

Commonwealth of Puerto Rico
OFFICE OF THE COMMISSIONER OF INSURANCE
Guaynabo, Puerto Rico

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Approved: Hon. Kenneth D. McClintock
Secretary of State
(Signed)
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RULE NO. 72

Operation of the Catastrophe Loss Reserve

Commonwealth of Puerto Rico
OFFICE OF THE COMMISSIONER OF INSURANCE
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OPERATION OF THE CATASTROPHE RESERVE

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RULE 72
OPERATION OF THE CATASTROPHE RESERVE

ARTICLE 1. LEGAL BASIS

The Puerto Rico Commissioner of Insurance hereby repeals Rule 72 of the current Regulations of the Puerto Rico Insurance Code and adopts a new Rule 72, "Operation of the Catastrophe Reserve," under the provisions of Articles 2.040, 25.030, 25.060, 25.070, and 25.090 of Public Law No. 77, enacted on June 19, 1957, as amended, known as the Puerto Rico Insurance Code, and the provisions of Public Law No. 170, enacted on August 12, 1988, as amended, known as the Uniform Administrative Procedures Act.

ARTICLE 2. PURPOSE

This new Rule 72 is adopted for the purpose of establishing the procedure that will govern the accumulation and exposure of the Catastrophe Reserve, and to establish how such reserve is to be calculated annually, as provided in Chapter 25 of the Puerto Rico Insurance Code.

ARTICLE 3. DEFINITIONS

The following terms shall have the meanings set forth below except when the context of any article of this Rule should indicate otherwise.

- A. "Insurer" - means a domestic insurer authorized to underwrite catastrophe insurance in Puerto Rico.
- B. "Code" - means the Puerto Rico Insurance Code and its Regulations.
- C. "Commissioner" - means the Puerto Rico Commissioner of Insurance.
- D. "Annual Statement" - means the Annual Financial Statement of the Insurer, filed under Article 3.310 of the Code.
- E. "Catastrophic Event" - means an insured incident or event that causes losses paid by an Insurer, including adjustment expenses, in excess of five percent (5%) of the Net Direct Premiums, as defined herein, subscribed by the Insurer during the year before the occurrence of said event.
- F. "Policyholder Surplus" - means the product of subtracting the Insurer's liabilities from total assets, both to be determined according to the provisions Chapter 5 of

the Code, and accounting principles established under the law, including the Minimum Accumulation Rate as a liability.

G. "Catastrophe Exposure" - means the probable maximum loss of an Insurer, not counting reinsurance, due to an occurrence of a Catastrophic Event that had been estimated using a risk-simulation model from a recognized catastrophe modeling firm accepted by the Commissioner. The risk simulation shall be done with at least two (2) recognized entities, and at least the arithmetical average shall be selected from among the results of each model. No simulations prepared by the insurers or its affiliates will be used for these calculations. This requirement may be adjusted with prior authorization by the Commissioner.

The simulation models to be used shall have a probability of occurring once in every one hundred (100) years and one (1) in two hundred and fifty (250) years for hurricanes and earthquakes, respectively.

H. "Net Direct Premiums" - means the gross direct premiums underwritten in Puerto Rico for catastrophe insurance, net returned premiums of portion thereof not used or absorbed in deposit premiums, as submitted on Statutory Page 14 of the Annual Statement and to which the percentages in the following table or those that may be subsequently established by the Commissioner through a Ruling Letter may be applied:

Coverage	% of Underwritten Premiums
1. Fire	100%
2. Earthquake	100%
3. Commercial Multiple Peril "Non Liability"	100%
4. Homeowners Multiple Peril	85%
5. Other Allied Lines	75%
6. Physical Damage to Automobiles	2%
7. Land Transportation	85%
8. Maritime Risk	75%

I. "Total Net Direct Premiums" - means the gross direct premiums underwritten in Puerto Rico for all los insurance, net all returned premiums or unused portions or unabsorbed portions of premiums deposited.

J. "Reserve" - means la Catastrophe Loss Reserve, as required under Article 25.030 of the Code.

K. "Minimum Withholding Rate" - means two percent (2%) of Catastrophe Exposure for hurricanes that shall be withheld by every Insurer for the purchase of reinsurance.

L. "Catastrophe Insurance" - means insurance covering real estate or personal property against losses due to earthquakes, storms, cyclones, hurricanes, fire or other catastrophes, and against losses as a consequence thereof.

ARTICLE 4. NET DIRECT PREMIUMS TO POLICYHOLDER SURPLUS RATIO

No provision of this Rule shall be construed as releasing an Insurer from strict compliance of the provisions of Article 4.150 of the Code regarding the Net Direct Premiums to policyholder surplus ratio

ARTICLE 5. ESTABLISHING THE RESERVE

Insurers shall calculate the annual contribution to the Reserve by applying to the percentage established by the Commissioner in a Ruling Letter, and said percentage shall never exceed five percent (5%).

ARTICLE 6. PROTECTION OF CATASTROPHE EXPOSURE

A. All Insurers shall acquire reinsurance to cover Catastrophe Exposure, provided that is in excess of the Minimum Withholding Rate.

B. Any Insurer who at the effective date of this Rule on acquiring reinsurance to cover Catastrophe Exposure retains an amount less than the Minimum Withholding Rate required under Article 25.030(7), shall be granted a term of three (3) years from the date of the approval of this Rule, to reach a withholding rate of at least one point five percent (1.5%) of the Insurer's additional Catastrophe Exposure and two (2) years in which to reach the Minimum Withholding Rate. It is further provided, that while the Insurer acquires such protection during those five (5) years, the Insurer may not withhold an amount less than the amount withheld at the effective date of this Rule.

C. In any given year insurers may retain an amount less than the required amount at the time of acquiring Catastrophe Exposure protection, with the prior approval by the Commissioner. No provision of this paragraph is intended to allow the Insurer include in the Annual Statement a smaller Minimum Withholding amount than what the insurer would otherwise be required to maintain.

ARTICLE 7. EXPOSURE OF POLICYHOLDERS SURPLUS

Notwithstanding the provisions of Article 6 of this Rule, the Insurer may withhold to the account of policyholders surplus, a larger amount than the portion established in said Article, provided that such amount will not exceed twenty percent (20%) of policyholder surplus.

ARTICLE 8. SUBMISSION AND ACCOUNTING OF THE RESERVE

The Catastrophe Reserve shall be submitted in the Annual Statement itemized as "Aggregate Write-ins for special surplus funds." The required Minimum Withholding amount will be considered a liability for the purpose of determining the available surplus for each Insurer. The Reserve will not be available to cover any deficit of the Insurer.

ARTICLE 9. PURCHASE OF REINSURANCE TO COVER CATASTROPHE EXPOSURE

A. All Insurers shall acquire and maintain reinsurance protection to cover Catastrophe Exposure not covered by any portion of the reserve, whether by means of traditional reinsurance or catastrophe reinsurance.

B. Every year, no later than March 31, all Insurers shall submit evidence of compliance with this provision to the Commissioner, except in the event that the Insurer has acquired protection de reinsurance for a different calendar year, the Insurer will have a term of ninety (90) days from the effective date of protection in which to provide evidence of compliance with this provision.

ARTICLE 10. RESERVE TO POLICYHOLDER SURPLUS RATIO

A. The ratio of the Catastrophic Reserve (R) and the Policyholder Surplus (E) may never be more than twice the ratio of Net Direct Premiums (NDP) and total Net Direct Premiums (TNDP). That is to say:

$$R/E \leq 2 (NDP/TNDP)$$

B. Any year in which Insurer obtains a higher ratio than that established in Paragraph A of this Article, when establishing the Reserve and accumulating the Reserve from prior years as provided in Article 25.030(2) of the Code, the Insurer shall only contribute the amount, if any, that will allow for not exceeding said ratio.

C. The modification allowed in Paragraph B of this Article may only be used by an Insurer for three (3) consecutive years. If after the fourth year, the Insurer still fails to comply with Paragraph A of this Article by establishing an annual reserve and an accumulated reserve for the previous two (2) years, the Insure shall contribute to Policyholder Surplus an amount that will allow for compliance with said paragraph, or will otherwise be unable to continue underwriting catastrophe insurance.

D. No provision herein will prevent the Commissioner from exercising his or her discretion to establish any other parameters, if after evaluation the situation of an Insurer that does not comply with requirements of paragraph A of this Article, the

Commissioner determines that the operational or financial situation of said Insurer deviates from the norm to such a degree as warranting treatment as an exceptional case.

ARTICLE 11. PROCEDURE FOR REQUESTING WITHDRAWAL FROM EXCESS RESERVE

Any Insurer that at the close of the calendar year has accumulated a Reserve amount that exceeds the amount required in Article 25.030(4) of the Code may file a request with the Commissioner to withdraw all or part of such excess amount. The term of thirty (30) days provided in said Article for the Commissioner to evaluate the request for withdrawal shall be counted from the date the Commissioner received such request in writing, in the manner to be determined by the Commissioner, and signed by one of the chief officers of the Insurer, preferably the President. The Commissioner will evaluate the request under the applicable provisions of Chapter 25 of the Code and this Rule and will authorized the withdrawal of funds if the Commissioner finds that the request complies with said legal provisions.

The Insurer shall pay taxes in the amount of fifteen percent (15 %) of the amount withdrawn, except when the Insurer states that no tax relief had been obtained and that the Insurers is not obligated to pay the fifteen percent (15 %) tax, and the Insurer shall file a certification by the Department of the Treasury to that effect along with the request for withdrawal.

ARTICLE 12. FAILURE TO ACCUMULATE THE RESERVE AND ACQUIRE PROTECTION

A. Under Article 25.090 of the Code, any Insurer who fails to establish a Reserve or make the required deposits, as provided in Article 25.040 of the Code, or should fail to acquire Catastrophe Exposure protection, as required in Articles 6 and 9 of this Rule, shall be subject to administrative sanctions.

B. The Commissioner may, at his or her discretion, suspend or revoke the certificate of authorization of any Insurer that fails to comply with the obligation to obtain such protection. The Commissioner will not reinstate such certificate of authorization until the Insurer submits evidence of compliance with the provisions of this Rule.

ARTICLE 13. UNCONSTITUTIONALITY OR ILLEGALITY

If any part of this Rule is held to be unconstitutional or illegal by a court of competent jurisdiction, such finding will not affect the remaining provisions of the Rule.

ARTICLE 14. EFFECTIVE DATE

The provisions of this Rule will enter into effect thirty (30) days from the date of filing of this Rule at the Puerto Rico Department of State, under the provisions of Public Law

No. 170, August 12, 1988, as amended, known as the Uniform Administrative Procedures Act.

(Signed)

RAMÓN L. CRUZ-COLÓN
COMMISSIONER OF INSURANCE

Date approved: February 12, 2010

Date filed at the Department of State:

Date filed at the
Library of the Legislature: