

BILL ANALYSIS

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S.B. 1431
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AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Currently, insurance companies and health maintenance organizations are subject to the Texas Insurance Holding Company Systems Act, which is codified as Chapter 823 (Insurance Holding Company Systems), Insurance Code. The current Texas requirements are substantially similar to model legislation developed by the National Association of Insurance Commissioners (NAIC). Recently, NAIC updated the model legislation in response to lessons learned from the nation's financial crisis, as well as discussion regarding group supervision that have been taking place in the international community. The updated model legislation addresses the needs of insurance regulators to be able to assess the enterprise risk within a holding company system and its potential impact on the solvency of an insurer within the holding company system. The updated model legislation does not expand the reach of regulatory authority to include entities that are currently exempt from regulation under the Insurance Code.

Under current Texas law, insurance companies and health maintenance organizations are not required to provide the Texas Department of Insurance (TDI) with reports on enterprise or system risks posed by non-insurance operations that may spread to an insurance company and potentially harm its financial condition. As a result, TDI is challenged by not having the regulatory tools needed to evaluate contagion risk that may be developing within an insurance holding company system, which impacts TDI's ability to protect the interests of the public and the state generally.

S.B. 1431 amends current Texas law to require that insurance companies and health maintenance organizations provide TDI with confidential reports about potential enterprise risks that may spread to insurance companies and negatively impact their financial condition. This bill also provides TDI with enhanced access to information about the financial condition of holding company systems, an enhanced framework for communication with other regulators, and enhanced examination authority.

The changes made by S.B. 1431 are intended to promote the public interest by various means including requiring the disclosure of pertinent information relating to and approval of changes in control of an insurer; requiring the disclosure and approval of material transactions and relationships between the insurer and insurer's affiliates, including certain dividends to shareholders paid by the insurer; and providing standards governing material transactions between the insurer and the insurer's affiliates (Section 823.001, Insurance Code).

As proposed, S.B. 1431 amends current law relating to the functions of insurance holding company systems.

RULEMAKING AUTHORITY

Rulemaking authority is expressly granted to the commissioner of insurance in SECTION 5 (Section 823.052, Insurance Code), SECTION 9 (Section 823.101, Insurance Code), and SECTION 12 (Section 823.154, Insurance Code) of this bill.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Section 823.002, Insurance Code, by adding Subdivisions (3-a), (3-b), and (4-a) and amending Subdivision (6), to define "divesting person," "divestiture," and "enterprise risk" and redefine "insurer."

SECTION 2. Amends Section 823.010, Insurance Code, by amending Subsections (c) and (d) and adding Subsections (e) and (f), as follows:

(c) Requires that the disclaimer, except as provided by Subsection (d), be deemed to have been allowed unless, not later than 60 days after the receipt of a completed disclaimer, the commissioner of insurance (commissioner) notifies the filing party that the disclaimer is disallowed. Deletes existing text providing that, after the disclaimer is filed, the insurer is not required to register or report under Subchapter B (Registration) because of a duty that arises out of the insurer's relationship with the person unless the commissioner disallows the disclaimer, in which event the duty to register or report begins on the date of the disallowance; and (2) the person is not required to comply with Sections 823.154, 823.155 (Amendment of Statement), 823.159 (Hearing; Time of Determination), and 823.160 (Deadline for Completion of Acquisition) unless the commissioner disallows the disclaimer.

(d) Authorizes the commissioner, notwithstanding Subsection (c), if the commissioner at any time determines that the information disclosed in the disclaimer is inaccurate or is no longer accurate, to disallow the disclaimer. Deletes existing text authorizing the commissioner to disallow the disclaimer only after providing to each party in interest notice of and the opportunity to be heard on the disallowance and making specific findings of fact to support the disallowance. Makes a nonsubstantive change.

(e) Authorizes the party who filed the disclaimer, if the commissioner disallows a disclaimer, to request an administrative hearing. Requires the commissioner to grant the request for the hearing.

(f) Provides that, if the commissioner allows a disclaimer, the party who filed the disclaimer is not required to register under Subchapter B or comply with Section 823.154, 823.155, 823.159, or 823.160 unless the commissioner determines that the disclaimer should be disallowed under Subsection (d).

SECTION 3. Amends Section 823.011, Insurance Code, by amending Subsections (b) and (d) and adding Subsections (e), (f), (g), and (h), as follows:

(b) Requires that the information be confidential and privileged for all purposes, rather than treated confidentially and not subject to subpoena.

(d) Authorizes the commissioner or another person, except as provided by Subsection (e), if the recipient of documents or other information agrees in writing to maintain the confidential and privileged status of the documents or other information, and verifies in writing the legal authority to maintain the confidential and privileged status of the documents or information, to disclose the information to any of the following entities functioning in an official capacity:

- (1) a commissioner of insurance or an insurance department of another state;
- (2) an authorized law enforcement official;
- (3) a district attorney of this state;
- (4) the attorney general;
- (5) a grand jury; or

(6) members of a supervisory college described by Section 823.0145.

Makes nonsubstantive changes.

(e) Authorizes the commissioner, notwithstanding Subsection (d), to share confidential and privileged information reported under Section 823.0595 only with the commissioner of insurance of a state that has a statute or rule substantially similar to Subsection (d) who agrees in writing not to disclose the information.

(f) Provides that information described by Subsection (a), including information in the possession of the National Association of Insurance Commissioners (NAIC) under this section, is confidential and privileged for all purposes, including for purposes of:

- (1) Chapter 552 (Public Information), Government Code;
- (2) a response to a subpoena; or
- (3) discovery or admissibility in evidence in a private civil action.

(g) Requires the commissioner to enter into written agreements with NAIC regarding the sharing and use of information provided under Subchapter B. Requires that an agreement entered into under this subsection:

- (1) specify procedures and protocols regarding the confidentiality and security of information shared with NAIC and its affiliates and subsidiaries under this section, including procedures and protocols for sharing by NAIC with other state, federal, or international regulators;
- (2) specify that ownership of information shared with NAIC and its affiliates and subsidiaries under this section remains with the commissioner, and that use of the information by NAIC is subject to the direction of the commissioner;
- (3) require prompt notice to an insurer whose confidential information is in the possession of NAIC under this section that the information is subject to a request or subpoena to NAIC for disclosure or production; and
- (4) require NAIC and its affiliates and subsidiaries to give consent to intervention by an insurer in any judicial or administrative action in which NAIC and its affiliates and subsidiaries may be required to disclose confidential information about the insurer shared with NAIC and its affiliates and subsidiaries under this section.

(h) Provides that the commissioner remains solely responsible for the administration, execution, and enforcement of this chapter, and the commissioner's sharing of information does not constitute a delegation of regulatory or rulemaking authority.

SECTION 4. Amends Subchapter A, Chapter 823, Insurance Code, by adding Section 823.0145, as follows:

Sec. 823.0145. SUPERVISORY COLLEGES. (a) Authorizes the commissioner, with respect to any insurer registered under Subchapter B, and in accordance with Subsection (c), to participate in a supervisory college for a domestic insurer that is part of an insurance holding company system with international operations in order to determine the insurer's compliance with this chapter. Authorizes the commissioner to:

- (1) initiate the establishment of a supervisory college;
- (2) clarify the membership and participation of other entities in the supervisory college;

- (3) clarify the functions of the supervisory college and the role of other entities in the supervisory college;
- (4) establish a group-wide supervisor;
- (5) coordinate the ongoing activities of the supervisory college, including meetings, regulatory activities, and processes for information sharing; and
- (6) establish a crisis management plan.

(b) Authorizes the commissioner, in order to assess the business strategy, financial position, legal and regulatory position, risk exposure, risk management and governance processes, and as part of the examination of individual insurers under Subchapter H (Examinations), to participate in a supervisory college with other entities that regulate the insurer or its affiliates, including other state, federal, and international regulatory entities. Authorizes the commissioner to enter into agreements under Section 823.011 (Confidentiality of Information) to cooperate with other regulatory entities. Requires that nothing in this section be construed as delegating to the supervisory college the commissioner's authority to regulate the insurer or its affiliates.

(c) Requires a registered insurer subject to this section to pay the reasonable expenses, including reasonable travel expenses, of the commissioner's participation in a supervisory college under Subsection (b). Authorizes a supervisory college, for purposes of this section, to be convened as either a temporary or permanent forum for communication and cooperation between the entities that regulate the insurer or its affiliates, and authorizes the commissioner to establish a regular assessment to the insurer for the payment of expenses related to the regulation of the insurer.

SECTION 5. Amends Section 823.052, Insurance Code, by amending Subsections (b) and (c) and adding Subsection (c-1), as follows:

(b) Requires that the registration statement be in a format prescribed by NAIC or adopted by rule of the commissioner and contain certain current information.

(c) Requires that the registration statement also contain certain information, including the corporate governance and internal control responsibilities of the insurer's board of directors, including a statement that the insurer's senior management or officers have approved and implemented, and continue to maintain and monitor, corporate governance and internal control procedures, and any other information that the commissioner requires by rule.

(c-1) Requires an insurer, on request of the commissioner, to include with the statement a copy of all financial statements for the insurance holding company system, including annual audited financial statements filed with the United States Securities and Exchange Commission pursuant to the Securities Act of 1933 (15 U.S.C. Section 77a et seq.) or the Securities Act of 1934 (15 U.S.C. Section 78a et seq.). Authorizes an insurer required by the commissioner to submit financial statements under this subsection to satisfy the requirement by submitting to the commissioner the financial statements that the insurer's parent corporation most recently filed with the Securities and Exchange Commission.

SECTION 6. Amends Subchapter B, Chapter 823, Insurance Code, by adding Section 823.0595, as follows:

Sec. 823.0595. ENTERPRISE RISK REPORT. (a) Requires the ultimate controlling person, as defined by Section 823.055 (Annual Registration Statement; Summary of Material Changes), of each insurer required to file an annual registration, except as provided by Subsection (d), to file with the registration an annual enterprise risk report. Requires that the report, to the best of the ultimate controlling person's knowledge, identify the material risks within the insurance holding company system that may pose enterprise risk to the insurer. Requires that the report be filed with the lead state

commissioner of the insurance holding company system, as determined by the procedures adopted by NAIC.

(b) Requires the ultimate controlling person of an insurer to file the first enterprise risk report required by this section not later than:

(1) January 1, 2012, if the total direct or assumed annual premiums of the insurer were \$5 billion or more on September 1, 2011;

(2) January 1, 2013, if the total direct or assumed annual premiums of the insurer were more than \$1 billion but less than \$5 billion on September 1, 2011;

(3) January 1, 2014, if the total direct or assumed annual premiums of the insurer were more than \$500 million but less than \$1 billion on September 1, 2011; or

(4) January 1, 2015, if the total direct or assumed annual premiums of the insurer were \$100 million or more but less than \$500 million on September 1, 2011.

(c) Provides that Subsection (b) and this subsection expire January 2, 2015.

(d) Provides that, except as provided by Subsection (e), the ultimate controlling person of an insurer with total direct or assumed annual premiums of less than \$100 million is not required to submit an enterprise risk report under Subsection (a).

(e) Requires the ultimate controlling person of an insurer that is not in compliance with applicable risk-based capital standards or that is otherwise in hazardous condition, as determined by the commissioner, regardless of total direct or assumed annual premium, to file an enterprise risk report required by Subsection (a) as directed by the commissioner.

SECTION 7. Amends Section 823.060, Insurance Code, as follows:

Sec. 823.060. VIOLATION OF SUBCHAPTER. Provides that the failure to file a registration statement or an amendment to a registration statement, or an enterprise risk report, within the time specified for filing the statement, amendment, or report, as required by this subchapter, is a violation of this subchapter. Makes a nonsubstantive change.

SECTION 8. Amends the heading to Section 823.101, Insurance Code, to read as follows:

Sec. 823.101. STANDARDS FOR TRANSACTION WITHIN AN INSURANCE HOLDING COMPANY SYSTEM.

SECTION 9. Amends Section 823.101, Insurance Code, by amending Subsection (a) and adding Subsection (b-1), as follows:

(a) Provides that this section applies only to a material transaction within an insurance holding company system to which an insurer subject to a registration under Section 843.052 (Required Information; Registration Statement) is a party, rather than to a material transaction between a registered insurer and an affiliate of the insurer.

(b-1) Requires that an agreement, including an agreement for cost-sharing, services, or management, include all provisions required by rule of the commissioner.

SECTION 10. Amends Section 823.102, Insurance Code, by amending Subsection (a) and adding Subsections (d) and (e), as follows:

(a) Provides that this section applies only to a sale, purchase, exchange, loan or other extension of credit, or investment between a domestic insurer and any person in the insurer's insurance holding company system, including an amendment or modification of an affiliate agreement previously filed under this section, that involves more than the lesser of five percent of the insurer's admitted assets or 25 percent of the insurer's surplus, as of December 31 of the year preceding the year in which the transaction occurs.

(d) Requires that the notice described by Subsection (c) include:

(1) the reasons for entering into or changing the transaction; and

(2) the financial impact of the transaction on the domestic insurer.

(e) Requires the domestic insurer, not later than the 30th day after the termination of a previously filed agreement, to give notice of the termination to the commissioner.

SECTION 11. Amends Section 823.103, Insurance Code, by amending Subsection (a) and adding Subsections (e) and (f), as follows:

(a) Provides that this section applies only to:

(1) a sale, purchase, exchange, loan or other extension of credit, or investment between a domestic insurer and any person in the insurer's insurance holding company system, including an amendment or modification of an affiliate agreement previously filed under this section:

(A) that involves more than the lesser of one-half of one percent of the insurer's admitted assets or five percent of the insurer's surplus, as of December 31 of the year preceding the year in which the transaction occurs; and

(B) the approval of which is not required under Section 823.102 (Notice of and Commissioner's Decision on Certain Large Transactions);

(2) a reinsurance agreement, including a reinsurance treaty or pooling agreement, or an amendment or modification of an agreement previously filed under this section, between a domestic insurer and any person in the insurer's holding company system, rather than between a domestic insurer and any person in the insurer's holding company system or a modification of such an agreement;

(3) a rendering of services between a domestic insurer and any person in the insurer's holding company system on a regular or systematic basis, including a tax-allocation agreement, or an amendment or modification of an agreement previously filed under this section; or

(4) any material transaction between a domestic insurer and any person in the insurer's holding company system that is specified by rule and that the commissioner determines may adversely affect the interests of the insurer's policyholders or of the public, including an amendment or modification of an agreement previously filed under this section.

(e) Requires that the notice described by Subsection (c) (requiring a domestic insurer to give to the commissioner written notice of the insurer's intent to enter into a certain transaction) include:

(1) the reasons for entering into or changing the transaction; and

(2) the financial impact of the transaction on the domestic insurer.

(f) Requires the domestic insurer, not later than the 30th day after the termination of a previously filed agreement, to give notice of the termination to the commissioner.

SECTION 12. Amends Section 823.154, Insurance Code, as follows:

Sec. 823.154. New heading: REQUIREMENTS FOR ACQUISITION OR EXERCISE OF CONTROL OR DIVESTITURE OF DOMESTIC INSURER. (a) Provides that a domestic insurer may, before a person who directly or indirectly controls, or after the acquisition would directly or indirectly control, in any manner acquire a voting security of a domestic insurer or before a person may otherwise acquire control of a domestic insurer or exercise any control over a domestic insurer, or before a person may initiate a divestiture of control of a domestic insurer:

(1) the acquiring person shall file with the commissioner a statement that satisfies the requirements of Subchapter E (Acquisition Statement);

(2) the acquisition or divestiture of control must be approved by the commissioner in accordance with this subchapter; and

(3) if the person is initiating a divestiture of control, the divesting person shall file with the commissioner a notice of divestiture on a form adopted by NAIC or adopted by the commissioner by rule.

(b) Requires the acquiring person or divesting person to send a copy of the statement filed under this section to the domestic insurer.

(c) Provides that a statement or notice filed under this section is required to be filed not later than the 60th day before the proposed effective date of the acquisition or change of control or divestiture and is subject to public inspection at the office of the commissioner.

(d) Provides that, notwithstanding Subsection (a), a divesting person is not required to provide the commissioner with notice of divestiture required by Subsection (a)(3) if an acquiring person submits the statement required by Subsection (a)(1) and that acquisition is approved by the commissioner.

SECTION 13. Amends Section 823.157, Insurance Code, as follows:

Sec. 823.157. New heading: APPROVAL OF ACQUISITION, CHANGE, OR DIVESTITURE OF CONTROL. (a) Requires the commissioner to approve or deny an acquisition, change, or divestiture of control for which a statement or notice is filed under Section 823.154 not later than the 60th day after the date the statement required by that section is filed. Authorizes that the 60-day period be waived by the person filing the statement or notice required by Section 823.154 and the domestic insurer. Requires the commissioner, on the request of either the person filing the statement or notice required by Section 823.154, or the domestic insurer, to hold a hearing on a denial. Makes a nonsubstantive change.

(b) Requires the commissioner, in considering whether to approve or deny, to consider whether:

(1) immediately on the acquisition, change, or divestiture of control the domestic insurer would not be able to satisfy the requirements for the issuance of a new certificate of authority to write the line or lines of insurance for which the insurer holds a certificate of authority;

(2) the effect of the acquisition, change, or divestiture of control would be substantially to lessen competition in a line or subclassification lines of insurance in this state or tend to create a monopoly in a line or subclassification lines of insurance in this state;

(3) the financial condition of the acquiring person may jeopardize the financial stability of the domestic insurer or prejudice the interest of the domestic insurer's policyholders;

(4) the acquiring person has a plan or proposal to liquidate the domestic insurer or cause the insurer to declare dividends or make distributions, sell any of its assets, consolidate or merge with any person, make a material change in its business or corporate structure or management, or enter into a material agreement, arrangement, or transaction of any kind with any person, and that the plan or proposal is unfair, prejudicial, hazardous, or unreasonable to the insurer's policyholders and not in the public interest;

(5) due to a lack of competence, trustworthiness, experience, and integrity of the persons who would control the operation of the domestic insurer, the acquisition or change of control would not be in the interest of the insurer's policyholders and the public;

(5-a) the divestiture of control may jeopardize the financial stability of the domestic insurer or prejudice the interest of the domestic insurer's policyholders and other claimants; or

(6) the acquisition, change, or divestiture of control would violate the law of this or another state or the United States.

Makes nonsubstantive changes.

(c) Authorizes the commissioner, if a proposed acquisition, change, or divestiture of control will require the approval of more than one commissioner, to participate in a public hearing referred to in this chapter held on a consolidated basis on request of the person filing the statement required by Section 823.154. Requires the person filing the statement under Section 823.154 to file the statement with NAIC within five days of making the request for a public hearing. Requires that a hearing conducted on a consolidated basis be public and be held within the United States before the commissioners of the states in which the insurers are domiciled. Requires the commissioners to hear and receive evidence at the hearing. Authorizes the commissioner to attend the hearing in person or by telecommunication.

(d) Provides that this section does not require the commissioner to hold a hearing before approving or denying an acquisition, change, or divestiture of control.

SECTION 14. Amends Section 823.201, Insurance Code, by adding Subsections (d) and (e), as follows:

(d) Requires the acquiring person, if the acquiring person is also the ultimate controlling person, to agree to provide the annual enterprise risk report required by Section 823.0595 for as long as the acquiring person maintains control of the insurer.

(e) Requires the acquiring person and all subsidiaries within the insurer's control in the insurance holding company system to provide information to the commissioner on request of the commissioner as the commissioner deems necessary to evaluate enterprise risk to the insurer.

SECTION 15. Amends Section 823.205, Insurance Code, by adding Subsection (c) to authorize an insurer required to file information under Section 823.154 to satisfy the requirement of Section 823.052(c-1) by providing the commissioner with the most recently filed parent corporation reports that have been filed with the United States Securities and Exchange Commission, if required by the commissioner.

SECTION 16. Amends Section 823.351, Insurance Code, by amending Subsections (a) and (b) and adding Subsections (a-1), (a-2), and (b-1), as follows:

(a) Authorizes the commissioner, subject to Section 823.352 (Limitation on Power), to examine an insurer registered under Subchapter B and its affiliates, rather than order an insurer registered under Subchapter B to produce records, books, or other information papers in the possession of the insurer or an affiliate of the insurer that are necessary, to ascertain the financial condition or legality of conduct of the insurer, including the enterprise risk to the insurer by the ultimate controlling party, or by any entity or combination of entities within the insurance holding company system, or by the insurance holding company system on a consolidated basis.

(a-1) Authorizes the commissioner to order an insurer registered under Subchapter B to produce records, books, or other information in the possession of the insurer or its affiliates as are reasonably necessary to determine compliance with this chapter.

(a-2) Authorizes the commissioner, to determine compliance with this chapter, to order any insurer registered under Subchapter B to produce information not in the possession of the insurer if the insurer can obtain access to the information pursuant to contractual relationships, statutory obligations, or other methods. Requires the insurer, in the event that the insurer is unable to obtain the information requested by the commissioner, to provide the commissioner with a detailed explanation of the reason why the insurer is unable to obtain the information, and the identity of the holder of information. Authorizes the commissioner, if it appears to the commissioner that the insurer's explanation is without merit, after notice and hearing to:

(1) require the insurer to pay a penalty of not less than \$100 for each day the insurer delays producing the information; or

(2) suspend or revoke the insurer's license.

(b) Authorizes the commissioner by order, if an insurer fails to comply with an order under this section, rather than under Subsection (a), to require the examination of each holding company of the insurer and each controlled person or affiliate in the insurer's insurance holding company system if the commissioner has cause to believe that:

(1) the operations of that person may materially affect the operations, management, or financial condition of any controlled insurer in that system; and

(2) the commissioner is unable to obtain relevant information from the controlled insurer.

(b-1) Authorizes the commissioner to issue subpoenas, administer oaths, and examine under oath any person for purposes of determining compliance with this section. Authorizes the commissioner, on the failure or refusal of a person to obey a subpoena, to petition a court of competent jurisdiction, and on proper showing, authorizes the court to enter an order compelling the witness to appear and testify or produce documentary evidence. Provides that failure to obey the court order is punishable as contempt of court. Requires a person to attend as a witness at the place specified in the subpoena, when subpoenaed, at any location in this state. Entitles the person to the same fees and mileage, if claimed, as a witness in district court. Requires that fees, mileage, and actual expenses necessarily incurred in securing the attendance of a witness be itemized and charged against, and be paid by, the insurer being examined.

SECTION 17. Amends Section 823.452, Insurance Code, by adding Subsection (a-1) to authorize a violation, if it appears to the commissioner that a person has committed a violation of Subchapter D (Control of Domestic Insurer; Acquisition or Merger) that prevents the full understanding of the enterprise risk to the insurer by affiliates or by the insurance holding company system, to serve as an independent basis for disapproving dividends or distributions

and for issuing an order under Chapter 404 (Financial Condition) or Chapter 441 (Supervision and Conservatorship).

SECTION 18. Effective date: September 1, 2011.