# TDI Biennial Report

- TDI published and distributed the agency's Biennial Report to the 83rd Texas Legislature on December 28, 2012. The report outlined:
  - 13 formal recommendations addressing several different areas within the agency including, Compliance, Financial, Regulatory Policy, the State Fire Marshal's Office and Workers' Compensation.
  - 6 "clean up recommendations" addressing outdated or inconsistent statutory provisions,
  - 2 "leveling the playing field" recommendations, and
  - 7 legislative considerations, which are not formal recommendations but rather items the Department is currently addressing on some level and felt the 83rd Legislature may wish to review during the legislative session.
- Of the 13 formal recommendations, this testimony will highlight 4 recommendations that TDI considers particularly noteworthy. TDI will be happy to meet with members should they wish to discuss the recommendations in greater detail.

# ORSA

Overview:
TDI regulates both insurance carriers and the relationships between insurance carriers and their affiliates. TDI also monitors the financial condition and risk profiles of holding company systems or "groups" of affiliates. It is imperative that TDI monitor these entities because risks posed by non-insurance operations can potentially spread to insurance companies and negatively impact their financial condition. This recommendation would help address future situations similar to the one that AIG faced during the nation's recent financial crisis.

In response to the global financial crisis and situations, such as AIG, as well as discussions held at the international level about group supervision, the National Association of Insurance Commissioners ("NAIC") recently adopted the Own Risk Solvency Assessment (ORSA) Model Act.

An ORSA is an internal assessment of the risks associated with an insurer's or insurance group's current business plan coupled with the sufficiency of its capital resources to support those risks. The new NAIC model act requires insurance companies or insurance groups to perform their own ORSA and to file an ORSA summary report with insurance regulators.

Recommendation:
TDI's recommendation is to amend the Insurance Code by adding a new chapter based on the *NAIC ORSA Model Act.* By adding a requirement for certain large insurance carriers to file ORSA summary reports with the agency, the Department believes it will improve the understanding of large carriers and their holding company systems by providing a group-level perspective on risk and capital, rather than just a snapshot of individual companies. This not only allows TDI to better protect Texas policyholders; it will also enhance our ability to participate in the supervision of insurers and insurance groups domiciled in multiple jurisdictions, and as a result, improve regulatory coordination at the national and international levels.

# Captives

Overview:
A "captive" generally refers to an insurance carrier that insures the risks of its owners. Most other states and foreign jurisdictions have laws that provide for the formation of captive insurance companies. There are many different types of captives. The most traditional form is called a "pure captive." A "pure captive" is typically owned by a large corporation, such as a Fortune 500 company, and is a form of self-insurance. Although there are some differences, the regulation of a "pure captive" is similar in many ways to the regulation of a traditional insurance carrier.

Insurance commissioners in states that license captives typically have some discretion to set the captive's minimum financial requirements based on the financial strength of the captive's owner (parent company). Captives often benefit from lower premium tax rates.

There are Texas-based corporations that desire to form their own captives. Current Texas law, however, does not authorize the formation of a captive insurance carrier in Texas. As a result, a Texas-based corporation must form its captive in another state or offshore. This creates additional expenses and administrative burdens since other states and jurisdictions often require captives to: utilize locally based management companies or other professionals; hold a minimum number of board meetings within their jurisdictions each year; and appoint a local resident to the board, resulting in increased compensation costs.

Recommendation:
By adding new provisions to the Insurance Code to provide for the formation of Texas-based "pure captives," TDI sees an opportunity to further enhance Texas' pro-business climate. Allowing the formation of Texas domestic captive insurance companies could help attract new businesses and retain existing Texas companies. In addition to touting the current benefits that Texas has to offer, Texas-based Fortune 500 and other corporations could benefit from reduced costs and administrative burdens related to their captive operations. This recommendation would also result in some additional tax revenue for Texas.

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# Attracting New Capital to Texas

Overview
Texas consumers and businesses paid more than $106 billion in insurance premiums last year, making Texas the 12th-largest insurance market in the world. Currently, more than 400 insurance companies are based in Texas. Many are small- and medium-sized regional carriers.

In relation to the size of the state's insurance market, Texas is home to only an average number of insurance companies. Texas is also average in terms of the number of large insurers (defined as insurers writing $500 million or more in annual premiums). By comparison, other states have a greater number of domestic insurers in relation to the size of their insurance markets and serve as the home to a disproportionately higher number of large insurance companies. TDI believes an opportunity exists to attract more insurance companies to Texas, particularly large insurers. The benefits of attracting more companies include:

- increased competition;
- support for the growth of the Texas economy; and
- enhanced ability of the state, including TDI, to influence regulatory developments at the national and international levels.

Suggested Considerations
The Texas Legislature may wish to:

1. Reduce costs borne by Texas-domestic insurers by spreading the costs of TDI's examination overhead assessments to all insurers licensed in Texas;
2. Amend regulatory approval thresholds in the Texas Holding Company Act based on the NAIC model act language to enhance uniformity and consistency from state to state;
3. Grant discretion to the commissioner of insurance, with concurrence from the comptroller of public accounts, to grant credits for premium or maintenance taxes for temporary periods of time for insurers who locate their physical operations in Texas; and
4. Update and streamline the incorporation and licensing statutes for insurance companies.

**1. Reduce costs borne by Texas-domestic insurers by spreading the costs of TDI's examination overhead assessments to all insurers licensed in Texas**

- The Department is responsible for the solvency regulation of all insurance carriers licensed in Texas, that is, both Texas and non-Texas insurers. There are approximately 425 Texas and 1,440 non-Texas insurance carriers currently licensed to sell insurance in Texas. The 1,440 non-Texas insurance carriers produced 66 percent of all premiums sold in Texas in 2011.

- Current Texas law provides that only Texas-domestic insurance carriers pay an examination overhead assessment, which is required by Section 401.151 (c) of the Insurance Code. Non-Texas insurers do not pay this assessment even though TDI is required to ascertain their financial condition as well. This places a burden on Texas-domestic carriers that is not shared by non-Texas carriers.

- Current regulation of insurers for solvency focuses on the overall financial condition of entire holding company systems, or "groups" of affiliated insurance carriers. These holding company systems typically include both Texas and non-Texas carriers. TDI expends considerable examination resources doing "coordinated examinations" of groups of affiliates, both Texas carriers and non-Texas carriers, in conjunction with regulators from other states.

- Modifying Section 401.151 (c) of the Insurance Code so that these examination assessments are allocated amongst all carriers licensed to sell insurance in Texas would reduce fiscal burdens on Texas-domestic insurers and thereby make being a Texas insurer a more attractive option. This modification would also increase regulatory efficiency.

- The proposal would not have any effect on how the direct costs of conducting an examination (examiner's salary, travel expenses, etc.) are currently being paid. This proposal is expressly limited to the examination overhead assessment, which covers costs that are not directly associated with conducting an examination.

- The proposal could have a slight impact on retaliatory taxes. In the past, the examination overhead assessment has been approximately $10 million. Non-Texas insurers would incur approximately $6.6 million in additional Texas assessments based on the premium written (66 percent of $10 million). This additional assessment would be spread over each of the 1440 non-Texas based insurers (proportionate to the premium written in Texas) and therefore would be a very small impact. As a result, the retaliatory tax impact, if any, would be de-minimis.

**2. Amend regulatory approval thresholds in the Texas Holding Company Act based on the NAIC model act language to enhance uniformity and consistency from state to state**

- Current Texas law requires that certain transactions between insurers and their affiliates be filed with TDI in advance. These filings are made to ensure that the insurance policyholders are not disadvantaged by potential situations where insurance carriers may enter into transactions that are not fair.

- These filings are regulated by Chapter 823 of the Texas Insurance Code and provide certain monetary thresholds before transactions must be filed with the Department. The Texas Holding Company Act is based on model legislation recommended by the NAIC; however, the thresholds contained in Texas statute differ from the NAIC model law.

- This is problematic for insurance companies, particularly those insurance companies that do business in multiple states. Amending the Texas law to match the thresholds in the NAIC model act will not reduce TDI's authority to regulate affiliated transactions. Rather, it would create a more uniform regulatory environment between states.

- Amending Chapter 823 to match the NAIC model would create more uniformity for carriers in Texas, thus making it a more attractive state to do business in.

**3. Grant discretion to the commissioner of insurance, with concurrence from the comptroller of public accounts, to grant credits for premium or maintenance taxes for temporary periods of time for insurers who locate their physical operations in Texas**

- Insurers writing business in Texas are required to pay premium taxes. The premium tax rate for property and casualty insurers is 1.6 percent of premium while the maximum premium tax rate for life insurers is 1.75 percent of premium. In summary, insurers pay between $16 and $17.50 per $1,000 of premium written in premium taxes.

- Creating a tax incentive program is a common tool used to encourage a specific industry to increase its business presence. Programs of this nature have been utilized by cities, counties, and states.

- Currently, there is not a tax incentive program in Texas targeted at the insurance industry.

- This program would be limited to insurers that located new physical operations or expanded existing physical operations in Texas.

- Other states, including Iowa and Nebraska, have established tax incentive programs targeted at the insurance industry with positive results.

- Controls for the program would include:
  - An overall cap on the credits allowed in the program.
  - In order to be considered for the program, insurers would have to demonstrate to the commissioner and the comptroller that taxes, fees, and other sources of revenue to the state associated with the expanded physical operations in Texas would offset or exceed and premium tax credits allowed under the program.
  - The program would be revenue neutral or positive.
  - The incentive would be temporary.

- The purpose of the program would be to incentivize insurers to establish or expand physical operations in Texas and overall make Texas a more attractive place to locate operations.

**4. Update and streamline the incorporation and licensing statutes for insurance companies**

Incorporation and Licensing

- Chapters 822, 841, and 861 of the Insurance Code require a two-step process where a company is first incorporated and then licensed to do insurance business. This two-step process is unnecessary because statute prohibits an insurer from operations that are not considered insurance. Thus, TDI can only incorporate an entity that it also licenses.

- Modifying this process into a single step where TDI can incorporate and license simultaneously would be more efficient for TDI and simpler for applicants.

Lines of Business- Cleanup

- The lines of business that TDI can license an insurer to write are not representative of the terms used in the industry today or the lines of business that are reported in a company's annual statement, which is filed with TDI. For example, a Texas insurer that wants to write a homeowners policy must be licensed to produce the following: fire, allied lines, liability other than automobile, burglary, and theft. Many of these lines of business are no longer commonly used in the marketplace and thus, cause confusion for both insurers and other states. This situation often results in calls to TDI from other states that are trying to determine what products a Texas insurer is licensed to write. (Another state can only license a Texas insurer to write business that it is licensed to write in Texas.) Therefore, some confusion is created by not using terms that are common among the industry and regulators, and it can act as a deterrent to be a Texas-domiciled company.

- Utilizing the lines of business included in a company's annual statement, rather than existing statutes, would create a more transparent licensing function for companies and other states eliminating questions and confusion that currently exists.

# Refund of Premium

Overview:
Currently the Insurance Code requires carriers to "promptly refund" premium owed to policyholders upon the cancellation of a policy. This money is commonly known as "unearned premium." While the Insurance Code requires insurers to "promptly refund" the unearned premium, the section neither defines "promptly refund" nor specifies the time limits for insurers to refund unearned premium to consumers. As a result, TDI receives hundreds of complaints annually from consumers regarding the length of time it takes insurers to refund their unearned premium following a policy cancellation.

- Complaints received relating to refund of premium
  - 2010: 438 complaints
  - 2011: 461 complaints
  - 2012: 445 complaints

Recommendation:
Therefore, TDI suggests amending the Insurance Code to require insurers to return unearned premium to consumers on homeowners and personal automobile insurance policies within 15 business days from the effective date of cancellation. This statutory change will provide a clear guideline for both consumers and insurers to follow.