

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

S

2

SENATE BILL 611

Pensions & Retirement and Insurance Committee Substitute Adopted 4/30/97

Short Title: Insurance Fronting.

(Public)

Sponsors:

Referred to:

April 1, 1997

A BILL TO BE ENTITLED
AN ACT TO PROTECT INSURANCE POLICYHOLDERS BY SETTING
STANDARDS FOR THE FRONTING OF INSURANCE BUSINESS.

The General Assembly of North Carolina enacts:

Section 1. Article 10 of Chapter 58 of the General Statutes is amended by adding a new Part to read:

"PART 4. DISCLOSURE AND REGULATION OF FRONTING.

"§ 58-10-70. Purpose.

(a) The purposes of this Part are to ensure proper:

(1) Disclosure and regulation of reinsurance transactions in which a domestic insurer delegates to an unauthorized reinsurer underwriting or claim settlement authority on business written directly by the licensed insurer or assumed from another licensed insurer.

(2) Disclosure of reinsurance transactions in which, if the transaction covers risks resident in this State, a foreign insurer licensed in this State delegates to an unauthorized reinsurer underwriting or claim settlement authority on business written directly by the licensed insurer or assumed from another licensed insurer.

1 (b) This Part applies to every domestic insurer that delegates underwriting or claim
2 settlement authority to an unauthorized reinsurer on business written directly by the
3 insurer or assumed from another licensed insurer.

4 **"§ 58-10-75. Definitions.**

5 As used in this Part:

6 (1) 'Affiliate' or 'affiliated with' has the meaning ascribed to it in G.S. 58-
7 19-5(1).

8 (2) 'Claim settlement authority' means the investigation, negotiation, and
9 settlement of claims arising under original policies subject to a
10 reinsurance agreement.

11 (3) 'Single-parent captive insurer' means an insurance company owned by
12 one or more affiliated persons, provided that the captive insurer directly
13 writes or reinsures only one or more of the following:

14 a. Risks of the owners of the insurance company and affiliates of
15 the owners.

16 b. Risks related to or arising out of the business or operations of the
17 owners and affiliates.

18 c. Risks derived from a pool, or other similar arrangement, whether
19 or not organized as an insurance company or a reinsurance
20 company, formed solely as a mechanism to cede, distribute, or
21 allocate among other qualifying single-parent captive insurers
22 whose parents are in the same industry, risks described in sub-
23 subdivision a. or b. of this subdivision, as long as all risks placed
24 in the pool are similar, the kinds of insurance covered are the
25 same, and each captive participating in the pool retains more than
26 fifty percent (50%) of its risks net of all other reinsurance
27 cessions.

28 (4) 'Unauthorized reinsurer' means an individual assuming reinsurer or a
29 group of assuming reinsurers or its affiliate or agent for which credit for
30 reinsurance is not allowed under G.S. 58-7-21 or a substantially similar
31 law in the insurer's state of domicile.

32 (5) 'Underwriting authority' means the acceptance or declination of risks
33 under original policies; and may include the determination of pricing
34 and of the terms and conditions of coverage under the original policies.

35 **"§ 58-10-80. Reporting requirements.**

36 (a) If the transaction covers risks resident in this State, this section also applies to
37 any foreign insurer licensed in this State that delegates underwriting or claim settlement
38 authority to an unauthorized reinsurer on business written directly by the insurer or
39 assumed from another licensed insurer.

40 (b) If an insurer does business with an unauthorized reinsurer, the insurer shall
41 report with its annual financial statement, in a form acceptable to the Commissioner, the
42 following information about the unauthorized reinsurer:

43 (1) The total gross original written premium.

- 1 (2) The total ceded written premium.
- 2 (3) The lines and classes of business involved.
- 3 (4) The identity, domicile, and NAIC number, if applicable, of the
4 reinsurer; and the name, address, and telephone number of the
5 reinsurer's senior operating officer.
- 6 (5) The total ceded losses incurred, including incurred but not reported
7 losses, and allocated loss adjustment expenses.
- 8 (6) The amount and type of collateral retained by the insurer for liabilities
9 for unearned premiums, unpaid losses, and allocated loss adjustment
10 expenses, including estimated incurred but not reported losses.
- 11 (7) The identity of any third party to which underwriting or claim
12 settlement authority has been delegated by the reinsurer.
- 13 (8) Any other information the Commissioner considers necessary.

14 **"§ 58-10-85. Prior approval of certain reinsurance transactions.**

15 (a) Before entering into a reinsurance transaction covering direct business written
16 or business assumed from a licensed insurer under which underwriting or claim
17 settlement authority will be delegated to an unauthorized reinsurer, a domestic insurer,
18 including a United States branch of an alien insurer entered through this State, shall
19 obtain prior approval of the Commissioner if:

- 20 (1) The annual gross written premium, as estimated by the insurer, for
21 business subject to the proposed reinsurance transaction, before
22 deduction of ceding commission or any other allowances, exceeds five
23 percent (5%) of the insurer's statutory policyholder surplus as reported
24 in its most recent annual financial statement; or
- 25 (2) The annual gross written premium, as estimated by the insurer, for
26 business subject to the proposed reinsurance transaction, before
27 deduction of ceding commission or any other allowances, when added
28 to the estimated annual gross written premium for all other business in
29 force that is subject to a similar reinsurance arrangement in which
30 underwriting or claim settlement authority has been delegated to an
31 unauthorized reinsurer, amounts in total to more than ten percent (10%)
32 of the insurer's statutory policyholder surplus as reported in its most
33 recent annual financial statement.

34 (b) Along with each application in subsection (a) of this section, the insurer shall
35 submit for the Commissioner's review and consideration the following information:

- 36 (1) The identity, domicile, and NAIC number, if applicable, of the reinsurer
37 and, if applicable, the reinsurer's representative to whom underwriting
38 or claim settlement authority will be delegated.
- 39 (2) A detailed description of the proposed transaction, setting forth the
40 rights and duties of the parties, the scope of underwriting or claim
41 settlement authority to be delegated, and the monitoring and control
42 procedures to be implemented by the insurer.

1 (3) The amounts and nature of any collateral to be held by the insurer for
2 the reinsurer's liabilities arising out of the proposed transaction.

3 (4) The annual gross written premium, as estimated by the insurer, before
4 deduction of ceding commission or any other allowances, for business
5 subject to the proposed reinsurance transaction, and for all business in
6 force that is subject to a similar reinsurance arrangement in which
7 underwriting or claim settlement authority has been delegated to an
8 unauthorized reinsurer. The premium data shall be broken down for
9 each state in which risks subject to the transactions reside or are located.

10 (c) The Commissioner shall be deemed to have approved the proposed reinsurance
11 transaction if approval is not denied within 45 days after receipt of the complete
12 information required under subsection (b) of this section.

13 **"§ 58-10-90. Exceptions.**

14 This Part does not apply to any reinsurance transaction:

15 (1) Involving only life insurance, annuities, or credit accident and health
16 insurance.

17 (2) Involving only an affiliate of the insurer or any pooling arrangement
18 within the same insurance holding company system.

19 (3) Involving any group, association, pool, or organization of insurers that
20 engages in joint underwriting activities and that is subject to
21 examination by any state regulatory authority or that operates under any
22 state, federal statutory, or federal administrative authorization.

23 (4) With a single-parent captive insurer.

24 (5) That is nonobligatory and facultative and in which the annual gross
25 written premium, before deduction of ceding commission or any other
26 allowances, does not exceed one percent (1%) of the insurer's statutory
27 policyholder surplus as reported in its most recent annual financial
28 statement.

29 **"§ 58-10-95. Responsibilities of the insurer.**

30 (a) Before the inception of any reinsurance transaction subject to G.S. 58-10-80 or
31 G.S. 58-10-85, the insurer shall:

32 (1) Make a determination that the reinsurer or its designated representative
33 possesses sufficient technical expertise and administrative capabilities to
34 perform satisfactorily the functions delegated to it.

35 (2) Obtain an opinion from a qualified actuary independent of the insurer
36 and the reinsurer or its designated representative that the premium rates
37 applicable to all policies subject to the reinsurance transaction make
38 reasonable provision for expected losses and loss adjustment expenses.

39 (3) Obtain a written commitment from the reinsurer and its designated
40 representative, if any, to abide by all provisions, stipulations, and
41 guidelines established by the insurer about:

42 a. Maximum annual gross written premium.

43 b. Maximum policy limits of liability.

- c. Lines and classes of business to be written.
- d. Policy rates and rating basis.
- e. Maximum policy period.
- f. Required policy wording and exclusions.
- g. Territorial limitations.
- h. Maximum claim settlement authority.
- i. Authorized independent claim adjusters and defense counsel.

(4) Obtain written acknowledgment from the reinsurer that all files and records for claims arising out of business subject to the reinsurance agreement shall be the property of both parties to the agreement, that the insurer shall be given unrestricted access to the files and records upon request, and that the files and records shall not be deleted or destroyed without the insurer's and the Commissioner's prior consent.

(b) The insurer shall perform, or have a qualified independent party perform, a compliance audit to verify the reinsurer's strict adherence to all of the established underwriting and claim settlement provisions, stipulations, and guidelines set forth in subdivision (a)(3) of this section. The audit shall be performed at least once a year, and records evidencing proper and timely performance of the audit shall be maintained in accordance with G.S. 58-10-100.

(c) If there is a disagreement or dispute between the insurer or reinsurer about the performance of any delegated underwriting or claim settlement functions, or upon the discovery of any failure on the part of the reinsurer to comply with all established underwriting or claim settlement provisions, stipulations, and guidelines, the insurer shall immediately suspend the reinsurer's authority to perform the functions until the disagreement, dispute, or noncompliance has been satisfactorily resolved.

(d) An insurer shall obtain written documentation from each captive with which it has entered into a reinsurance transaction and for which an exemption is claimed under G.S. 58-10-90(4), verifying that the captive is in fact a single-parent captive insurer.

"§ 58-10-100. Records to be maintained by domestic insurers.

(a) A domestic insurer shall maintain the following records for each reinsurance transaction subject to this Part:

- (1) A copy of the complete reinsurance agreement properly executed by the parties, and any amendments.
- (2) A copy of all accounting records detailing written and earned premiums, commission, paid losses, and loss adjustment expenses, reserves for outstanding losses, including incurred but not reported losses, and collateral held by the insurer with respect to the liabilities of the reinsurer.
- (3) A copy of the reinsurer's latest audited financial statement.
- (4) A copy of the document detailing the guidelines, procedures, and controls applicable to any underwriting, loss reserving, or claim settlement functions delegated to the reinsurer or its affiliate.

1 (5) A copy of the report of a compliance audit, to be conducted at least once
2 a year by the insurer or a qualified independent party, with respect to
3 any delegated functions.

4 (b) All of the records required by this section shall be made available for review at
5 any time by the Commissioner and shall be retained for at least three years after the end
6 of the reinsurance agreement, or until the completion of an examination conducted under
7 G.S. 58-2-131 covering the period during which the reinsurance agreement was in effect,
8 whichever is later. Records on claims arising under policies subject to the reinsurance
9 agreement shall be retained until the claims are finally settled and closed.

10 **"§ 58-10-105. Required reinsurance agreement provisions for domestic insurers.**

11 A reinsurance transaction between a domestic insurer and an unauthorized reinsurer
12 shall be documented properly in a reinsurance agreement to be executed by the parties
13 within 120 days after its inception, which, in addition to any other requirements of this
14 Chapter, shall include the following provisions:

15 (1) A funding clause obligating the unauthorized reinsurer to provide
16 collateral in a form prescribed by G.S. 58-7-26 and in an amount equal
17 to no less than one hundred percent (100%) of its liabilities for unearned
18 premiums, unpaid losses, and allocated loss adjustment expenses,
19 including estimated incurred but not reported losses.

20 (2) A reports and remittances clause obligating the reinsurer to remit
21 payment in full of all balances due and payable and not in dispute within
22 30 days after the receipt of satisfactory proof of loss. Any balance in
23 dispute shall be deposited in an interest-bearing escrow account pending
24 resolution of the dispute, to be remitted with interest to the appropriate
25 party as determined by the arbitration panel within 30 days after the
26 resolution of the dispute.

27 (3) An insolvency clause obligating the reinsurer to pay all balances due
28 under the terms of the reinsurance agreement on the basis of the
29 insurer's liability, without diminution because of the insolvency of the
30 insurer, to the liquidator, receiver, conservator, or statutory successor of
31 the insurer.

32 (4) A service of suit clause obligating any unauthorized reinsurer to submit
33 to the jurisdiction of a court of competent jurisdiction within this State
34 and to designate the Commissioner as its lawful agent for receipt of
35 service in any suit or proceeding arising out of the reinsurance
36 agreement.

37 (5) An arbitration clause obligating the parties to the agreement to submit
38 disagreements or disputes to arbitration and to promptly comply with
39 the decision rendered by the arbitration panel.

40 (6) A cancellation clause allowing the insurer to cancel the agreement at
41 any time with 30-days' written notice to the reinsurer and at the insurer's
42 option:

- 1 a. Obligating the reinsurer to remain liable for all losses on policies
2 in force as of the cancellation date of the reinsurance agreement;
3 or
4 b. Relieving the reinsurer of liability for all losses occurring after
5 the cancellation date of the reinsurance agreement and obligating
6 the reinsurer to refund to the insurer the applicable unearned
7 reinsurance premium, unless the Commissioner has authorized an
8 alternative disposition.

- 9 (7) If the services of a reinsurance intermediary have been used in effecting
10 the reinsurance transaction, an intermediary clause stipulating that
11 balances payable to the insurer, exclusive of any payments made by the
12 reinsurer directly to the policyholder or claimant on the insurer's behalf,
13 shall be deemed to have been paid only to the extent that the balances
14 have been received by the insurer, and that balances payable to the
15 reinsurer shall be deemed to have been paid if those balances have been
16 remitted to the intermediary.

17 **"§ 58-10-110. Commissioner's authority.**

18 In addition to other remedies or penalties under this Chapter, the Commissioner may,
19 after notice and opportunity to be heard, order a domestic insurer found to be in violation
20 of this Part to do any or all of the following:

- 21 (1) Issue no new or renewal policies subject to this Part.
22 (2) Make no cessions under the reinsurance agreement.
23 (3) Immediately draw upon all letters of credit or other collateral to the
24 extent of the reinsurer's overdue liabilities under the reinsurance
25 agreement.

26 **"§ 58-10-115. Effective date and scope.**

27 This Part applies to all reinsurance agreements entered into or renewed on and after
28 January 1, 1998. A reinsurance agreement is deemed to be renewed on each anniversary
29 of its inception date."

30 Section 2. This act becomes effective January 1, 1998.