

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1997

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SENATE BILL 611

Short Title: Insurance Fronting.

(Public)

Sponsors: Senator Miller.

Referred to: Pensions & Retirement and Insurance.

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.

The purpose of this Part is to ensure proper disclosure and regulation of reinsurance transactions in which a domestic insurer or, 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.

"§ 58-10-75. Definitions.

As used in this Part:

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

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

- 1 (3) 'Single-parent captive insurer' means an insurance company owned by
2 one or more affiliated persons and domiciled in a jurisdiction that is
3 accredited under the financial regulation standards of the NAIC,
4 provided that the captive insurer writes directly or reinsures only one or
5 more of the following:
6 a. Risks of the owners of the insurance company and affiliates of
7 the owners;
8 b. Risks related to or arising out of the business or operations of the
9 owners and affiliates; or
10 c. Risks derived from a pool (or other similar arrangement, whether
11 or not organized as an insurance company or a reinsurance
12 company) formed solely as a mechanism to cede, distribute, or
13 allocate among other qualifying single-parent captive insurers
14 whose parents are in the same industry, risks described in
15 subdivision (1) or (2) of this section, provided that all risks
16 placed in the pool are similar, the kinds of insurance covered are
17 the same, and provided further that each captive participating in
18 the pool retains more than fifty percent (50%) of its risks net of
19 all other reinsurance cessions.
20 (4) 'Unauthorized reinsurer' means an individual assuming reinsurer or a
21 group of assuming reinsurers or any affiliate or agent thereof with
22 respect to which credit for reinsurance is not allowed in accordance with
23 G.S. 58-7-21 or pursuant to a substantially similar law in the insurer's
24 state of domicile.
25 (5) 'Underwriting authority' means the acceptance or declination of risks
26 under original policies, which may include the determination of pricing
27 and of the terms and conditions of coverage under the original policies.

28 **"§ 58-10-80. Reporting requirements.**

29 (a) This Part applies to every domestic insurer or, if the transaction covers risks
30 resident in this State, any foreign insurer licensed in this State that delegates underwriting
31 or claim settlement authority to an unauthorized reinsurer on business written directly by
32 the insurer or assumed from another licensed insurer.

33 (b) The insurer shall report with its annual financial statement, in a form
34 acceptable to the Commissioner, the following information regarding each unauthorized
35 reinsurer:

- 36 (1) The total gross original written premium.
37 (2) The total ceded written premium.
38 (3) The lines and classes of business involved.
39 (4) The identity, domicile, and NAIC number of the reinsurer; and the
40 name, address, and telephone number of its senior operating officer.
41 (5) The total ceded losses incurred, including incurred but not reported
42 losses, and allocated loss adjustment expenses.

1 (6) The amount and type of collateral retained by the insurer with respect to
2 liabilities for unearned premiums, unpaid losses, and allocated loss
3 adjustment expenses, including estimated incurred but not reported
4 losses.

5 (7) The identity of any third party to which underwriting or claim
6 settlement authority has been delegated by the reinsurer.

7 (8) Any other information deemed to be necessary by the Commissioner.

8 **"§ 58-10-85. Prior approval of certain reinsurance transactions.**

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

14 (1) The annual gross written premium, as estimated by the insurer, for
15 business subject to the proposed reinsurance transaction, before
16 deduction of ceding commission or any other allowances, exceeds five
17 percent (5%) of the insurer's statutory policyholder surplus as reported
18 in its most recent annual financial statement; or

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

28 (b) Before entering into a reinsurance transaction that covers risks resident or
29 located in this State under which there will be a delegation of underwriting or claim
30 settlement authority to an unauthorized reinsurer, an insurer licensed in this State shall
31 obtain approval of the Commissioner before implementing the transaction if the
32 transaction will exceed either threshold contained in subsection (a) of this section, and:

33 (1) The annual gross written premium, as estimated by the insurer, for risks
34 resident in this State represents at least 10 percent (10%) of the
35 estimated annual gross written premium estimated to be derived from all
36 the states in which risks to be underwritten are resident; or

37 (2) It is estimated that no state will generate at least ten percent (10%) of
38 the estimated annual gross written premium.

39 (c) Along with each application for prior approval of a proposed reinsurance
40 transaction as required in subsection (a) or (b) of this section, the insurer shall submit for
41 the Commissioner's review and consideration the following information:

- 1 (1) The identity, domicile, and NAIC number of the reinsurer and, if
2 applicable, its representative to which underwriting or claim settlement
3 authority will be delegated.
- 4 (2) A detailed description of the proposed transaction, setting forth the
5 rights and duties of the parties, the scope of underwriting or claim
6 settlement authority to be delegated, and the monitoring and control
7 procedures to be implemented by the insurer in connection therewith.
- 8 (3) The amounts and nature of any collateral to be held by the insurer in
9 respect of the reinsurer's liabilities arising out of the proposed
10 transaction.
- 11 (4) The annual gross written premium, as estimated by the insurer, before
12 deduction of ceding commission or any other allowances, for business
13 subject to the proposed reinsurance transaction, and for all business in
14 force that is subject to a similar reinsurance arrangement in which
15 underwriting or claim settlement authority has been delegated to an
16 unauthorized reinsurer. The premium data shall be broken down for
17 each state in which risks subject to the transactions reside or are located.
- 18 (d) The Commissioner shall be deemed to have approved the proposed reinsurance
19 transaction if approval is not denied within 45 days after receipt of the complete
20 information required under subsection (c) of this section.

21 **"§ 58-10-90. Exceptions.**

22 This Part does not apply to:

- 23 (1) Any reinsurance transaction involving only life insurance or annuities,
24 or credit accident and health insurance.
- 25 (2) Any reinsurance transaction involving only an affiliate of the insurer or
26 any pooling arrangement within the same insurance holding company
27 system.
- 28 (3) Any reinsurance transaction involving any group, association, pool, or
29 organization of insurers that engages in joint underwriting activities and
30 that is subject to examination by any state regulatory authority or that
31 operates pursuant to any state, federal statutory, or federal
32 administrative authorization.
- 33 (4) Any reinsurance transaction with a single-parent captive insurer.
- 34 (5) Any nonobligatory facultative reinsurance transaction in which the
35 annual gross written premium, before deduction of ceding commission
36 or any other allowances, does not exceed one percent (1%) of the
37 insurer's statutory policyholder surplus as reported in its most recent
38 annual financial statement.

39 **"§ 58-10-95. Responsibilities of the insurer.**

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

- 1 (1) Make a determination that the reinsurer or its designated representative
2 possesses sufficient technical expertise and administrative capabilities to
3 perform satisfactorily the functions delegated to it.
- 4 (2) Obtain an opinion from a qualified actuary independent of the insurer
5 and the reinsurer or its designated representative that the premium rates
6 applicable to all policies subject to the reinsurance transaction make
7 reasonable provision for expected losses and loss adjustment expenses.
- 8 (3) Obtain written commitment from the reinsurer and its designated
9 representative, if any, to abide by all provisions, stipulations, and
10 guidelines established by the insurer regarding:
- 11 a. Maximum annual gross written premium.
12 b. Maximum policy limits of liability.
13 c. Lines and classes of business to be written.
14 d. Policy rates and rating basis.
15 e. Maximum policy period.
16 f. Required policy wording and exclusions.
17 g. Territorial limitations.
18 h. Maximum claim settlement authority.
19 i. Authorized independent claim adjusters and defense counsel.
- 20 (4) Obtain written acknowledgment from the reinsurer that all files and
21 records pertaining to claims arising out of business subject to the
22 reinsurance agreement shall be considered to be the property of both
23 parties thereto, that the insurer shall be given unrestricted access to the
24 files and records upon request, and that the files and records shall not be
25 deleted or destroyed without the insurer's prior consent.
- 26 (b) The insurer shall perform, or engage a qualified independent party to perform,
27 a compliance audit to verify the reinsurer's strict adherence to all of the established
28 underwriting and claim settlement provisions, stipulations, and guidelines set forth in
29 subdivision (a)(3) of this section. The audit shall be performed no less frequently than
30 annually, and records evidencing proper and timely performance of the audit shall be
31 maintained in accordance with the requirements set forth in G.S. 58-10-100.
- 32 (c) In the event of any disagreement or dispute regarding the performance of any
33 delegated underwriting or claim settlement functions, or upon discovery of any failure on
34 the part of the reinsurer to comply with all established underwriting or claim settlement
35 provisions, stipulations, and guidelines, the insurer shall immediately suspend the
36 reinsurer's authority to perform the functions pending satisfactory resolution of the
37 disagreement, dispute, or instance of noncompliance.
- 38 (d) The insurer shall obtain written documentation from each captive with which it
39 has entered into a reinsurance transaction and for which an exemption is claimed under
40 G.S. 58-10-90(4), verifying that the captive is in fact a single-parent captive insurer.
41 **§ 58-10-100. Records to be maintained by the insurer.**
- 42 (a) The insurer shall maintain the following records for each reinsurance
43 transaction subject to this Part:

- 1 (1) A copy of the complete reinsurance agreement properly executed by the
2 parties, and any amendments thereto;
- 3 (2) A copy of all accounting records detailing written and earned premiums,
4 commission, paid losses, and loss adjustment expenses, reserves for
5 outstanding losses, including incurred but not reported losses, and
6 collateral held by the insurer with respect to the liabilities of the
7 reinsurer;
- 8 (3) A copy of the reinsurer's latest audited financial statement;
- 9 (4) A copy of the document detailing the guidelines, procedures, and
10 controls applicable to any underwriting, loss reserving, or claim
11 settlement functions delegated to the reinsurer or its affiliate; and
- 12 (5) A copy of the report of a compliance audit, to be conducted no less
13 frequently than annually by the insurer or a qualified independent party,
14 with respect to any delegated functions.

15 (b) All of the records required by this section shall be made available for review at
16 any time deemed appropriate by the insurance regulator of the insurer's state of domicile
17 and shall be retained for at least three years after the termination of the reinsurance
18 agreement, or until the completion of a statutory examination conducted under G.S. 58-2-
19 131, 58-2-132, and 58-2-133 covering the period during which the reinsurance agreement
20 was in effect, whichever is later. Records pertaining to claims arising under policies
21 subject to the reinsurance agreement shall be retained until the claims are finally settled
22 and closed.

23 **"§ 58-10-105. Required reinsurance agreement provisions.**

24 A reinsurance transaction subject to this Part shall be documented properly in a
25 reinsurance agreement, to be executed by the parties within 120 days after its inception,
26 which, in addition to any other requirements of this Chapter, shall include the following
27 provisions:

- 28 (1) A funding clause obligating the unauthorized reinsurer to provide
29 collateral in a form prescribed by G.S. 58-7-26 and in an amount equal
30 to no less than one hundred percent (100%) of its liabilities for unearned
31 premiums, unpaid losses, and allocated loss adjustment expenses,
32 including estimated incurred but not reported losses.
- 33 (2) A reports and remittances clause obligating the reinsurer to remit
34 payment in full of all balances due and payable and not in dispute within
35 30 days after the receipt of satisfactory proof of loss. Any balance in
36 dispute shall be deposited in an interest-bearing escrow account pending
37 resolution of the dispute, to be remitted with interest to the appropriate
38 party as determined by the arbitration panel within 30 days after the
39 resolution of the dispute.
- 40 (3) An insolvency clause obligating the reinsurer to pay all balances due
41 under the terms of the reinsurance agreement on the basis of the
42 insurer's liability, without diminution because of the insolvency of the

1 insurer, to the liquidator, receiver, conservator, or statutory successor of
2 the insurer.

3 (4) A service of suit clause obligating any unauthorized reinsurer to submit
4 to the jurisdiction of a court of competent jurisdiction within the United
5 States and to designate the Commissioner or such other officer, as
6 specified in the insurance code of the state in which the insurer is
7 domiciled, as its lawful agent for receipt of service in any suit or
8 proceeding arising out of the reinsurance agreement.

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

12 (6) A cancellation clause permitting the insurer to effect cancellation of the
13 agreement at any time with 30-days' written notice to the reinsurer and
14 at the insurer's option:

15 a. Obligating the reinsurer to remain liable for all losses on policies
16 in force as of the cancellation date of the reinsurance agreement;

17 or

18 b. Relieving the reinsurer of liability for all losses occurring
19 subsequent to the cancellation date of the reinsurance agreement
20 and obligating the reinsurer to refund to the insurer the applicable
21 unearned reinsurance premium, unless the insurance regulator of
22 the state in which the insurer is domiciled has authorized an
23 alternative disposition of the reinsurer's liabilities.

24 (7) If the services of a reinsurance intermediary have been utilized in
25 effecting the reinsurance transaction, an intermediary clause stipulating
26 that balances payable to the insurer, exclusive of any payments made by
27 the reinsurer directly to the policyholder or claimant on the insurer's
28 behalf, shall be deemed to have been paid only to the extent that the
29 balances have been received by the insurer, and that balances payable to
30 the reinsurer shall be deemed to have been paid if such balances have
31 been remitted to the intermediary.

32 **"§ 58-10-110. Commissioner's authority.**

33 (a) The Commissioner may, after notice and opportunity to be heard, order a
34 domestic insurer found to be in violation of any of the provisions of this Part to:

35 (1) Issue no new or renewal policies subject to this Part;

36 (2) Make no cessions under the reinsurance agreement;

37 (3) Immediately draw upon all letters of credit or other collateral to the
38 extent of the reinsurer's overdue liabilities under the reinsurance
39 agreement; and

40 (4) Pay a civil penalty in accordance with G.S. 58-2-70 for each violation of
41 this Part.

42 (b) The commissioner may, after notice and opportunity to be heard, order an
43 insurer licensed in this State but domiciled in any other state, including any United States

1 branch of an alien insurer entered through another state, found to be in violation of any of
2 the provisions of this Part to:

3 (1) Issue no new or renewal policies subject to this Part that cover risks
4 resident in this State;

5 (2) Make no cessions under the reinsurance agreement for policies covering
6 risks resident in this State; and

7 (3) Pay a civil penalty in accordance with G.S. 58-2-70 for each violation of
8 this Part.

9 (c) No action shall be taken pursuant to subsection (b) of this section unless the
10 Commissioner allows at least 45-days' prior notice to the insurance regulator of the
11 insurer's state of domicile, or state of entry for a United States branch of an alien insurer.

12 **"§ 58-10-115. Effective date and scope.**

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

16 Section 2. If any section or provision of this act is declared unconstitutional or
17 invalid by the courts, it does not affect the validity of the act as a whole or any part other
18 than the part so declared to be unconstitutional or invalid.

19 Section 3. This act becomes effective January 1, 1998.