

**SUBCHAPTER A. HAZARDOUS CONDITIONS AND
REMEDY OF HAZARDOUS CONDITIONS
28 Texas Administrative Code §8.3**

1. INTRODUCTION. The commissioner of insurance adopts amendments to the title of 28 TAC Chapter 8 and amendments to §8.3, concerning hazardous conditions for insurers. The amendments are adopted with nonsubstantive changes to the proposed text as published in the June 22, 2012, issue of the *Texas Register* (37 TexReg 4558) to correct punctuation, clarify, and conform to current agency style.

2. REASONED JUSTIFICATION. The amendments to §8.3 update hazardous conditions and make §8.3 consistent with the National Association of Insurance Commissioners Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition. The amendments add subsection (a) to the enumerated items in §8.3, add to or clarify the hazardous conditions in subsection (a), and add new subsections (b) and (c). The amendments also correct punctuation, clarify, and conform to current agency style. The hazardous conditions enumerated in §8.3(a) do not conclusively indicate that an insurer is in hazardous condition. One or more of the conditions set forth in §8.3(a) can exist in an insurer which is in satisfactory condition. However, one or more of these conditions has often been found in an insurer which is unable to perform its obligations to its policyholders, claimants, creditors, and shareholders or has required the commissioner of insurance to initiate regulatory action to protect policyholders, claimants, creditors, and shareholders.

3. HOW THE SECTION WILL FUNCTION. The amendments delete “Early Warning System For” from the title of chapter 8, and add “and Remedy of Hazardous Conditions” to the title of §8.3. Subsection (a) has been added to the enumerated items in §8.3 and hazardous conditions have been added or clarified in §8(a). New §8.3(b) provides that, for purposes of making a determination of an insurer’s financial condition under this section, the commissioner may take action, including: (1) disregard any credit or amount receivable resulting from transactions with a reinsurer that is insolvent, impaired, or otherwise subject to a delinquency proceeding; (2) make appropriate adjustments, including disallowance, to asset values attributable to investments or transactions consistent with the NAIC Accounting Policies and Procedures Manual, state laws, and regulations; (3) refuse to recognize the stated value of accounts receivable if the ability to collect receivables is highly speculative in view of the age of the account or the financial condition of the debtor; and (4) increase the insurer’s liability in an amount equal to any contingent liability, pledge, or guarantee not otherwise included if there is a substantial risk that the insurer will be called on to meet the obligation undertaken within the next 12-month period.

New §8.3(c) provides that, if the commissioner determines that the continued operation of the insurer licensed to transact business in this state may be hazardous to its policyholders, creditors, or the general public, the commissioner may take any action the commissioner considers reasonably necessary to remedy the hazardous condition, including, but not limited to, those actions set forth in Insurance Code §404.003(c) and

the following additional actions: (1) require the insurer to reduce, suspend, or limit the volume of business being renewed; (2) suspend or limit the declaration and payment of dividends by an insurer to its stockholders or to its policyholders; (3) require the insurer to file reports, in the form acceptable to the commissioner, concerning the market value of an insurer's assets; (4) require the insurer to limit or withdraw from certain investments or discontinue certain investment practices, to the extent the commissioner deems necessary; (5) require the insurer to file, in addition to regular annual statements, interim financial reports on the form adopted by the National Association of Insurance Commissioners, or in a format acceptable to the commissioner; (6) require the insurer to provide a business plan to the commissioner, in order to continue to transact business in this state; (7) adjust rates for any non-life insurance product written by the insurer that the commissioner considers necessary to improve the financial condition of the insurer, notwithstanding any other provision of law limiting the frequency or amount of premium rate adjustment; (8) document the adequacy of premium rates in relation to the risks insured; and (9) correct corporate governance practice deficiencies, and adopt and utilize governance practices acceptable to the commissioner.

4. SUMMARY OF COMMENTS. The department received comments supporting the amendments to §8.3, stating that the changes proposed appear to strengthen the commissioner's ability to declare an insurer in hazardous financial condition and act to address any potential problems.

5. NAMES OF THOSE MAKING COMMENTS FOR AND AGAINST THE PROPOSAL.

For: Office of Public Insurance Counsel

Against: None

6. STATUTORY AUTHORITY. The amendments are adopted under Insurance Code §§404.003(a), 404.003(c), 404.003(d), 404.005, 404.006, and 36.001. Section 404.003(a) provides that if the financial condition of an insurer, when reviewed as provided by §404.003(b), indicates a condition that might make the insurer's continued operation hazardous to the insurer's policyholders or creditors or the public, the commissioner may, after notice and hearing, order the insurer to take action reasonably necessary to remedy the condition. Section 404.003(c) provides that in an order issued under §404.003(a), the commissioner may take any action the commissioner considers reasonably necessary to remedy the condition described in §404.003(a), including those actions identified in §404.004(c). Section 404.003(d) states that the commissioner may use the remedies available under §404.003(c) in conjunction with the provisions of Insurance Code Chapter 83, if the commissioner determines that the financial condition of the insurer is hazardous and can be reasonably expected to cause significant and imminent harm to the insurer's policyholders or the public. Section 404.005 provides that the commissioner may, by rule, establish uniform standards and criteria for early warning that the continued operation of an insurer might be hazardous to the insurer's policyholders or creditors or the public and establish standards for evaluating the financial condition of an insurer. Standards established by the commissioner under

§404.005 must be consistent with the purposes of §404.003. Section 404.006 provides that the commissioner may enter into an agreement with the insurance regulatory authority of another jurisdiction concerning the management, volume of business, expenses of operation, plans for reinsurance, rehabilitation, or reorganization, and method of operations of, and type of risks to be insured by an insurer that is licensed in the other jurisdiction and considered to be in a hazardous financial condition or in need of a specific remedy that may be imposed by the commissioner and the insurance regulatory authority of the other jurisdiction. Section 36.001 provides that the commissioner may adopt any rules necessary and appropriate to implement the powers and duties of the department under this code and other laws of this state.

7. TEXT.

§8.3. Hazardous Conditions and Remedy of Hazardous Conditions

(a) An insurer may be found to be in hazardous condition when one or more of the following conditions are found to exist by the commissioner:

- (1) an insurer does not file a financial statement within the time required by the Insurance Code, or as requested by the agency;
- (2) an insurer files financial information which is false or misleading; releases false or misleading financial information to lending institutions or the general public; or makes a false or misleading entry or omits an entry of material amount in the insurer's books;

- (3) an insurer fails to respond to inquiries related to the condition of the insurer or furnishes false and misleading information concerning an inquiry;
- (4) an insurer does not amend its financial statement when requested by the agency;
- (5) an insurer overstates its surplus by 25 percent or more;
- (6) an insurer's unassigned surplus has a deficit which is in excess of 20 percent of surplus;
- (7) an insurer's financial ratios are outside the acceptable ranges as established by the National Association of Insurance Commissioners or the insurer's financial condition is otherwise hazardous as identified in the financial analysis tools and reports of the National Association of Insurance Commissioners;
- (8) adverse findings are reported in financial condition and market conduct examination reports, audit reports, and actuarial opinions, reports, or summaries of an insurer;
- (9) the net reduction (excluding net income and change in paid-in capital and change in paid-in or contributed surplus) to the insurer's surplus is greater than 25 percent of beginning surplus on the insurer's annual financial statements;
- (10) an insurer's operating loss in the last 12-month period or any shorter period of time, including net capital gain or loss, change in non-admitted assets and cash dividends paid to shareholders, is greater than 50 percent of the insurer's remaining surplus in excess of the minimum required;

(11) an insurer's operating loss in the last 12-month period or any shorter period of time, excluding net capital gains, is greater than 20 percent of the insurer's remaining surplus in excess of the minimum required;

(12) a projection by the agency of an insurer's current financial condition indicates that the sum of its paid-in capital, paid-in surplus, and contributed surplus will be reduced within the next 12 months;

(13) an insurer has grown so rapidly and to such an extent that it lacks adequate financial and administrative capacity to meet its obligations in a timely manner;

(14) an insurer has experienced, or will experience in the foreseeable future, cash flow or liquidity problems;

(15) an insurer's aggregate net retained risk, direct or assumed, under any one insurance policy or certificate of insurance under a group policy, is more than 10 percent of the insurer's surplus, except where otherwise permitted by law;

(16) contingent liabilities, pledges, or guaranties which, either individually or collectively, involve a total amount which, in the opinion of the commissioner, may affect the solvency of the insurer;

(17) an insurer has not made adequate provision, according to presently accepted actuarial standards of practice, for the anticipated cash flows required by the contractual obligations and related expenses of the insurer, when considered in light of the assets held by the insurer with respect to the reserves and related actuarial items, including, but not limited to, the investment earnings on such assets, and the

considerations anticipated to be received and retained under such policies and contracts;

(18) management establishes reserves that do not comply with minimum standards established by state insurance laws, regulations, statutory accounting standards, sound actuarial principles and standards of practice, or persistently engages in material under-reserving that results in adverse development;

(19) an insurer's reserves for losses and loss adjustment expenses are discounted more than 10 percent of surplus without the commissioner's prior written approval;

(20) an insurer has reinsurance reserve credits, recoverables, or receivables which are disputed by the reinsurer, or are due and payable and remain unpaid, and such reinsurance credits, recoverables, and receivables are more than 10 percent of an insurer's surplus; or a reinsurer does not have the ability to perform and the insurer's reinsurance program does not provide sufficient protection for the insurer's remaining surplus, after taking into account the insurer's cash flow, the classes of business written, and the financial condition of the reinsurer; or the reinsurer is insolvent or threatened with insolvency or delinquent in payment of its monetary or other obligations and which, in the opinion of the commissioner, may affect the solvency of the insurer;

(21) in the opinion of the commissioner, the age and collectability of the insurer's receivables may affect the solvency of the insurer;

(22) any entity within the insurer's insurance holding company system is unable to pay its obligations as they become due and payable, is insolvent, threatened with insolvency, or delinquent in payment of its monetary or other obligations and which, in the opinion of the commissioner, may affect the solvency of the insurer;

(23) an entity conducting business with the insurer is delinquent in the transmitting or payment of net premiums to the insurer;

(24) a life, accident, and health insurer has premium writings which result in surplus being less than 5 percent of the aggregate general account reserves for the life insurance in force plus 25 percent of the net annualized accident and health premium writings;

(25) a property and casualty insurer has net premium writings which, if annualized, would be an amount more than 300 percent of surplus;

(26) an insurer consistently issues subordinate premium or surplus debentures to finance its operations;

(27) an insurer does not maintain books and records sufficient to permit examiners to determine the financial condition of the insurer, examples of which include, but are not limited to:

(A) books and records of a domestic insurer maintained outside the state of Texas in violation of the Insurance Code Chapter 803;

(B) person(s) responsible for generating or maintaining books of original entry for a domestic insurer are officed outside the state of Texas; or

(C) an insurer moves, or maintains, the location of the books and records necessary to conduct an examination without notifying the agency of such location;

(28) an insurer has reinsurance agreements affecting 20 percent or more of the insurer's gross written premiums, direct or assumed, and the assuming insurers are not licensed to do insurance business in the state of Texas;

(29) an insurer has reinsurance credits taken or assets claimed on which there is not complete evidence of reinsurance agreements with insurers, signed by the reinsurer, and which are more than 10 percent of surplus;

(30) an insurer has transactions among affiliates, subsidiaries, or controlling persons for which the insurer receives assets or capital gains that do not provide sufficient value, liquidity, or diversity to assure the insurer's ability to meet its outstanding obligations as they mature, or which require all surplus funds which are in excess of an insurer's statutory minimum capital and surplus, or equivalent, to be distributed;

(31) an insurer's management, including officers, directors, or any other person who directly or indirectly controls the operation of an insurer, does not have the experience, competence, fitness, reputation, or trustworthiness to operate the insurer in a safe and sound manner;

(32) an insurer's management engages in unlawful transactions, including, but not limited to, failing to meet financial and holding company filing requirements, in the absence of a reason satisfactory to the commissioner;

(33) an insurer or an affiliate does not comply with the terms of an agreement entered into between the insurer and affiliate;

(34) the administration of an insurer's business is delegated to a person who, directly or indirectly, produces more than 25 percent of the insurer's gross written premiums, or an insurer delegates an insurance function necessary to the insurer's survival without adequate controls or which creates a conflict of interest;

(35) one person, other than a full time, salaried employee, controls production of more than 10 percent of the gross written premiums of an insurer;

(36) an insurer has a pattern of not settling valid claims within a reasonable time after due proofs of loss have been received;

(37) an insurer does not follow a policy on rating and underwriting standards appropriate to the risk;

(38) an insurer violates the Insurance Code Chapters 422 and 423;

(39) a final administrative or judicial order, initiated by an insurance regulatory agency of another state, is issued against an insurer;

(40) an insurer is in any condition that the commissioner of insurance finds to present a hazard to policyholders, creditors, or the general public.

(b) For purposes of making a determination of an insurer's financial condition under this section, the commissioner may take action, including:

(1) disregard any credit or amount receivable resulting from transactions with a reinsurer that is insolvent, impaired, or otherwise subject to a delinquency proceeding;

(2) make appropriate adjustments, including disallowance to asset values attributable to investments or transactions consistent with the NAIC Accounting Policies and Procedures Manual, state laws and regulations;

(3) refuse to recognize the stated value of accounts receivable if the ability to collect receivables is highly speculative in view of the age of the account or the financial condition of the debtor; or

(4) increase the insurer's liability in an amount equal to any contingent liability, pledge, or guarantee not otherwise included if there is a substantial risk that the insurer will be called on to meet the obligation undertaken within the next 12-month period.

(c) If the commissioner determines that the continued operation of the insurer licensed to transact business in this state may be hazardous to its policyholders, creditors, or the general public, then the commissioner may take any action the commissioner considers reasonably necessary to remedy the hazardous condition, including, but not limited to, those actions set forth in Insurance Code §404.003(c) and the following additional actions:

(1) require the insurer to reduce, suspend, or limit the volume of business being renewed;

(2) suspend or limit the declaration and payment of dividends by an insurer to its stockholders or to its policyholders;

(3) require the insurer to file reports, in a form acceptable to the commissioner, concerning the market value of an insurer's assets;

(4) require the insurer to limit or withdraw from certain investments or discontinue certain investment practices, to the extent the commissioner deems necessary;

(5) require the insurer to file, in addition to regular annual statements, interim financial reports on the form adopted by the National Association of Insurance Commissioners, or in a format acceptable to the commissioner;

(6) require the insurer to provide a business plan to the commissioner, in order to continue to transact business in this state;

(7) adjust rates for any non-life insurance product written by the insurer that the commissioner considers necessary to improve the financial condition of the insurer, notwithstanding any other provision of law limiting the frequency or amount of premium rate adjustment;

(8) document the adequacy of premium rates in relation to the risks insured; and


(9) correct corporate governance practice deficiencies, and adopt and utilize governance practices acceptable to the commissioner.

CERTIFICATION. This agency certifies that legal counsel have reviewed the adoption and found it to be a valid exercise of the agency's legal authority.

Issued at Austin, Texas on August 30, 2012.


Sara Waitt, General Counsel
Texas Department of Insurance

The commissioner orders that the amendments to §8.3 are adopted.


ELEANOR KITZMAN
COMMISSIONER OF INSURANCE

Attest:

Sara Waitt, General Counsel
Texas Department of Insurance

COMMISSIONER'S ORDER NO. 12-0722