

109TH CONGRESS
1ST SESSION

H. R. 2668

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

MAY 26, 2005

Mr. FOLEY (for himself, Mr. ENGLISH of Pennsylvania, Mr. ROYCE, Mr. RADANOVICH, Mr. DOOLITTLE, and Mr. PAUL) 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.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Policyholder Disaster
5 Protection Act of 2005”.

6 **SEC. 2. FINDINGS.**

7 The Congress makes the following findings:

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

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

16 (3) Revising the tax laws applicable to the prop-
17 erty and casualty insurance industry to permit care-
18 fully controlled accumulation of pretax dollars in
19 separate reserve funds devoted solely to the payment
20 of claims arising from future major natural disasters
21 will provide incentives for property and casualty in-
22 surers to make natural disaster insurance available,
23 will give greater protection to the Nation's home-
24 owners, small businesses, and other insurance con-

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

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

9 **SEC. 3. CREATION OF POLICYHOLDER DISASTER PROTEC-**
10 **TION FUNDS; CONTRIBUTIONS TO AND DIS-**
11 **TRIBUTIONS FROM FUNDS; OTHER RULES.**

12 (a) CONTRIBUTIONS TO POLICYHOLDER DISASTER
13 PROTECTION FUNDS.—Subsection (c) of section 832 of
14 the Internal Revenue Code of 1986 (relating to the taxable
15 income of insurance companies other than life insurance
16 companies) is amended by striking “and” at the end of
17 paragraph (12), by striking the period at the end of para-
18 graph (13) and inserting “; and”, and by adding at the
19 end the following new paragraph:

20 “(14) the qualified contributions to a policy-
21 holder disaster protection fund during the taxable
22 year.”.

23 (b) DISTRIBUTIONS FROM POLICYHOLDER DISASTER
24 PROTECTION FUNDS.—Paragraph (1) of section 832(b) of
25 such Code is amended by striking “and” at the end of

1 subparagraph (D), by striking the period at the end of
 2 subparagraph (E) and inserting “, and”, and by adding
 3 at the end the following new subparagraph:

4 “(F) the amount of any distributions from
 5 a policyholder disaster protection fund during
 6 the taxable year, except that a distribution
 7 made to return to the qualified insurance com-
 8 pany any contribution which is not a qualified
 9 contribution (as defined in subsection (h)) for a
 10 taxable year shall not be included in gross in-
 11 come if such distribution is made prior to the
 12 filing of the tax return for such taxable year.”.

13 (c) DEFINITIONS AND OTHER RULES RELATING TO
 14 POLICYHOLDER DISASTER PROTECTION FUNDS.—Section
 15 832 of such Code (relating to insurance company taxable
 16 income) is amended by adding at the end the following
 17 new subsection:

18 “(h) DEFINITIONS AND OTHER RULES RELATING TO
 19 POLICYHOLDER DISASTER PROTECTION FUNDS.—For
 20 purposes of this section—

21 “(1) POLICYHOLDER DISASTER PROTECTION
 22 FUND.—The term ‘policyholder disaster protection
 23 fund’ (hereafter in this subsection referred to as the
 24 ‘fund’) means any custodial account, trust, or any
 25 other arrangement or account—

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

4 “(B) under the terms of which—

5 “(i) the assets in the fund are re-
6 quired to be invested in a manner con-
7 sistent with the investment requirements
8 applicable to the qualified insurance com-
9 pany under the laws of its jurisdiction of
10 domicile,

11 “(ii) the net income for the taxable
12 year derived from the assets in the fund is
13 required to be distributed no less fre-
14 quently than annually,

15 “(iii) an excess balance drawdown
16 amount is required to be distributed to the
17 qualified insurance company no later than
18 the close of the taxable year following the
19 taxable year for which such amount is de-
20 termined,

21 “(iv) a catastrophe drawdown amount
22 may be distributed to the qualified insur-
23 ance company if distributed prior to the
24 close of the taxable year following the year
25 for which such amount is determined,

1 “(v) a State required drawdown
2 amount may be distributed, and

3 “(vi) no distributions from the fund
4 are required or permitted other than the
5 distributions described in clauses (ii)
6 through (v) and the return to the qualified
7 insurance company of contributions that
8 are not qualified contributions.

9 “(2) QUALIFIED INSURANCE COMPANY.—The
10 term ‘qualified insurance company’ means any insur-
11 ance company subject to tax under section 831(a).

12 “(3) QUALIFIED CONTRIBUTION.—The term
13 ‘qualified contribution’ means a contribution to a
14 fund for a taxable year to the extent that the
15 amount of such contribution, when added to the pre-
16 vious contributions to the fund for such taxable
17 year, does not exceed the excess of—

18 “(A) the fund cap for the taxable year,
19 over

20 “(B) the fund balance determined as of the
21 close of the preceding taxable year.

22 “(4) EXCESS BALANCE DRAWDOWN
23 AMOUNTS.—The term ‘excess balance drawdown
24 amount’ means the excess (if any) of—

1 “(A) the fund balance as of the close of
2 the taxable year, over

3 “(B) the fund cap for the following taxable
4 year.

5 “(5) CATASTROPHE DRAWDOWN AMOUNT.—

6 “(A) IN GENERAL.—The term ‘catastrophe
7 drawdown amount’ means an amount that does
8 not exceed the lesser of the amount determined
9 under subparagraph (B) or (C).

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

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

19 “(i) the qualified losses for the taxable
20 year, over

21 “(ii) the lesser of—

22 “(I) the fund cap for the taxable
23 year (determined without regard to
24 paragraph (9)(E)), or

1 “(II) 30 percent of the qualified
 2 insurance company’s surplus as re-
 3 gards policyholders as shown on the
 4 company’s annual statement for the
 5 calendar year preceding the taxable
 6 year.

7 “(D) SPECIAL DRAWDOWN AMOUNT FOL-
 8 LOWING A RECENT CATASTROPHE LOSS
 9 YEAR.—If for any taxable year included in the
 10 reference period the qualified losses exceed the
 11 amount determined under subparagraph (C)(ii),
 12 the ‘catastrophe drawdown amount’ shall be an
 13 amount that does not exceed the lesser of the
 14 amount determined under subparagraph (B) or
 15 the amount determined under this subpara-
 16 graph. The amount determined under this sub-
 17 paragraph shall be an amount equal to the ex-
 18 cess (if any) of—

19 “(i) the qualified losses for the taxable
 20 year, over

21 “(ii) the lesser of—

22 “(I) $\frac{1}{3}$ of the fund cap for the
 23 taxable year (determined without re-
 24 gard to paragraph (9)(E)), or

1 “(II) 10 percent of the qualified
 2 insurance company’s surplus as re-
 3 gards policyholders as shown on the
 4 company’s annual statement for the
 5 calendar year preceding the taxable
 6 year.

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

“For a taxable year beginning in—	The reference period shall be—
2009 and later	The 3 preceding taxable years.
2008	The 2 preceding taxable years.
2007	The preceding taxable year.
2006 or before	No reference period applies.

10 “(6) STATE REQUIRED DRAWDOWN AMOUNT.—
 11 The term ‘State required drawdown amount’ means
 12 any amount that the department of insurance for
 13 the qualified insurance company’s jurisdiction of
 14 domicile requires to be distributed from the fund, to
 15 the extent such amount is not otherwise described in
 16 paragraph (4) or (5).

17 “(7) FUND BALANCE.—The term ‘fund balance’
 18 means—

19 “(A) the sum of all qualified contributions
 20 to the fund,

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

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

3 “(8) QUALIFIED LOSSES.—

4 “(A) IN GENERAL.—The term ‘qualified
5 losses’ means, with respect to a taxable year—

6 “(i) the amount of losses and loss ad-
7 justment expenses incurred in the qualified
8 lines of business specified in paragraph
9 (9), net of reinsurance, as reported in the
10 qualified insurance company’s annual
11 statement for the taxable year, that are at-
12 tributable to one or more qualifying events
13 (regardless of when such qualifying events
14 occurred),

15 “(ii) the amount by which such losses
16 and loss adjustment expenses attributable
17 to such qualifying events have been re-
18 duced for reinsurance received and recover-
19 able, plus

20 “(iii) any nonrecoverable assessments,
21 surcharges, or other liabilities that are
22 borne by the qualified insurance company
23 and are attributable to such qualifying
24 events.

1 “(B) QUALIFYING EVENT.—For purposes
2 of subparagraph (A), the term ‘qualifying event’
3 means any event that satisfies clauses (i) and
4 (ii).

5 “(i) EVENT.—An event satisfies this
6 clause if the event is 1 or more of the fol-
7 lowing:

8 “(I) Windstorm (hurricane, cy-
9 clone, or tornado).

10 “(II) Earthquake (including any
11 fire following).

12 “(III) Winter catastrophe (snow,
13 ice, or freezing).

14 “(IV) Fire.

15 “(V) Tsunami.

16 “(VI) Flood.

17 “(VII) Volcanic eruption.

18 “(VIII) Hail.

19 “(ii) CATASTROPHE DESIGNATION.—
20 An event satisfies this clause if the event—

21 “(I) is designated a catastrophe
22 by Property Claim Services or its suc-
23 cessor organization,

24 “(II) is declared by the President
25 to be an emergency or disaster, or

1 “(III) is declared to be an emer-
2 gency or disaster in a similar declara-
3 tion by the chief executive official of a
4 State, possession, or territory of the
5 United States, or the District of Co-
6 lumbia.

7 “(9) FUND CAP.—

8 “(A) IN GENERAL.—The term ‘fund cap’
9 for a taxable year is the sum of the separate
10 lines of business caps for each of the qualified
11 lines of business specified in the table contained
12 in subparagraph (C) (as modified under sub-
13 paragraphs (D) and (E)).

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

20 “(i) net written premiums reported in
21 the annual statement for the calendar year
22 preceding the taxable year in such line of
23 business, multiplied by

24 “(ii) the fund cap multiplier applica-
25 ble to such qualified line of business.

1 “(C) QUALIFIED LINES OF BUSINESS AND
 2 THEIR RESPECTIVE FUND CAP MULTIPLIERS.—
 3 For purposes of this paragraph, the qualified
 4 lines of business and fund cap multipliers speci-
 5 fied in this subparagraph are those specified in
 6 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.

7 “(D) SUBSEQUENT MODIFICATIONS OF
 8 THE ANNUAL STATEMENT BLANK.—If, with re-
 9 spect to any taxable year beginning after the ef-
 10 fective date of this subsection, the annual state-
 11 ment blank required to be filed is amended to
 12 replace, combine, or otherwise modify any of
 13 the qualified lines of business specified in sub-
 14 paragraph (C), then for such taxable year sub-
 15 paragraph (C) shall be applied in a manner
 16 such that the fund cap shall be the same
 17 amount as if such reporting modification had
 18 not been made.

19 “(E) 20-YEAR PHASE-IN.—Notwith-
 20 standing subparagraph (C), the fund cap for a
 21 taxable year shall be the amount determined

1 under subparagraph (C), as adjusted pursuant
 2 to subparagraph (D) (if applicable), multiplied
 3 by the phase-in percentage indicated in the fol-
 4 lowing table:

“Taxable year beginning in:	Phase-in per- centage to be applied to fund cap computed under sub- paragraphs (A) and (B):
2006	5 percent
2007	10 percent
2008	15 percent
2009	20 percent
2010	25 percent
2011	30 percent
2012	35 percent
2013	40 percent
2014	45 percent
2015	50 percent
2016	55 percent
2017	60 percent
2018	65 percent
2019	70 percent
2020	75 percent
2021	80 percent
2022	85 percent
2023	90 percent
2024	95 percent
2025 and later	100 percent

5 “(10) TREATMENT OF INVESTMENT INCOME
 6 AND GAIN OR LOSS.—

7 “(A) CONTRIBUTIONS IN KIND.—A trans-
 8 fer of property other than money to a fund
 9 shall be treated as a sale or exchange of such
 10 property for an amount equal to its fair market
 11 value as of the date of transfer, and appro-
 12 priate adjustment shall be made to the basis of

1 such property. Section 267 shall apply to any
2 loss realized upon such a transfer.

3 “(B) DISTRIBUTIONS IN KIND.—A transfer
4 of property other than money by a fund to the
5 qualified insurance company shall not be treat-
6 ed as a sale or exchange or other disposition of
7 such property. The basis of such property im-
8 mediately after such transfer shall be the great-
9 er of the basis of such property immediately be-
10 fore such transfer or the fair market value of
11 such property on the date of such transfer.

12 “(C) INCOME WITH RESPECT TO FUND AS-
13 SETS.—Items of income of the type described in
14 paragraphs (1)(B), (1)(C), and (2) of sub-
15 section (b) that are derived from the assets held
16 in a fund, as well as losses from the sale or
17 other disposition of such assets, shall be consid-
18 ered items of income, gain, or loss of the quali-
19 fied insurance company. Notwithstanding para-
20 graph (1)(F) of subsection (b), distributions of
21 net income to the qualified insurance company
22 pursuant to paragraph (1)(B)(ii) of this sub-
23 section shall not cause such income to be taken
24 into account a second time.

1 “(11) NET INCOME; NET INVESTMENT LOSS.—

2 For purposes of paragraph (1)(B)(ii), the net in-
3 come derived from the assets in the fund for the tax-
4 able year shall be the items of income and gain for
5 the taxable year, less the items of loss for the tax-
6 able year, derived from such assets, as described in
7 paragraph (10)(C). For purposes of paragraph (7),
8 there is a net investment loss for the taxable year
9 to the extent that the items of loss described in the
10 preceding sentence exceed the items of income and
11 gain described in the preceding sentence.

12 “(12) ANNUAL STATEMENT.—For purposes of
13 this subsection, the term ‘annual statement’ shall
14 have the meaning set forth in section 846(f)(3).

15 “(13) EXCLUSION OF PREMIUMS AND LOSSES
16 ON CERTAIN PUERTO RICAN RISKS.—Notwith-
17 standing any other provision of this subsection, pre-
18 miums and losses with respect to risks covered by a
19 catastrophe reserve established under the laws or
20 regulations of the Commonwealth of Puerto Rico
21 shall not be taken into account under this subsection
22 in determining the amount of the fund cap or the
23 amount of qualified losses.

24 “(14) REGULATIONS.—The Secretary shall pre-
25 scribe such regulations as may be necessary or ap-

1 appropriate to carry out the purposes of this sub-
2 section, including regulations—

3 “(A) which govern the application of this
4 subsection to a qualified insurance company
5 having a taxable year other than the calendar
6 year or a taxable year less than 12 months,

7 “(B) which govern a fund maintained by a
8 qualified insurance company that ceases to be
9 subject to this part, and

10 “(C) which govern the application of para-
11 graph (9)(D).”.

12 (d) EFFECTIVE DATE.—The amendments made by
13 this section shall apply to taxable years beginning after
14 December 31, 2005.

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