

BILL ANALYSIS

Senate Research Center
85R20892 MEW-F

C.S.S.B. 1070
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Business & Commerce
4/20/2017
Committee Report (Substituted)

AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

S.B. 1070 relates to the regulation of reinsurance. Insurance companies buy insurance, called reinsurance, from other insurers to increase their capacity to sell additional insurance to consumers and to protect their solvency and liquidity. Insurers who purchase reinsurance in compliance with state law may take a "credit" for this reinsurance on their accounting statements, which typically means the insurers are allowed to reduce the amount of reserves that they hold.

Chapters 492 and 493, Texas Insurance Code, contain the current law on reinsurance. Current Texas law requires reinsurers domiciled in other countries to post 100 percent collateral in order for Texas insurers to receive credit for the purchase of that reinsurance. Texas law dictates this 100 percent collateral requirement to insurers who purchase reinsurance from foreign reinsurers, regardless of the reinsurer's financial strength. In contrast, reinsurers located in the United States (U.S.) do not have to post collateral, regardless of their financial strength or weakness.

The current Texas law creates restrictions on insurers' ability to negotiate the terms of their reinsurance contracts. Moreover, basing collateral requirements solely on the reinsurer's geographic location, rather than financial strength, runs contrary to current financial solvency regulation, which focuses primarily on financial strength rather than jurisdiction. In addition, since most of the world's strongest reinsurers are located in other countries (90 percent of all reinsurance premium is sold by reinsurers from other countries), restrictions on collateral for foreign reinsurers restricts Texas insurers' ability to negotiate certain terms for the majority of their reinsurance contracts. The restrictions in current law also result in trapped capital that could otherwise be infused into the economy or insurance marketplace.

S.B. 1070 gives Texas insurers the option to negotiate reinsurance contracts that do not require 100 percent collateral. There are, however, still parameters on the reinsurers. In order to qualify for reduced collateral requirements, reinsurers must: (i) meet financial requirements and (ii) reside in a jurisdiction with a history of honoring and enforcing U.S. judgments. (Original Author's / Sponsor's Statement of Intent)

C.S.S.B. 1070 amends current law relating to authorized reinsurance and financial statement credit and accounting for reinsurance.

RULEMAKING AUTHORITY

Rulemaking authority previously granted to the commissioner is rescinded in SECTION 1.12 (Sections 492.003, 492.051, and 492.055, Insurance Code) of this bill.

Rulemaking authority previously granted to the commissioner is modified in SECTION 2.01 (Section 36.002, Insurance Code) of this bill.

SECTION BY SECTION ANALYSIS

ARTICLE 1. AUTHORIZED REINSURANCE; CREDIT AND ACCOUNTING FOR REINSURANCE

SECTION 1.01. Amends the chapter heading to Chapter 493, Insurance Code, to read as follows:

CHAPTER 493. AUTHORIZED REINSURANCE; CREDIT AND ACCOUNTING

SECTION 1.02. Amends Section 493.002(a), Insurance Code, as follows:

(a) Deletes the exception provided by Subsection (b). Includes all life, health, and accident insurance companies regulated by the Texas Department of Insurance (TDI), including certain entities, and a health maintenance organization operating under Chapter 843 (Health Maintenance Organizations) in the list of insurers to which this chapter (Resinsurance for Property and Casualty Insurers) applies.

SECTION 1.03. Amends Section 493.051(b), Insurance Code, to authorize an insurer authorized to engage in business in this state to provide reinsurance under this chapter on any line of insurance in which the insurer is authorized to engage in this state, rather than authorizes an insurer authorized to engage in business in this state that writes any line of insurance regulated by Title 10 (Property and Casualty Insurance) to provide reinsurance under this chapter while the insurer is in compliance with law.

SECTION 1.04. Amends Section 493.102(a), Insurance Code, as follows:

(a) Includes an assuming insurer that is certified as a reinsurer in this state under Section 493.1033 and maintains an amount of security based on the ratings assigned by the commissioner of insurance (commissioner) and based on the requirements under Section 493.1036 to the list of assuming insurers to whom reinsurance is ceded. Makes nonsubstantive changes.

SECTION 1.05. Amends Subchapter C, Chapter 493, Insurance Code, by adding Sections 493.1033, 493.1034, 493.1035, 493.1036, 493.1037, 493.1038, and 493.1039, as follows:

Sec. 493.1033. CREDIT ALLOWED FOR CERTAIN CERTIFIED REINSURERS. (a) Requires that credit be allowed when the reinsurance is ceded to an assuming insurer that meets certain criteria.

(b) Requires the assuming insurer, to be eligible for certification, to meet certain requirements.

(c) Provides that credit for reinsurance under this section applies only to a reinsurance contract entered into or renewed on or after the effective date of the certification of the assuming insurer.

Sec. 493.1034. CERTAIN ASSOCIATIONS MAY BE CERTIFIED REINSURERS. (a) Authorizes an association that includes incorporated and individual unincorporated underwriters to be a certified reinsurer under Section 493.1033. Requires that the association satisfy the requirements of Section 493.1033 and this section to be eligible for certification.

(b) Requires that the association satisfy minimum capital and surplus requirements through the capital and surplus equivalents, net of liabilities, of the association and its members that is required to include a joint central fund in an amount determined by the commissioner to provide adequate protection that may be applied to any unsatisfied obligation of the association or any of its members.

(c) Prohibits the incorporated members of the association from engaging in any business other than underwriting and provides that the members are subject to the same level of regulation and solvency control by the association's domiciliary regulator as are the unincorporated members.

(d) Requires the association, not later than the 90th day after the date the association's financial statements are due to be filed with the association's domiciliary regulator, to provide the commissioner with certain documentation.

Sec. 493.1035. QUALIFIED JURISDICTIONS. (a) Requires the commissioner to develop and publish a list of qualified jurisdictions in one of which an assuming insurer is required to be licensed and domiciled in order to be considered for certification by the commissioner under Section 493.1033 as a certified reinsurer. Requires the commissioner, in developing the list, to consider the following factors:

- (1) the framework under which the assuming insurer is regulated;
- (2) the structure and authority of the domiciliary regulator with regard to solvency regulation requirements and financial surveillance;
- (3) the substance of financial and operating standards for assuming insurers in the domiciliary jurisdiction;
- (4) the form and substance of financial reports required to be filed or made publicly available by reinsurers in the domiciliary jurisdiction and the accounting principles used in those reports;
- (5) the willingness of the domiciliary regulator to cooperate with other regulators in the United States and, in particular, the commissioner;
- (6) the history of performance by assuming insurers in the domiciliary jurisdiction;
- (7) evidence of problems with the enforcement of final United States judgments in the domiciliary jurisdiction; and
- (8) any other information that shows that qualification of the jurisdiction would be beneficial or harmful to insurers or consumers in this state.

(b) Requires the commissioner, in order to determine whether a jurisdiction of an assuming insurer located outside of the United States (U.S.) is eligible to be recognized as a qualified jurisdiction under Subsection (a), to conduct certain evaluations and make certain considerations.

(c) Requires a jurisdiction, in order to be qualified, to agree in writing to share information and cooperate with the commissioner with respect to all certified reinsurers doing business in the jurisdiction.

(d) Prohibits a jurisdiction from being recognized as a qualified jurisdiction if the commissioner determines that the jurisdiction does not or may not adequately and promptly enforce final U.S. judgments or arbitration awards.

(e) Authorizes the commissioner, if a certified reinsurer's domiciliary jurisdiction ceases to be a qualified jurisdiction, to suspend the reinsurer's certification indefinitely, instead of revoking the certification.

Sec. 493.1036. REQUIREMENTS FOR CERTIFIED REINSURER. (a) Requires the commissioner to assign a rating to each certified reinsurer based on the factors listed in Subsections (d)-(h).

(b) Requires the commissioner to publish a list of the ratings for all certified reinsurers.

(c) Requires a certified reinsurer to secure obligations assumed from ceding insurers domiciled in the U.S. in accordance with the rating assigned by the commissioner under Subsection (a) and with the amount of required security computed as a percentage of those obligations according to a certain chart.

(d) Requires a certified reinsurer to maintain financial strength ratings from at least two of the rating agencies listed in Subsection (e). Requires that the ratings be based on interactive communication between the rating agency and the certified reinsurer, and prohibits the ratings from being based solely on publicly available information. Provides that the financial strength ratings are one factor in determining the rating the commissioner assigns to the certified reinsurer.

(e) Provides that certain rating agencies are acceptable for purposes of Subsection (d).

(f) Requires that a certified reinsurer be rated on a legal entity basis, giving due consideration to the group rating when appropriate, except that an association that includes incorporated and individual unincorporated underwriters that has been approved to do business as a single certified reinsurer is authorized to be evaluated on the basis of the association's group rating. Authorizes the commissioner to consider the following factors as part of the initial and ongoing evaluation process in assigning a rating:

(1) a certified reinsurer's financial strength rating from an acceptable rating agency as described by Subsection (e);

(2) the business practices of the certified reinsurer in dealing with ceding insurers, including the certified reinsurer's record of compliance with reinsurance contractual terms and obligations;

(3) for a certified reinsurer domiciled in the United States, a review of the most recent applicable annual statement blanks;

(4) the market conduct and prompt payment of claims history of the certified reinsurer under reinsurance agreements, including the proportion of obligations that are more than 90 days past due or in dispute;

(5) regulatory actions against the certified reinsurer;

(6) the report of the independent auditor on the financial statements of the insurance enterprise, on a basis described in Subdivision (7);

(7) for a certified reinsurer not domiciled in the United States, three years of audited financial statements filed with the domiciliary regulator on certain accounting bases;

(8) actuarial opinion, as filed with the certified reinsurer's domiciliary regulator;

(9) the liquidation priority of obligations to a ceding insurer in the certified reinsurer's domiciliary jurisdiction in the context of an insolvency proceeding; and

(10) a certified reinsurer's participation in a liquidation, reorganization, or similar solvency-related arrangement or proceeding, regardless of the characterization of the arrangement or proceeding, that involves United States ceding insurers.

(g) Requires that the maximum rating the commissioner is authorized to assign a certified reinsurer correspond with the certified reinsurer's financial strength based on a certain table.

(h) Requires the commissioner to use the lowest financial strength rating a certified reinsurer receives from an approved rating agency to establish the maximum rating that may be assigned to the certified reinsurer. Provides that a

reinsurer that fails to obtain or maintain at least two financial strength ratings from acceptable rating agencies is not eligible for certification.

(i) Requires a certified reinsurer to annually file information with the commissioner for the commissioner's evaluation of the certified reinsurer's compliance with the standards under this section.

(j) Requires the certified reinsurer, for a domestic ceding insurer to qualify for full financial statement credit for reinsurance ceded to a certified reinsurer, to maintain security in a form acceptable to the commissioner and consistent with the insurance laws of this state or in a multibeneficiary trust in accordance with Subchapter D (Requirements for Trust Credit Alliance), except as otherwise provided.

(k) Requires a certified reinsurer, if a certified reinsurer maintains a trust under Subchapter D to secure its obligations, and chooses to secure its obligations incurred as a certified reinsurer with a multibeneficiary trust, to maintain separate trust accounts for the obligations incurred under reinsurance agreements the certified reinsurer issued or renewed with reduced security as permitted by this section or comparable laws of other United States jurisdictions and for its obligations subject to Subchapter D. Provides that it is a condition of the grant of certification under Section 493.1033 that the certified reinsurer has bound itself, by the language of the trust agreement and agreement with the insurance commissioner or other chief insurance regulatory official with principal regulatory oversight over each trust account, to fund, on termination of the trust account, out of the remaining surplus of the trust any deficiency of any other trust account described by this subsection.

(l) Provides that the minimum trustee surplus requirements provided in Subchapter D do not apply to a multibeneficiary trust described by this section, except that the trust is required to maintain a minimum trustee surplus of \$10 million.

(m) Provides that, with respect to obligations incurred by a certified reinsurer under this section, if the security is insufficient, the commissioner:

(1) is required to reduce the allowable credit by an amount proportionate to the deficiency; and

(2) is authorized to impose further reductions in allowable credit on finding that there is a material risk that the certified reinsurer's obligations will not be paid in full when due.

(n) Requires that, for purposes of this section, a reinsurer whose certification has been revoked, suspended, or voluntarily surrendered or whose certification status has become inactive for any reason be treated as a reinsurer required to secure 100 percent of its obligations, except that if the commissioner continues to assign to the reinsurer a higher financial strength rating as permitted by this section, the security requirement does not apply to a reinsurer whose certification has been suspended or whose certification status has become inactive.

Sec. 493.1037. CERTIFICATION BY OTHER STATES. Provides that if an applicant for certification has been certified as a reinsurer in another state by the commissioner of insurance of that state:

(1) the commissioner is authorized to make a determination to use the other state's certification and the financial strength rating assigned by that state; and

(2) if the commissioner makes the determination authorized by Subdivision (1), the applicant is required to be considered to be a certified reinsurer in this state.

Sec. 493.1038. **SUSPENSION OR REVOCATION OF ACCREDITATION OR CERTIFICATION; INACTIVE STATUS.** (a) Authorizes a certified reinsurer that ceases to assume new business in this state to request to maintain its certification in inactive status to continue to qualify for a reduction in security for in-force business. Requires an inactive certified reinsurer to continue to comply with all applicable requirements of this section, and requires the commissioner to assign a financial strength rating that takes into account, if relevant, the reasons the reinsurer is not assuming new business.

(b) Authorizes the commissioner, after notice and opportunity for hearing, to suspend or revoke the reinsurer's accreditation or certification, if an accredited or certified reinsurer ceases to meet the requirements for accreditation or certification. Prohibits a suspension or revocation from taking effect until after the date of the commissioner's order on the hearing, unless certain conditions are met.

(c) Provides that, while a reinsurer's accreditation or certification is suspended, a reinsurance contract issued or renewed after the effective date of the suspension does not qualify for credit except to the extent that the reinsurer's obligations under the contract are secured in accordance with Subchapter D.

(d) Prohibits credit for reinsurance from being granted after the effective date of the revocation except to the extent that the reinsurer's obligations under the contract are secured in accordance with Section 493.1036 or Subchapter D, if a reinsurer's accreditation or certification is revoked.

Sec. 493.1039. **CONCENTRATION RISK.** (a) Requires a ceding insurer to manage its reinsurance recoverable proportionate to its book of business. Requires a domestic ceding insurer to notify the commissioner not later than the 30th day after the date reinsurance recoverable from any single assuming insurer, or group of affiliated assuming insurers, exceeds or is likely to exceed 50 percent of the domestic ceding insurer's last reported surplus to policyholder. Requires that the notification demonstrate that the exposure is safely managed by the domestic ceding insurer.

(b) Requires a ceding insurer to diversify its reinsurance program. Requires a domestic ceding insurer to notify the commissioner not later than the 30th day after the date the insurer cedes to any single assuming insurer, or group of affiliated assuming insurers, an amount that exceeds or is likely to exceed 20 percent of the ceding insurer's gross written premium in the prior calendar year. Requires that the notification demonstrate that the exposure is safely managed by the domestic ceding insurer.

SECTION 1.06. Amends Section 493.151, Insurance Code, as follows:

Sec. 493.151. **APPLICABILITY OF SUBCHAPTER.** Includes Sections 493.1036(k) and (l) in the section describing a certain trust to which this subchapter applies. Creates Subdivisions (1) and (2) from existing text and makes nonsubstantive changes.

SECTION 1.07. Amends Section 493.152, Insurance Code, by amending Subsection (a) and adding Subsection (a-1), as follows:

(a) Requires a trust to, among other requirements if the assuming insurer is a single insurer, include a trustee surplus of at least \$20 million, except after the assuming insurer has permanently discontinued underwriting new business secured by the trust for not less than three calendar years, the insurance commissioner or other chief insurance regulatory official with principal regulatory oversight over the trust may authorize a reduction in the required trustee surplus, but only after a certain finding, rather than include a trustee surplus of at least \$20 million.

(a-1) Authorizes the risk assessment to involve an actuarial review, including an independent analysis of reserves and cash flows, and requires that the assessment consider all material risk factors, including, when applicable, certain factors. Prohibits the minimum required trusteed surplus from being reduced to an amount less than 30 percent of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers.

SECTION 1.08. Amends Section 493.153, Insurance Code, as follows:

Sec. 493.153. FORM OF TRUST. (a) Creates this subsection from existing text. Requires that the trust be established in a form approved by the commissioner or an insurance commissioner or other chief insurance regulatory official of another state who, under the trust instrument, has principal regulatory oversight over the trust to individuals who approve the trust, rather than be established in a form approved by the commissioner.

(b) Requires a copy of the trust instrument and any amendment to the trust instrument to be filed with the insurance commissioner or other chief insurance regulatory official of each state in which the ceding insurer beneficiaries of the trust are domiciled.

SECTION 1.09. Amends Section 493.155, Insurance Code, by amending Subsection (b) and adding Subsections (c), (d), (e), and (f), as follows:

(b) Requires the assuming insurer to report certain information to TDI to enable the commissioner to determine the sufficiency of the trust fund under Section 493.102(a)(3) and for purposes of Sections 493.1036(k) and (l).

(c) Requires an assuming insurer that maintains a trust fund, not later than February 28 of each year, if requested by a beneficiary of the trust fund, to provide or make available to the assuming insurer's U.S. ceding insurers or those ceding insurers' assigns and successors in interest certain information.

(d) Requires the assuming insurer to provide, if requested by a ceding insurer, in addition to the information under Subsection (c), a certification that discloses and certifies certain information.

(e) Requires that the assuming insurer also provide, if requested by the ceding insurer, a certification of certain aggregate information of the trust.

(f) Authorizes an assuming insurer to decline to release trade secrets or commercially sensitive information to a ceding insurer.

SECTION 1.10. Amends Section 493.156(a), Insurance Code, to prohibit a ceding insurer from being allowed credit for reinsurance ceded to an assuming insurer that is not authorized, accredited, or certified to engage in the business of insurance or reinsurance in this state unless the assuming insurer makes certain agreements in the reinsurance contract.

SECTION 1.11. Amends Subchapter D, Chapter 493, Insurance Code, by adding Section 493.1561, as follows:

Sec. 493.1561. CERTAIN TRUSTEED ASSUMING REINSURERS; REQUIREMENTS FOR TRUST AGREEMENT. (a) Defines "commissioner."

(b) Prohibits the credit permitted by Section 493.102(a)(3) or (4) from being allowed unless the assuming insurer makes certain agreements in the trust agreement, if the assuming insurer does not meet the requirements of Section 493.102(a)(1) or (2).

SECTION 1.12. Repealer: Chapter 492 (Reinsurance for Life, Health, and Accident Insurance Companies and Related Entities), Insurance Code, and Section 493.002(b) (relating to application of this chapter to certain ceding insurers), Insurance Code.

ARTICLE 2. CONFORMING AMENDMENTS

SECTION 2.01. Amends Section 36.002, Insurance Code, to delete Section 492.051(b) or (c) from the list of provisions the commissioner is authorized to adopt reasonable rules appropriate to accomplishing their purpose.

SECTION 2.02. Amends Section 422.005(a), Insurance Code, to delete the provision that this chapter (Exemptions) does not apply to a reinsurance agreement or any trust account related to the reinsurance agreement if the agreement and trust account meet the requirements of Chapter 492.

SECTION 2.03. Amends Section 841.002, Insurance Code, to provide that certain insurance companies are subject to certain statutes, including Chapter 493, rather than Chapters 492 and 1506.

SECTION 2.04. Amends Section 841.257, Insurance Code, to prohibit a certain insurance company from accepting a risk or writing an insurance policy in this state or any other state or county other than, among certain exceptions, reinsurance under Chapter 493, rather than reinsurance under Section 492.051(b) and (c) or Chapter 493.

SECTION 2.05. Amends Section 841.402(10), Insurance Code, to redefine "letter of credit."

SECTION 2.06. Amends Section 841.409(c), Insurance Code, to provide that a limited purpose subsidiary life insurance company is considered to be licensed to transact the business of reinsurance for the purposes of Section 493.051, rather than 492.051, but may only reinsure risks of the company's affiliated companies.

SECTION 2.07. Amends Section 841.412(b), Insurance Code, to authorize a certain limited purpose subsidiary life insurance company to reduce the amount of the company's excess reserves on account of reinsurance that complies with Chapter 493 and a letter of credit that complies with Section 493.104(b)(2)(C), rather than reinsurance that complies with Chapter 492 and a letter of credit that complies with Section 492.104(b)(2)(C).

SECTION 2.08. Amends Sections 841.413(b) and (c), Insurance Code, as follows:

(b) Replaces a reference to Section 492.104(b)(2)(C) with Section 493.104(b)(2)(C).

(c) Authorizes the commissioner to approve a reinsurance contract if the commissioner finds that the proposed reinsurance complies with Chapter 493, rather than Chapter 492.

SECTION 2.09. Amends Section 862.101(f), Insurance Code, to delete Subdivision (2), redesignate existing Subdivision (3) as Subdivision (2), and make nonsubstantive changes.

SECTION 2.10. Amends Section 884.002(c), Insurance Code, to provide that Chapter 493, other than Section 493.051(b), rather than Chapter 492, other than Sections 492.051(b) and (c), apply to a stipulated premium company.

SECTION 2.11. Amends Section 884.402, Insurance Code, to delete Chapter 1506 and replace reference to Chapter 492, other than Sections 492.051(b) and (c), with Chapter 493, other than Section 493.051(b), in the list of provisions that authorize certain health or accident insurance coverage.

SECTION 2.12. Amends Section 964.052(d), Insurance Code, to delete Subchapter C, Chapter 492, from certain provisions under which a captive insurance company is authorized to take credit for reserves on risks or portions of risks ceded to reinsurers.

SECTION 2.13. Amends Section 1807.002(a), Insurance Code, to delete Section 492.051 from the list of sections that do not apply to marine insurance.

SECTION 2.14. Amends Section 4152.152, Insurance Code, to require a broker who places reinsurance with a reinsurer that is not authorized, accredited, or trusteeed in this state under Chapter 493, rather than Chapters 492 or 493, to take certain actions.

SECTION 2.15. Amends Section 4152.214(a), Insurance Code, to require a manager who places reinsurance with a reinsurer that is not authorized, accredited, or trusteeed in this state under Chapter 493, rather than under Chapters 492 or 493, to take certain actions.

ARTICLE 3. TRANSITION; EFFECTIVE DATE

SECTION 3.01. Makes application of this Act prospective to January 1, 2018.

SECTION 3.02. Effective date: September 1, 2017.