107TH CONGRESS
1ST SESSION

H. R. 785

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 HOUSE OF REPRESENTATIVES

FEBRUARY 28, 2001

Mr. FOLEY (for himself, Mr. MATSUI, Mr. GONZALEZ, Mr. ROYCE, Mr. TANNER, Mr. MCINNIS, Mr. CRANE, Mr. HERGER, Mr. WATKINS, Mr. ENGLISH, Mr. SAM JOHNSON of Texas, Mr. HAYWORTH, Mr. HOUGHTON, Mr. PORTMAN, Mr. WATTS of Oklahoma, Ms. PRYCE of Ohio, Mr. EHRLICH, Mr. CHAMBLISS, Mr. MILLER of Florida, Mr. JONES of North Carolina, Mr. BONILLA, Mr. BOEHNER, Mr. RADANOVICH, Mr. HINCHEY, Mr. CANNON, Mr. PAUL, Mrs. MEEK of Florida, Mr. CHABOT, Ms. JACKSON-LEE of Texas, Mr. DOOLITTLE, and Mr. CALVERT) introduced the following bill; which was referred to the Committee on Ways and Means

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 2001''.

SEC. 2. FINDINGS.

The Congress makes the following findings:

(1) Rising costs resulting from 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 in-

surers to make natural disaster insurance available, will give greater protection to the Nation's homeowners, small businesses, and other insurance consumers, 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 the taxable income of insurance companies other than life insurance companies) 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 new paragraph:

''(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 such Code 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 new subparagraph:

"(F) the amount of any distributions from a policyholder disaster protection fund during the taxable year, except that a distribution made to return to the qualified insurance company any contribution which is not a qualified contribution (as defined in subsection (h)) for a taxable year shall not be included in gross income if such distribution is made prior to the filing of the tax return for such taxable year.".

(c) DEFINITIONS AND OTHER RULES RELATING TO POLICYHOLDER DISASTER PROTECTION FUNDS.—Section 832 of such Code (relating to insurance company taxable income) is amended by adding at the end the following new subsection:

"(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 no less frequently than annually,

"(iii) an excess balance drawdown amount is required to be distributed to the qualified insurance company no later than the close 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 prior to the close of the taxable year following the 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) and the return to the qualified insurance company of contributions that are not qualified contributions.

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

"(3) QUALIFIED CONTRIBUTION.—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 previous contributions to the fund for such taxable year, does not exceed the excess of—

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

"(B) the fund balance determined as of the close of the preceding 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 AMOUNT.—

"(A) IN GENERAL.—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 a taxable year beginning in—	The reference period shall be—
2005 and later	The 3 preceding taxable years.
2004	The 2 preceding taxable years.
2003	The preceding taxable year.
2002 or before	No reference period applies.

"(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), net of reinsurance, as reported in the qualified insurance company's annual statement for the taxable year, that are attributable to one or more qualifying events (regardless of when such qualifying events occurred),

"(ii) the amount by which such losses and loss adjustment expenses attributable to such qualifying events have been reduced for reinsurance received and recoverable, 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 (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 Multi Peril (non-liability portion)	0.50
Earthquake	13.00
Inland Marine	0.25.

"(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 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):
2002	5 percent
2003	10 percent
2004	15 percent
2005	20 percent
2006	25 percent
2007	30 percent
2008	35 percent
2009	40 percent
2010	45 percent
2011	50 percent
2012	55 percent
2013	60 percent
2014	65 percent
2015	70 percent
2016	75 percent
2017	80 percent
2018	85 percent
2019	90 percent
2020	95 percent
2021 and later	100 percent.

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

"(A) CONTRIBUTIONS IN KIND.—A transfer 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 transfer, and appropriate adjustment shall be made to the basis of such property. Section 267 shall apply to any loss realized upon such a transfer.

"(B) DISTRIBUTIONS IN KIND.—A transfer 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. The basis of such property immediately after such transfer shall be the greater of the basis of such property immediately before such transfer or the fair market value of such property on the date of such transfer.

"(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.

"(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 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) 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 a qualified 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, 2001.

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