TPFA consultants, and TPFA counsel. If the commissioner finds that all or any portion of the authorized amount of class 1 public securities cannot be issued, the commissioner may order the issuance of class 2 public securities in an amount that does not exceed the authorized principal amount of class 2 public securities as determined in §5.4125(c) of this title.

(e) The order must specify:

(1) the maximum principal amount of class 2 public securities that are to be issued;

(2) the information and amount required under §5.4127(b) of this title (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments);

(3) the maximum term of the class 2 public securities;

(4) when the association is to begin collecting funds under this section for deposit in the repayment obligation trust fund;

(5) the premium surcharge and member assessment repayment obligation; and

(6) the year repayment begins under §5.4128 of this title (relating to Repayment of Premium Surcharges to Policyholders and Member Assessments to Insurers).

(f) The commissioner may revise the commissioner's order described in subsection (d) of this section if the commissioner determines revision is necessary due to the association's prepayment of amounts due or to maintain the association's ability

to fund the class 1 payment obligations or other association obligations, including losses.

(g) The TPFA may issue the class 2 public securities authorized in the commissioner's order under this section. The TPFA may issue the class 2 public securities that are subject to §5.4127(b) of this title as a separate series from other class 2 public securities.

(h) If class 2 public securities are issued in the manner authorized under this section, class 3 public securities may be issued only after class 2 public securities have been issued in the statutory authorized principal amount of \$1 billion for that catastrophe year. Notwithstanding the restriction on issuing class 3 public securities in this subsection, the association may request, the commissioner may approve, and the TPFA may prepare for the issuance of class 3 public securities prior to the issuance of all class 2 public securities. Class 3 public securities must be requested as provided in §5.4123 of this title (relating to Public Securities Request, Approval, and Issuance) and §5.4125 of this title.

§5.4127. Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments.

(a) All public security obligations and public security administrative expenses for class 2 public securities issued under §5.4126 of this title (relating to Alternative for Issuing Class 2 and Class 3 Public Securities) must be paid 30 percent from member assessments and 70 percent from premium surcharges on those catastrophe area

insurance policies subject to premium surcharge under the Insurance Code §2210.613, including automobile and property insurance policies.

(1) For purpose of the premium surcharge, in this section and §5.4128 of this title (relating to Repayment of Premium Surcharges to Policyholders and Member Assessments to Insurers), the term insurer has the meaning that is defined in §5.4172 of this title (relating to Premium Surcharge Definitions).

(2) The association must collect and deposit the member assessments and premium surcharges as directed in §§5.4143 - 5.4145 of this title (relating to Trust Funds for the Payment of Class 2 Public Securities; Excess Class 2 Premium Surcharge Revenue; and Excess Class 2 Member Assessment Revenue).

(b) The commissioner's order described in §5.4126(d) of this title must require the association to repay the cost of the class 2 public securities issued under subsection (a) of this section in an amount equal to the lesser of:

(1) \$500 million total principal amount, plus any costs associated with that amount; or

(2) that portion of the total principal amount of class 1 public securities authorized to be issued as described in §5.4125 of this title (relating to Issuance of Public Securities after a Catastrophic Event) that cannot be issued, plus any costs associated with that portion.

(c) The association must repay the costs under subsection (b) of this section by repaying the amount of premium surcharges and member assessments that are paid, or

payable, on the total principal amount, plus any costs and contractual coverage amount associated with that amount.

(d) The sources of funds for the repayment required under subsection (b) of this section include:

(1) the association's net premium and other revenue that is not contractually pledged to class 1 payment obligations; and

(2) excess amounts released from the class 1 public security obligation revenue fund that are released as described in §5.4142 of this title (relating to Excess Obligation Revenue Fund Amounts).

(e) In addition to premium and other revenue amounts that the association must collect to pay for outstanding class 1 payment obligation, the association must collect premium and other revenue in an amount sufficient to repay the premium surcharge and member assessment obligation owed under the commissioner's order in subsection (b) of this section.

(f) Using either or both of the following methods, the association must repay the amounts required owed under the commissioner's order in subsection (b) of this section.

(1) To reduce the need for collecting premium surcharges and member assessments, the association may deposit funds described in subsection (d) of this section in the premium surcharge trust fund, member assessment trust fund, or both funds, before the collection of any premium surcharges or member assessments.

(2) The association may deposit funds described in subsection (d) of this section in the repayment obligation trust fund for repayment of class 2 premium surcharges and member assessments already collected.

(g) For each year in which the association owes amounts to repay member assessments or premium surcharges used to pay debt service for public securities described under subsection (b) of this section, the association must record the following information:

(1) the amount of premium surcharges the association owes to each insurer for that year; and

(2) the amount of member assessments the association owes to each insurer for that year.

(h) Notwithstanding any other requirement in this division, an insurer may pay on behalf of its policyholder all or any part of a premium surcharge that is subject to repayment under this section. If the insurer makes the payment under this subsection, the insurer is entitled to the repayment of that amount when the association repays it.

The insurer:

(1) may only pay the premium surcharge for amounts to pay the amounts of class 2 public security obligations and public administrative expenses associated with the amount to be repaid under the commissioner's order in subsection (b) of this section;

(2) must pay the premium surcharges for all policyholders of that insurer subject to the premium surcharge equally; and

(3) must track the amount of premium surcharges paid for their policyholders and those not paid.

§5.4128. Repayment of Premium Surcharges to Policyholders and Member Assessments to Insurers.

(a) When providing a repayment to insurers for amounts paid for class 2 premium surcharges and member assessments, the association must specify the surcharge and assessment period being repaid.

(b) Beginning with the year designated in the commissioner's order described in §5.4126 of this title (relating to Alternative for Issuing Class 2 and Class 3 Public Securities), not later than March 1 of each year the association must direct payment of the funds held in the repayment obligation trust fund to the insurer or insurance group to which the funds are owed for repayment of premium surcharges or member assessments.

(c) Within 90 days of receipt of a premium surcharge repayment from the association, insurers must repay to the policyholders who made the payments all amounts received from the association. Premium surcharge repayments must be proportional to the amount of premium surcharge each insured paid in the period the association specified in its repayment. To the extent that the insurer paid all or any portion of the premium surcharge for its policyholders as provided under §5.4127 of this title (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments), the insurer may

recoup the amount it paid for the period refunded from the association repayment as if it were the insured to whom the repayment was owed.

§5.4133. Public Security Proceeds.

(a) As necessary, the association must [~~Association shall~~] make written requests to the TPFA for the disbursement [~~distribution~~] of public security proceeds for the association [~~Association~~] program, including:

(1) for the payment of incurred claims and operating expenses of the association [~~Association~~]; or

(2) other amounts as authorized in the Insurance Code §2210.608 [~~to purchase reinsurance for the Association~~].

(b) The association's [~~Association's~~] written request must specify:

(1) the amount of the request; and

(2) the purpose of the request.

(c) To facilitate timely payment of losses, the association [~~Association~~] may request funds to be disbursed to the association [~~Association~~] prior to the settlement of incurred claims.

(d) The association must [~~Association shall~~] account for the receipt and use of public security proceeds separately from all other sources of funds. The association [~~Association~~] may hold public security proceeds in the manner authorized by the association's [~~Association's~~] plan of operation or as required by agreement with the TPFA.

§5.4135. Marketable Public Securities; the Amount of Class 1 Public Securities that Cannot be Issued; Market Conditions and Requirements; and Cost-Benefit Analysis.

(a) Marketable public securities under this division are public securities for which the association in consultation with the TPFA determines:

(1) are consistent with state debt issuance policy requirements;

and

(2) achieve the goals of the association.

(b) In determining the amount of class 1 public securities that can and cannot be issued, the association must consider:

(1) the association's current premium and net revenue;

(2) the estimated amount of debt service for the public securities,

including any contractual coverage requirement;

(3) the association's obligations for outstanding class 1 public securities,

including contractual coverage requirements and public security administrative expenses;

(4) the estimated class 2 repayment obligations;

(5) the association's outstanding class 2 repayment obligations;

(6) the association's obligations for other financing arrangements;

(7) any conditions precedent to issuing class 1 public security obligations

contained in any applicable public security financing documents;

(8) TPFA administrative rules;

(9) applicable State of Texas debt issuance policies;

(10) administrative rules of the Office of the Attorney General that require evidence of debt service and other obligation coverage; and

(11) market conditions and requirements necessary to sell marketable public securities, including issuing classes in installments.

(c) The association may rely on the advice and analysis of the TPFA, TPFA consultants, TPFA counsel, and third parties the association has hired for this purpose in determining "market conditions and requirements" under subsection (b) of this section. The association's determination may include consideration of the following factors:

(1) interest rate spreads;

(2) municipal bond ratings of the public securities;

(3) prior issuances of catastrophe related public securities in Texas or any other state;

(4) similar financings in the market within the preceding 12-month period;

(5) news or other publications relating to the association or the issuance of catastrophe related public securities;

(6) a nationally recognized investment banking firm's confidence memorandum;

(7) legal and regulatory conditions; and

(8) any other market conditions and requirements that the association deems necessary and appropriate.

(d) As part of each request for public securities, the association must submit to the commissioner a cost-benefit analysis of the various financing methods and funding structures that are available to the association. A cost-benefit analysis must include:

(1) for public securities requested under §5.4124 of this title (relating to Issuance of Class 1 Public Securities before a Catastrophic Event):

(A) estimates of the monetary costs of issuing public securities, including issuance costs, debt service costs, and any contractual coverage requirement;

(B) the benefits associated with issuing public securities, including benefits to the association's claim-paying capabilities, liquidity position, and other benefits associated with issuing public securities before a catastrophic event; and

(C) estimates of the monetary costs, benefits associated with, and the availability of funding alternatives, such as:

(i) purchasing additional reinsurance for similar funding and at a similar layer;

(ii) providing financing arrangements, or additional financing arrangements, that provide similar funding and at a similar layer; or

(iii) other alternative risk transfer arrangements, such as catastrophe bonds, that provide similar funding and at a similar layer;

(2) for public securities requested under this division following a catastrophic event:

(A) estimates of the monetary costs of issuing public securities, including issuance costs, debt service costs, and any contractual coverage requirement;

(B) the benefits associated with issuing public securities, including benefits to the association's claim-paying capabilities and other benefits associated with issuing public securities; and

(C) the availability of alternative funding arrangements, if any, including the monetary costs and benefits associated with any available alternative funding arrangements.

§5.4136. Association Rate Filings. While there are outstanding class 1 public securities, or there are repayment obligations under §5.4127(b) of this title (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments), the association:

(1) must consider its obligations for the payment of class 1 public securities and the repayment of class 2 public securities, including the additional amount of any debt service coverage that the association determines is required for the issuance of marketable public securities in developing its rates;

(2) must include in a rate filing submitted to the department an analysis that demonstrates that the filed rates produce premium sufficient to provide for at least:

(A) the expected operating costs of the association, including expected non-hurricane wind and hail losses and loss adjustment expenses; and

(B) the expected payment of class 1 public security obligations and the expected repayment of class 2 public securities, including the additional amount of any debt service coverage the association determines is required for the issuance of marketable public securities, during the period in which the rates will be in effect; and

(3) must include a cost component in the rates sufficient to at least provide for the expected payment of class 1 public security obligations and the expected repayment of premium surcharge and member assessment repayment obligation during the period in which the rates will be in effect.

§5.4141. Obligation Revenue Fund for the Payment of Class 1 Public Security Obligations and Operating Reserve Fund.

(a) While class 1 public securities are outstanding, the association must ~~[all of the Association's net revenue shall be paid into the obligation revenue fund created for such class 1 public securities. The Association shall]~~ deposit net premium and other revenue in ~~[the required amounts in]~~ the obligation revenue fund ~~[created for class 1 public securities]~~ at such periods and in such amounts as required by the class 1 public security agreements to fund the class 1 payment obligation ~~[under agreements with the TPFA].~~

(b) Without limiting other options, the class 1 public security agreements may include an ~~[The]~~ operating reserve fund ~~[shall be held by the Association]~~. If the class 1 public securities obligation revenue fund does not contain sufficient money to pay debt service on the class 1 public securities, administrative expenses on the class public

securities, or other class 1 public security obligations, the association [~~Association~~] must [~~shall~~] transfer sufficient money from the operating reserve fund or other association held funds to the obligation revenue fund [~~for class 1 public securities~~] to make such payment.

§5.4142. Excess [~~Class 1 Public Security~~] Obligation Revenue Fund Amounts.

(a) Excess revenue collected in the obligation revenue fund [~~to fund class 1 public security obligations~~] that is disbursed to the association must [~~Association shall~~] be an asset of the association [~~Association~~] and may be used for any purpose authorized in the Insurance Code §2210.056, including as provided in §5.4127 of this title (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments), or deposited in [~~into~~] the CRTE [~~catastrophe reserve trust fund~~].

(b) As specified in the Insurance Code §2210.072(a), class 1 public securities may be repaid before their full term if the association's [~~Association's~~] board of directors elects to do so and the commissioner approves.

§5.4143. Trust Funds [~~Obligation Revenue Fund~~] for the Payment of Class 2 Public Securities.

(a) On receipt, the association must [~~The Association shall~~] deposit collected:
(1) premium surcharges [~~and Association member assessments~~] pursuant to the Insurance Code §2210.613 in the premium surcharge trust [~~obligation~~]

~~revenue] fund [created for class 2 public securities].~~ The trust company must
~~[Association shall also]~~ deposit in that premium surcharge trust ~~[obligation revenue] fund~~
any investment income earned on the premium surcharges ~~[and Association member~~
~~assessments]~~ while these amounts are on deposit in the premium surcharge trust fund
~~[held by the Association].~~ The deposits must ~~[shall]~~ be made as required under
agreements with the TPFA and the trust company;~~[-]~~

(2) association member assessments pursuant to the Insurance Code
§2210.613 in the member assessment trust fund. The trust company must deposit any
investment income earned on the association member assessments while these
amounts are held on deposit in the member assessment trust fund. The deposits must
be made as required under agreements with the TPFA and the trust company.

(b) ~~[Pending deposit as required under subsection (a) of this section, the~~
~~Association shall hold such collected premium surcharges and Association member~~
~~assessments as required under agreements with the TPFA, or in the absence of an~~
~~agreement, as required in the Association's plan of operation, including this section.~~
~~Premium surcharges and Association member assessments collected by the~~
~~Association pursuant to the Insurance Code §2210.613, must be held by the~~
~~Association separately from all other Association funds.]~~ The association ~~[Association]~~
may not directly or indirectly use, borrow, or in any manner pledge or encumber
premium surcharges and association ~~[Association]~~ member assessments collected, or
to be collected, by the association ~~[Association]~~ pursuant to the Insurance Code

§2210.613 except for the payment of class 2 public security obligations and as otherwise authorized in this title.

§5.4144. Excess Class 2 Premium Surcharge Revenue.

(a) Revenue collected in any calendar year from premium surcharges under the Insurance Code §2210.613 that exceeds the amount of class 2 public security obligations and class 2 public security administrative expenses payable in that calendar year from premium surcharges and interest earned on the [~~class 2 public security~~] premium surcharge trust [~~obligation~~] fund deposits may, in the discretion of the association [~~Association~~], be:

(1) used to pay class 2 public security obligations payable in the subsequent calendar year, offsetting the amount of the premium surcharge that would otherwise be required to be levied for the year under the Insurance Code Chapter 2210, Subchapter M;

(2) used to redeem or purchase outstanding class 2 public securities; or

(3) deposited in the CRTF [~~catastrophe reserve trust fund~~].

(b) As specified in the Insurance Code §2210.073(a), class 2 public securities may be repaid before their full term if the association's [~~Association's~~] board of directors elects to do so and the commissioner approves.

§5.4145. Excess Class 2 Member Assessment Revenue.

(a) Revenue collected in any calendar year from a member assessment under the Insurance Code §2210.613 that exceeds the amount of class 2 public security obligations and class 2 public security administrative expenses payable in that calendar year from member assessments and interest earned on the member assessment trust fund created for class 2 public securities deposits may, in the discretion of the association, [may] be:

(1) used to pay class 2 public security obligations payable in the subsequent calendar year, offsetting the amount of the member assessment that would otherwise be required to be levied for the year under the Insurance Code Chapter 2210, Subchapter M; [or]

(2) used to redeem or purchase outstanding class 2 public securities; or

(3) deposited in the CRTF.

(b) As specified in the Insurance Code §2210.073(a), class 2 public securities may be repaid before their full term if the association's [Association's] board of directors elects to do so and the commissioner approves.

~~[(c) If options (1) and (2) of subsection (a) of this section have been fully satisfied, the excess member assessments may be deposited in the catastrophe reserve trust fund.]~~

§5.4146. Member Assessment Trust [Obligation Revenue] Fund for the Payment of Class 3 Public Securities.

(a) On receipt, the association must ~~[The Association shall]~~ deposit collected member assessments pursuant to the Insurance Code §2210.6135 in the member assessment trust ~~[obligation revenue]~~ fund ~~[created for class 3 public securities]~~. The trust company must ~~[Association shall also]~~ deposit in that member assessment trust ~~[obligation revenue]~~ fund any investment income earned on the member assessments while these amounts are ~~[held by the Association]~~ on deposit in the member assessment trust fund. The deposits must ~~[shall]~~ be made as required under agreements with the TPFA and the trust company.

(b) ~~[Pending deposit as required under subsection (a) of this section, the Association shall hold such collected Association member assessments as required under agreements with the TPFA, or in the absence of an agreement, as required in the Association's plan of operation, including this section. Member assessments collected by the Association pursuant to the Insurance Code §2210.6135, must be held by the Association separately from all other Association funds.]~~ The association ~~[Association]~~ may not directly or indirectly use, borrow, or in any manner pledge or encumber association ~~[Association]~~ member assessments collected, or to be collected, by the association ~~[Association]~~ pursuant to the Insurance Code §2210.6135, except for the payment of class 3 public security obligations and as otherwise authorized in this division.

§5.4147. Excess Class 3 Member Assessment Revenue.

(a) Revenue collected in any calendar year from a member assessment under the Insurance Code §2210.6135 that exceeds the amount of class 3 public security obligations and class 3 public security administrative expenses payable in that calendar year from member assessments and interest earned on member assessment trust fund created for class 3 public securities deposits may, in the discretion of the association, ~~may~~ be:

(1) used to pay class 3 public security obligations payable in the subsequent calendar year, offsetting the amount of the member assessments that would otherwise be required to be levied for the year under the Insurance Code Chapter 2210, Subchapter M; ~~or~~

(2) used to redeem or purchase outstanding class 3 public securities; or

(3) deposited in the CRFT.

(b) As specified in the Insurance Code §2210.074(a), class 3 public securities may be repaid before their full term if the association's ~~[Association's]~~ board of directors elects to do so and the commissioner approves.

~~[(c) If options (1) and (2) of subsection (a) of this section have been fully satisfied, the excess member assessments may be deposited in the catastrophe reserve trust fund.]~~

§5.4148. Repayment Obligation Trust Fund for the Payment of Amounts Owed under §5.4127.

(a) As required by the commissioner's order under §5.4126(d) of this title (relating to Alternative for Issuing Class 2 and Class 3 Public Securities), the association must deposit funds collected under §5.4127(d)(2) of this title (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments) in the repayment obligation trust fund. The trust company must deposit any investment income earned on these amounts while they are on deposit in the repayment obligation trust fund.

(b) The association may not directly or indirectly use, borrow, or in any manner pledge or encumber repayment obligation trust funds held by the trust company except as authorized under the Insurance Code Chapter 2210 and this division.

§5.4149. Excess Repayment Obligation Trust Fund Amounts. Following the payment of all class 2 public securities subject to repayment under §5.4127(b) of this title (relating to Payment of Class 2 Public Securities Issued Under §5.4126 and Repayment of Premium Surcharges and Member Assessments) and the repayment of all amounts owed under §5.4127(b) of this title, any funds remaining in the repayment obligation trust fund must be disbursed to the association as an asset of the association and may be used for any purpose authorized in the Insurance Code §2210.056.