106TH CONGRESS
1ST SESSION

S. 1914

To amend the Internal Revenue Code of 1986 to provide for the creation of disaster protection funds by property and casualty insurance companies for the payment of policyholders' claims arising from future catastrophic events.

IN THE SENATE OF THE UNITED STATES

NOVEMBER 10, 1999

Mr. MACK (for himself and Mrs. HUTCHISON) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1986 to provide for the creation of disaster protection funds by property and casualty insurance companies for the payment of policyholders' claims arising from future catastrophic events.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Policyholder Disaster Protection Act of 1999''.

SEC. 2. FINDINGS.

Congress makes the following findings:

(1) Rising costs resulting from major natural disasters are placing an increasing strain on the ability of property and casualty insurance companies to assure payment of homeowners' claims and other insurance claims arising from major natural disasters now and in the future.

(2) Present tax laws do not provide adequate incentives to assure that natural disaster insurance is provided or, where such insurance is provided, that funds are available for payment of insurance claims in the event of future catastrophic losses from major natural disasters, as present law requires an insurer wishing to accumulate surplus assets for this purpose to do so entirely from its after-tax retained earnings.

(3) Revising the tax laws applicable to the property and casualty insurance industry to permit carefully controlled accumulation of pretax dollars in separate reserve funds devoted solely to the payment of claims arising from future major natural disasters will provide incentives for property and casualty insurers to make natural disaster insurance available, will give greater protection to the Nation's homeowners, small businesses, and other insurance con-

sumers, and will help assure the future financial health of the Nation's insurance system as a whole.

(4) Implementing these changes will reduce the possibility that a significant portion of the private insurance system would fail in the wake of a major natural disaster and that governmental entities would be required to step in to provide relief at taxpayer expense.

SEC. 3. CREATION OF POLICYHOLDER DISASTER PROTECTION FUNDS; CONTRIBUTIONS TO AND DISTRIBUTIONS FROM FUNDS; OTHER RULES.

(a) CONTRIBUTIONS TO POLICYHOLDER DISASTER PROTECTION FUNDS.—Subsection (c) of section 832 of the Internal Revenue Code of 1986 (relating to insurance company taxable income) is amended by striking ''and'' at the end of paragraph (12), by striking the period at the end of paragraph (13) and inserting ''; and'', and by adding at the end the following:

''(14) the qualified contributions to a policyholder disaster protection fund during the taxable year.''

(b) DISTRIBUTIONS FROM POLICYHOLDER DISASTER PROTECTION FUNDS.—Paragraph (1) of section 832(b) of the Internal Revenue Code of 1986 is amended by striking ''and'' at the end of subparagraph (D), by striking the period at the end of subparagraph (E) and inserting ", and", and by adding at the end the following:

"(F) the fair market value of any distributions from a policyholder disaster protection fund during the taxable year."

(c) DEFINITIONS AND OTHER RULES RELATING TO POLICYHOLDER DISASTER PROTECTION FUNDS.—Section 832 of the Internal Revenue Code of 1986 is amended by adding at the end the following:

"(h) DEFINITIONS AND OTHER RULES RELATING TO POLICYHOLDER DISASTER PROTECTION FUNDS.—For purposes of subsections (b)(1)(F) and (c)(14)—

"(1) POLICYHOLDER DISASTER PROTECTION FUND.—The term 'policyholder disaster protection fund' (hereafter in this subsection referred to as the 'fund') means any custodial account, trust, or any other arrangement or account—

"(A) which is established to hold assets that are set aside solely for the payment of qualified losses, and

"(B) under the terms of which—

"(i) the assets in the fund are required to be invested in a manner consistent with the investment requirements applicable to the qualified insurance company under the laws of its jurisdiction of domicile,

"(ii) the net income for the taxable year derived from the assets in the fund is required to be distributed to the qualified insurance company not less frequently than annually,

"(iii) an excess balance drawdown amount is required to be distributed to the qualified insurance company not later than the last day of the taxable year following the taxable year for which such amount is determined,

"(iv) a catastrophe drawdown amount may be distributed to the qualified insurance company if distributed not later than the last day of the taxable year following the taxable year for which such amount is determined,

"(v) a State-required drawdown amount may be distributed, and

"(vi) no distributions from the fund are required or permitted other than the distributions described in clauses (ii) through (v).

"(2) QUALIFIED INSURANCE COMPANY.—The term 'qualified insurance company' means any insurance company subject to tax under section 831(a).

"(3) QUALIFIED CONTRIBUTION.—

"(A) IN GENERAL.—The term 'qualified contribution' means a contribution to a fund for a taxable year to the extent that the amount of such contribution, when added to the amount of any other contributions to the fund for such taxable year, does not exceed the excess of—

"(i) the fund cap for the taxable year, over

"(ii) the fund balance determined as of the close of the preceding taxable year.

"(B) CARRYOVER OF EXCESS CONTRIBUTIONS.—The amount of contributions to a fund in excess of the amount of qualified contributions for a taxable year shall be treated as an amount contributed to the fund for the following taxable year.

"(4) EXCESS BALANCE DRAWDOWN AMOUNTS.—The term 'excess balance drawdown amount' means the excess (if any) of—

"(A) the fund balance as of the close of the taxable year, over

"(B) the fund cap for the following taxable year.

"(5) CATASTROPHE DRAWDOWN AMOUNTS.—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, the term 'catastrophe drawdown amount' means an amount that does not exceed the lesser of the amount determined under subparagraph (B) or (C).

"(B) NET LOSSES FROM QUALIFYING EVENTS.—The amount determined under this subparagraph shall be equal to the qualified losses for the taxable year determined without regard to clause (ii) of paragraph (8)(A).

"(C) GROSS LOSSES IN EXCESS OF THRESHOLD.—The amount determined under this subparagraph shall be equal to the excess (if any) of—

"(i) the qualified losses for the taxable year, over

"(ii) the lesser of—

"(I) the fund cap for the taxable year (determined without regard to paragraph (9)(E)), or

"(II) 30 percent of the qualified insurance company's surplus as regards policyholders as shown on the company's annual statement for the calendar year preceding the taxable year.

"(D) SPECIAL DRAWDOWN AMOUNT FOLLOWING A RECENT CATASTROPHE LOSS YEAR.—If for any taxable year included in the reference period the qualified losses exceed the amount determined under subparagraph (C)(ii), the 'catastrophe drawdown amount' shall be an amount that does not exceed the lesser of the amount determined under subparagraph (B) or the amount determined under this subparagraph. The amount determined under this subparagraph shall be an amount equal to the excess (if any) of—

"(i) the qualified losses for the taxable year, over

"(ii) the lesser of—

"(I) ⅓ of the fund cap for the taxable year (determined without regard to paragraph (9)(E)), or

"(II) 10 percent of the qualified insurance company's surplus as regards policyholders as shown on the company's annual statement for the calendar year preceding the taxable year.

"(E) REFERENCE PERIOD.—For purposes of subparagraph (D), the reference period shall be determined under the following table:

"For taxable years beginning in:	**The reference period shall be:**
2003 and later	The 3 preceding taxable years.
2002	The 2 preceding taxable years.
2001	The preceding taxable year.
2000 or before	No reference period applies.

"(F) MINIMUM CATASTROPHE DRAWDOWN AMOUNT FOR SUBSEQUENT DEVELOPMENT OF GROSS LOSSES FROM PRIOR EVENTS.—Notwithstanding any other provision of this paragraph, the 'catastrophe drawdown amount' determined for the taxable year shall not be less than the amount described in this subparagraph. The amount described in this subparagraph includes qualified losses for the taxable year attributable to any qualifying event if, in a prior taxable year—

"(i) qualified losses attributable to such qualifying event were incurred, and

"(ii) qualified losses for such taxable year attributable to all qualifying events exceeded the amount determined under subparagraph (C)(ii) (or, if applicable, the amount determined under subparagraph (D)(ii)) for such taxable year.

"(6) STATE REQUIRED DRAWDOWN AMOUNT.—The term 'State required drawdown amount' means any amount that the department of insurance for the qualified insurance company's jurisdiction of domicile requires to be distributed from the fund, to the extent such amount is not otherwise described in paragraph (4) or (5).

"(7) FUND BALANCE.—The term 'fund balance' means—

"(A) the sum of all qualified contributions to the fund,

"(B) less any net investment loss of the fund for any taxable year or years, and

"(C) less the sum of all distributions under clauses (iii) through (v) of paragraph (1)(B).

"(8) QUALIFIED LOSSES.—

"(A) IN GENERAL.—The term 'qualified losses' means, with respect to a taxable year—

"(i) the amount of losses and loss adjustment expenses incurred in the qualified lines of business specified in paragraph (9), as reported in the qualified insurance company's annual statement for the taxable year, that are attributable to 1 or more qualifying events (regardless of when such qualifying events occurred), plus

"(ii) the amount by which such losses and loss adjustment expenses attributable to such qualifying events have been reduced for reinsurance, plus

"(iii) any nonrecoverable assessments, surcharges, or other liabilities that are borne by the qualified insurance company and are attributable to such qualifying events.

"(B) QUALIFYING EVENT.—For purposes of subparagraph (A), the term 'qualifying event' means any event that satisfies clauses (i) and (ii).

"(i) EVENT.—An event satisfies this clause if the event is 1 or more of the following:

"(I) Windstorm (including hurricane, cyclone, or tornado).

"(II) Earthquake (including any fire following).

"(III) Winter catastrophe (snow, ice, or freezing).

"(IV) Fire.

"(V) Tsunami.

"(VI) Flood.

"(VII) Volcanic eruption.

"(VIII) Hail.

"(ii) CATASTROPHE DESIGNATION.—An event satisfies this clause if the event—

"(I) is designated a catastrophe by Property Claim Services or its successor organization,

"(II) is declared by the President to be an emergency or disaster, or

"(III) is declared to be an emergency or disaster in a similar declaration by the chief executive official of a State, possession, or territory of the United States, or the District of Columbia.

"(9) FUND CAP.—

"(A) IN GENERAL.—The term 'fund cap' for a taxable year is the sum of the separate lines of business caps for each of the qualified lines of business specified in the table contained in subparagraph (C) (as modified under subparagraphs (D) and (E)).

"(B) SEPARATE LINES OF BUSINESS CAP.—For purposes of subparagraph (A), the separate lines of business cap, with respect to a qualified line of business specified in the table contained in subparagraph (C), is the product of—

"(i) net written premiums reported in the annual statement for the calendar year preceding the taxable year in such line of business, multiplied by

"(ii) the fund cap multiplier applicable to such qualified line of business.

"(C) QUALIFIED LINES OF BUSINESS AND THEIR RESPECTIVE FUND CAP MULTIPLIERS.—For purposes of this paragraph, the qualified lines of business and fund cap multipliers specified in this subparagraph are those specified in the following table:

"Line of business on annual statement blank:	Fund cap multiplier:
Fire	0.25
Allied	1.25
Farmowners Multiple Peril	0.25
Homeowners Multiple Peril	0.75
Commercial Multiple Peril (non-liability portion)	0.50
Earthquake	13.00
Inland Marine	0.25
Private Passenger Auto Physical Damage	0.01
Commercial Auto Physical Damage	0.01.

"(D) SUBSEQUENT MODIFICATIONS OF THE ANNUAL STATEMENT BLANK.—If, with respect to any taxable year beginning after the effective date of this subsection, the annual statement blank required to be filed is amended to replace, combine, or otherwise modify any of the qualified lines of business specified in subparagraph (C), then for such subsequent taxable year subparagraph (C) shall be applied in a manner such that the fund cap shall be the same amount as if such reporting modification had not been made.

"(E) 20-YEAR PHASE-IN.—Notwithstanding subparagraph (C), the fund cap for a taxable year shall be the amount determined under subparagraph (C), as adjusted pursuant to subparagraph (D) (if applicable), multiplied by the phase-in percentage indicated in the following table:

"Taxable year beginning in:	Phase-in percentage to be applied to fund cap computed under subparagraphs (A) and (B):
2001	5 percent
2002	10 percent
2003	15 percent
2004	20 percent
2005	25 percent
2006	30 percent
2007	35 percent
2008	40 percent
2009	45 percent
2010	50 percent

"Taxable year beginning in:	Phase-in percentage to be applied to fund cap computed under subparagraphs (A) and (B):
2011	55 percent
2012	60 percent
2013	65 percent
2014	70 percent
2015	75 percent
2016	80 percent
2017	85 percent
2018	90 percent
2019	95 percent
2020 or thereafter	100 percent.

"(10) TREATMENT OF INVESTMENT INCOME AND GAIN OR LOSS.—

"(A) CONTRIBUTIONS IN KIND.—The qualified insurance company's contribution of property other than money to a fund shall be treated as a sale or exchange of such property for an amount equal to its fair market value as of the date of the contribution and appropriate adjustment shall be made to the basis of such property. Section 267 shall apply to any loss realized upon such contribution as if the fund were a trust and the qualified insurance company were the grantor of such trust.

"(B) DISTRIBUTIONS IN KIND.—A distribution of property other than money by a fund to the qualified insurance company shall not be treated as a sale or exchange or other disposition of such property. In the case of such a distribution, the basis of such property immediately after the distribution shall be equal to its fair market value on the date of distribution.

"(C) INCOME WITH RESPECT TO FUND ASSETS.—Items of income of the type described in paragraphs (1)(B), (1)(C), and (2) of subsection (b) that are derived from the assets held in a fund, as well as losses from the sale or other disposition of such assets, shall be considered items of income, gain, or loss of the qualified insurance company. Notwithstanding paragraph (1)(F) of subsection (b), distributions of net income to the qualified insurance company pursuant to paragraph (1)(B)(ii) of this subsection shall not cause such income to be taken into account a second time.

"(D) NET INVESTMENT LOSSES DISALLOWED.—Losses described in the first sentence of subparagraph (C) shall not be allowed to the qualified insurance company to the extent the amount of such losses for the taxable year exceeds the amount of income for the taxable year described in the first sentence of subparagraph (C).

"(11) NET INCOME; NET INVESTMENT LOSS.—For purposes of paragraph (1)(B)(ii), the net income derived from the assets in the fund for the taxable year shall be the items of income and gain for the taxable year, less the items of loss for the taxable year, derived from such assets, as described in paragraph (10)(C). For purposes of paragraph (7), there is a net investment loss for the taxable year to the extent that the items of loss described in the preceding sentence (determined without regard to paragraph (10)(D)) exceed the items of income and gain described in the preceding sentence.

"(12) ANNUAL STATEMENT.—For purposes of this subsection, the term 'annual statement' shall have the meaning set forth in section 846(f)(3).

"(13) EXCLUSION OF PREMIUMS AND LOSSES ON CERTAIN PUERTO RICAN RISKS.—Notwithstanding any other provision of this subsection, premiums and losses with respect to risks covered by a catastrophe reserve established under the laws or regulations of the Commonwealth of Puerto Rico shall not be taken into account under this subsection in determining the amount of the fund cap or the amount of qualified losses.

"(14) TREATMENT OF FUND IN CERTAIN MERGERS AND ACQUISITIONS.—

"(A) REORGANIZATIONS, ETC.—A fund shall be treated as an item described in section 381(c)(22) for purposes of any transaction of the qualified insurance company to which section 381 applies.

"(B) STOCK PURCHASE TREATED AS ASSET ACQUISITION.—In any case where the qualified insurance company undergoes a deemed sale of its assets under section 338—

"(i) gain or loss upon the deemed sale of the assets held in the fund shall be taken into account for purposes of the distribution of net income required under paragraph (1)(B)(ii);

"(ii) immediately prior to the close of the acquisition date, the qualified insurance company shall include in its gross income an amount equal to the excess (if any) of—

"(I) the sum of all qualified contributions to the fund, over

"(II) the sum of all distributions under clauses (iii) through (v) of paragraph (1)(B);

"(iii) the fund shall be treated as a fund of the new corporation (within the meaning of section 338(a)(2)) established on the first day after the acquisition date, and such new corporation shall be treated as contributing to the fund on such date an amount equal to the amount described in clause (ii); and

"(iv) if the acquisition date is not December 31, the fund cap for the first taxable year beginning after the acquisition date shall be determined by reference to the annual statement of the qualified insurance company for the calendar year preceding the calendar year that includes the acquisition date.

"(15) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, including regulations—

"(A) which govern the application of this subsection to a qualified insurance company having a taxable year other than the calendar year or a taxable year less than 12 months, "(B) which govern a fund maintained by an insurance company that ceases to be subject to this part, and

"(C) which govern the application of paragraph (9)(D)."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 4. PENALTY TAX ON CERTAIN DRAWDOWNS.

(a) EXCESS BALANCE DRAWDOWNS ATTRIBUTABLE TO REINSURANCE WITH RELATED PARTIES.—Part II of subchapter L of chapter 1 of the Internal Revenue Code of 1986 (relating to the taxation of insurance companies other than life insurance companies) is amended by adding at the end the following:

"SEC. 836. PENALTY TAX ON CERTAIN DRAWDOWNS FROM POLICYHOLDER DISASTER PROTECTION FUNDS.

"(a) PENALTY TAX.—The tax imposed by section 831(a) for any taxable year shall be an amount equal to the tax (if any) otherwise imposed by that section (determined without regard to this section), plus an amount equal to 65 percent of any penalty drawdown from a policyholder disaster protection fund.

"(b) PENALTY DRAWDOWN.—For purposes of subsection (a), the term 'penalty drawdown' means that portion of any excess balance drawdown amount (as defined in section 832(h)(1)(B)(iii)) received for the taxable year which is attributable to reinsurance ceded by a qualified insurance company (as defined in section 832(h)(2), and hereafter in this section referred to as the 'ceding company') to 1 or more other qualified insurance companies (hereafter in this section referred to as the 'reinsurer' or 'reinsurers') which are members of the same controlled group of corporations (as defined in section 1563(a)) as the ceding company.

"(c) REDUCTION OF PENALTY DRAWDOWN AMOUNT.—For purposes of this section, the amount of any penalty drawdown determined under subsection (b) shall be reduced by the sum of the amounts determined under this subsection for each reinsurer described in subsection (b). For each such reinsurer, the amount determined under this subsection shall be equal to the lesser of—

"(1) the reinsurer's contributions to a policyholder disaster protection fund for the taxable year, or

"(2) the portion of the reinsurer's fund cap for the taxable year (within the meaning of section

832(h)(9)) that is attributable to the reinsurance described in subsection (a).''

(b) CONFORMING AMENDMENTS.—

(1) Section 831(c) of the Internal Revenue Code of 1986 is amended by adding at the end the following:

''(4) For penalty tax on certain drawdowns from policyholder disaster protection funds, see section 836.''

(2) The table of sections for part II of subchapter L of chapter 1 of such Code is amended by adding at the end the following:

''Sec. 836. Penalty tax on certain drawdowns from policyholder disaster protection funds.''

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

○