TDI BIENNIAL REPORT RECOMMENDATION WORKSHEET
TO BE FURNISHED ONLINE

1. Organization Contact Information

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2. Topic

Application of Section 1152.055, Insurance Code to foreign insurers for the approval of certain group annuity policy forms.

3. Background

In 1983, the Texas Legislature enacted Article 3.75 regulating the use of separate accounts by Texas domestic insurers.[1] Other states adopted similar provisions. Generally, an insurer that desires to create a separate account for use in a life or annuity obtains the approval of its domiciliary state. This approval includes requirements for investments and reserve requirements. In 2001, the Legislature recodified Article 3.75 into a new Chapter 1152. Recodification is not intended to change the law but instead only to recodify existing law.

TEX. INS. CODE §1152.051. **Establishment of Separate Accounts**, provides in pertinent part as follows:

> "A **domestic** life insurance company may establish separate accounts under this subchapter and may allocate to each account amounts,…….to:
>
> …..
>
> (2) fund a benefit for a pension, retirement….plan payable in a fixed amount,……". (Emphasis supplied).'

In all instances between 1983-2012, only the domiciliary state was required to approve separate accounts or reserve requirements. Foreign insurers were not required to obtain a separate Commissioner's Order under Section 1152.055 until sometime in 2012 when TDI staff determined

[1] See, Acts 1983, 68th Leg., ch. 648.

on an ad hoc basis that this statute should now be interpreted to require a commissioner's Order on certain policy forms filed in Texas involving a separate account.

Between 1983-2012, foreign insurers were not required to obtain a separate commissioner's order in Texas to obtain approval for policy forms or certificates of insurance forms filed in Texas that involved separate accounts approved and created under their state of domicile. Between 1983 and the present, Texas is the only state that has imposed the Commissioner's Order requirement to obtain approval of policy forms involving a certain separate account for foreign based insurers. The requirements in the Orders has varied and been the subject of frequent discussion and concern.

The type of policies where this requirement has been imposed are single premium annuity group policy forms, which are typically being used to fund and replace employee pension plans qualified under Section 401(a) of the Internal Revenue Code of 1986 and are regulated by ERISA requirements. These contracts are highly negotiated between the plan sponsor and several competing insurers. The contracts at issue involve the irrevocable guarantee of benefits by the insurer to plan participations. If separate account funds received from an employer are insufficient, the insurer guarantees obligations from its general account.

In 2014, TDI staff proposed informal draft rules to address requirements for approval of these types of policy contracts. TALHI and other insurers submitted written objections to numerous provisions in the informal draft rules including the enhanced RBC requirements and requirements to cease writing business. This rule was never adopted but TDI staff continues to use many of these proposed standards as requirements for a Commissioner's Order under Section 1152.055.

The ad hoc change in 2012 that required use of a Commissioner's Order has resulted in considerable confusion and delays in the form filing and approval process. If a separate account is chosen by a particular employer, the delays associated with getting an annuity form approved in Texas can be among the longest of any state in the United States.

Staff has recently attempted to impose similar requirements for certificates where the group policy is filed and issued outside of Texas.

4. Relevant Data (Cite Source)

Various Commissioner's Orders; 2014 Informal Draft Rule and Comments Received; Article 3.75; and Chapter 1152.

5. Issue:

Confusion and delays through informal ad hoc procedures in the filing of certain group annuity policy forms could result in Texas employers being unable to timely transfer ERISA regulated pension funds to an annuity.

*   **6. Recommendation (include statute/ rule citation)**

Recommendation: Amend Section 1152.055, Insurance Code to read as follows:

Sec. 1152.055. GUARANTEED BENEFITS AND MONEY RESTRICTION FOR SEPARATE ACCOUNTS. [~~An~~] A domestic insurance company may not maintain a reserve for a benefit guaranteed as to dollar amount and duration or funds guaranteed as to principal amount or stated rate of interest in a separate account except with the commissioner's approval and under conditions for investments, and other matters, that recognize the guaranteed nature of the benefits provided and that are prescribed by the department by rule.

*   **7. What problem is being solved?**

Clarifying Texas law to what it was intended to be and as applied between 1983-2012. This change described in paragraph 6 above would remove the recent uncertainty, delays, and ad hoc standards being used in requiring separate Commissioner's Orders on certain group annuity products used by foreign insurers to fund employer pension plans under ERISA.

***   8. What is the benefit to the Texas market/ consumers?**

Texas employers who maintain pension benefits under Section 401(a) of the Internal Revenue Code of 1986 and are regulated by ERISA requirements and seek to purchase a single premium group annuity will benefit. Insurers doing business for this market will benefit through knowing reasonable standards and procedures that will be used that are consistent with those in other states.

9. Supporting Documentation

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2. Topic

Certain Mortgage Type Investments by Texas Domestic Stipulated Premium Life Insurers under Chapter 425, Subch. C, §§ 425.206, 425.214.

3. Background

The Federal Home Loan Mortgage Corporation is sometimes referred to as Freddie Mac. Freddie Mac is a private corporation that was founded by Congress in 1971. The Federal National Mortgage Association is sometimes referred to as Fannie Mae. Initially founded in 1934 as part of the National Housing Act, Fannie Mae was converted to a privately held corporation in 1968 to remove its debt from the federal budget. Fannie Mae and Freddie Mac are still referred to as a "government sponsored enterprise" (GME) even though they are privately owned, publicly held corporations. Both entities exist to expand secondary mortgage by securitizing mortgages in a form frequently referred to as "mortgage backed securities". Both entities acquire private mortgages from private lenders consistent with the underwriting criteria established for mortgage lending.

After private mortgages are acquired, both entities transfer ownership of the mortgages to trusts. Under the trusts, both entities act as trustee and administrator. Private investors, particularly insurance companies, buy undivided participating interests in the mortgages through investments referred to as "mortgage backed securities". A mortgage-backed security (MBS) is a type of asset-backed security that is secured by a first lien mortgage or collection of mortgages. This security must also be grouped in one of the top two ratings as determined by an accredited credit rating agency, and usually pays periodic payments that are similar to coupon payments. Furthermore, the mortgage must have originated from a regulated and authorized financial institution.[1]

An MBS is also known as a "mortgage-related security" or a "mortgage pass through." An MBS can be bought and sold through a broker and the minimum investment varies between issuers.

[1] http://www.investopedia.com/terms/m/mbs.asp

It is issued by either a federal government agency company, government-sponsored enterprise (GSE), or private financial company. In the case of Companies, all of their investments were "mortgage backed securities" or participation certifications obtained through either Fannie Mae or Freddie Mac.

Articles and other information clearly indicate …"when an investor invests in a mortgage-backed security, the investor is essentially lending money to a home buyer or business. An MBS is a way for a smaller regional bank *or insurance company* to lend mortgages to its customers without having to worry about whether the customers have the assets to cover the loan. Instead, the bank or insurer acts as a middleman between the home buyer and the investment market participants."[2] This description indicates clearly the nature of the investments made by the insurance companies.

For several decades, Texas domestic life companies have made two types of investments involving Fannie Mae and Freddie Mac. The first type of investment is debt securities, which are separate and distinct from MBS. Debt securities would be notes or "bonds". Debt securities would be corporate bonds and subject to the limitations in TEX. INS. CODE §425.206(e).

The second type of investment is sometimes referred in various documents as a mortgage pass through certificates that represent "undivided beneficial ownership interests" in the assets of certain Trusts created by Fannie Mae and Freddie Mac. These are a type of residential mortgages that qualify under Fannie Mae and Freddie Mac lending requirements, and other information should be qualified investments under Tex. Ins. Code §§425.214, 425.215.

` Despite this plain reading, Texas examiners have sometimes recently applied different readings of these statutes in examination reports in the last 15 years. One examiner recently decided to impose the investment limitations on MBS investments using Section 425.206 even though the assets were not a corporate bond or mortgages on property owned by a single entity.

Section 425.215 allows and insurer to "take as collateral an obligation secured by a first lien on real property……….that is eligible to security a loan under Section 425.214." The facts mentioned above support the conclusion that this is what this investment is. The facts also support the conclusion that all of the MBS investments of Companies would be eligible under Section 425.214.

Texas law has permitted stipulated premium life insurers to make investments similar to that described above since 1961.[3] The same law permitted such insurers to make investments in certain mortgage or real estate loans where collateral is secured by a first lien on real state without limitation. These laws were recodified in 2005 but the relevant provisions relating to corporate bonds and real estate loans have not changed since 1961 for stipulated premium companies. Texas investment laws allowing legal reserve life insurers to make real estate loans started as early as 1947.[4]

Some TALHI members were recently examined where the TDI examiner took the position that a MBS was a type of bond and not a real estate investment. Despite changing the last final

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[2] Supra.

[3] Ch.22 added to the Insurance Code along with changes to article 3.39 authorized investments for domestic insurers. Acts 1961, 57th Leg., Ch. 180 creating Tex. Ins. Code Ch. 22, now recodified as Tex. Ins. Code ch. 884 in 2001; investments were provisions were amended in Acts 1961, 57th Leg., ch. 410, amending art. 3.39, Insurance Code, recodified as Tex. Ins. Code §ch. 425, Subch. D.in 2005.

[4]See, the 1951 Code, art. 3.39, which recodified art. 4725 §2, Vernon's Civil Statutes. Art. 4725 was enacted by Acts 1947, 50th Leg., ch. 232. .

exam report in 2017, language still appears in management letters issued by the department that seems to continue the ability of future examiners to make a similar mistake.

The NAIC Model Investment Law permits investment in “trust certificates of mortgages backed securities ” as a type of real estate investment. Texas law should be amended to make this clear so that future examiners will be clear and Texas insurers are permitted to continue to make these types of investments.

Virtually all other states, including Oklahoma, permit these investments without limitation.

4. Relevant Data (Cite Source)

Chapter 425 Subchapter C; Various articles on Fannie Mae, Freddie Mac and investment articles on trust certificates for mortgages held in trust; various past examination reports of certain Texas domestic insurers where these investments were allowed and other reports re-characterizing these as some type of corporate bond.

5. Issue

Clarifying Texas law to make it clear that Texas domestic stipulated premium life companies can continue to invest in residential mortgages through trust certificates administered through FANNIE MAE and Freddie Mac.

* **6. Recommendation (include statute/ rule citation)**

<u>Recommendation:</u> Amend Chapter 425, Subchapter C, to make it clear that investments in MBS trust certificates are qualified investments as loans secured by real property.

One way to accomplish this would be to amend Section 425.214(a), and Section 425.215 Insurance Code to read as follows:

> Sec. 425.214. AUTHORIZED INVESTMENTS FOR ALL FUNDS: LOANS SECURED BY REAL PROPERTY. (a) Subject to this section, an insurer may <u>invest in trust certificates or </u>loan any of the insurer's funds and accumulations and take as collateral a first lien on real property to which the title is valid.

* * *

> Sec. 425.215. AUTHORIZED INVESTMENTS FOR ALL FUNDS: LOANS SECURED BY CERTAIN COLLATERAL SECURED BY REAL PROPERTY. An insurer may <u>invest in trust certificates or </u> loan any of the insurer's funds and accumulations and take as collateral an obligation secured by a first lien on real property or a leasehold estate that is eligible to secure a loan under Section 425.214

Statute/ Rule Citation: Sections 425.214, 425.215, Insurance Code

*** 7. What problem is being solved?**

Texas law will be clarified so that certain Texas based insurers can invest in MBS trust certificates with first liens on real estate loans administered by Fannie Mae and Freddie Mac.

*** 8. What is the benefit to the Texas market/ consumers?**

Texas consumers would benefit through higher potential interest rates credited to life and annuity products offered by Texas insurers that can invest in these products. Texas insurers will be allowed to make these investments and be competitive with insurers domiciled in other states because these investments are widely allowed and similar to NAIC model investment laws.

9. Supporting Documentation

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2. Topic

Texas Life and Health Guaranty Association coverage for long-term care insurance

3. Background

The guaranty association system provides a critical consumer protection. It is designed and intended to ensure that consumers can purchase insurance products safe in the knowledge that their coverage will be protected if there is a future insolvency.

For this state-controlled consumer protection system to be workable, efficient, and sustainable in the new environment, it needs to treat the industry that funds it fairly, which is not the case today.

This was especially true after the insolvency of Penn Treaty Insurance Company that had issued a large block of long-term care (LTC) insurance policies. As a consequence of this insolvency, large assessments were imposed on major medical health insurers to protect Penn Treaty LTC policyholders.

Over the course of the last year, representatives from the health insurance industry and the life insurance industry have worked together to develop a proposal that would ensure the long-term stability and fairness of the state-based guaranty association system. The agreed-upon proposal would split future assessments for long-term care insolvencies equally between life insurance companies and health insurance companies, and also brings HMOs into the equation.

This approach has recently been approved in updates to the NAIC Life and Health Insurance Guaranty Association Model Act. Texas must make certain that the structure of its state-based guaranty association system ensures appropriate participation by all health industry participants, including HMOs, in the event there is another large insolvency involving long-term care insurance.

4. Relevant Data (Cite Source)

NAIC Life and Health Guaranty Association Model Act (#520) and Chapter 463, Insurance Code.

5. Issue

Updating Texas law to split future assessments for long-term care insolvencies equally between health insurers and life insurers and to ensure all types of insurers participate by including HMOs..

*** 6. Recommendation (include statute/ rule citation)**

Recommendation : Amend chapter 463 to conform to recent amendments to the NAIC Model Life and Health Guaranty Association Model law.

Statute/ Rule Citation; Chapter 463, Insurance Code.

* **7. What problem is being solved?**

Amending current law that imposes the burden of assessments for long-term care policies only on a few health insurers.

* **8. What is the benefit to the Texas market/ consumers?**

Spreading the risk of future insolvencies among all participants will be consistent with basic risk spreading concepts inherent in insurance. The potential for future insolvencies from long-term care still exist and changes to Texas law will provide considerably more resources and protection for Texas consumers and will allow insurers to better manage and plan for their own risk of potential assessment.

9. Supporting Documentation

Recent amendments to NAIC Model laws can be made available upon request.

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2. Topic

Consumer Choice Plans under Chapter 1507, Insurance Code

3. Background

Consumer Choice of Benefits Health Plans ("Consumer Choice" plans) were an idea for enhanced flexibility in health plan design that was adopted in 2005 in the 79th Legislative Session. Since the time that these plans became available, they have become a popular option for insurers and policyholders.

The basic idea was to provide consumers, both individual and group policyholders, enhanced choices in the health insurance market by allowing health insurers to create health plans that may not include all the benefits historically mandated under state statutes. This increased flexibility in plan design came with disclosure requirements so that policyholders would be made aware that they were purchasing a plan that did not include all the state mandated benefits.

As Consumer Choice plans have become popular, the mechanism for selling the plans has become its own mandate that should be reconsidered. When an insurer sells a Consumer Choice plan, the policyholder is provided a disclosure, with language largely required by TDI, regarding the mandated benefits that may not be included in the plan. This disclosure makes sense and is important language that should be provided to policyholders in applications and policy materials. However, the additional requirement that insurers obtain a signature from the policyholder, including a new signature upon each annual renewal of the plan, is unnecessarily problematic. Insurers and agents are encountering difficulties in obtaining signatures from busy customers and tracking signed authorizations is an unnecessary administrative burden for everyone involved.

A proposed change could include meaningful notice and disclosure opportunities without the unnecessary administrative steps of waiting on separate signatures from busy small business owners and other purchasers before issuing a policy or a renewal. Streamlining the process would

be a step forward in easing the difficulties for consumers, agents and insurers in the process of providing coverage opportunities.

4. Relevant Data (Cite Source)

Section 1507.006(b), Insurance Code requires a disclosure statement signed by each policyholder at renewal.

5. Issue

Requiring a signature at each renewal is duplicative and burdensome on many businesses that are already aware of the coverage purchased. The statute requires a separate notice and disclosure. The disclosure must be signed again at renewal.

* **6. Recommendation (include statute/ rule citation)**

Recommendation: Amend Section 1507.006(b), Insurance Code to read as follows:

> (b) Each applicant for initial coverage [~~and each policyholder on renewal~~] of coverage must sign the disclosure statement provided by the health carrier under Subsection (a) and return the statement to the health carrier. Under a group policy or contract, the term "applicant" means the employer.

Statute/ Rule Citation: Section 1507.006(b), Insurance Code

* **7. What problem is being solved?**

Consumers are not required to re-sign at every renewal of a policy where adequate disclosures and notices were provided at policy inception.

*** 8. What is the benefit to the Texas market/ consumers?**

Texas consumers would continue to receive notices and disclosures required by law. Texas consumers will not have to take the time, expense or effort to sign a document that has already been executed. The proposed change could include meaningful notice and disclosure opportunities without the unnecessary administrative steps of waiting on separate signatures from busy small business owners and other purchasers before issuing a policy or a renewal. Streamlining the process would be a step forward in easing the difficulties for consumers, agents and insurers in the process of providing coverage opportunities.

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2. Topic

Disclosures for increases in non-guaranteed cost of insurance elements in certain life insurance policies.

3. Background

In 2017, Rep Craddick filed HB 3370 that would have restricted any increase in premium for a life policy to 10%. Rep Craddick received a large increase on a universal life policy that had been in effect for a number of years. Most universal life and other similar products have certain non-guaranteed cost of insurance provisions where the costs charged by the insurer can be increased in the future. HB 3370 as originally drafted would have been an unprecedented approach to the regulation of life insurance and could have materially impacted a both consumers and insurers for all types of life insurance products issued in Texas. In the last few days of the session, representatives from TALHI, Rep Craddick and TDI staff worked on a revised bill that would have required disclosures to consumers to give them adequate time to determine whether to continue with the policy or replace coverage with another type of policy. The need for increased costs of insurance has increased in part due to the prolonged low interest rate environment and other sources. Other states and the NAIC are reviewing appropriate responses but it is felt that adequate disclosure prior to an increase is the best approach because of the complexity of pricing these competitive products.

4. Relevant Data (Cite Source)

The Committee Substitute for HB 3370 that was considered by the Senate Business & Commerce Committee was a rushed attempt to address this issue through disclosure. This bill needed considerable more work. TALHI has been working with its members, key legislative staff, and the department to find a workable bill that assists consumers.

5. Issue

Providing disclosures prior to the implementation of an increase of a cost of insurance provision in certain life insurance policies.

* **6. Recommendation (include statute/ rule citation)**

Recommendation: Create a new Subchapter in Chapter 1101, Insurance Code, regulating life insurance policies to require disclosure prior to the implementation of a cost of insurance increase in life policies with non-guaranteed cost of insurance elements.

Statute/ Rule Citation: Chapter 1101, Insurance Code

* **7. What problem is being solved?**

Consumers that received 30 days or less notice of a cost of insurance increase on a life insurance policy.

*** 8. What is the benefit to the Texas market/ consumers?**

Texas consumers would receive adequate notice before a cost of insurance increase was required in order to keep a life insurance policy in force. This would give consumers time to review the increase or to determine whether to take the cash value and exchange it for other coverage. Insurers would benefit from clear rules on the notice required.

9. Supporting Documentation

TALHI will provide draft proposed legislation on this issue.