

BILL ANALYSIS

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C.S.H.B. 3161
By: Hancock (Van de Putte)
State Affairs
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Committee Report (Substituted)

AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

C.S.H.B. 3161 amends current law relating to limited purpose subsidiary life insurance companies.

RULEMAKING AUTHORITY

Rulemaking authority is expressly granted to the commissioner of insurance in SECTION 1 (Section 841.410, Insurance Code) of this bill.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Chapter 841, Insurance Code, by adding Subchapter I, as follows:

SUBCHAPTER I. LIMITED PURPOSE SUBSIDIARY LIFE INSURANCE COMPANIES

Sec. 841.401. **PURPOSE.** Provides that the purpose of this subchapter is to authorize the establishment of domestic limited purpose subsidiary life insurance companies (LPS) to enable those companies to support excess reserves for certain life insurance policies.

Sec. 841.402. **DEFINITIONS.** Defines, in this subchapter, "affiliated company," "appointed actuary," "ceding insurer," "controlled person," "excess reserves," "guarantor," "guaranty," "holding company," "insurer," "letter of credit," "limited purpose subsidiary life insurance company," "material transaction," "organizational document," "organizing company," "parent," "person," "reinsurance contract," and "risk."

Sec. 841.403. **ORGANIZATIONAL DOCUMENTS.** (a) Authorizes a wholly owned domestic insurer authorized to transact the business of insurance under this chapter or an affiliated company organized or authorized to conduct business under the laws of this state to organize an LPS under this subchapter.

(b) Authorizes an LPS to reinsure risks of the organizing company and of an affiliated company.

(c) Requires that an LPS's organizational documents:

(1) limit the company's authority to transact the business of insurance to reinsuring only the risks of a ceding insurer;

(2) provide that the LPS may not otherwise engage in the business of insurance; and

(3) provide that the LPS must always be wholly owned by a domestic insurer authorized to transact the business of insurance under this chapter or by an affiliated company organized or authorized to do business under the laws of this state.

Sec. 841.404. **CERTIFICATE OF AUTHORITY REQUIRED.** Prohibits an LPS from engaging in the business of reinsurance in this state unless the LPS obtains from the

commissioner of insurance (commissioner) a certificate of authority under this subchapter.

Sec. 841.405. APPLICATION FOR CERTIFICATE OF AUTHORITY. Requires the incorporators of the company, to obtain a charter for an LPS, to pay to the Texas Department of Insurance (TDI) a charter fee in an amount determined under Chapter 202 (Fees) and file with TDI:

- (1) an application for charter on the form prescribed by, and containing the information prescribed by, the commissioner;
- (2) the company's articles of incorporation;
- (3) an affidavit made by the company's president, vice president, treasurer, or chief financial officer stating that the minimum capital and surplus requirements of this subchapter are satisfied; the capital and surplus are the bona fide property of the company; the information in the articles of incorporation is true and correct; the proposed organization and operation of the LPS comply with all applicable provisions of this subchapter; the LPS's investment policy reflects and takes into account the liquidity of assets and the reasonable preservation, administration, and management of those assets with respect to the risks associated with the reinsurance contract; and any reinsurance contract and arrangement for securing the LPS's obligations under the reinsurance contract, including any agreements or other documentation to implement the arrangement;
- (4) a business plan that includes pro forma financial statement projections that demonstrate how the LPS will comply with Section 841.412;
- (5) a copy of any proposed guaranty that demonstrates how compliance with Sections 841.412 and 841.417 will be achieved;
- (6) an opinion of a qualified independent actuary acceptable to the commissioner that the methodology and assumptions used to set and discount reserves made good and sufficient provision for the risk assumed by the LPS, including significant stress tests on key assumptions; and
- (7) any other statement or document required by the commissioner to evaluate the LPS's application for a certificate of authority.

Sec. 841.406. INVESTMENT OF CERTAIN SURPLUS BY ORGANIZING COMPANY. Authorizes an organizing company, if the company that organizes the LPS is a domestic life insurance company, to invest funds from the organizing company's surplus in the LPS.

Sec. 841.407. OFFICERS AND DIRECTORS. Authorizes the officers and directors of a company that organizes an LPS to serve as officers and directors of the LPS.

Sec. 841.408. ISSUANCE OF CERTIFICATE OF AUTHORITY. (a) Authorizes the commissioner to issue a certificate of authority to an LPS, authorizing the company to transact reinsurance business in this state as an LPS based on a finding that:

- (1) the company's application meets the criteria contained in this subsection;
- (2) the proposed plan of the LPS provides for viable operation of the company, including a determination by the commissioner that the LPS applicant has sufficiently strong financial support;
- (3) the guaranties meet the requirements of Section 841.417;

(4) the terms of any reinsurance arrangement, including the reinsurance contract and related transactions, comply with this subchapter and all applicable insurance laws and rules;

(5) the proposed application and reinsurance arrangement is not hazardous to any ceding insurer; and

(6) the proposed application and reinsurance contract will always fund authorized investments that comply with Section 841.412, including statutory reserves for life insurance with invested assets at least equal to the amount of reserves required under generally accepted accounting principles.

(b) Authorizes the commissioner, in conjunction with the issuance of a certificate of authority under this section, to issue an order that includes any provisions, terms, and conditions regarding the organization, licensing, and operation of the LPS that the commissioner deems appropriate and that are not inconsistent with this chapter, including requesting from the company information to monitor the financial strength of guarantors and requiring the periodic reporting and monitoring of assets behind any guaranties issued.

Sec. 841.409. **SCOPE OF CERTIFICATE OF AUTHORITY.** (a) Authorizes an LPS that has been issued a certificate of authority to reinsure only the risks of a ceding insurer. Prohibits an LPS from otherwise engaging in the business of insurance.

(b) Authorizes an LPS to purchase reinsurance to cede the risks assumed under a reinsurance contract.

(c) Provides that an LPS organized under this subchapter is considered to be licensed to transact the business of reinsurance for the purposes of Section 492.051 (Reinsurance Authorized), but may only reinsure risks of the company's affiliated companies.

(d) Requires an LPS to provide the commissioner with notice of any change in the company's business plan required by Section 841.405, including any material change in the methods used to comply with Section 841.413.

Sec. 841.410. **CAPITAL AND SURPLUS.** (a) Prohibits the commissioner from issuing a certificate of authority to an LPS unless the company possesses and maintains unimpaired paid-in capital and surplus of not less than \$10 million.

(b) Requires an LPS to comply with the risk-based capital requirements adopted by the commissioner by rule.

(c) Requires an LPS to maintain risk-based capital in an amount that is at least equal to 300 percent of the authorized control level of risk-based capital adopted by the commissioner.

Sec. 841.411. **FORECLOSURE ON COLLATERAL.** Requires an LPS to immediately notify the commissioner of any action by a ceding insurer or any other person to foreclose on, or otherwise take possession of, collateral provided by the LPS to secure an obligation of the company.

Sec. 841.412. **MINIMUM AUTHORIZED INVESTMENT REQUIREMENT AFTER CREDIT FOR REINSURANCE; LETTERS OF CREDIT; GUARANTIES.** (a) Requires an LPS to hold investments authorized under Subchapters C (Authorized Investments and Transactions for Capital Stock Life, Health, and Accident Insurers) and D (Authorized Investments and Transactions for Other Life, Health, and Accident Insurers), Chapter 425, exclusive of investments in affiliates, in an amount that at least equals the sums of:

- (1) the minimum capital and surplus requirements of Section 841.410;
- (2) the risk-based capital requirements adopted by the commissioner; and
- (3) reserves calculated using generally accepted accounting principles.

(b) Authorizes an LPS, subject to compliance with Subsection (a) and notwithstanding Chapter 425 (Reserves and Investments for Life Insurance), to reduce the amount of the company's excess reserves on account of:

- (1) reinsurance that complies with Chapter 492 (Reinsurance for Life, Health, and Accident Insurance Companies and Related Entities);
- (2) a letter of credit that complies with Section 492.104(b)(2)(C) (relating to a clean, irrevocable, unconditional letter of credit); or
- (3) guaranties from a holding company or an affiliated company as provided by Section 841.417.

(c) Authorizes an LPS, notwithstanding Subsection (b), to hold guaranties from a holding company or an affiliated company as provided by Section 841.417 as an admitted asset with an offsetting increase in special surplus funds to support excess reserves only.

Sec. 841.413. PERMITTED REINSURANCE. (a) Authorizes an LPS to only reinsure the risks of a ceding insurer under a reinsurance contract.

(b) Prohibits an LPS, unless otherwise approved in advance by the commissioner, from assuming or retaining exposure to reinsurance losses for the company's own account that are not funded by:

- (1) premium and other amounts payable by the ceding insurer to the LPS under the reinsurance contract, or any return on the investment of the premiums or other amounts;
- (2) letters of credit that qualify under Section 492.104(b)(2)(C); or
- (3) guaranties of a holding company or an affiliated company as provided by Section 841.417.

(c) Authorizes an LPS to cede risks assumed under a reinsurance contract to one or more reinsurers through the purchase of reinsurance, subject to prior approval of the commissioner. Authorizes the commissioner to approve a reinsurance contract under this subsection if the commissioner finds that:

- (1) the proposed reinsurance complies with Chapter 492;
- (2) the proposed reinsurer has sufficient liquidity, admitted assets, and the policyholder surplus to support the liabilities assumed under the reinsurance contract; and
- (3) the proposed reinsurance contract would not result in a hazardous financial condition for the LPS.

(d) Authorizes an LPS to enter into contracts and conduct other commercial activities related or incidental to, and necessary to fulfill the purposes of, a reinsurance contract.

Sec. 841.414. REPORTS ON RESERVES AND RISK-BASED CAPITAL. (a) Requires an LPS annually to file an opinion of the appointed actuary acceptable to the

commissioner concerning the methods and assumptions used to set reserves. Requires that the opinion demonstrate that the LPS holds risk-based capital and invested admitted assets that are at least equal to reserves specified by generally accepted accounting principles.

(b) Authorizes the commissioner to reject the opinion of the appointed actuary if the commissioner determines that accepting the opinion would be hazardous to policyholders, enrollees, creditors, or the public.

(c) Requires an LPS annually to file with the commissioner a report of the LPS's risk-based capital level as of the end of the preceding calendar year containing the information required by the risk-based capital instructions adopted by the commissioner.

Sec. 841.415. OTHER LAWS NOT APPLICABLE. Provides that the deposit requirements in Subchapter H (Deposit of Securities) do not apply to an LPS.

Sec. 841.416. APPLICABILITY OF OTHER LAW. Provides that, except as specifically provided by law, all provisions of this code apply to an LPS formed under this subchapter.

Sec. 841.417. GUARANTY REQUIREMENTS. (a) Prohibits a guaranty from being used to comply with this chapter without prior written approval of the commissioner.

(b) Requires the commissioner, before approving a guaranty, to find that:

(1) the guarantor has capital and surplus of \$100 million, exclusive of investments in subsidiaries and affiliates;

(2) the guarantor has admitted assets backing capital and surplus in an amount sufficient to fulfill the guaranty, and the sufficiency on an ongoing basis is demonstrated to the satisfaction of the commissioner;

(3) the guarantor and all affiliates are in good standing with TDI;

(4) the guarantor has provided all information requested by the commissioner; and

(5) the guarantor is otherwise acceptable to the commissioner.

(c) Authorizes the commissioner, notwithstanding Subsection (b), to allow, subject to the commissioner's prior approval, an affiliated company of the holding company to serve as guarantor. Authorizes the commissioner to approve an affiliated company as a guarantor on a finding that the affiliated company possesses the independent financial means to discharge the guaranty using the affiliated company's own financial resources.

Sec. 841.418. SUNSET PROVISION. Provides that this subchapter is valid for business sold only until January 1 of the year in which principle-based reserve requirements become operative in Texas under the adoption of the National Association of Insurance Commissioners' (NAIC) 2009 amendments to the NAIC Model Standard Valuation Law. Prohibits an LPS, after that January 1, from assuming new risks of a ceding insurer related to business sold after that date.

Sec. 841.419. CERTIFICATION OF ACTUARIAL OFFICER. (a) Requires a senior actuarial officer of each ceding insurer, at the time an LPS files an application for a certificate of authority under this subchapter, and not later than March 1 of each year that the LPS is in operation and is ceded new business from a ceding insurer, to file with the commissioner a certification that the ceding insurer's transactions with the LPS are not being used to gain an unfair advantage in the pricing of the ceding insurer's products.

(b) Prohibits a ceding insurer from being deemed to have an unfair advantage if the pricing of the policies and contracts reinsured by the LPS reflects, at the time the policies and contracts were issued, a reasonable long-term estimate of the cost to the ceding insurer of an alternative third-party transaction, and uses current pricing assumptions.

(c) Requires the ceding insurer to keep documentation between examinations that sets forth the manner in which a senior actuarial officer arrived at the conclusions in the certification.

Sec. 841.420. ACCOUNTING AND FINANCIAL REPORTING. Requires the commissioner to prescribe accounting and financial reporting requirements with regard to the LPS and any insurer as defined by Section 841.402 that organizes an LPS.

SECTION 2. Effective date: upon passage or September 1, 2011.