

(Substitute for  
H. B. 2106)

**(No. 227)**

(Approved October 13, 2006)

## **AN ACT**

To amend Article 25.010, add subsections (6) and (7) to Article 25.020, amend subsections (2), (4) and (6) of Article 25.030 and to add subsection (7), and amend subsection (2) of Article 25.050 and subsection (2) of Article 25.070 of Act No. 77 of June 19, 1957, as amended, known as the “Insurance Code of Puerto Rico,” to modify the cap on funds to be accrued by domestic insurers as a reserve for catastrophic insurance losses; and for other purposes.

### **STATEMENT OF MOTIVES**

Act No. 73 of August 12, 1994, as amended, added Chapter 25 to the Insurance Code of Puerto Rico to require domestic insurers to establish a special reserve for the payment of losses arising from catastrophes to which our Island is exposed, for the purpose that said insurers may, in turn, have the financial capacity to offer greater protection against such risks.

Said reserve is nourished from contributions computed annually by each domestic insurer by applying a specific percentage to be determined by the Office of the Insurance Commissioner every year to the volume of underwritten premiums. At present, and by mandate of Act No. 73, the establishment of such reserve is required up to an amount that reaches a sum that is at least four (4) times the annual average volume of premiums underwritten by the insurer in the last three calendar years.

Since the volume of catastrophic risk premiums has been increasing significantly, the cap established at present by Act No. 73 has become, to a certain extent, unreachable. In view of this, it is deemed necessary to modify the cap to be accrued in the reserve by means of the use of a formula that answers more directly to the needs for protection of each insurer, in accordance with their catastrophic exposure.

Furthermore, this legislative measure proposes to require from insurers a minimum withholding at the time of the purchase of reinsurance for catastrophic insurance. This shall result in a reduction of the catastrophic reinsurance cost insofar as the insurer shall acquire catastrophic reinsurance only in excess of such withholding. At the same time, the bill provides for the insurer to consider as a liability only the amount of the reserve that is exposed for a catastrophic event. This shall allow the insurer to increase its surplus for policyholders, and therefore, its capacity to underwrite new risks.

**BE IT ENACTED BY THE LEGISLATURE OF PUERTO RICO:**

Section 1.- Article 25.010 of Act No. 77 of June 19, 1957, as amended, is hereby amended to read as follows:

“Article 25.010.- Statement of Purposes

The purpose of this Chapter is to require domestic insurers to establish a reserve for the payment of losses arising from the catastrophes to which Puerto Rico is exposed, so that said insurers may have the financial capacity to offer the greatest protection to those insurers exposed to said risks. The provisions of this Chapter also seek that domestic insurers depend less on the capacity of foreign reinsurers, since when purchasing reinsurance for these risks, they would only be compelled to buy the excess of the required minimum withholding amounts. As a result of this, the types of catastrophic

premium insurance rates in Puerto Rico would be affected in the least possible by the price demands of the world reinsurance market.”

Section 2.- Subsections (6) and (7) are hereby added to Article 25.020 of Act No. 77 of June 19, 1957, as amended, to read as follows:

“Article 25.020.- Definitions

As used in this Chapter:

- (1) ...
- (2) ...
- (3) ...
- (4) ...
- (5) ...
- (6) “Minimum Withholding” - Means the amount to be withheld by each insurer in the purchase of reinsurance for catastrophic insurance.
- (7) “Catastrophic Exposure” – Means the maximum probable loss to be sustained by an insurer before deducting reinsurance, due to the occurrence of a catastrophic event that has been estimated in accordance with a risk simulation model developed by a recognized firm and accepted by the Commissioner. In case of a hurricane, the simulation model shall use a hurricane whose occurrence probability is one in every one hundred (100) years, and for an earthquake, the simulation model to be used shall be an earthquake whose occurrence probability is one in every two hundred fifty (250) years.”

Section 3.- Subsections (2), (4) and (6) of Article 25.030 of Act No. 77 of June 19, 1957, as amended, are hereby amended, and subsection (7) is added thereto to read as follows:

“Article 25.030.- Required Reserve for Catastrophic Insurance Losses

- (1) ...
- (2) Each domestic insurer shall annually compute the contribution to the reserve for catastrophic insurance losses by applying the proportion that the Commissioner, through regulations to such effect, determines from time to time, to its net direct premiums for that year. In order to determine said proportion, the Commissioner shall take into account the aggregate of the reserves for catastrophic insurance losses of the domestic insurers, the cost and availability of reinsurance, the cost of doing catastrophic insurance business in Puerto Rico, and any other factor that directly affects the capacity of domestic insurers to underwrite catastrophic insurance. Provided, that the proportion shall at no time exceed five (5%) percent of the net direct premiums.
- (3) ...
- (4) The reserve for catastrophic insurance losses shall continue to increase until the total thereof reaches a sum that is at least eight (8%) percent of its catastrophic exposure for hurricanes. Insurers who, at the end of each calendar year maintain an amount accrued in their reserve for catastrophic insurance losses that exceeds the amount of the reserve required under Article 25.030(4), may withdraw the excess through a written request to the Commissioner. The Commissioner shall authorize said withdrawal within a term of not more than thirty (30) days following the receipt of the request.
- (5) ...

- (6) The reserve for catastrophic insurance losses shall be part of the liabilities of the domestic insurer up to a total amount of at least two (2%) percent of its catastrophic risk for hurricanes. The remaining portion of the reserve shall be part of the surplus of the insurer and shall not be considered as the reserve required for purposes of Section 4.14 (4) (a) of this Code. The Commissioner, through regulation, order or administrative determination to such effects, shall establish the mechanism to be used by the insurer to show the amount of the liabilities required by this Chapter in the annual financial statement. The contributions to the catastrophic reserve losses shall be in the nature of unpaid losses and the required minimum withholding shall be charged against the assets of the domestic insurer upon determination of his/her financial situation. Contributions to the catastrophic reserve shall be deductible as a loss when determining the taxable net income under the Puerto Rico Internal Revenue Code.
- (7) At the time of the purchase of reinsurance for catastrophic insurance, every insurer shall be bound to establish a minimum withholding of at least two (2%) percent of its catastrophic risk for hurricanes. The Commissioner, through regulations, order or administrative ruling to such effects, shall establish the procedure to be followed by the insurer to comply with this obligation.”

Section 4.- Subsection (2) of Article 25.070 of Act No. 77 of June 19, 1957, as amended, is hereby amended to read as follows:

“Article 25.070.- Withdrawal of Domestic Insurer from the Market

- (1) ...
- (2) Once the period stipulated herein has elapsed, the domestic insurer may eliminate the reserve for catastrophic insurance losses only with the prior approval of the Commissioner, and through the payment to the Secretary of the Treasury, via the Commissioner, of a special tax of fifteen (15%) percent on the paid-in amounts and the taxable income obtained from the investment thereof which at the time of the approval are deposited in the trust established pursuant to 25.040 of this Code, and whose taxation has been deferred pursuant to Article 25.030(6) of this Code. The domestic insurer may eliminate the reserve for catastrophic insurance losses and withdraw the assets from the trust only after having obtained said approval and having paid the special tax.
- (3) ...”

Section 5.- Transitory or Special Provisions

Those insurers who, at the time this Act takes effect, maintain an amount accrued in their reserve for catastrophic insurance losses that exceeds the amount of the reserve required by Article 25.030(4) may withdraw the excess through a written request to the Commissioner. The Commissioner shall make a determination to such effects within sixty (60) days following the receipt of the request.

Said withdrawal shall only be subject to the tax rate provided in Article 25.070 of this Code to the extent in which the insurer obtained a tax benefit from the deduction of said amount. In accordance with the aforementioned

provisions, the Secretary of the Treasury shall establish the methodology to determine the tax liability, if applicable.

#### Section 6.- Penalties

If a domestic insurer does not establish the reserve for catastrophic insurance losses or does not deposit the corresponding amounts of money in the trust, pursuant to the requirements of Sections 2503 and 2504 of this title, he/she shall be subject to an administrative fine not to exceed the reserve not established or the amount of money not deposited in the trust, in addition to compliance with the aforementioned Sections.

A second and subsequent violation of this nature may entail the revocation of the certificate of authority of the domestic insurer, which certificate shall not be rehabilitated for at least one year as of the date of the revocation.

#### Section 7.- Transitory or Special Provisions

Those insurers who, at the time this Act takes effect, maintain an amount accrued in their reserve for catastrophic insurance losses that exceeds the amount of the reserve required by Article 25.030(4) may withdraw the excess through a written request to the Commissioner. The Commissioner shall make a determination to such effects within sixty (60) days following the receipt of the request.

Said withdrawal shall only be subject to the tax rate provided in Article 25.070 of this Code to the extent in which the insurer obtained a tax benefit from the deduction of such amount. In accordance with the aforementioned provisions, the Secretary of the Treasury shall establish the methodology to determine the tax liability, if applicable.

#### Section 8.- This Act shall take effect immediately after its approval.

## CERTIFICATION

I hereby certify to the Secretary of State that the following Act No. 227 (Substitute for H.B. 2106) of the 4<sup>th</sup> Session of the 15<sup>th</sup> Legislature of Puerto Rico:

**AN ACT** to amend Article 25.010, add subsections (6) and (7) to Article 25.020, amend subsections (2), (4) and (6) of Article 25.030 and to add subsection (7), and amend subsection (2) of Article 25.050 and subsection (2) of Article 25.070 of Act No. 77 of June 19, 1957, as amended, known as the “Insurance Code of Puerto Rico,” to modify the cap on funds to be accrued by domestic insurers as a reserve for catastrophic insurance losses; and for other purposes,

has been translated from Spanish to English and that the English version is correct.

In San Juan, Puerto Rico, today 17<sup>th</sup> of September of 2007.

Francisco J. Domenech  
Director