

BILL ANALYSIS

Senate Research Center
76R11950 PB-F

H.B. 3042
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Economic Development
5/10/1999
Engrossed

DIGEST

In 1997, the 75th Legislature gave broader authority to life insurance companies to diversify their investment portfolios to increase their returns. No similar provision was made for property and casualty insurers. Currently, property and casualty insurers are authorized to buy put options or sell call options and terminate them, buy or sell interest rate on futures contracts and options on interest rate futures contracts, or utilize such other instruments or devices as are consistent with this article and are traded on an established exchange regulated by the Securities and Exchange Commission only for purposes of protecting such asset values or interest rates and for risk reduction. H.B. 3042 would establish conditions regarding investment requirements for certain insurance companies.

PURPOSE

As proposed, H.B. 3042 establishes conditions regarding investment requirements for certain insurance companies.

RULEMAKING AUTHORITY

Rulemaking authority is granted to the commissioner of insurance in SECTIONS 2 and 3 (Section 3(f), Article 2.10-3A; and Section 5(b) and Section 7, Article 2.10-4, Insurance Code) of this bill.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Article 2.10, Insurance Code, as follows:

ARTICLE 2.10. INVESTMENT OF FUNDS IN EXCESS OF MINIMUM CAPITAL AND MINIMUM SURPLUS.

- (a) Requires the board of directors of each insurer, or the corresponding designated authority to adopt a written investment plan consistent with the requirements of this article and certain other articles of this code and the other applicable statutes governing investments by the insurer. Sets forth requirements for the investment plan.
- (b) Requires the board of directors or other authority, at least annually, to review the adequacy of the investment plan and the implementation of the investment plan.
- (c) Requires the insurer to maintain the investment plan in its principal office and to provide the plan to the commissioner of insurance (commissioner) or the commissioner's designee on request. Requires the commissioner or designee to maintain the investment plan as a privileged and confidential document, and the plan is not subject to public disclosure.
- (d) Requires the insurer to maintain investment records covering each transaction. Requires the insurer to be able to demonstrate to the Texas Department of Insurance (department) that its investments are within the limitations prescribed by the statutes.
- (e) Prohibits the amount of deposits by a company from investing its funds over and above its minimum capital and its minimum surplus in any type or form of savings deposits, time deposits, certificates of deposit, NOW accounts, and money market accounts in solvent banks, savings and loan associations, credit unions, and branches of those financial institutions, if made in accordance with the applicable laws or regulations, provided the amounts of the deposits in any one bank, savings and loan association, or credit union, may not exceed the greater of certain amounts.

Deletes text regarding the aggregate of all investments. Makes conforming and nonsubstantive changes.

(f) Establishes that the percentage authorizations and limitations set forth in this article apply only at the time of the original acquisition of an investment or at the time a transaction is entered into and do not thereafter apply to the insurer or the investment or transaction, except as provided by this subsection. Provides that an investment, once qualified, remains qualified notwithstanding any refinancing, restructuring, or modification solely to circumvent the requirements or limitations of this article.

(g) Prohibits an investment in the aggregate from exceeding five percent of the insurer's total assets, with certain exceptions, and authorizes the quantitative limitations regarding any investment to be waived by prior written approval of the commissioner if certain conditions exist, notwithstanding Subsections (a)-(e) of this article.

SECTION 2. Amends Chapter 2, Insurance Code, by adding Article 2.10-3A, as follows:

**Art. 2.10-3A. SECURITIES LENDING; REPURCHASE; REVERSE REPURCHASE, AND
DOLLAR ROLL TRANSACTIONS**

Sec. 1. DEFINITIONS. Defines "dollar roll transaction," "repurchase transaction," "reverse repurchase transaction," and "securities lending transaction."

Sec. 2. TRANSACTIONS AUTHORIZED. Authorizes an insurer to engage in securities lending, repurchase, reverse repurchase, and dollar roll transactions. Requires the insurer to enter into a written agreement for each transaction, other than a dollar roll transaction, which requires each transaction to terminate not later than the first anniversary of the inception of the transaction.

Sec. 3. TRANSACTION REQUIREMENTS. Sets forth requirements regarding cash received in a transaction. Requires the insurer or the insurer's agent or custodian, while the transaction is outstanding, to maintain possession of certain aspects regarding the acceptable collateral received in a transaction, either physically or through certain book entry systems. Prohibits an issuer from entering into a transaction if, as a result of and after giving effect to the transaction, the aggregate amount of securities loaned, sold to, or purchased from does not exceed a certain amount. Authorizes the effect, in computing the amount sold to or purchased from a business entity counterparty under a repurchase or reverse repurchase transaction, to be given to netting provisions under a master written agreement. Provides that the amount of collateral required for a securities lending, repurchase, or reverse repurchase transaction is the amount required under the Purposes and Procedures Manual of the Securities Valuation Office or a successor publication. Authorizes the commissioner to adopt reasonable rules and orders consistent with, and as necessary to implement, this article.

SECTION 3. Amends Article 2.10-4, Insurance Code, as follows:

ART. 2.10-4. RISK-LIMITING PROVISIONS

Sec. 1. DEFINITIONS. Defines "acceptable collateral," "business entity," "cap," "cash equivalent," "collar," "counterparty exposure amount," "derivative instrument," "derivative transaction," "floor," "forward," "future," "futures exchange," "hedging transaction," "income generation transaction," "market value," "option," "over-the-counter derivative instrument," "potential exposure," "qualified clearinghouse," "replication transaction," "securities exchange," "swap," "swaption," "underlying interest," and "warrant."

Sec. 2. AUTHORIZED RISK CONTROL TRANSACTIONS; GENERAL REQUIREMENTS RELATING TO DERIVATIVE TRANSACTIONS. Authorizes the insurer, except as provided by Section 8 of this article, to engage in risk control transactions, for the purposes of protecting the assets against certain risks. Requires the board of directors of the insurer, before entering into a derivative transaction, to approve a derivative plan as part of the insurer's investment plan otherwise required by law. Sets forth requirements of the derivative use plan. Sets forth requirements by which the insurer is required to establish written internal control procedures.

Requires the insurer to be able to demonstrate to the commissioner, on request, the intended hedging characteristics and ongoing effectiveness of the derivative transaction or combination of transactions through cash flow testing, duration analysis, or other appropriate analysis. Requires the insurer to include all counterparty exposure amounts in determining compliance with the limitations of this article. Authorizes an insurer to purchase or sell one or more derivative instruments to offset a derivative instrument previously purchased or sold without regard to the quantitative limitations of this article if the offsetting transaction uses the same type of derivative instrument as the derivative instrument being offset.

Sec. 3. REQUIREMENTS RELATING TO HEDGING TRANSACTIONS. Sets forth requirements by which the insurer must notify the commissioner in writing by a certain date. Requires an insurer engaged in hedging transactions on September 1, 1999 to send to the commissioner a notice containing the required statements not later than October 1, 1999. Authorizes the insurer to enter into hedging transactions, after the required notice, if certain conditions result from and give effect to each hedging transaction. Authorizes the commissioner after the notice and opportunity for a public hearing, if a hedging transaction entered into is not in compliance, or may create a hazardous financial condition, to order the issuer to take action that the commissioner determines is reasonable and necessary to either rectify or prevent the hazardous financial situation. Deletes text regarding certain promulgated rules and limitations promulgated by the State Board of Insurance; and buying and selling of certain options.

Sec. 4. REQUIREMENTS RELATING TO INCOME GENERATION TRANSACTIONS. Authorizes an insurer to enter into an income generation transaction only if, as a result of and after giving effect to the transaction, the aggregate statement value of admitted assets that are the subject to call or that generate the cash flows for required payments, statement values, and purchase prices, does not exceed 10 percent of the insurer's assets. Sets forth requirements by which the transaction must be of sale. Sets forth requirements for the insurer if the transaction is a sale of a put option on assets. Sets forth requirements for the insurer if the transaction is a sale of a call option on a derivative instrument, including a swaption. Sets forth requirements for the insurer if the transaction is a sale of a cap or floor.

Sec. 5. REQUIREMENTS RELATING TO REPLICATION TRANSACTIONS. Requires an insurer to enter into a replication transaction only with the prior written approval of the commissioner. Sets forth conditions by which a person is eligible for approval by the commissioner. Authorizes the commissioner to adopt rules regarding replication transactions necessary to implement this section.

Sec. 6. TRADING REQUIREMENTS. Sets forth requirements for each derivative instrument. Deletes text regarding certain purchases and sales of certain options and rules that effect those purchases and sales.

Sec. 7. RULES. Authorizes the commissioner to adopt rules consistent with this article that prescribe reasonable limits, standards, and guidelines, with respect to the risk-limiting transactions authorized under this article and plans related to those transactions. Deletes text authorizing the State Board of Insurance to make rules. Makes conforming changes.

Sec. 8. NOTICE TO COMMISSIONER. Requires an insurer that has a statutory net capital and surplus of less than \$10 million to file a notice with the commissioner describing the need to engage in the transaction, the lack of acceptable alternatives, and the insurer's plan to engage in the transaction. Authorizes the insurer to engage in the transaction, if the commissioner does not issue an order prohibiting the transaction within 90 days. Prohibits an insurer with a statutory net capital and surplus less than the minimum amount of capital and surplus required for a new charter and certificate of authority for the same type of insurer from engaging in the transactions authorized under this article. Provides that the net capital and surplus are determined by the most recent financial statement of the insurer required to be filed with the department.

SECTION 4. Repealer: Article 2.10-3, Insurance Code (regarding repurchase agreements).

SECTION 5. Effective date: September 1, 1999.

SECTION 6. Emergency clause.

